

Balancing free with IP: potential competition law issues for open source software

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Open source (OS) software aims to encourage innovation without imposing proprietary licence constraints. However, it has achieved such a key role in software development that it may, in certain limited circumstances, begin to raise competition law issues as significant OS networks could potentially have anti-competitive effects (rather than any anti-competitive object) due to:

- One of OS's basic principles, that source code must be freely available to all, without payment, whenever included in software that is published or distributed.
- The GNU operating system's General Public Licence's (GPL) Copyleft principles. Copyleft is the idea that freedoms guaranteed by the GPL (including the use of the source code without payment) also apply to new works derived from or containing the original GPL-licensed software (*Article 2(b), version 2 of the GPL*). In contrast to the traditional role of copyright, which grants the author of original software exclusive rights to certain restricted acts (in the language of UK copyright law), Copyleft gives the user certain rights of access to the source code without payment (other than to cover the cost of copying).

This article discusses the possibility that, if an OS solution or platform has considerable market power or is a de facto standard in a relevant market, the OS licence's terms (requiring redistribution free of charge) and/or the GPL's Copyleft provisions might be found to be exclusionary or unfair to a non-OS operator who is an intellectual property (IP) right holder. If an IP right holder is excluded in practice from participating in the OS solution on commercially viable terms, this would lead to the removal or reduction of market choice and incentives to innovate, leading to consumer harm. The article focuses specifically on the arguments surrounding unfair and/or exclusionary terms of access to a market, by looking at the way in which this issue has previously been assessed in the context of standard setting.

While there are a number of technical mechanisms which may allow an IP right holder to avoid the impact of the Copyleft principles and therefore competition issues, there is debate as to what degree these mechanisms are effective. This article does not consider the technical questions and assumes that competition arguments would be called into question if the IP right holder were unable to use these mechanisms successfully to protect its rights or could not find another commercial solution to monetise them.

The competition aspects of the GPL were the subject of a US anti-trust challenge in the US Court of Appeal case *Wallace v International Business Machines Corporation and Others (2006)* (*Wallace v IBM*) in which the claim that the GPL was either a conspiracy or a form of price fixing by the OS community was rejected. However, the case focused on conspiracy, predatory pricing

and price fixing, and did not touch on issues of dominance or market choice. Competition questions remain open concerning a situation where an OS solution has a dominant market position and, collectively or individually, the participation terms pose a threat to consumer welfare.

There is obviously no obligation to participate in OS licensing. However, if an IP right holder can only enter a market by engaging with the OS community and in so doing must waive all royalty claims to any IP rights it holds, competition law arguments could arise if this were to result in either reductions in market choice or unfair participation terms. In the same way that OS campaigners have argued that proprietary, royalty bearing technology can exclude participants from a technical market, so too could the reverse be true. If OS solutions become widely used in a given sector, it may be necessary to sign up to certain licence terms to participate. Where this involves royalty-free licensing, this could exclude, discriminate against or undermine the commercial viability of the IP right owner.

EFFECTS ON COMPETITION

Article 101 of the TFEU (formerly Article 81 of the EC treaty) prohibits agreements which prevent, restrict or distort competition within the Common Market and affect trade between member states.

In principle, a network of OS licensing agreements between existing OS participants could be caught by Article 101 where, due to the volume of licence agreements between OS participants, involvement in distribution of the OS software would impose royalty-free licensing on anyone seeking to enter the market. If the effects of such a licensing structure are that an IP right holder can only participate in the markets covered by the OS licensing structure on terms that are not commercially viable, the network of agreements might be seen to distort competition. This would be even more potent in the case of a GPL licence if, in addition, the IP right holder must comply with Copyleft principles.

The practical effect of such a network of OS licence agreements would be similar to a group boycott of the IP right holder by the OS community. The counter argument that the IP right holder has a choice is meaningless if, in practice, the alternative is market exclusion.

In such a situation there may be grounds for an exemption. Exemption is granted under Article 101(3) for agreements that:

- Contribute to improving the production or distribution of goods or to promoting technical or economic progress.
- Allow consumers a fair share of the resulting benefit.
- Are necessary for the attainment of their objectives.

- Do not substantially eliminate competition for the products in question.

OS licence supporters are likely to be able to argue that the efficiencies provided by the OS network give rise to conditions which merit an Article 101(3) exemption, although where there is significant market coverage, a relevant block exemption may not be available. The individual requirements for the application of Article 101(3) must be determined in the circumstances of each case and it cannot be assumed that OS licences automatically benefit from an exemption.

