

Comments on European Commission Proposals for reform relating to horizontal cooperation

1. Introduction

This paper provides comments on behalf of Telefonaktiebolaget LM Ericsson (“Ericsson”) in respect of:

- the 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”); and
- the Draft Regulation on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of research and development agreements (the “Draft Regulation”).

Ericsson would welcome the opportunity to discuss further the comments made in this paper with representatives of the European Commission.

2. The Draft Horizontal Cooperation Guidelines – Joint Ventures

The comments in this section of the paper focus on the discussion of joint ventures in paragraph 11 of the Draft Guidelines. The relevant part of paragraph 11 states:

“As a joint venture forms part of one undertaking with each of the parent companies that jointly exercise decisive influence and effective control over it, Article 101 does not apply to agreements between the parents and such a joint venture, provided the creation of the joint venture did not infringe EU competition law.”

The principle that interactions between a joint venture and its jointly controlling shareholders will generally not infringe Article 101 is a welcome proposition. However, Ericsson is concerned that the proposed interpretation of the single economic undertaking doctrine would provide broad scope for joint venture shareholders to be held liable for any fines imposed on a joint venture for participating in a cartel, even in circumstances where the shareholders had no knowledge of any cartel activities. It is Ericsson’s understanding that this interpretation of the single economic undertaking doctrine is currently subject to appeal to the General Court in Luxembourg in a number of cartel cases. This interpretation also appears to be at odds with the Commission’s treatment of full function joint venture undertakings under the EC Merger Regulation and the Ancillary Restraints Notice.¹

Ericsson therefore suggests that, rather than seeking to rely on a presumption of a single undertaking, the Draft Guidelines should explain that interactions between a joint venture and its jointly controlling shareholders will generally be considered to be pro-competitive and not an infringement of Article 101. The Draft Guidelines could then describe the situations in which Article 101 might however be infringed and explain how the Commission would propose to analyse such interactions.

¹ Commission Notice on restrictions directly related and necessary to concentrations (2005/C 56/03).

3. The Draft Horizontal Cooperation Guidelines – Standardisation Agreements

The comments in this section of the paper focus on the revised standardisation chapter of the Draft Guidelines. Ericsson recognises the importance of ICT standardisation policy in the European Union and welcomes increased guidance in this area. Ericsson would however like to make a number of comments on the revised chapter, which are structured along the following lines:

- General remarks;
- Comments on the proposed conditions for standardisation agreement to fall outside Article 101; and
- Proposals for improvements to the FRAND system.

3.1 General remarks on the revised standardisation chapter

IPR and efficiency gains

It is Ericsson's view that the revised chapter on standardisation agreements adopts a largely negative view of IPR in relation to standards. However, as recognised by the Commission's Technology Transfer Guidelines, IPR licensing is generally "pro-competitive as it leads to dissemination of technology and promotes innovation".²

Ericsson strongly supports the view that the IPR system encourages innovation in technology. The issue of whether an invention could be patentable is one of the key factors considered by companies when deciding where to invest billions of euros in R&D funding in Europe every year. Without the protection of the patent system, European companies could lose considerable business to companies able to plagiarise European inventions and manufacture more cheaply outside of Europe.

The IPR system can also play a key role in the development of open standards and open interfaces. A good example is the European telecoms industry which has enjoyed remarkable growth in the last two decades, providing affordable communication to billions of people worldwide. Telecoms standards such as GSM and UMTS, principally developed by European companies, have proven to be the most globally successful technologies in their field due to technological superiority and commercially viable IPR regimes. These standards are built on the basis of leading technologies licensed in accordance with commitments by the relevant patent holders to waive their normal patent rights and instead commit to licensing on fair, reasonable, and non-discriminatory ("FRAND") terms and conditions.

It is Ericsson's view that the revised chapter on standardisation would benefit from recognising these positive aspects of the IPR system in addition to considering the potential restrictive effects of IPR.

² Paragraph 9 of the Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements.

Paragraph 274: Vertically integrated companies and cross-licenses

The current draft of paragraph 274 suggests that companies who cross-license their IPR will do so instead of seeking royalties, which is not necessarily the case. A cross-license is the result of a bilateral negotiation during which the two parties' respective patent portfolio are evaluated. Such an evaluation could lead to a scenario where neither party pays royalties or could equally result in one party paying a royalty to the other (although at a lower rate than if it had no IPR of its own to cross-license).

3.2 Commission's proposed conditions for standardisation agreement to fall outside Article 101(1) TFEU

Paragraphs 276 *et seq* of the Draft Guidelines set out "safe harbour" conditions which, if satisfied, will mean that the relevant standard-setting arrangements should fall outside the scope of Article 101(1). The Draft Guidelines explain that it "*is not necessary for standard-setting agreements to fulfil these conditions, but normally they will be sufficient to avoid the application of Article 101(1).*"

Ericsson welcomes additional guidance in this area but considers the text to be too prescriptive and notes that a number of SSOs would not satisfy the conditions as currently drafted. For example, the ETSI IPR Policy would not fall within the envisaged "safe harbour" for a number of reasons as explained in further detail below. It is therefore Ericsson's view that a more flexible approach would be beneficial in order to accommodate the various forms of standardisation development.

