EU-China Trade Project (II)
中国-欧盟世贸项目（二期）

A project funded by the
EUROPEAN COMMISSION
欧盟资助项目

Microsoft & Qualcomm

Ninette Dodoo, 3 June 2011
Head of Antitrust, China
Clifford Chance LLP

Overview

- Microsoft
  - Background
  - Refusal to supply
  - Tying
  - Lessons from *Microsoft*

- Qualcomm
  - Background
  - FRAND pricing in the standards context
  - Standards setting agreements
  - Lessons from *Qualcomm*

Microsoft

Background

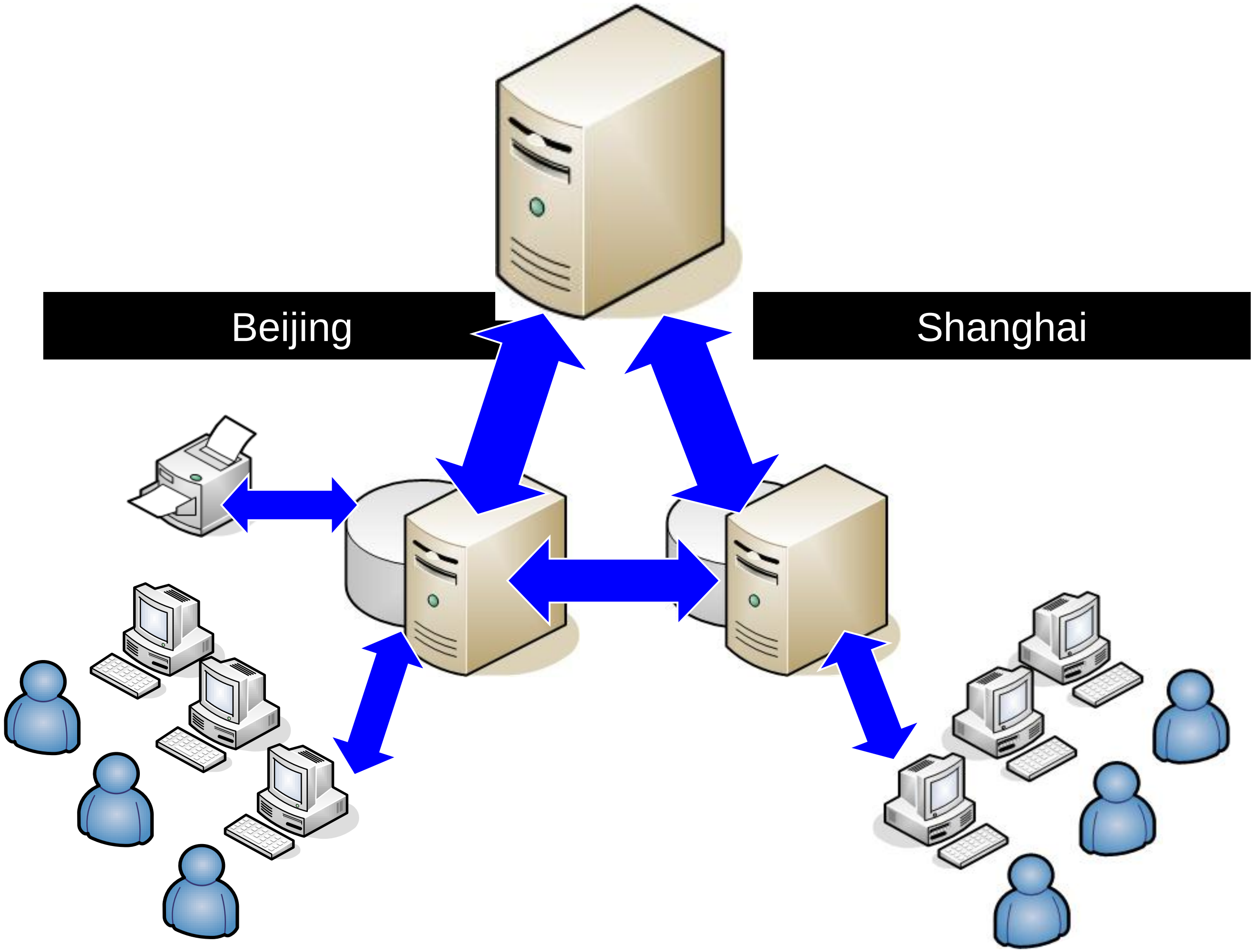
- European Commission investigation began in 1998 with a complaint from Sun Microsystems
- European Commission broadened the scope of its investigation in 2000
- European Commission claimed:
  - Microsoft refused to provide interface information for interoperability with competing server operating systems
    - “Interfaces” are essentially the rules and methods by which software products interact and communicate
  - Microsoft unlawfully tied Windows Media Player with the Windows Operating System (PC OS)
  - Both cases predicated on Microsoft’s PC OS dominance

