Intellectual Property Owners Association

June 18, 2010

European Commission
Alexander Italianer
Directorate-General for Competition
Antitrust Registry
Ref.: HT.1407
1049 Bruxelles/Brussel
BELGIQUE/BELGIË

RE: INTELLECTUAL PROPERTY OWNERS ASSOCIATION COMMENTS REGARDING DRAFT EC HORIZONTAL GUIDELINES

Dear Directorate-General Italianer,

The Intellectual Property Owners Association ("IPO") thanks the European Commission (EC) for the opportunity to submit these comments with respect to the EC's Draft Guidelines on the Applicability of Article 101 of the Treaty on the Functioning of the European Union to Horizontal Co-Operation Agreements (the "Draft Guidelines" or "Draft").

IPO is an international association, based in the United States. More than 200 companies and 11,000 individuals are involved in the activities of the association. Founded in 1972, IPO represents the interests of all owners of intellectual property covering all areas of technology, many of whom are involved in various formal and informal standards development organizations (SDOs) around the world. IPO members file approximately 30 percent of the patents filed in the United States Patent and Trademark Office by U.S. nationals and a significant number of EPO applications.

IPO, therefore, has a significant interest in the Draft Guidelines, specifically Chapter 7, which concerns standardization agreements and the involvement of intellectual property rights ("IPRs"). This commentary, which is provided on behalf of IPO's full membership and not to advance the interests or positions of any particular member, is intended to highlight the positive features of the Draft Guidelines, identify areas that may be interpreted in a manner that may hinder competition and/or innovation, and point out instances where the wording of the Draft Guidelines could have unintended practical consequences for IPR owners.

IPO observes that the intersection of standards, competition law and intellectual property law is highly complex and not easily susceptible to the application of all-encompassing prescriptive rules. As the Draft Guidelines observe, there is a natural tension among firms involved in standardization based on their business models and the way that they decide to use their intellectual property. As the Draft Guidelines also observe, all such interests must be accommodated and IPR policies must balance the interests of IPR owners with the interests of those who seek to use IPRs as part of standardized solutions (recognizing that in the standards ecosystem these are not distinct categories of stakeholders). Prescriptive rules, by their nature, do not provide the flexibility to accommodate all such interests and all

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potential circumstances, as well as each dynamic variable that might arise in connection with standards development. Of particular importance is that the adoption of rigid prescriptive rules may discourage firms with significant IPRs from participating at all.

For these reasons, IPO believes that competition is, and will continue to be, best served if standard setting organizations and their members are allowed the freedom to come to agreement on reasonable IPR disclosure and licensing policies. This will allow policies to properly balance the interests of all stakeholders and avoid the risk of diluting the value of IPRs of entities that participate in the standards development process. It also will enable competition among standards and standards bodies, which can have its own benefits. Competition authorities such as the EC will continue to have a role in guarding against anticompetitive conduct by addressing such conduct as it may arise.

IPO provides these comments recognizing that the Draft Guidelines seek to establish "safe harbors" for standardization of IPR policies. IPO encourages the idea of the Draft Guidelines highlighting provisions that may present low risk of a competition enforcement action, but we would caution that the Draft Guidelines should take care not to exclude other valid provisions that may also provide for an efficient, successful and pro-competitive environment. We note that the Draft Guidelines should be careful not to discourage or condemn policies outside the "safe harbor" as necessarily in violation of EC competition law. Such discouragement could subject such policies to challenge and thereby increase the costs and inefficiencies of standards development, and could discourage full participation by IPR holders. This is a particular concern for IPO because of the great variation among IPR policies that currently exist, a substantial majority of which will not fall within the "safe harbor" sought to be established. Indeed, IPO submits that the Draft Guidelines should not disturb the settled expectations among participants in existing standards organizations.

We provide the following additional remarks for consideration and thank the Commission for the opportunity to comment and for its efforts to address the very difficult and complex area involving competition law, IP law, and standardization. This is an area of great interest and concern for IPO members, and any advances in clarifying the issues are always welcome.

