

Patents and standardisation: are SSO IPR policies an effective remedy to the hold-up problem?

Wim Maas en Charlotte de Boer, Banning N.V.

Introduction

In today's technology-driven world, the importance of standardisation, product interoperability and compatibility have become crucial to promoting innovation and competition.¹ A standard can be described as a set of technical specifications that either provides or is intended to provide a common design for a product or process. There are several types of standards: standards that have arisen from the market itself, standards that have been set by the government and standards that have been set by private standard setting organisations. This article focuses only on the latter.

In the process of setting standards, companies can join a standard setting organisation (SSO)² in their field. During the process, all the members discuss what the new standard should be. At first sight, this seems a brilliant form of cooperation between companies pooling their knowledge. However, problems may arise when it comes to patents. The importance of patents in the field of complex innovation is growing and so is the probability that standard designers cannot work around existing protected knowledge.³ When all the members have finally agreed on the standard and production is already in full swing, it can be very harmful if patent infringement comes to light. The costs of switching to another technology are much higher, as participants have already made substantial investments in the standard. Participants may find themselves locked into the chosen technology. Had they known about the existing patent, an alternative technology could have been chosen or they could have tried to invent around the patent at an earlier stage.⁴ When the standard has been set, the patentee has a very strong negotiating position and is able to extract unreasonably high royalties or even to block the use of the standard. This is known as the hold-up problem.

Patent owners may even intentionally create this situation by keeping their patents secret until a standard has been set. In addition it is conceivable that a member who has a relevant patent pending will use his right to write amendments or divisional claims covering the technology that the SSO is developing.⁵ This is not an illusionary problem as it actually happened in the RAMBUS case.⁶

¹ J.M. Mueller, "Potential antitrust Liability Bases on a Patent Owner's Manipulation of Industry Standard Setting", *IV State Antitrust ABA Committee Newsletter*, 10-25, 2003 p. 3

² There are several formal standardisation bodies on different geographic levels:

- on a 'local' level: the NEN (*NEderlandse Norm*) and the NEC (*Stichting Nederlands Electrotechnisch Comité*);
- on a 'regional' (European) level: the CEN (*Comité Européen de Normalisation*), the CENELEC (*Comité Européen de Normalisation Electrotechnique*) and the ETSI (*Europese Telecommunicatie en Standaardisatie Instituut*); and
- on an international level: the ISO (International Organisation for Standardisation) and the IEC (International Electrotechnical Commission).

³ R. Bekkers and I. Liotard, "European standards for mobile communications: the tense relationship between standards and intellectual property rights", *EIPR* 1999, 21(3), p. 115

⁴ C. Shapiro, "Navigating the patent thicket: cross licenses, patent pools, and standard setting" prepared for presentation at "Innovation Policy and the Economy", *National Bureau of Economic Research*, April 11, 2000 Washington DC, p. 124

⁵ H.J. Hovenkamp, "Patent continuations, patent deception, and standard setting: the Rambus and Broadcom decisions", *University of Iowa Legal Studies Research Paper* 2008, 08-25, p. 6

⁶ *Rambus Inc. v. Infineon Techs. AG*, 164 F.Supp. 2d 743, 746 (E.D. Va. 2001)

To avoid the problem of patent hold-up, most SSOs have their own IPR policy. In that respect two of the most common obligations laid down in the IPR policy rules of SSOs are (i) the obligation to timely disclose relevant patents during the standard setting procedure and (ii) the obligation to license relevant patents on fair, reasonable and non-discriminatory (FRAND) terms.⁷ However, IPR policies differ from one SSO to the next. Moreover, it is often unclear what their judicial status is and how they can be enforced. Is it possible for a patent holder to sue for patent infringement a company manufacturing products that function in accordance with the standard, if the patent holder breached his obligation to disclose essential patents during the standard setting process? And under what circumstances can the owner of an essential patent be forced to license under FRAND conditions? In this article we hope to provide some guidelines under Dutch law on how to use and/or amend the IPR policy rules of SSOs to effectively deal with the hold-up problem.

Enforcement through contract law

The enforcement of IPR-policy rules is first of all a matter of contract law. Those rules can be incorporated in the SSO's articles of association or in the applicable membership contracts. An obligation based on articles of association differs in its formation from an obligation based on a contract. However, this does not change the character of the obligation itself.⁸ Hence, the general contract law provisions of Book 6 of the Dutch Civil Code and the legal acts of Book 3 of the Dutch Civil Code (up to Article 3:326) are – at least in principle – equally applicable.⁹ *In this respect* it is therefore essentially irrelevant whether the IPR-policy is incorporated in articles of association or in separate membership contracts. In case of non-compliance both situations should be dealt with by applying the remedies of general Dutch contract law.

