25 June 2010

Apple Inc.'s Comments on Section 7 of the Commission's Draft Guidelines on Horizontal Co-Operation Agreements

A. Introduction

1. Apple, Inc designs and markets a broad range of innovative products including personal computers, portable digital music players, mobile telecommunications devices, and various other products and services. Apple regularly implements a wide range of standards in these products, which are sold worldwide, including in the European Union.

2. Apple appreciates the opportunity to contribute to the Commission's consultation on the Draft Guidelines on Horizontal Co-operation Agreements ("Draft Guidelines"). As a participant in standard-setting organizations (SSOs) such as the European Telecommunications Standards Institute ('ETSI") as well as an implementer of standards in its products, the Draft Guidelines' statements on standardization agreements are of particular significance to Apple. We thus focus our comments on Chapter 7 of the Draft Guidelines.

3. Like other innovators relying on ubiquitous technical standards such as GSM and UMTS, Apple has been faced with unreasonable demands by companies seeking to exploit the claimed "essentiality" of their patented technology to industry standards. Based on this experience, Apple shares the Commission's concern that companies participating in standard setting may use the standard-setting process to collude and to erect entry barriers to exclude innovative new entrants.[1] In particular, the Draft Guidelines correctly highlight the danger of intellectual property rights ('IPR") owners "holding up" users by charging excessive royalties.[2] While the Commission rightly points to standardization's benefits, appropriate safeguards must be in place to prevent competitors from using standard setting to collude and to prevent unilateral or concerted hold-ups. The Draft Guidelines are an important step in that direction, but in Apple's view could be strengthened in a number of respects, as detailed below.

4. The Draft Guidelines' approach is to spell out safe-harbour rules for standard-setting agreements, sometimes also referred to as standardization agreements. The Draft Guidelines' intention appears to be to help standard-setting organizations ("SSOs") formulate their ground rules, in particular their IPR policies, and at the same time to identify "best practices" that will limit the risk of anticompetitive agreements among participants in the standard-setting process. Apple welcomes this general approach. However, the Commission should not lose sight of the fact that the problems in standard-setting may not be caused by the SSOs themselves, but rather by certain participants in the standard-setting process that individually or jointly subvert the process in order to limit innovation or foreclose downstream competition for their

---

[1] Draft Guidelines, paras. 259 and 260.
[2] Draft Guidelines, para. 261.

own advantage. The Commission should clarify that even where the SSO's rules meet the conditions for the application of the safe-harbour rules, this does not mean that agreements among some or all of the companies participating in the standard-setting process also benefit from the safe harbour.

B. SSOs should have clear disclosure rules for standards-essential IPR

5. Given the limits of FRAND commitments as a remedy to potential hold-up problems discussed further below, and the inherent superiority of *ex ante* market-based mechanisms over *ex post* regulatory or judicial intervention, it is particularly important that SSOs set out clear rules that encourage timely disclosure of standards-essential IPR. The better participants in the standard-setting process are able to gauge the full costs as well as the benefits of selecting a given technology for inclusion in the standard, the more efficient the outcome will be. Given the paramount importance of *ex ante* disclosure, Apple respectfully suggests expanding the single paragraph in the Draft Guidelines[3] currently devoted to the issue, as follows:

6. **Importance of identifying patent applications.** The disclosure of patent applications is as important as the disclosure of patents already granted. This point should not merely be contained in a footnote,[4] but should be included in the main text, for emphasis.

7. **More guidance on the scope of good faith disclosure obligation.** The Commission should also provide more detailed guidance on what constitutes the "reasonable efforts" that a company should undertake to identify standards-essential IPR. To benefit from a safe-harbour, SSO rules should, in particular, specify what kind of patent searches are reasonably required. A requirement to conduct repeated searches of their entire portfolio of issued patents and pending patent applications may place an undue burden on large technology companies and may deter them from participating in standard-setting. Conversely, there is a core of disclosure requirements that are clearly reasonable and indeed should be viewed as mandatory for an SSO to benefit from the safe-harbour. Thus, at a minimum, formal disclosure should be required where a working group participant has personal knowledge of a patent or patent application, in the most extreme case, for example, because he or she is named as an inventor. For the SSO rules to benefit from the safe harbour, it would moreover appear reasonable to attach effective sanctions for a failure to disclose in such circumstances, such as a default royalty-free license to non-disclosed patents for any implementer of the standard.

