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Setting the standards high

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Ladies and gentlemen,

2009 has been a big year for competition policy. We've seen not only the inauguration of the Obama administration and the new approaches that has involved, but also the coming-of-age of competition regimes in other parts of the world. I have just returned from signing a Memorandum of Understanding with Brazil, for example – the likes of Brazil and China are witnessing big leaps in competition enforcement. And in Europe we have had to fight hard to prove the value of our established competition policies, given the challenges of the financial and economic crisis.

In that context I think the European Commission has done well to not only keep the European Single Market intact – but also to push forward on a number of other policy fronts. You may have read about developments in our relationship with Microsoft and further real progress in our energy cases, for example.

But what I want to address directly in my remarks is another issue affecting not only the technology sector and many American companies, but also a range of sectors. That issue is standards.

In essence, standards are good because they create the level playing field on which all can compete. More than that, good standard-setting helps consumers, boosts competitiveness and can spur market growth. Remember, for example, the wide-spread benefits of some of the most common standards in everyday use I am thinking of the GSM standard for mobile phone, Internet protocols, the magnetic stripe on various ID and banking cards, MPEG for videos and podcasts.

A year ago, I gave a speech about the importance of standards. I stressed the major role standards play in facilitating economies of scale and interoperability, particularly in the IT and communications industries.

Since then many people from industry have approached me and asked for more specific guidance on competition issues which may arise in the standard setting context. It's a very reasonable question, but to answer it properly the Commission has needed time to build up the evidence and experience in the various cases centred around standards. Now, as these cases have progressed, it is time to flesh out the Commission's approach.

We are also currently revising the guidelines for horizontal agreements in which we plan to improve the existing chapter on standardisation to provide more guidance on standard setting.

Let me start first with the theme of transparency – because it is something that runs through our competition policy and practice, and standards is no exception. If standardisation processes are open and transparent, then standards can bring significant benefits to consumers by ensuring compatibility between products, which will generate competition on price and innovation. There are costs as well as benefits of course. Standardise too early and you will likely pick the wrong technology and hinder the development of the market. Standardise on proprietary technology when non-proprietary alternatives are just as good, and you will raise costs for the industry as a whole, and risk lock-in to a particular vendor's products.

Naturally, we can't give a carte blanche endorsement to the idea of companies sitting around a table agreeing technical developments. We need to put some safeguards in place to make sure the general interest is served. And – although we will intervene only in exceptional circumstances - we must also be vigilant when dominant companies refuse to license de facto standards

To help illustrate these points, it is helpful to turn to the technology sector. Many of the competition problems we face have occurred within the context of standards involving technology and therefore intellectual property rights (IPRs).

Let me give an example - that of a "patent ambush" where our intervention is clearly required. A "patent ambush" occurs when a company taking part in the standard-setting process hides the fact that it holds essential IPRs over the standard being developed, and starts asserting such IPRs only after the standard has been agreed and other companies are “locked in” to using it.

The company that engages in the deception excludes potential competing technologies from the market. Moreover, if successful, such an ambush distorts competition by allowing a company to charge an artificially inflated, ex-post price for its IPR or to even charge a royalty in the first place. There have been cases of this on both sides of the Atlantic, and the enforcement agencies all take a rather dim view of this behaviour.

As you may know these are precisely the issues we have been investigating in the Rambus case. Rambus has offered commitments to address the Commission's concerns and we are currently in the process of examining these.

Preventative competition policy

A more productive type of intervention is, however, when the Commission follows the adage that "prevention is better than cure". In other words, it is a lot better if we can prevent abuses of standard setting processes from occurring in the first place rather than have individual problem cases coming onto our radar screen.

We will address this in our revised guidelines on horizontal agreements. The draft will be ready for public consultation in early 2010. You should not expect any radical changes in this document, but it will reflect our learning from recent experiences. I would encourage you to participate in this consultation exercise so that we can benefit from your practical experience.

For example, I see an important pro-competitive rationale to having standards bodies require the disclosure of patents and, where relevant, patent applications, in the early stages of standard-setting. Ex ante disclosure helps those involved make a properly informed decision, and competition law should not stand in the way.

This will almost always entail ex ante disclosure of the **existence** of essential patents. But it could also entail unilateral ex ante disclosure of maximum royalty rates and the most restrictive licensing terms that would apply should a company's technology be made the standard.

I see no inherent reason why such a mechanism would fall foul of the competition rules, unless it is some kind of smokescreen for a cartel. Indeed, the benefits can be significant since competition on price can happen before the standard is set, and the choice of technology in the standard can be based on a full understanding of the price and quality trade-offs that businesses and individuals make every day. I think it is a shame that some have tried to invoke the competition rules as an argument for slowing down progress in this direction. I would encourage standard-setting organisations to investigate whether this could be a way forward.

At the same time, I recognise that those who innovate deserve to be rewarded accordingly, and that incentives to innovate are therefore important. I do not think ex ante price disclosure rules would reduce incentives to innovate. If you have a unique, pioneering, and innovative technology for which no alternative exists, then the market will value it accordingly.