Very truly yours,

Douglas K. Norman

Douglas K. Norman
President

Enclosure

Comments of Intellectual Property Owners Association (IPO)
on the Draft European Commission Horizontal Guidelines

I. The Draft Guidelines Appropriately Recognize the Procompetitive Potential of Standards Development

The Draft Guidelines recognize some important principles related to standardization and the competitive effects that may result from such activities. In particular, the Draft Guidelines observe that generally positive economic effects arise from standardization (*see* ¶ 258) and that unbiased, unrestricted and transparent procedures and voluntary compliance obligations are appropriate. *See, e.g.,* ¶¶ 261, 277, 279. In terms of unbiased procedures, the Draft Guidelines specify that IPR policies of standards organizations should not discriminate among specific groups of IPR holders and there should be no bias in favor or against royalty free standards. *See* ¶ 278.

The Draft thus recognizes that diversity among stakeholders' interests in the standard setting process is inevitable, because companies often desire to promote their own solutions, and because there exist differences in business models and strategies among different firms. *See* ¶¶ 270-274. As the Draft further observes, such diversity may particularly arise because different firms may have different business models and economic incentives, including even within their own operations. A further enhancement to this section would be to expressly recognize that, depending on the circumstances, firms participating in the standards development process often constitute hybrids of these various categories because they may, for example, have numerous and differentiated lines of business, changing strategic directions, a focus on specific standards projects that involve different decision making, and varying considerations regarding relevant IPRs.

II. Portions Of The Draft Guidelines Could Be Interpreted As Unnecessarily Hostile To Standards That Require Access to Intellectual Property Rights

Some paragraphs of the Draft Guidelines could be interpreted as overstating the risk of competitive harm posed by IPR in the standard setting context.

For example, the draft could be interpreted as suggesting that the use of IPRs in standards poses significant risk of anticompetitive effects resulting from the creation of barriers to entry, increased market power for IPR holders, "hold ups" and the charging of "abusive royalty rates." *See, e.g.,* ¶¶ 260, 262, 275 and 280. Such a depiction, however, could be interpreted as suggesting that such effects will necessarily arise when a standard includes essential IPRs. This is not the case (in part because the implementation of most standards is voluntary), and indeed, the inclusion of proprietary technology may result in the technically optimal and less costly solution.

For this reason, IPO suggests that it would be appropriate if a balanced explanation were provided that noted that risks of anticompetitive conduct may arise in some cases where standards are based on IPRs, but also that there are significant competitive benefits that may result from including proprietary technology in standards. The Draft Guidelines appear to prefer minimizing short-term, or static, effects arising from the inclusion of IPRs in standards that some interests might view as negative, and therefore in need of mitigation. One example of a short-term, static effect would be avoiding "abusive" royalty rates, assuming such a term could be defined (*see, e.g.,* ¶ 280). Avoiding this possible effect, however, may have a chilling impact and eventually harm the dynamic or long term efficiencies afforded by inclusion of IPRs. As an example, companies may be less willing to continue their investment in R&D, to obtain IPR based on that R&D, and to make that IPR available to a wide audience through inclusion in a standard, unless they have some assurance that they will be compensated for their respective investments. These dynamic, long term efficiencies may outweigh any short term, static effects.

Conversely, the Draft Guidelines include other language suggesting a risk of anticompetitive effects from over-inclusive standards, in that standards setting organizations are urged not to adopt specifications with multiple, substitute technologies in order to avoid “foreclosure of competition by excluding one potentially competing alternative technology from being included in a different standard" (¶ 288). Yet such standards, which permit compliance by manufacturers using one of several alternative technologies, can be an effective tool for minimizing any potential for market foreclosure or IPR hold up. If a risk of IPR-based standards is competitive foreclosure, then standards which allow alternative technologies would appear generally to be procompetitive and efficiency-enhancing. Additionally, by indicating a preference that standards developers move competing technologies into different standards, the Draft would encourage balkanization of standards, which defeats the important economic purposes of such horizontal collaboration. In IPO’s view, the risk of competitive restraints arising from standards, which we regard as an unlikely consequence of most standards incorporating IPR, is in large part eliminated where practicing a standard permits choice among different, substitute technologies.