ABUSE OF A DOMINANT POSITION

Article 102 of the TFEU (formerly Article 82 of the EC treaty) prohibits the abuse by one or more undertakings of a dominant position within a market, or in a substantial part of it, that affects trade between member states. Abuses include imposing unfair or discriminatory terms, tying, bundling or exclusionary behaviour.

Article 102 applies where there is individual or collective dominance in a relevant market. To demonstrate dominance, the relevant product and geographic market must first be defined. Generally, a market share in excess of 40% can indicate dominance, and a share of over 50% is likely to do so, although barriers to entry and elasticity of demand must also be considered.

Once dominance is established a number of forms of abuse may be identified:

- Unfair licensing terms. This may apply if royalty-free licensing is not commercially viable for the IP right holder; or, for the GPL, where access is conditional on licensing IP rights that the right holder does not wish to surrender without receiving royalties.
- Discriminatory behaviour. This may apply if a proprietary owner is treated in the same way as non-proprietary owner when they are in materially different positions.
- Constructive refusal to supply. This may apply if the terms for participating in the OS network are not commercially viable.
- Predatory pricing.

Although royalty-free licensing or Copyleft provisions may be considered to be objectively justifiable due to bringing efficiencies into the market, this would depend on the facts of a particular case and there is no reason to conclude that, as a matter of principle, such efficiency arguments would always apply when OS licensing is involved.

THE CREATION OF DE FACTO STANDARDS

The risk that commercial operators who are involved in developing an OS solution may become individually or collectively dominant in a market is not entirely theoretical as the network effects arising from new technologies can rapidly lead to high market shares. The various EU competition and US anti-trust decisions against Microsoft demonstrate how significant network effects can be. In these circumstances the need for inter-operability with the technology concerned can mean a software solution becoming so widely adopted in a given market that it becomes a de facto standard. Some of the competition law issues that arise in relation to OS solutions are analogous to standard settings in high-tech sectors.

BACKGROUND TO EU STANDARD SETTING IN THE TECHNOLOGY SECTOR

The potential competition law issues have similarities with those encountered at the beginning of the 1990s in the EU (then the EC) under the European Telecommunications Standards Institute (ETSI). At the time, the European Commission primarily sought to overcome national barriers to trade. However, with the burgeoning telecoms market and in particular the growth in mobile phones, technical trade barriers were superimposed on national market fragmentation. ETSI was established as a solution to this problem. There were three ways in which the standards created by ETSI, including the European Telecommunications Standard (ETS) was intended to influence the market:

- In some cases ETS would provide a presumption of conformity with the essential requirements of the Directives under the new approach, such as the Radio Equipment and Telecommunications Terminal Equipment Directive (1999/5/EC).
- Where a single technical solution was fundamental to intra-Community interconnectivity, the ETS formed a mandatory part of a Common Technical Regulation (CTR).
- Under public procurement rules, technical specifications were to be defined by reference to national standards transposing European standards.

Therefore, if an ETS contained a specification which was covered by an IP right, the right holder had a captive market if the ETS:

- Formed part of a CTR and every operator in the market was required to use it.
- Was the basis of a presumption of conformity with an essential requirement and, although its use was voluntary, most market operators would adopt the ETS as the simplest means of demonstrating regulatory compliance.
- Was also part of a preferred specification for public contracts.

There was therefore a clear need for basic rules about how IP could be both incorporated in a standard and then licensed. The ETSI IP rights policy seeks a balance between the need for standardisation in the field of telecommunications and the interests of the IP right holders. The policy sets a framework requiring the disclosure of IP rights and their licensing on fair, reasonable and non-discriminatory (FRAND) terms.

Since, under the ETSI policy an IP right holder must disclose essential IP and is then given three months to provide a licence to its IP on FRAND terms, it is implicit that an IP right holder has the right not to contribute its technology to the standard if it does not wish to do so.

Having established these basic principles, some of the most contentious issues remain to be assessed, including:

- Determining whether IP is essential.
- The point at which IP disclosure takes place.
- The meaning of FRAND terms.

Even within ETSI, where there is a relatively comprehensive policy in place, these matters are far from certain and the recent investigations by the European Commission into Rambus (MEMO/07/330) and Qualcomm (MEMO/07/389) are evidence of how some of these issues can be problematic.

As well as the questions currently being looked at by the Commission in the Qualcomm and Rambus investigations, other potential Article 102 abuses and Article 101 breaches can arise in standards setting. Just as an IP right holder can gain market power by having its IP right included within a standard, so the participants in standards setting organisations (either formal or informal) can, by collective agreement or by means of an individually dominant undertaking or a collectively dominant group on a relevant market, exert pressure on IP right holders in order to extort cheap licences. A right holder has a choice not to participate in standard setting, but if the standard controls access to the market, this may be of little practical value.