Each party that becomes a member of an SSO undertakes to comply with the IPR rules of the SSO in question: a contract is born. A contract only creates obligations for the parties to that contract,¹⁰ thus principally only the SSO is authorised to enforce the obligations of its member. As other members of the SSO are technically not parties to that contract, they have no legal right to enforce compliance with the IPR rules by their fellow members. In our opinion that situation is undesirable. Imagine a member of the SSO breaching its obligation to license on FRAND terms. Although the SSO itself aims to create standards that can broadly be adopted, it might for many reasons be reluctant to take hard measures against breaching members.¹¹ Moreover, not the SSO but only competitors of the breaching member (irrespective of whether they took part in the standard setting procedure as a member) will have an

⁷A FRAND commitment is an abstract promise, because although the patent holder commits himself to license on fair, reasonable and non-discriminatory grounds, it is unclear beforehand what the exact licensing terms will be. It is also impossible to negotiate the exact terms of a potential licence beforehand, as at that time it is not yet clear whether the appropriate member owns relevant patents and what the value of his patents in relation to the standard will be. With regard to the intention of the FRAND obligation, it is most logical to consider the fair and reasonable grounds to be the royalties that would have been negotiated by parties with knowledge of the content before participants became *committed* to using the patented technology (in other words, in the fictitious situation that alternatives are still available) (Farrel and others 2007, p. 637). The non-discriminatory element requires that licence terms for similarly situated parties are the same (Geradin and Rato 2006, p. 13).

⁸ G.J.C. Rensen, *Extra-verplichtingen van leden en aandeelhouders*, Deventer: Kluwer 2005 p. 268

⁹ G.J.C. Rensen, *Extra-verplichtingen van leden en aandeelhouders*, Deventer: Kluwer 2005 p. 268

¹⁰ Jac. Hijma and others, *Rechtshandeling en Overeenkomst*, Deventer: Kluwer 2004 p. 375

¹¹ C. Shapiro, "Navigating the patent thicket: cross licenses, patent pools, and standard setting" prepared for presentation at "Innovation Policy and the Economy", *National Bureau of Economic Research*, April 11, 2000 Washington DC, p. 128

immediate commercial benefit if the breaching member is prevented from further invoking its patent against them.

Fortunately, under Dutch law there are some circumstances in which a contract generates legal effects for third parties. Those circumstances can be found in Articles 6:251-257 of the Dutch Civil Code. One of those exemptions is the *jus quaesitum tertio* or third-party clause (*derdenbeding*) of Article 6:253 paragraph 1 of the Dutch Civil Code: a third party can derive rights from a contract if the initial parties have so agreed, provided that the third party concerned has accepted the third-party clause.¹² The important question arises whether SSO IPR policy rules, as a contract between a member and the SSO, imply a third-party clause benefiting other members and non-members (such as other competitors and other companies applying the standard). We are of the opinion that the obligations (i) to timely disclose relevant patents during the standard setting procedure and (ii) to provide licences on FRAND terms, can under circumstances be regarded as third-party clauses. The aim of SSO IPR rules is to prevent the hold-up problem and to safeguard the freedom for *anyone willing to apply the standard* – a phrase commonly used in IPR-policy rules – provided of course that those parties have obtained and complied with the FRAND licence. Therefore all those parties are the intended beneficiaries of the IPR policy rules.¹³ In this respect, the SSO is the stipulator while each individual member is a promisor. The promisor each time commits himself towards all the other members to disclose his patents in a timely manner and to license on FRAND terms. Whether the contract between SSO (stipulator) and member (promisor) tends to provide the third parties concerned (all other competitors) with an independent right towards the promisor to enforce is a question of interpretation. In our opinion, given the rationale behind the existence of the rules, it is indeed fair to interpret the SSO IPR policy rules contract this way. The IPR rules really would not be of much significance if they could not be enforced by the other members and non-members.