In short, owners of IPRs should be provided incentives for making their inventions available, even if there is a cost for obtaining access to such technology through a license. As the EC has explained, the opportunity of firms to gain access to patented technology, which can lower their costs of entry and participation in markets, creates a virtuous cycle of dynamic competition that more than offsets any short term effect of high prices during the term of a patent’s life. And to the extent patented technology improves performance or reduces the cost of implementation of a standard, the increase in value or cost savings may significantly outweigh any associated licensing costs.

III. <u>The Draft Guidelines Should Eliminate Provisions That Suggest That License Fee Regulation Is Appropriate</u>

The Draft Guidelines should expressly recognize the need to balance the legally granted and limited exclusionary power of IPR holders with the interests of parties seeking to use the patented technology. To the extent the Draft Guidelines can be read to claim a sort of fee-setting or fee-regulating authority, it would be inconsistent with such a balanced approach because it could be interpreted as in conflict with the economic principles behind intellectual property law in the first instance, such as providing a market-based reward to drive innovation and allowing a fair return on investment in research and development. Regulatory enforcement may also lessen the ability of private sector actors to address their own competing rights in this context. In this regard, one of IPO’s primary concerns is the Draft Guidelines’ reference to “excessive” or “abusive” royalties or license fees, the boundaries of which are not well-defined. *See* ¶¶ 283, 285.

Currently, an implementer that wishes to utilize an IPR owner’s patented technology may seek one or more patent licenses that will cover its products. Such a license negotiation between the implementer and the IPR owner may involve multiple patents, including some patents infringed by the implementer’s design decisions (e.g. non-essential patents) and some which may be essential to the implementation of one or more standards related to such products. Any final resolution of a dispute as to contractual obligations made by the potential licensor (such as obligations to offer licenses to essential IPRs on Fair, Reasonable and Non-Discriminatory (FRAND) terms) prior to or within the licensing negotiation would be best left to courts or other tribunals. Such issues have already been raised in such fora, which have indicated an ability to address such claims and resolve disputes over appropriate royalties and other licensing terms.

Allowing such disputes over the amount of royalties or fees demanded by an IPR owner, even of standards-essential IPRs, to be resolved by the parties in courts or other tribunals, rather than based on regulatory intervention by competition agencies, would also be preferable because such disputes may reflect only commercial disputes that might be better addressed under contract principles, for example, and not competition law principles. Alternatively, the cases may illustrate a simple desire by IPR users to incur no cost in order to gain access to patented technology, preferring instead to infringe claiming "excessive" or "abusive" royalties as an excuse. This involves no competition law issue. Rather, if anything, it reflects a strategy that undermines the incentives for making IPRs available for use in standards.

Note might also be taken of inherent characteristics of standardization that mitigate concerns related to "excessive" or "abusive" royalties and fees. For example, IPR holders seeking broad adoption of their patented technologies (especially over available competing technologies), may moderate the royalties sought so as to gain inclusion of the technology in the standard in the first instance and widespread implementation of the standardized solution. By so doing, IPR holders will be able to realize favorable returns on their R&D investment. Other firms may not even seek royalties because their strategy is to realize a return on their R&D investment through the sale of products or services. Yet further firms may seek to use their IPRs only defensively, and may offer (F)RAND terms without compensation and seek to attract the cross-licensing of other standards essential IPRs. Further, it is well-recognized that standardization is a "repeat game," meaning that abusive conduct by IPR holders will not be repeated. In sum, self-governing conditions and incentives already exist to prevent, or at least minimize, any opportunities for anticompetitive conduct that may give rise to competition law concerns.

The foregoing also suggests that an enforcement agency, such as the Commission, is not an appropriate arbiter of a dispute of what may be deemed a "reasonable" or "fair and reasonable" royalty, as compared to what may be a royalty that is "abusive" or "excessive." Standards organizations are equally ill-equipped to make these determinations. There is nothing improper in encouraging or asking the owner of IPRs to state its royalty intentions prior to approval of the standard, and for those who develop and later implement standards unilaterally to make their selection decisions based on the response, but any policy that allows an agency – after the fact – to determine what is reasonable and nondiscriminatory runs the risk of discouraging participation from the outset. In large measure, this is the reason that, with few exceptions, existing IPR policies defer determination of licensing terms to the negotiations of the parties to a prospective licensing agreement outside the standards organization.[1] If agreement can be reached by the parties, competition law should not play a role to undo the parties' determination of terms absent some compelling evidence of anticompetitive conduct.[2] And, any such competition law review must avoid compromising the fundamental rights of IPR holders under IPR laws, and carefully distinguish what may be commercial disputes that, at best, may give rise to contract-based claims.

