ANTITRUST DIVISION ENDORSES *EX ANTE* DISCLOSURE OF MAXIMUM ROYALTY RATE AND LICENSING TERMS IN CONTEXT OF STANDARD SETTING

The Antitrust Division of the Department of Justice (the "Division") announced in a business review letter that it will not oppose the proposed policy of VMEbus International Trade Association ("VITA") regarding the disclosure and licensing of patents. As discussed below, the Division's letter is significant because it is the first time that, in the context of standard-setting activities, the Division has endorsed disclosure by the patent holder of its maximum royalty rate and its most restrictive nonprice licensing terms.

Background

The Business Review Procedure, 28 C.F.R. § 50.6, provides a mechanism for organizations to obtain a statement of the Division's antitrust enforcement intentions with respect to a proposed course of action. VITA is a standard-setting organization ("SSO") that develops and promotes standards for VMEbus computer architecture, *i.e.*, robust pathways through which information travels within a computer system. VITA's proposed policy requires a patent holder to: (1) disclose patents that may become essential to implementing a new standard; (2) commit to license essential patent claims on fair, reasonable, and nondiscriminatory terms; and (3) declare irrevocably the maximum royalty rate and most restrictive nonprice licensing terms that it will require to license any such patents. (The full business review letter is available at http://www.usdoj.gov/atr/public/busreview/219380.htm.)

The antitrust enforcement agencies have shown considerable interest in the activities of SSOs and their participants because of the recognized procompetitive benefits that standard setting can provide as well as the potential for its misuse in connection with exclusionary and collusive practices that have resulted in antitrust liability. Recent enforcement actions in *Rambus*, FTC Docket No. 9302, Opinion, and *Unocal*, FTC Docket No. 9305, Complaint and Consent Order, for example, have addressed the failure of participating patent holders to disclose relevant patents or patent applications unilaterally to the SSO and its members. Earlier cases that highlight the antitrust risks associated with SSOs include *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 509-10 (1988), in which Sherman Act liability was found based on the manipulation of a standard-setting process.

Seeking to avoid such antitrust risks, many SSOs implemented rules designed to eliminate activities that pose the risk of antitrust liability. For example, many SSOs have refused to permit licensing terms to be discussed during the standard-setting process. The Division's letter regarding VITA's proposed policy may cause SSOs to reconsider whether and how some of those rules should still be applied.

Endorsement Of *Ex Ante* Disclosure

The Division's letter provided to VITA represents the first time that, in the context of standard-setting activities, the Division has endorsed "*ex ante*" disclosure (disclosure before or during the standard-setting process) by a patent holder of a maximum royalty rate and the patent holder's most restrictive nonprice licensing terms. Last year, both FTC Chairman Majoras and former Assistant Attorney General Pate explained that discussions of licensing terms and royalty rates before or during the standard-setting process could be procompetitive and should be analyzed under the rule of reason. The business review letter discusses the potential benefits to competition of such *ex ante* disclosure of price and other terms. Those benefits include allowing SSO members to evaluate substitute technologies on both technical merit and licensing terms and encouraging each patent holder to compete by submitting declarations that favor the selection of its patented technology. In addition, while the declarations, once made, are irrevocable, the VITA policy allows patent holders to submit subsequent declarations containing less restrictive terms. Permitting supplemental declarations will presumably foster additional competition among the patent holders seeking inclusion in the standard.

The VITA disclosure requirements also decrease the likelihood that the standard-setting efforts will be jeopardized by disputes over royalty rates and licensing terms after a particular technology has been made a part of a standard. VITA previously attempted to prevent such controversies by incorporating technology only if the patent holder committed to license it on fair, reasonable, and nondiscriminatory terms. VITA, like many SSOs, found that requirement insufficient, as disagreements inevitably developed over whether royalty rates and terms were, in fact, fair, reasonable, and nondiscriminatory. Those disagreements interfered with VITA's procompetitive goal of developing open standards.

Important Qualifications

Significantly, the Division emphasized certain limitations in VITA's disclosure requirements. First, the Division noted favorably that VITA's standard-setting fulfilled procompetitive purposes by enabling many firms to produce VME hardware as a result of a series of open VITA standards. Second, the VITA proposal specifies that VITA members are not to negotiate collectively the actual royalty and nonprice terms. Instead, the patent holder and each potential licensee must negotiate independently, subject only to the "most restrictive terms" disclosed in the patentee's declaration. In addition, the declaration of maximum royalty and other terms binds the patent holder only with respect to potential licensees that are utilizing the technology as part of the established standard. Those seeking to license the technology for other purposes will not obtain the advantage of the terms specified in the declaration.

Open Issue: Collective Negotiation Of Fees And Licensing Terms

The Division also addressed the question of whether collective negotiation of licensing fees in the context of standard-setting activity might be permissible. Although the VITA proposal specifically prohibits collective negotiation, the Division indicated that "[i]f the proposed policy did allow such negotiations and discussion, the Division would likely evaluate any antitrust concerns about them under the rule of reason because such practices could be procompetitive."

In other contexts, FTC Chairman Majoras has indicated that collective *ex ante* royalty discussions that are reasonably necessary to avoid a "holdup" would not warrant *per se* condemnation under the antitrust laws. "Holdup" describes a situation in which a patent holder declines to license other members of an SSO on objectively reasonable terms after a standard has been set. The Division has indicated, however, that any efforts to reduce competition by rigging royalties or by using the declaration process as a cover to fix prices would be illegal *per se* under the Sherman Act.

Implications

As a practical matter, VITA's policy might enable its SSO participants to exert pressure on patent holders to commit to maximum royalties or risk having their technology excluded from the standard. Alternatively, patent holders might have an incentive not to participate in VITA's standard-setting process (and thus not to commit to maximum royalty rates) if they believe that their technology will be selected for inclusion in the standard and they can maximize their negotiating leverage after the standard has been adopted.

More generally, the Division's willingness to evaluate some collective negotiation under the rule of reason in some settings does not eliminate the antitrust risk in collective discussions regarding royalty rates and licensing terms, particularly before or during the standard-setting process. Indeed, SSOs and participants must exercise care in encouraging collective negotiation before or during the standard-setting process, as guidelines have not yet been articulated that identify when such negotiations are procompetitive and when they may produce the opposite effect.

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