However, with respect to IPR-policy rules incorporated in the articles of association of the SSO the following must be noted. Although we have already stated above that it is essentially irrelevant whether the IPR-policy is incorporated in articles of association or in separate membership contracts, this does not hold truth with respect to the position of non-member *vis-à-vis* a breaching member. The articles of association of the SSO only include obligations between members and the SSO. This means that – in principle – it is up to the SSO to take action towards the breaching member, and only to the SSO. Third parties being non-members have no part in the corporate relationship between a SSO and its members. Applying the doctrine of the third party clause makes it possible for other members¹⁴ to derive rights from the articles of association, but this does not work for non-members.¹⁵ Although at first glance this seems strange and undesirable even, we do believe this is dogmatically correct. Third parties should not in any way be involved in the ‘corporate governance’ of legal entities.

¹² Jac. Hijma and others, *Rechtshandeling en Overeenkomst*, Deventer: Kluwer 2004 p. 383

¹³ Some SSOs have IPR policy rules whose wording is not broad enough to also include non-members as beneficiaries. Those rules should be amended to make it possible for non-members to claim for breach of the FRAND licence obligation by a member.

¹⁴ G.J.C. Rensen, *Extra-verplichtingen van leden en aandeelhouders*, Deventer: Kluwer 2005 p. 274.

¹⁵ G.J.C. Rensen, *Extra-verplichtingen van leden en aandeelhouders*, Deventer: Kluwer 2005 p. 275.

If they were it could, for instance, be argued that their prior approval is required for taking certain corporate decisions or that these third parties have a right to claim damages in case of a legal merger or division.¹⁶ The legislator found such interference to be undesirable and therefore ruled out the possibility for third parties, not being the SSO or members of the SSO, to derive rights from the articles of association. We therefore advise SSOs to always incorporate their IPR policy rules in separate membership contracts instead of in their articles of association, also providing non-members with rights to enforce the obligations imposed on members by the SSO.

Furthermore, it is important to stress that it is common for SSOs to incorporate the wording “*to anyone willing to apply the standard*” in their IPR-policy rules *only* in respect of the obligation for its members to grant FRAND licenses. However, unlike the FRAND license obligation, the disclosure obligation is an obligation directed *only* towards fellow members, as it is applicable during the standard setting procedure. Therefore, the obligation to timely disclose essential patents can in our opinion not be considered a third-party clause for non-members. This means that only members of the SSO may derive rights from the disclosure obligation. We do not regard this as a problem, since it is not of interest to non-members to invoke the same rights on timely disclosure as members have. Only the SSO *and* its members need to know in time which patents are deemed essential to a certain technology in order to be able to choose a different, cheaper or non-patented, technology. After the technology has already been incorporated in the standard, it is obviously too late to choose for a different technology and therefore there is no interest for non-members in later stage to be able to enforce the disclosure obligation.

What remains is the issue of acceptance by the third party. The third-party clause in the SSO membership contract should be regarded as a third-party clause for no consideration. According to Article 6:253 paragraph 4 of the Dutch Civil Code, acceptance of a third-party clause for no consideration is assumed if the third party became familiar with the clause and did not object forthwith. For members of the SSO familiarity with the IPR policy rules is obvious. When they do not object to the obligations imposed by the IPR policy rules, their acceptance is a fact. But also if the third-party clause in the membership contract cannot be considered a clause for no consideration, acceptance need not be a problem as it can follow from behaviour. A party will be deemed to have accepted the third-party clause when it uses the stipulated right.¹⁷ This is for instance the case when a party (member or non-member) applies the standard *and* requests for a FRAND licence.

Possible legal actions

In case of non-compliance with the IPR policy rules by a member, we have established that fellow members and non-members (in respect of the FRAND license obligation) have the right to enforce their rights derived from these rules, provided that they comply with a FRAND licence. In that case

¹⁶ P.J. Dortmund, *Extra verplichtingen: De Personenvennootschap: enkele gedachten van de ontwerper van het eerste uur*, Kluwer 2008, p. 52.

¹⁷ G.J.C. Rensen, *Extra-verplichtingen van leden en aandeelhouders*, Deventer: Kluwer 2005 p. 76

several legal actions are available under Dutch contract law, as for all other contract disputes. If a holder of an essential patent is unwilling to provide you with a FRAND licence, you can demand performance of that obligation pursuant to the applicable IPR policy rules.