Another issue we will seek to address in appropriate cases is that of "hold-up" situations where IPR holders do not live up to ex ante commitments to fair, reasonable and non discriminatory (FRAND) licensing terms they have clearly agreed to for a given standard and in accordance with the rules of the standard setting organisation.

In my view, there are a number of ways to assess whether there has been an excessive pricing abuse under Article 82 EC and the methodologies used will depend on the factual matrix. One method is to compare the (ex-ante) market value of the relevant IPR with the ex post royalty rate, if the evidence clearly permits such a comparison. If the ex post royalty is significantly and unjustifiably higher than the ex ante price, then we may have an excessive pricing case. In practice, such assessments may be much more complex than this brief description of the issues implies, and any antitrust enforcer has to be careful about overturning commercial agreements without a clear and coherent evidence base.

But if standards are set in an open and transparent manner, industry can concentrate on delivering products which comply with these standards and which bring benefits to consumers, rather than devoting their energies to litigating in front of courts and competition authorities. Whilst it is for industry to choose what type of scheme is best suited to its needs, the Commission is ready to give inputs to ensure that standard setting is efficient and in line with the law.

Interoperability

Standards may facilitate economies of scale, but it is with interoperability that they really add value to the economy. Standards are the foundation of interoperability – they create the level playing field needed for interoperability, where all can compete. When good standard-setting allows everyone to interoperate, it is also more likely that consumers will get the sort of high-quality and innovative products that work in a wide range of situations.

That is why I am so pleased at the progress that has been made in the field of interoperability. I think that Microsoft has been on a journey itself. It is doing things on interoperability that were unimaginable just a few years ago – publishing now, for free, a broad range of interoperability protocols. Microsoft itself now stresses the benefits of such greater openness, and it needs to ensure that it keeps on delivering.

But please don’t think standards are an issue only for the tech sector. Just yesterday the Commission finalised a commitment decision (Article 9) case in the shipping industry.

Ship Classification

In its Ship Classification decision adopted yesterday, the Commission adopted a decision which makes binding several key commitments offered by the International Association of Classification Societies (IACS). Such Classification Societies date back to 1760 and they establish and certify compliance with technical requirements on ships. They look at everything from the safety of design and construction through to the equipment, maintenance and survey of ships. Within this market worth 3.5 billion euros annually – or about US$5 billion - members of IACS cover more than 90% the world's cargo carrying tonnage.

Now, IACS members set down their technical requirements in a series of documents for use by members. But due to the size of its ten members, IACS is able to set *de facto industry standards* for classification. In other words – while these documents may be intended for members, they become the minimum requirements which all Classification Societies need to know - and be capable of applying. Effective competition is likely to be absent when this information is not available.

We were concerned that competition was being locked-out because of an IACS policy to prevent non-IACS Classification Societies from participation in the creation of these standards. Non-members were unable to join IACS' technical working groups, or even access the technical background documents relating to these standards.

The question then becomes – how can one apply these standards if it is difficult or impossible to access them and to understand their origins.

To address these concerns, IACS proposed a series of commitments that bind it to deliver access to the standards on FRAND terms. This includes:

1. Full access to IACS standards and background documents, and
2. The possibility for non-member to participate in IACS working groups.
3. IACS has also volunteered to offer its technical documents royalty-free and without licence.

There is an important element of IACS' work we did not intervene in, however. We have acknowledged the special technical competence of IACS and their right to set high minimum standards. This is important; openness must not be a synonym for low standards.

In fact, IACS' standards play an important role in ensuring maritime safety and preventing marine pollution. So my message is: pro-competitive standards and standard-setting processes are not at odds with safety.

We remain alert to the possibility that anticompetitive foreclosure may occur under the disguise of technical competence requirements but this is dealt with by a further commitment from IACS. They will establish objective and transparent competence conditions for membership of IACS. They must also ensure the non-discriminatory application of these conditions.

So in other words – as long as a classification society can meet the objective technical competence conditions for admission to IACS, it will now have the possibility to co-decide future *de facto* industry standards. This is good for the industry in my view, and shows that an open process for standard-setting is widely applicable as best practice.

Conclusion

If I may summarise my thinking:

1. Standards can greatly affect the fortunes of both individual companies and the wider economy. As such standardisation must occur through open and transparent processes.
2. Ex ante price disclosure schemes will generally not raise competition issues.
3. Standards should be as open as possible. This is not a black and white choice but a question of degree, and it is in society's best interest that standards should be as open as possible.

4. In many industries de facto standards are just as beneficial and valuable as de jure ones. And that requires that the creation and availability of de facto standards are held to a similarly high level of scrutiny by market participants and competition authorities.

And of course, any standards body should see the Commission as a partner. We have an open door to discuss these issues. It is in the interests of all parties that we work together toward openness, and towards high standards.