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[1] In this regard, IPO comments specifically that ¶ 267 might be clarified by including, in addition to the potentially anticompetitive effects of *ex ante* agreements by IPR holders regarding royalties or fees, that *ex ante* agreements by potential IPR users regarding the maximum royalties or fees they will pay, as a condition for including a technology in a standard, may also have anticompetitive effects because that could reduce the value of IPRs below the level at which a return on an IPR holder's investment is possible. Such actions can have adverse competitive effects by discouraging participation in standards organizations and reducing incentives for firms to invest in R&D.

[2] *See* Neelie Kroes, *"On ex ante standards setting and new horizontal agreement guidelines,"* October 15, 2009 Address Brussels, Belgium ("any antitrust enforcer has to be careful about overturning commercial agreements without a clear and coherent evidence base").

IV. The Draft Guidelines Should Approach Enforcement With An Eye Toward Policing Anticompetitive Deceptive Conduct Without Unduly Constraining Standard Setting Organizations

While competition law should certainly guard against agreements whose object is to foreclose competition (*see* ¶¶ 266-268), cases in which noteworthy technology standard setting organizations have acted in such a way are exceedingly rare, and such cases that do exist have not involved the standards organizations' IPR policies. Standards organizations will, of course, strive to promote the technologies that are the subject of their standard setting activities, but the organizations and their participant members are typically conscious of (and frequently warned about) price coordination and other competition law violations. Indeed, even in those cases challenging an individual firm's conduct related to IPRs and standards, the terms and conditions of the relevant standards organizations' IPR policies were not the basis for the antitrust or competition law claims alleged.[3] Rather, what has always been challenged as "abusive" or "hold up" has been a firm's conduct in relation to its IPRs.

Accordingly, we suggest that paragraphs 266 – 268 of the Draft Guidelines are misdirected toward seeking to regulate standards organizations through the imposition of what could be interpreted as mandatory rules. These provisions, while important in the context of general competition law principles, do not specifically concern standardization agreements and would be more properly located among the basic principles set out in Section 1 of the Draft Guidelines. The more appropriate focus for the Section on standards would be on the specific conduct of firms that participate in the standards process. This would be more consistent with the proper exercise of competition laws, and a better approach for ensuring the continued effectiveness of the existing voluntary standard setting system.

The goal, typically, of standardization is interoperability of technologies. In advancing that end, a standard setting organization can be a forum for lively debate on the merits of particular technologies and considerations of whether to use particular intellectual property. Organizations have a variety of rules for IPR based on their objectives and their members' preferences in this regard. Whatever the approach, participants generally want to know what intellectual property is in play and, at a high level, how it will be treated before either committing to allow their own intellectual property to be used in a standard or opting to include another member's. The real competition problems in standard setting and IPR thus have tended to arise in instances of anticompetitive deceptive behaviors by participant members or ex-members of the standards setting organization.

For these reasons, organizations do and should be encouraged to continue to set their own IPR rules and members can opt to participate or not in view of those rules. Sections of the Draft Guidelines, however, seem to suggest a one-size-fits-all approach that is inconsistent with the flexibility that is needed to allow standards organizations to flourish. One particular passage of concern is Example 2 in ¶ 316, which could be read to suggest that IPR policies that "encourage" but do not "require" disclosure of all essential IPR will violate EC competition law. Many standard-setting organizations—including many American National Standards Institute (ANSI)-accredited standards organizations that follow the ANSI policy literally—currently have "encouragement-based" IPR policies. The Common Patent Policy of

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[3] In those rare cases in which standard setting bodies themselves have been held liable under Sections 1 or 2 of the Sherman Act, it has usually been vicarious liability brought on by the anticompetitive behavior of member organizations. *See, e.g., Allied Tube & Conduit Corp. v. Indian Head, Inc*., 486 U.S. 492 (1988) (insufficient safeguards to prevent standard setting process from being corrupted by members with economic interest in restraining competition resulted in antitrust violation); *American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp.*, 456 U.S. 556 (1982) (association held liable for restraint of trade caused by association members misinterpreting an association standard for their own purposes).