8. **Broader scope for *ex ante* disclosure of maximum royalties.** For participants in the standard-setting process to make informed decisions, it is vital that they are not only aware of the scope of standards-essential patent claims, but also of the total costs that may be attached to the inclusion of technology covered by such patent claims. Clarifying that unilateral *ex ante* disclosures of maximum royalties do not take SSO rules out of the safe harbour[5] is a useful step in this direction. However, the Draft Guidelines' subsequent qualification that the rules must not allow for the joint negotiation or even discussion of licensing terms (and in particular royalty rates)[6]

---

[3] Draft Guidelines, para. 281.
[4] See Draft Guidelines, footnote 94.
[5] See Draft Guidelines, para. 287.
[6] See Draft Guidelines, para. 288, see

appears overly restrictive or at a minimum ambiguous and in need of clarification. The limitation could be read as discouraging IPR policies that prescribe certain terms of licenses to standards-essential patents, or that specify mandatory or default licensing models. More generally, at least following initially unilateral disclosure of the most restrictive licensing terms, the Commission should make it clear that joint discussions of such terms will be subject to an unbiased evaluation under Article 101 (1) and 101 (3), and not be classified as restriction by object.[7]

9. **Safeguards against over-declaration.** As discussed below, a permissive FRAND regime may create incentives for over-declaration of even trivial patents as essential. The Guidelines should encourage SSO rules that require disclosures to be based on a good-faith belief that the patent or application is in fact essential, and to encourage withdrawal of previous disclosures where the IPR owner realizes that the patent or application is in fact not or no longer essential.

C. FRAND obligations must be more clearly defined if they are to prevent hold-ups effectively

10. In addition to clear-cut obligations to disclose standards-essential IPR, SSO rules need to incorporate a clear notion of what licensing terms can be deemed fair, reasonable and non-discriminatory. Otherwise, a FRAND obligation for disclosed IPR will not provide any meaningful protection against hold-ups. Apple welcomes the guidance that the Draft Guidelines currently provide,[8] but believes that this guidance could and should be strengthened in a number of respects.

11. **Implications of FRAND commitment for injunctive relief.** The Draft Guidelines do not explicitly address the question whether a holder of standards-essential patents who has given a FRAND commitment may seek an injunction against a company implementing the standard. In Apple's view, the right to seek an injunction would be incompatible with the aim of the FRAND obligation, namely to "ensure that patented technology incorporated in a standard is accessible to the users of that standard".[9] The threat of an injunction against a company that has committed substantial sunk investments to implementing a standard gives the IPR holder a degree of bargaining power that virtually assures that licensing conditions will not be fair and reasonable. The Guidelines should thus make it clear that in order to benefit from the safe harbour, SSO rules should stipulate that a FRAND commitment, or the failure to disclose standards-essential IPR, implies a waiver of the right to seek an injunction against a party implementing the standard, unless there has been a judicial determination of FRAND licensing terms and the implementing party has failed to satisfy those judicially mandated terms.

12. **Reciprocity limited to standards-essential IPR.** While it may be appropriate for SSOs to impose reciprocal licensing obligations with respect to standards-essential patents, the Guidelines should clarify that any such a reciprocal licensing obligation must not extend to patents that are not essential to any standard. It is clearly abusive for a holder of standards-essential patents to demand grant-back licenses to non-

---

[7] Cf. Draft Guidelines, para. 267 (agreements by IPR holders on the licensing terms they *will* disclose will constitute restrictions of competition by object within the meaning of Article 101 (1)).

[8] See Draft Guidelines, paras. 284-285.

[9] See Draft Guidelines, para. 283.

standards-essential patents, and SSO rules that permit such behaviour should not benefit from any safe harbour under TFEU Article 101(1).

13. **Implications of *ex ante* assessment for what is fair and reasonable.** Apple welcomes the Draft Guidelines' emphasis on ascertaining the license fees that were (or could have been) obtained *ex ante* in a competitive environment before the industry has been locked into the standard. But the Guidelines could spell out the implications of that approach more clearly:

   - The Draft Guidelines correctly recognize that the key factual elements for determining a fair and reasonable royalty are those that exist at the time that the standard is adopted. As the *Rambus* case[10] illustrates, such an *ex ante* assessment may lead to the conclusion that an appropriate royalty rate can be zero under certain circumstances, in particular where the IPR holder deceived other participants in the standard-setting process about the existence of patents or patent applications in violation of the SSO's disclosure rules.

   - An *ex-ante* approach means that developments after the adoption of the standard cannot justify a higher FRAND royalty than was justified at the time that the standard was adopted. The commercial success of innovative products implementing the standard many years after its adoption cannot justify a higher royalty, however unanticipated such success may have been at the time the standard was set. Indeed, an *ex ante* approach may lead to the conclusion that a FRAND royalty rate would be degressive over time, as it cannot be assumed without more that in an *ex ante* scenario without lock-in effects, a hypothetical negotiation would result in potential implementers of the standard agreeing to consistently high royalty rates for a very long period.

14. **Implications of *ex post* valuation based on objective quality and centrality to the standard at issue.** Given the practical difficulties of determining the hypothetical *ex ante* royalty rate, the Draft Guidelines rightly point to the alternative of having an independent expert assessing the respective IPR portfolio's "objective quality and centrality to the standard at issue."[11] The Commission may want to state explicitly that an IPR portfolio's value cannot be ascertained by mechanically counting the number of purported essential patents without regard to the value of the patented invention. Otherwise, there is severe risk of further incentivizing companies to declare even the most trivial patents as essential. For certain standards, such as those for wireless communications, over-declaration of patents as "essential" is already a widely acknowledged problem.

