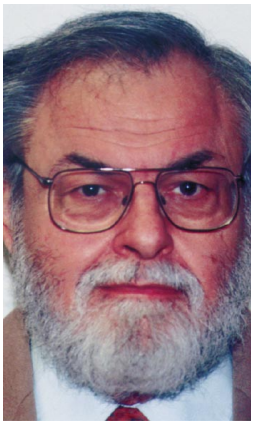

Inviting participants in standard setting

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Your daughter is having a birthday party. She wants to invite most of the kids in her class. But a few troublemakers exist. Billy, for example, always disrupts the party: knocking the birthday cake onto the floor, spilling ice cream over your Persian rug, stepping on the cat's tail.... Must you invite Billy, too?

Not in the US: the First Amendment gives you a constitutional right to freedom of association. You don't have to invite troublemakers and other undesirables (as you subjectively define that term) into your home. As far as the law is concerned, your home is your castle. Billy's only recourse is to get his mother to phone you and complain, and you can be unresponsive. Billy has no possible legal claim against you for invidious discrimination.

Now, suppose that you are setting a standard for a new bus or optical disk format. Does the principle that your home is your castle apply? That is problematic.

The problem

Say that your hypothetical industry has a "Billy," a (purely) notional Femtosquishy Inc. Femto is notorious for trying to distort any industry standard toward a format that nobody else's technology can use. Moreover, it usually turns out that Femto has a half-dozen pending patent applications that will issue six months after the standard is adopted. At that point, surprise, Femto insists that everyone must respect its intellectual property rights. Translation: accept licenses on onerous and restrictive terms. Other times, Femto just tries to gum up the works to stall the adoption of any standard to prevent standardization from occurring—or until the standard has become irrelevant. Or Femto adopts the standard, but develops its own proprietary feature supersets.

Femto's competitors comply with the standard and do not use Femto's proprietary supersets. Some Femto customers and competitors use Femto's added features in their products. As a result, these customers' products won't operate with the products of Femto's competitors. There is one-way compatibility.

Products following the standard work run under Femto's system, while products using Femto's superset won't run under competitors' systems. The result is that Femto subverts the standard by eliminating the interoperability that the standard is supposed to ensure. One might think that this is a reason not to let Femto

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1) participate in creating the standard, and 2) use (and later abuse) the standard.

But suppose that your standard bus or optical disk format becomes a de facto standard for the industry. Suppose that products that do not conform to the standard are commercially unacceptable, as a practical matter, making the standard an "essential facility." Suppose that the technology of the standard is such that it excludes the technology that Femto uses. (Consider HTML 3, marquees-vs.-Java script banners, or inline frames.) In such circumstances, might refusal to let Femto participate in the standard-setting process amount to conspiring to exclude it from the market? Would it be an illegal boycott?

Participation in standard setting

First, refusing to let Femto come to the party *might* be an antitrust violation or an unfair trade practice. But the matter is sufficiently uncertain to justify not inviting Femto and, if it then asks to join the process, to persist in rejecting its participation.

Before a standard exists, there is no basis for concluding that it will become a de facto industry standard and an essential facility. In any event, such a refusal would most likely be tested under the amorphous "rule of reason." So, if you are willing to incur a little litigation risk, keeping Femto out of the standard-setting process might well squeak by.

Femto would need to convince a court that it was being irreparably injured by the refusal to invite it into the process. Moreover, there are no provable damages at the outset. A court might well react favorably upon a recitation of a litany of Femto's past misdeeds in other standardization efforts. The chances of prevailing against Femto in any litigation would be good. Anyway, the worst-case scenario would be an order to invite Femto in. Then the standard setters would most likely be entitled to eject Femto the first time it acted up.

Refusal to license the standard

What about refusing to grant Femto a patent or copyright license under the technology needed to comply with the standard, once it has been adopted? (Of course, if there is no intellectual property at all associated with the standard—which is most unlikely—no license would be needed to comply with the standard.)

Might refusal to let a company participate in the standard-setting process amount to conspiring to exclude it from the market?

An absolute refusal to license is likely to be an antitrust violation, particularly if several firms pooled the technology used in the standard. They might cross-license one another and keep their respective rights to license their individual technology, or they might create a pool entity to license all of the technology needed to comply with the standard. (The latter may be more convenient for licensees.) Either way, if the effect of refusing a license is actually to exclude Femto from the relevant market, there is probably an antitrust violation: a monopolistic denial of access to an essential facility and probably a horizontal boycott agreement too.

So, once your industry group has set a standard, and it has become equivalent to the only bridge across the Mississippi River at St. Louis, your standard-setting group cannot deny Femto access to the standard. So, what can you do about the likelihood that Femto will use the license to subvert the standardization process?