It should be noted that the District Court of The Hague rendered a judgment on 17 March 2010 (B9 8682) ruling that the holder of an essential patent is free to invoke its patent against anyone who has not (or not yet) obtained a FRAND licence. This means that parties that are willing to take a FRAND licence but have not been granted one or have been offered an unreasonable licence are also infringing an essential patent. This ruling differs from the judgment of the *Bundesgerichtshof* in the Orange Book case (6 May 2009, B9 7936). The *Bundesgerichtshof* decided that a patent holder who is unwilling for whatever reason to grant a licence on FRAND terms is liable towards the party that wishes to acquire a FRAND licence from the patent holder only if he has already acted as if he had been granted one. We agree with the approach adopted by the District Court of The Hague, because the legal certainty for all parties is best served this way. Moreover, anyone who is willing to apply the standard, but is not granted a licence or is offered an unreasonable licence may commence legal proceedings against the patent holder to demand his compliance with the IPR policy rules. In our opinion this system will work perfectly, avoiding legal uncertainty and offering an efficient remedy in case of a deadlock.

However, the problem arises if the other main obligation under the IPR policy rules, *i.e.* timely disclosure of essential patents, is breached by a member with intent or wilful neglect. Such breach is irreparable. By failing to disclose an essential patent, the breaching member deprives SSO of the freedom to adopt an alternative technology (cheaper or free) during the standard setting procedure. It is very difficult to calculate the damage that fellow members and non-members have suffered and will suffer in the future. The available remedies under Dutch contract law fall short in repairing the actual harm done by a patent holder who has breached its disclosure obligations. The patent has already been adopted by the standardisation committee and therefore every company that manufactures or sells products applying the standard is forced to comply with the patent holder's demands.

Under the above circumstances we believe it is justified for the defendant to invoke the doctrine of forfeiture of rights. See *Philips/LG*¹⁸, where the District Court of The Hague ruled that if LG could prove that Philips – the holder of an undisclosed patent essential to the JPEG-standard – attended the meetings of the SSO, LG rightfully invoked the doctrine of forfeiture of rights. However, the court also ruled that before deciding on the invocation of forfeiture of rights another question had to be answered. That question was whether LG was prepared to take a licence on FRAND terms from Philips, since a FRAND licence is “*what LG would have been obliged to, if Philips had disclosed its patent on time*”.¹⁹ In our opinion this is a remarkable ruling, since forfeiture of rights means that a claimant is no longer entitled to enforce its legal right *at all*. The right to grant a FRAND licence is derived directly from the patent right itself, and if the right to invoke a patent is forfeited, the right to

¹⁸ Court of The Hague, 25 April 2007 and 9 May 2007, HA ZA 06-955 (*Philips/LG*)

¹⁹ Paragraph 5.21, Court of The Hague, 25 April 2007 and 9 May 2007, HA ZA 06-955 (*Philips/LG*)

grant a licence is also forfeited. The total loss of the right to invoke an undisclosed essential patent right may at first glance seem too harsh, but we believe that this is the fairest solution in the circumstances described above. The breaching member deprived the SSO of the option of a cheaper or non-patented technology, which gives rise to damage for all the parties that apply the standard and find themselves surprisingly confronted with an undisclosed patent of a competitor. If despite this breach a patent holder keeps its right to demand FRAND licences, there is in fact no penalty at all for breach of the disclosure obligation. If you comply with the IPR policy rules and disclose your patent, you may run the risk of the SSO choosing another cheaper or free technology and, if the SSO does choose your patented technology, you have the right to demand FRAND licences from anyone willing to apply the standard. However, in accordance with the reasoning of the court in *Philips/LG*, a member who chooses not to disclose an essential patent always keeps his right to demand a FRAND licence and does not have to worry that this right is also forfeited. We believe this approach is unfair and legally incorrect.

Conclusion

We are of the opinion that SSO IPR-policy rules can form an effective remedy for the hold-up problem. Both the obligation to disclose an essential patent and the obligation to grant FRAND licences can be regarded as third-party clauses in accordance with Article 6:253 paragraph 1 of the Dutch Civil Code. Both members and non-members may under circumstances derive rights from these obligations imposed on the members of the SSO. The obligation to grant FRAND licences can be enforced by invoking the remedies of general contract law. However, if a member breaches its obligation to timely disclose an essential patent, these remedies fall short. Under these circumstances and if the breach is caused by intent or wilful neglect on the part of the member, the doctrine of forfeiture of rights offers relief to all the companies that apply the standard and that find themselves confronted with an unexpected essential patent of a member of the standard committee.