Dominance

- Microsoft acknowledged that it held a dominant position in the PC OS market:
  - Microsoft has a very high and stable market share: 95%
  - Microsoft has ubiquitous market presence
  - Barriers to entry are very high:
    - Applications barrier to entry: indirect network effects
    - High sunk costs involved in developing OS
  - Market was not contestable with fringe competitors: Linux and Apple
- European Commission also found that Microsoft was dominant in the work group server OS market

Refusal to Supply

Work Group Server Interoperability



Unlawful refusal to supply

- A dominant firm’s refusal to license an IP right can constitute an abuse if four conditions are met:
  1. Information is indispensable
     - Objective necessity
     - But, also economic viability
  2. Refusal risks eliminating (effective) competition
     - On the downstream market
     - Refusal is likely to lead to consumer harm
  3. Refusal prevents appearance of new products
     - But, includes limitation of innovation
     - Interoperability barrier prevented consumers from choosing competitors’ products they valued more highly
  4. No objective justification
     - Existence of IPRs does not justify refusal
     - But, refusal to disclose may be justified if there is sufficient adverse impact on the licensor’s innovation incentives

The view of former CFI President Bo Vesterdorf

- The view of former CFI President Bo Vesterdorf
  - *"… [I]t seems obvious to me that [the interoperability case] has expanded the case law on four important points. One regarding the **indispensability** criterion, which now in addition to objective indispensability also covers "economic viability", thereby allowing the authorities a wide margin of appreciation; secondly, that the **new product** criterion no longer covers only new products in strict terms but also technical development of an existing product; third, **elimination of competition** means elimination of all effective competition and not all competition. Finally, the **value of the IP right** or the degree of innovation involved or the negative effect on incentives to invest does not – at least easily – count as objective justification for a refusal"*

    ("Article 82 EC: Where do we stand after Microsoft?", London, 12 March 2008)

Article 82 Guidance Paper: Refusal to Supply

- Constructive refusal is sufficient *e.g.*, delay or excessive pricing
- Refusal must relate to a product or service that is essential for a competitor
- Likely to lead to the elimination of effective competition on the downstream market
- Negative consequences of refusal to supply must outweigh the negative consequences of imposing an obligation to supply
- *Microsoft* test applies to all refusals to supply and not only refusals to license IP rights
- European Commission will consider enforcement a priority if the following cumulative conditions are met:
  - Refusal relates to a product/service, which is objectively necessary to compete effectively on a downstream market
  - Refusal is likely to lead to the elimination of effective competition on the downstream market
  - Refusal is likely to lead to consumer harm

Disclosure Remedy (1)

- Microsoft ordered to disclose accurate and complete interface information, not implementation detail *i.e.*,
  - Not source code
  - Not internal make-up of programs
  - Not information that enables competitors to clone Microsoft's products
- Interface information ordered to be disclosed equates with standards level information

Disclosure Remedy (2)

- Microsoft ordered to disclose interface information on reasonable and non-discriminatory terms:
  - Microsoft entitled to reasonable remuneration to the extent that interface information reads on IP rights
  - Remuneration must not reflect strategic value stemming from Microsoft's market power in the client PC OS market, or in the WGSOS market
- Microsoft's implementation of disclosure remedy
  - Geographic scope – accepted worldwide disclosures
  - Level of royalty rates – case pending before General Court in Luxembourg
  - Timing of the disclosures

Lessons from *Microsoft* (1)

