Chapter 3
Interpreting and Enforcing the Voluntary FRAND Commitment

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ABSTRACT
Although often debated as though it were public law, a FRAND undertaking is a private contract between a patent-holder and an SSO. Applying ordinary principles of contract interpretation to the case of ETSI IPR policy reveals that “interpretations” of FRAND advocated by some authors—including cumulative royalty limits, royalties set by counting patents, or a prohibition on capture by the patent-holder of any gains created by standardization—cannot be correct (ETSI, n.d.). Rather, a FRAND obligation leaves wide latitude to private parties negotiating a license. However, this does not mean that a FRAND commitment has no substance to be enforced by courts. In this paper, the authors review how, consistent with both contract principles and established judicial method, courts can enforce a contractual obligation to offer licenses on FRAND terms, without becoming IPR price regulators. Similarly, ordinary principles of contract interpretation reveal that the “non-discriminatory” portion of FRAND cannot be interpreted to be coextensive with common “most favored nations” provisions, but instead contemplates substantial latitude for private parties to negotiate terms suited to their particular situations.

INTRODUCTION

A. Overview

Technical standards are far from a new phenomenon. Since the late eighteenth and early twentieth centuries, national and international bodies—in many cases purely private and voluntary bodies—have been promulgating standards in a wide array of commercially important technical fields. Over the years, thousands of such standards have been developed, approved, and used in industry. Until recently, all this was very largely the domain of engineers; until the last decade, despite their commercial and international importance, technical standards attracted very little litigation or legal commentary.
But times have changed. Now, lawyers are studying intensively each stage of the standardization process: membership rules of standards-setting organizations (“SSOs”), policies concerning disclosure of potentially relevant patents, licensing of “essential” patents, and enforcement in the case of alleged violations of SSO policies—all are now transformed into legal topics.

In this new world of standards, one of the currently most contentious issues concerns the meaning of a commitment by the holder of patents “essential” to the practice of a standard to license such patents on “fair, reasonable, and nondiscriminatory” (FRAND) terms and conditions. The body of legal literature addressing this question is by now substantial, and growing. While not necessarily reaching similar conclusions, a number of authors have addressed this issue as a question of economic theory: what limitations (if any) on the freedom of the parties negotiating a licence to essential patents will best ensure efficient outcomes?

As a response to this question, authors have variously argued that, in order to satisfy a “fair and reasonable” commitment, a patent holder:

- Must charge no more than the incremental value of his invention over the next best technical alternative (Lemley & Shapiro, 2007; Dolmans, 2008; Temple Lang, 2007);
- Must not negotiate for a royalty-free cross-licence as part of the consideration for a license (Dolmans, 2008);
- Must set his royalty rate based on a mathematical proportion of all patents essential to the practice of a standard (Chappatte, 2009; Temple Lang, 2007);
- Must set his royalty rate in such a way as to prevent cumulative royalties on the standardised product from exceeding a low percentage of the total sale price of that product (Lemley & Shapiro, 2007);
- Must not raise requested royalty rates after the standard has been adopted, or after the relevant market has grown to maturity (Chappatte, 2009; Shapiro & Varian, 1999; Swanson & Baumol, 2005);
- Is not entitled to seek injunctive relief against a standard implementer should they fail to agree on licence terms (Farrell et al., 2007; Temple Lang, 2007).

The types of economic arguments relied on by these authors to justify these restrictive regimes may well be useful in debating public policy and the proper application of antitrust rules—although one of the present authors and others have elsewhere critiqued the merits of many of these calls for what is essentially government intervention in the private licencing process. But in this paper we step back to ask a different question: What do these arguments and proposed regimes have to do with the contract which is the source of the FRAND obligation?

This paper is divided in four section. Section 1 reviews the basic fact that a FRAND commitment is the result of a voluntary contract between essential patent holders and a standards-setting organization, with the important corollary that the meaning of that commitment must be determined through the legal methods of contractual interpretation. Using a FRAND undertaking to ETSI as an example, it identifies the main categories of information potentially relevant to contract construction, including for instance the contract language itself, and the “negotiation history” of the ETSI IPR Policy (ETSI, n.d.). Section 2 shows that none of these categories of information support any of the restrictive limitations listed at the opening of this introduction. On the contrary, “fair and reasonable” are on their face flexible terms the specific content of which is substantially left to the negotiation between the parties. Our research also shows that all attempts made subsequent to the ETSI IPR Policy’s adoption to alter the balance of interests between essential