15. **Royalties imposing a "tax" on innovation outside the standard are not fair and reasonable.** Many multi-functional devices (such as Apple's iPhone and iPad) implement standards, but also contain numerous innovative features not covered by any standard. Royalty demands by holders of standards-essential patents that are based on the average selling price of the entire multi-functional device effectively tax innovation outside the standard, and are thus almost by nature abusive. It would be helpful if the Guidelines contained an affirmative statement to this effect. The Commission already recognized the issue in *Rambus*, where it insisted that the royalty

[10] See Commission decision of 9 December 2009, Case COMP/38.636 – Rambus.
[11] Draft Guidelines, para. 285.

caps in the commitments be based on sales of DRAM-chips themselves, not on the sales of devices incorporating DRAM-chips, or sales of multi-function chips incorporating DRAM functionality.[12]

16. **Guidance on "non-discriminatory" part of FRAND test.** In contrast with Commission precedent,[13] the Draft Guidelines do not discuss the "non-discriminatory" element of the FRAND test. Apple would encourage the Commission to provide some guidance here, for example on the following points:

- ***Cross-licenses as benchmark.*** Often holders of standards-essential IPR cross-license such IPR to each other. Those cross-licenses can provide a meaningful benchmark for both other holders of standards-essential IPR and manufacturers that were not involved in the standard-setting process. Where, for example, holders of standards-essential IPR grant each other royalty-free cross-licenses, the existence of those royalty-free cross-licenses is highly relevant to the requirement of non-discrimination in licensing other holders of standards-essential IPR. The absence of clear non-discrimination rules risks encouraging a pattern in which a core group of companies involved in the early development of a standard uses a web of royalty-free cross-licenses that incentivizes the mutual "packing" of the standard with their own IPR in order to make the IPR "essential." The IPR can subsequently be used individually or collectively to demand prohibitively high royalties from innovative new entrants and other "outsiders" not involved in the early standard-setting process.

- ***Transparency of licensing terms for standards-essential IPR.*** An obligation to license standards-essential IPR on non-discriminatory terms is not meaningful if potential licensees have no means of verifying that other industry participants are licensed and have no information as to the prevailing FRAND terms. Standards-essential IPR holders should not be permitted to misuse non-disclosure obligations to avoid providing any information, even on an aggregated basis, that would provide guidance on the contours of a FRAND rate. This misuse of non-disclosure commitments ensures that other licensees cannot verify the non-discriminatory nature of the terms they are being offered and is inconsistent with a serious commitment to FRAND licensing.

D. SSOs should be free to adopt rules that encourage royalty-free licensing

17. The Draft Guidelines rightly point out the need for unrestricted participation in the standard-setting process, including objective and non-discriminatory procedures for allocating voting rights. [14] SSO rules that exclude or discriminate against certain participants should not only be found to fall outside of the safe harbour, but should be presumed to have restrictive effects under Article 101 (1).

---

12 See Commission decision of 9 December 2009, Case COMP/38.636 – Rambus, para. 66.

13 In *Rambus*, the Commission insisted on strictly non-discriminatory royalties even though some DRAM makers argued that such a strict requirement would remove Rambus' incentive to offer anyone royalties below the stipulated caps. A strict non-discrimination requirement is also consistent with the Commission's treatment of dominant patent pools in its Technology Transfer Guidelines. See Commission's Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, 2004/C 101/02, para. 226.

14 Draft Guidelines, para. 278.

18. However, the requirement that "there should be no bias in favour or against royalty free standards" should be clarified. Several well-established SSOs, such as the World Wide Web Consortium (W3C) or the Bluetooth Interest Group, currently operate default or mandatory royalty-free models that require participating patent holders to take affirmative steps (sometimes during time-limited review periods) if they wish to opt out of a default commitment to license their standards-essential IPR on a royalty-free basis. These mechanisms can be very effective in limiting the proliferation of alleged standards-essential patents that could subsequently give rise to hold-up problems. The Commission should clarify that it is not discouraging the formation, or indeed the continued operation, of SSOs that use such models.

19. Apple supports the Commission's efforts to provide guidance on the issues relating to standards development and, in particular, the Commission's recognition of the risk of patent hold-up that may arise from inadequate SSO rules. Current SSO rules have not provided meaningful constraints on opportunistic behaviour by certain participants in the standards-development process, leaving Apple and other companies implementing ubiquitous industry standards exposed to unreasonable licensing demands and ultimately litigation. Apple would like to thank the Commission for the opportunity to comment on the draft Horizontal Cooperation Guidelines and would welcome an opportunity to discuss the views expressed herein.

* * *