ISO/IEC/ITU allows for a General Patent Statement and Licensing Declaration that does not require the listing of individual patents. Such well established and highly functional organizations could be put at risk of suit or liability under EC competition law notwithstanding the lack of evidence that their voluntarily chosen policies actually harm competition. In addition, a legal obligation to conform to a "requirement-based" policy could create disharmony where many non-EC standard-setting organizations work together with EC-based ones in, for example, 3GPP and 3GPP2. Thus, such decisions are best left to the standards organizations.

From a more practical perspective, the approach reflected in the example to ¶ 316 could cause standards organizations to change their policies to avoid the risk of claims, even if unfounded, to reflect "safe harbor" terms under the Draft Guidelines, even though such terms do not best accommodate the interests or needs of the organization or its members. This will, itself, weaken the ability of firms to voluntarily develop standards. Moreover, assuming such a change could be made, it would not have retroactive effects, thus leaving open for challenge the thousands upon thousands of standards that have already been developed based on IPRs.

A number of other provisions in the Draft Guidelines also appear to reflect the substitution of the Commission's policy preferences for the way industry has defined IPR policies for standards organizations through consensus decision making. By way of example, the Draft suggests that standards organizations must *require* members to meet certain disclosure obligations. Specifically, as envisioned by the Draft Guidelines, standards organizations must require their participating members to undertake "reasonable efforts" to identify existing and pending IPR reading on a potential standard. *See* ¶ 281. Patent searching, however, can be extremely burdensome. So while some standards organizations include in their policies similar provisions—*e.g.*, ETSI's policy providing for "reasonable endeavours" to make disclosures—other organizations maintain a less definitive approach. *See* ANSI's Policy. And even ETSI's policy (as well as many others) expressly disclaims the need to conduct patent searches.

Another example of the substitution of the Commission's policy preferences for the industry's consensus decision making is reflected by the Draft's requirement that IPR holders giving a FRAND commitment to further commit to ensure that any assignee of its IPR will be bound by the FRAND commitment. *See* ¶ 286. This may, in fact, be a good policy, and some standards organizations have amended their policies to include a provision to address the underlying concern. But that is not universally the case for all standards organizations, as many are concerned about the difficulty of tracking such commitments and the concern that the commitment will be more broadly construed than was originally intended.

Likewise, the Draft restricts the decision-making flexibility of standards developers by indicating the EC may assess the legitimacy of a standard by evaluation of its underlying technological justification. Specifically, Paragraph 306 states that "it must be justifiable why one standard is chosen over another." The import of this language may suggest that competition law should substantively evaluate the technical basis for standards in assessing their competitive effects. IPO believes this result would be untoward and unsettling. While there is of course room for a requirement that standards organizations articulate a competitively neutral justification for their selections, the language quoted above strongly suggests that insufficient justification would be grounds to condemn a standard as a competition law violation. While a judicial or enforcement approach in which procedure—namely inclusion, notice, disclosure and due process— and effects may be an appropriate focus, one that seeks to assess technological merits would not be. This is because the evaluation of different technologies to determine if the one selected is "justifiable" would be an open-ended inquiry by enforcement agencies and courts that might transform every standards decision into a potential antitrust case. IPO does not believe that was the intent of this provision of the Draft and suggests that clarification to emphasize that the Draft Guidelines do not propose a substantive technological role for antitrust law would be appropriate.

The most problematic provision of the Draft, a provision that is inconsistent with many organizations' existing IPR policies today, is that standards organizations "require" all holders of essential IPR in technology that "may" be adopted as part of a standard to commit to license their patents on FRAND terms. *See* ¶ 282. This provision raises a number of issues.