Protecting the process

Probably the best you can do is place standardization-protecting conditions on the license such that, if Femto (or any licensee) disregards or disobeys them, that action would be material nonperformance. That would justify immediate termination of the license and pave the way for an injunction against infringement of the intellectual property rights underlying the standard.

As already indicated, a major risk is a standard's subversion by development of proprietary-feature supersets. This results in one-way compatibility and migration of customers away from the standard to the superset. This has been an issue, for example, with Java and HTML. What can standard-setting groups do to prevent this and other standardization-subverting acts?

They could set up a list of foreseeable subversive acts and expressly make the license conditional on the licensee not doing them. This does not always work well, however. A licensor cannot lawfully prohibit licensees from engaging in technological innovation, nor would a sensible industry group want to see that happen. The real problem is not development of feature supersets, but exploitation or manipulation of them in an anticompetitive manner. How do you address that?

One way, lawful in the US, is requiring all licensees to license improvements back to the licensor (the licensing pool if there is one or the individual licensor if that is how licenses are issued), with sublicensing rights. (An improvement might be defined as any technology whose use enhances the use of the standard's technology.) Must the back-license be royalty bearing? Can the licensor insist that it be royalty free?

Insisting on royalty-free back-licenses and sublicensing rights can discourage licensees from investing in making technological advances. A lightbulb patent licensing program of General Electric was held violative of the antitrust laws on this ground in the l950s. On the other hand, a firm like Femto might set a standard-defeating high royalty or might impose highly restrictive licensing terms, unless it gives the standards group adequate licensing rights.

One approach is just to accept the possible antitrust risks of demanding royalty-free back-licensing. A less aggressive

continued on p. 79

continued from p. 7

approach is to provide that a back-license goes into effect at once. An arbitrator would determine the other terms and the royalty rate in due course. The arbitrator would be directed to set a rate commensurate with (and in no event more than *x*% of) the royalty charged for the technology of the standard.

Timing factors and a dynamic marketplace may create further problems. Femto may rely on what the economist Schumpeter explained as the creative and destructive gale of innovation. Femto may keep changing its feature superset faster than others can react to it. By the time competitors and the industry standard adjust to a new feature superset, another one has come along. Perhaps, reasonable advance notification requirements should be placed in the technology license for the standard as a countermeasure.

Dealing with the unforeseeable

Now, say that one of your industry's problems in dealing with Femto is that it is highly imaginative and the marketplace is very dynamic. Nobody can ever foresee all of the anticompetitive things that Femto will do. That's why your standard-setting industry group didn't want to deal with Femto, and wouldn't license it if the group thought it could lawfully avoid doing so. You can write a list of prohibited practices, A, B, C, ... N, that are relevant at the time you write the list. But Femto will surely think up X, Y, and Z that you never thought of, and will do so faster than you can lengthen the list conditioning the license. In any event, the world keeps changing.

How about saying that any time there is a disagreement about the propriety of a business practice that a licensee of the standard is engaging in, it will be arbitrated? Say that the "industry fair practices committee" will be charged as an arbitrator to prohibit unfair methods of competition. This is probably a very bad idea and likely to be an antitrust violation. In a nutshell, the antitrust law does not like private legislatures. Courts tend to define their actions as illegal boycotts. This approach is too risky.

Here is a possible alternative: Suppose that the standards group operates in state A, which like many states has a so-called Little FTC Act. (That law prohibits "unfair or deceptive business practices," in essentially the same broad language that the national Federal Trade Commission Act does. Federal and state FTC acts define unfair conduct in broad, unspecific terms because of the difficulty in specifying in advance every conceivable kind of commercial bad act. The law is civil and remedial, not criminal, and therefore avoids due-process limitations that would undo such a law if criminal sanctions applied.)

Say that state A also has an attorney general willing to enforce vigorously the state's Little FTC Act. The antitrust laws do not prohibit state action, for example, action by state officials, that might otherwise raise antitrust problems.

Consider putting these provisions in the license:

- Licensee warrants that it will, at all times, in engaging in business practices that involve the licensed technology or its utilization, obey state A's Little FTC Act.
- Any party to a license under the technology of the standard may advise the licensor that another party to a license is violating the foregoing warranty. In that event, if the licensor shares the complainant's concerns, it may request an advisory opinion from the attorney general of state A. The attorney general will be asked to advise whether the challenged conduct violates state A's Little FTC Act.
- Any such advisory opinion of the state attorney general will be regarded as a legally binding determination (that is, equivalent to an arbitration award). It shall be legally enforceable as between the licensor and challenged licensee.

If the state attorney general says that Femto (or whoever it is) has engaged in an unfair act and practice under state A's law, Femto has breached its warranty of good behavior. Consequently, the licensor may terminate Femto's license. If Femto uses the technology of the standard, it is a patent or copyright infringer.

Nobody has tried this sort of license, as far as I know. But it might provide a way to deal with the problem of having to invite Billy to the party even though you know he will be spilling ice cream on your best Persian rug.