- Applies and clarifies earlier case law:
  - Case C-418/01 IMS Health
  - Joined Cases C-241/91 P and C-242/91 P Magill
- Intellectual property and competition law
  - When is a refusal to license IP rights unlawful?
  - When can/will disclosure of IP rights be ordered?
  - Not all abuses are based on an abuse of IP rights
- Safeguarding incentives to invest
  - Simply stating that IPRs must be licensed is not sufficient to show that incentives to invest will be reduced
  - Dominant firms may demonstrate that their incentives to invest would be reduced by a compulsory license
  - The burden of proof is on the dominant firm

Lessons from *Microsoft* (2)

- Cases are highly fact-specific
- In *Microsoft* other relevant factors included:
  - Strong evidence of foreclosure resulting in consumer harm: interoperability barrier prevented consumers from choosing competitors' products, which they valued more highly
  - Making interoperability information available is industry practice
  - Termination of an existing level of supply
  - Evidence of anti-competitive intent
  - Refusal had both leveraging and monopoly maintenance effect

Tying

Unlawful tying

- Under *Microsoft*, a tying abuse is committed where:
  - Dominance in the tying market
  - Separate tying and tied products
  - Tying product is not offered without the tied product
    - Coercion can be contractual, commercial or technical
  - Absence of an objective justification

Separate tying and tied product

- Evidence of separate demand:
  - Are there separate suppliers active in the market for the tied product?
  - Role of OEMs: importance in the competitive process
  - Microsoft’s own commercial practice confirmed the existence of a separate market:
    - Microsoft offered WMP separately for other operating systems
    - No technical reasons for offering products together – no stability issues arose if products offered separately

Coercion

- Coercion of a contractual and technical nature
- Consumers could not obtain WMP without Windows
- OEMs were the main focus of the tying practice, and this impacted customer choice
- Additional considerations:
  - That consumers could obtain WMP for “free” was not relevant, and, in any event, WMP was *not* free of charge
  - That consumers could use third party alternative media players with Windows was not relevant

Forclosure

1. Tying afforded WMP ubiquitous presence
2. Disincentivised OEMs and consumers to consider alternatives
3. Tying undermined competition on the merits
4. Indirect network effects reinforced lock-in effect of tying
5. Tying negatively impacted innovation in the market

Absence of objective justification

- Integration is not generally a defence to tying
  - Microsoft's technical benefits arguments were not substantiated
  - Microsoft acknowledged that there was no technical reason for tying WMP with Windows
  - Integration can make the foreclosure effect more severe
- Benefits of a uniform platform
  - Tying was not essential to achieve platform benefits
  - Standardisation must stem from competition on the merits

Disclosure Remedy

- Microsoft ordered to offer a version of Windows without WMP to end users and OEMs, but retained right to offer a version of Windows with WMP
- Microsoft must refrain from using any means that would have the equivalent effect of tying WMP to Windows, *i.e.*,
  - Any commercial, technological, contractual or other means that would undermine attractiveness or performance of Windows without WMP
  - Any discounts given to OEMs or users conditional upon their obtaining Windows together with WMP
- Microsoft's implementation of disclosure remedy
  - Microsoft released a version of Windows without WMP, Windows XP N, for sale in the EEA
  - Windows XP N sold at the same price as standard Windows XP
  - Timing of the disclosures

Lessons from *Microsoft* (1)

- Applies and clarifies earlier case law:
  - Case T-83/91, upheld on appeal in Case C-333/94 P Tetra Pak II
  - Case T-30/89 Hilti
- Cases are highly fact-specific
- Integration is not normally a defence
- *De facto* standardisation is permissible, but must be based on competition on the merits of the product
- Limiting innovation is an expression of a restriction on consumer choice
  - Foreclosure of qualitatively superior products
- Remedy is typically untying, but measures should be taken to ensure the effectiveness of the remedy

Lessons from *Microsoft* (2)

- Follow-on cases from original *Microsoft* case:
  - "IE browser tying case" following Opera complaint
    - Ended through formal settlement: choice screen from which users could easily download and use competing web browsers
  - Office format and server interoperability case based on ECIS complaint
    - Microsoft voluntarily put forward interoperability commitments

Lessons from *Microsoft* (3)