First, it could be interpreted to impose a requirement that licenses be made available for IPR that relates to non-essential technology. In such circumstances, however, competition law concerns will not exist and the Draft Guidelines would impose an unwarranted compulsory licensing obligation on firms that legitimately decide to refrain from licensing their IPR or who prefer, for example, to sell proprietary components they make or have made for their own account, rather than license others to make such products. Second, the provision might also be interpreted that where IPR is in fact essential to a standard, the IPR owner would also be required to license its non-essential IPR. Third, this provision would require a standards organization to impose this requirement even on non-members. This is not plausible. Fourth, such a requirement would impose enormous costs on IPR holders, and potentially standards organizations, because efforts would have to be made to determine whether any patent within a portfolio is even potentially essential to what may become a finalized standard. This burden would be far more than the patent searches discussed above.

It should be further noted that many standards organizations throughout the world seek to avoid policies that compel licensing. The provision in question would be inconsistent with the policies of at least some organizations, including ETSI as well as the ITU, ISO and IEC, each of which have no such requirement and follow a different path. The ANSI IPR Policy also has no such requirement. Rather, these standards organizations provide, generally, that an essential IPR owner may give a FRAND assurance (with or without compensation), or declare that the standards essential patents will not be enforced, or declare that it will not license its standards-essential IPR. If the last declaration is given, or no declaration by an essential IPR owner is obtained, then the organizations' policies provide for steps to be taken regarding how the situation will be handled. Indeed, following complaints in the 1990s that its IPR policy required compulsory licensing, and after complaints to the EC, ETSI modified its policy to accommodate such an approach.

Paragraphs 281 and 282 suggest that standards bodies should have an IPR policy that both requires disclosure of patents that might become essential and also an up-front licensing commitment by all participants that they will license any essential patent claims they have vis-à-vis the final version of the standard on FRAND terms. Yet most standards bodies adopt either a disclosure-based policy (that first seeks disclosures of likely essential patents and then asks the patent holder to either commit to licensing or disclose that it is not willing to license on FRAND terms) or a participation-based policy (that may have few or no disclosure obligations, but which binds all participating companies to a FRAND or other licensing commitment for any patent claims that they have that end up being essential vis-à-vis the final standard). Almost no standards body takes both approaches in its IPR policy.

As noted above, ¶ 282 can be read to require a holder of IPRs that are not "essential" to the standard to license those IPRs as well. This is because of the provision's reference to technology that "may" be adopted as part of a standard. We do not think that this is what is intended and the Draft should be clarified to express its intent more clearly. In this regard, the Draft seems to confuse typical policies that address the disclosure of IPRs that may be or may become essential to a standard, and licensing commitment statements in connection with patents that may be or may become, essential. The "may-be-adopted" licensing requirement threatens to diminish intellectual property rights more than most standard-setting organizations deem necessary to achieve workable standards. For most standards bodies with a disclosure-based IPR policy, participating patent holders are asked to disclose early (when the standard is not yet finalized) whether they have IPRs that may be or may become essential when the standardization process is completed. But typically the licensing commitment that is made will apply only to those patent claims that end up being essential vis-à-vis the final version of the standard. As explained in connection with determining what may be a reasonable versus "excessive" royalty, here too, the Commission, respectfully, is ill-equipped to substitute its judgments for those reflected in existing IPR polices that have been developed through exhaustive and intense industry efforts to achieve consensus.

For at least a decade, standards bodies have been attempting to find the proper balance of all competing interests in a particular standard or industry and to promote the effective development of standards. To establish a "safe harbor," as described in the Draft Guidelines, raises problems and issues that are unwarranted. We submit such an approach is inappropriate, especially given that competition and antitrust laws will still exist to address specific conduct that may raise anticompetitive concerns.

V. Inter-Jurisdictional Considerations Are Paramount for Standards

As a final point, we encourage the Commission to ensure that the Draft Guidelines strive for harmonization with the rules of other major competition regulatory authorities. If adopted, the Draft Guidelines would have worldwide impact. Technology licensing and standardization occur on a global scale. Firms must compete worldwide. If the Draft Guidelines establish positions inconsistent with those in other prominent jurisdictions, the certainty needed by firms to compete globally will be diminished, as will participation in global standards development.

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