The ETSI IP rights policy, that was eventually adopted after a European Commission investigation following a complaint brought by the Computer and Business Equipment Manufacturers' Association (CBEMA), recognises that IP right holders must be protected as well as the open standards community. Originally, compulsory licensing of IP rights had been one of the options proposed. The eventual adoption of a policy in which IP right holders could decide not to contribute IP rights, or if they did so to receive FRAND terms for their inclusion, balances the interests of right holders and users, although early disclosure of IP rights is required to prevent patent ambush (see the European Commission's investigation into this issue in 2005 (*IP/05/1565*)).

A similar point has been considered under US anti-trust law. In the Federal Trade Commission's Decision on Sanitary Engineering (1986), it was found to be an abuse for The American Society of Sanitary Engineering (ASSE) to adopt a policy of refusing to develop a standard for a product which is patented or manufactured by only one manufacturer, regardless of the merits. The ASSE decision therefore implies that a right holder cannot be arbitrarily excluded from participating in a standard technological specification merely because others will have to pay for using the technology in question.

If a particular technology is necessary, or even possibly just advantageous, and an IP right holder of that technology would be excluded from operating in a relevant market unless it were to participate in the standard, the group position should not prevent the IP right holder from receiving a fair return for its investment. The requirement that IP rights be licensed on FRAND terms may be necessary in some cases to protect the IP right holder as much as the licensee, as it ensures that the right holder can receive a reasonable return for the effort involved in creating the IP. This argument is supported by the general principle that underlies IP protection, that innovation and investment of time and creative effort should be rewarded.

STANDARDS AND OS

If an IP right holder seeking access to a market that is dominated by an OS solution can only access that market by engaging with that OS community on their terms, then effectively it has no choice but to do so or be excluded.

The principal aim of OS is to improve efficiency and its agenda is far from anti-competitive. OS is underpinned by the belief that licensing terms requiring a royalty to be paid to the IP owner limit the availability of the source code to all potential users. However, by adopting this approach there is a risk that, where OS developers look to other technologies to create new derivative products and the IP right holder finds that market access is blocked except by participating on the terms of the OS licence, the OS community may fall foul of such competition arguments in a manner that is analogous with the early debate surrounding the use of IP in ETSI standards.

Arguably, as the OS network's benefits only arise as a result of the participants' IP contributions, all should contribute on the same basis in order to enjoy the OS advantage. On this basis, FRAND terms would mean that the IP right holder must license its rights royalty-free. However, the fair balance between the OS founders and a subsequent contributor may not always be this simple. Whether the FRAND terms should be royalty-free is a matter of fact to be determined on a case by case basis, particularly in situations where a de facto OS standard has been created. It will depend on the circumstances, such as the participants involved, the role that new derivative technology will play, and the effect on the market.

While OS royalty-free principles may well prevail in most cases, it is possible to imagine a situation where the founding members' IP sacrifices had little commercial or economic significance and the network grew as a result of many business models commercially exploiting the OS. For example, where hardware is sold as a result of a downstream or upstream software market, the hardware suppliers benefit from the new software IP, yet a software IP holder may not have a hardware business to offset its IP investment, for which it would obtain no royalties under the OS licensing terms.

Another argument in favour of the OS principles is that the IP right holder has the choice not to participate. This argument is made in *Wallace v IBM* and probably applies in many cases. However, as discussed, there may be areas of software development where OS systems become such an important platform that a decision not to participate is an effective barrier to entry into a market. This would be particularly relevant if switching costs were high or if there was evidence that the OS licensing participants had developed an OS solution with a view to excluding a particular proprietary technology.

In other circumstances, there may be commercial pressure for participants in the existing OS community to use a particular technology rather than waiting until an IP unencumbered one is available. This principle has already been acknowledged by one internet standards body, the Internet Engineering Task Force (IETF), which has an OS licence for source code included in its standards.

CONCLUSION

OS principles have, in many cases, overcome the conflicts between the rights of the IP right holder with competition law and the economic imperatives arising from collective agreements, dominance and standardisation, by imposing royalty-free terms. However, competition issues may arise if OS solutions begin to dominate certain markets, particularly if they become de facto standards and right holders find themselves excluded from markets with no commercial options available to monetise their IP investments. In these circumstances, it is unclear whether EU competition authorities will always reach the same conclusion as the US Court of Appeal in *Wallace v IBM* that the GPL and OS software have nothing to fear from anti-trust laws.

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