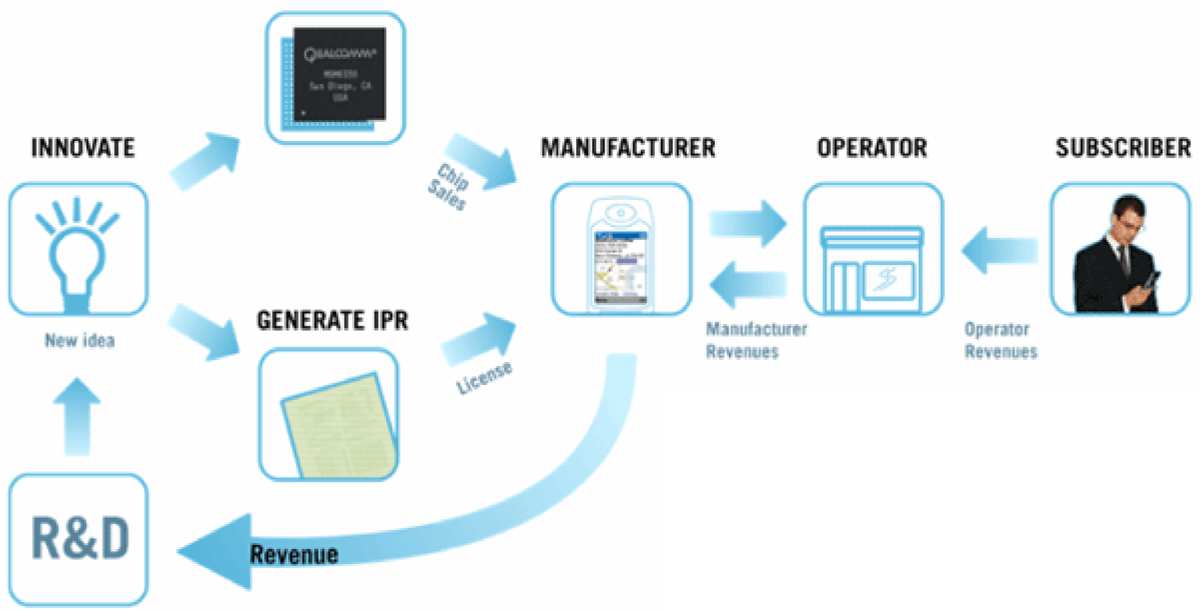
Qualcomm

Background

- *Qualcomm* investigation
  - European Commission investigated Qualcomm for a potential abuse of a dominant position upon complaints from wireless device makers
  - In 2005, complainants claimed that Qualcomm charged excessive licensing fees for patents held in the UMTS standard
  - Complaints claimed licensing fees violated Qualcomm's commitment to standard-setting bodies (SSOs) to license on FRAND terms
  - European Commission investigation focused on the valuation of Qualcomm's patented technology included in the UMTS standard
  - European Commission eventually closed the investigation without a formal finding of an abuse after complainants withdrew complaints

Qualcomm Business Model

QUALCOMM Business Model - Technology Enabler *



- QC chip/software platforms enable low cost entry for new manufacturers to drive competition
- QC R&D and chip/software development funded through sales and license revenue

* Presentation to FTC/DOJ Joint Hearings on Single Firm Conduct, 30 January 2007
Michael D. Hartogs, Senior Vice President, Division Counsel P, QUALCOMM Technology Licensing

Pricing and standards

- Excessive pricing of essential IPRs (*e.g.*, patents essential to implementing a standard) can amount to an **exploitative abuse** of a dominant position under Article 102(a) TFEU
  - Joined Cases C-110/88, 241/88 and C-242/88 Lucazeau
- Excessive pricing of essential IPRs can also constitute an **exclusionary abuse** under Article 102(b) TFEU
- A standard-setting agreement will benefit from **safe-harbour** from antitrust scrutiny under Article 101 TFEU if it contains, *inter alia*, a commitment to license on FRAND terms

FRAND pricing in the standards context (1)

- IP right owner will normally disclose patents that it considers might be essential for a standard
- IP right owner will typically commit to license disclosed essential patents included in the standard on FRAND terms
- Licensing terms are often discussed and negotiated before adoption of a final standard on a bilateral basis outside SSO
- FRAND terms is, amongst others, a pricing question
  - No generally agreed definition of “FRAND”
  - FRAND pricing means different things to the IP owner and IP licensee, and their respective incentives differ
  - Organisations where competitors meet to discuss pricing typically attract antitrust scrutiny

FRAND pricing in the standards context (2)

- Theories underlying excessive pricing claims
  - Market power: adoption of patented technology in a standard confers or enhances market power
  - Hold-up and opportunism: an IP owner with essential patents in a standard may be inclined to abuse this opportunistically
    - Refusal to license or excessive pricing
    - Limitations on the development of the standard
    - Consumers could pay higher prices for products that use the standard

FRAND pricing in the standards context (3)

- Possible methods for determining whether essential IP included in a standard can be considered to be *FRAND*:
  - *Numeric proportionality*: each IP owner contributing patents to a standard would receive a proportion of the total royalties based on the number of essential patents that IP owner has disclosed
  - *Competitive auctions*: if a choice exists between alternative technologies for inclusion in a standard, FRAND pricing should reflect the competitive rate that IP owner would have charged prior to the adoption of the standard if a competitive auction had occurred
  - *Industry experience*: consider relevant comparables in the industry
  - *Georgia-Pacific and the 15-pronged framework*: developed in the US for determining reasonable royalties in patent infringement cases

FRAND pricing in the standards context (4)

- Possible methods for determining whether essential IP included in a standard can be considered to be *FRAND cont.*
  - Economic models:
    - Efficient Component Pricing based on market competition/efficient pricing
    - Shapley value method based on cooperative game theory and fairness considerations
      - Both models assume that alternative technologies exist at the time of selection for inclusion in the standard
      - Both models assume that the level of competition is a key element in determining the value of the patent

Standard setting agreements (1)

- Horizontal Guidelines: safe-harbour for standard-setting agreements if a number of criteria are met:
  - Participation must be unrestricted (including voting rights)
  - Procedure must be transparent
  - No obligation to comply with the standard
  - Access to the standard must be on FRAND terms
  - Good faith *ex-ante* disclosure of IPRs
    - Reasonable endeavour to identify IP and ongoing disclosures as standard develops
      - Participants can meet this requirement even if they declare that they are likely to have IP rights over particular technology, without specifying those rights
    - Reduces threat of patent ambush: enforcing hidden patents after own technology has been elected as a standard
    - No disclosure requirement for royalty-free licenses
  - What is FRAND?
    - *Ex-ante* valuation
  - Unilateral ex-ante disclosures not normally restrictive

Standards setting agreements (2)

- If standards agreement not covered by safe-harbour: agreement may still be considered on balance pro-competitive under “efficiency defence” of Article 101(3) TFEU
- Case-by-case analysis is required:
  - Are SSO members free to develop alternative standards or products that are non-compliant?
  - Is there effective competition between the standard and other solutions outside it?
  - Is participation unrestricted? If not, what impact does this have on competition?
    - Effective competition between several standards/SSOs
    - Is it necessary in some cases to limit participation to enable wider adoption of the standard?
  - If the standard setting agreement is discriminatory this would raise competition concerns
    - Example: Excluding upstream only actors (and thus better technologies)
  - IPR policy of the SSO: does it in practice prevent informed choice between technologies?

Lessons from *Qualcomm*

- Investigation of alleged anti-competitive IP licensing is predicated on proof of dominance
- Valuation of IPRs is complex and even more so in the standard-setting context
- In the absence of clear regulatory guidance on FRAND, licensing terms, including price, are appropriately discussed and negotiated on a bilateral basis outside SSO – *ex ante* if a choice between alternative technologies for inclusion exist
- *Ex ante* disclosure of essential patents and valuation are preferred in the standard-setting context
- Intervention should occur in limited circumstances, and must be practical and effective in the circumstances

Conclusions

Conclusions

- Intervention on competition law grounds occurs only in exceptional circumstances – to preserve competition
- Careful analysis of the specific facts of each case is crucial
- The starting point of any investigation into alleged anti-competitive activity is proof of dominance
- IP rights in IT sector do not necessarily confer market power, and abusive conduct may not necessarily stem from IP rights
- Strong IP protection is essential to innovation in the IT sector and preserves innovation incentives
- Preserving consumer choice in the IT sector is equally as important to spur innovation
- Pricing mandated access is complex and even more so in the absence of clear and precise regulatory guidance – especially in the standard-setting context

Q & A

Microsoft & Qualcomm

Ninette Dodoo
ninette.dodoo@cliffordchance.com