It is also Ericsson's view that the Draft Guidelines should provide additional guidance on the principles the Commission will adopt to assess standard setting activities that do not fall within the proposed "safe harbour" conditions (this issue is considered in further detail in section 3.3 below).

Paragraph 280: Binding IPR rules

Paragraph 280 of the Draft Guidelines explains that, in order to avoid the application of Article 101(1), SSOs should set binding rules on their members that seek to avoid the misuse of the standardisation process through hold-ups and the charging of abusive royalty rates. Ericsson agrees that binding rules should form part of the IPR policy of an SSO in order to avoid these issues. However, Ericsson believes it should be made clear that the enforcement powers of the SSO in respect of such rules should be limited to excluding members who are in breach of the rules. Otherwise, the fact that an SSO (including its management) is comprised of its members means that any further enforcement powers could result in a substantial conflict of interest.

Paragraph 281: Ex ante disclosures of essential patents/patent applications

Paragraph 281 of the Draft Guidelines envisages extensive disclosure obligations both for members and non-members of an SSO. It is Ericsson's view that a mandatory requirement to disclose patent information would not work in relation to companies outside of the standard setting process since, as non-members, they are not subject to the rules of the SSO.

Furthermore, there is a risk that such extensive disclosure obligations could result in a culture of excessive over-declarations by SSO members. As described in further detail below (in relation to paragraphs 284 and 285), R&D is normally carried out in parallel with the standardisation process

meaning there is a time-delay in identifying essential patents. In addition, the draft specification of a standard is continuously subject to change as the various parts of the standard are developed. It is therefore very unclear during the development phase which patents will ultimately read on the standard. In these circumstances, SSO members might feel obliged to disclose hundreds of patents and patent applications which at a very broad level “might be essential” but ultimately prove to be irrelevant. The cumulative effect of so many disclosures by all the members of an SSO would be to substantially obfuscate the patent landscape.

Ericsson also considers important to note that any proposals for IPR holders to “*make reasonable efforts to identify existing and pending IPR reading on the potential standards*” should expressly not contain any obligation to conduct IPR searches. If this was not the case, such searches would require unreasonable amounts of work and costs given the vast numbers of patents and patent applications held by many companies.

The ETSI IPR policy addresses the issues above in the following terms:

“4 Disclosure of IPRs

4.1 Subject to Clause 4.2 below, each MEMBER shall use its reasonable endeavours, in particular during the development of a STANDARD or TECHNICAL SPECIFICATION where it participates, to inform ETSI of ESSENTIAL IPRs in a timely fashion. In particular, a MEMBER submitting a technical proposal for a STANDARD or TECHNICAL SPECIFICATION shall, on a bona fide basis, draw the attention of ETSI to any of that MEMBER's IPR which might be ESSENTIAL if that proposal is adopted.

4.2 The obligations pursuant to Clause 4.1 above do however not imply any obligation on MEMBERS to conduct IPR searches.

4.3 The obligations pursuant to Clause 4.1 above are deemed to be fulfilled in respect of all existing and future members of a PATENT FAMILY if ETSI has been informed of a member of this PATENT FAMILY in a timely fashion. Information on other members of this PATENT FAMILY, if any, may be voluntarily provided.” (Emphasis added)

These limitations on the obligation to make disclosures provide a workable system that provides SSO members with sufficient time (“a timely fashion”) to make a proper assessment as to whether or not their IPR might be essential for the standard. To the extent that the Commission proposes to retain such conditions in the Draft Guidelines, it is Ericsson’s view that the obligation to make disclosures should be similarly limited in order to avoid an unworkable disclosure burden.

Paragraph 282: FRAND commitment

Paragraph 282 of the Draft Guidelines suggests that all holders of essential IPR in technology which may be adopted as part of a standard provide an irrevocable commitment in writing to license their IPR on FRAND terms. This approach is inconsistent with ETSI’s current IPR Policy which states:

“When an ESSENTIAL IPR relating to a particular STANDARD or TECHNICAL SPECIFICATION is brought to the attention of ETSI, the Director-General of ETSI shall immediately request the owner to give within three months an irrevocable undertaking in

writing that it is prepared to grant irrevocable licences on fair, reasonable and non-discriminatory terms and conditions under such IPR...”³

Where the relevant IPR holder refuses to give such a FRAND commitment, the ETSI IPR policy states that ETSI shall decide whether to:

“suspend work on the relevant parts of the STANDARD or TECHNICAL SPECIFICATION until the matter has been resolved and/or submit for approval any relevant STANDARD or TECHNICAL SPECIFICATION.”⁴

In effect, this means that an IPR holder is given the choice of whether or not they wish to provide a FRAND commitment in respect of a technology that may read on the standard. If they decide not to provide such a FRAND commitment, ETSI may suspend the work and look for viable alternative technologies which are not blocked by the relevant IPR and satisfy ETSI’s requirements.

If the ability to refuse to provide a FRAND commitment is taken away, this could potentially impinge the basic rights of IPR holders to prevent others from using your patented inventions. For example, a scenario can be envisaged where an SME’s business, consisting of selling only products based on the company’s propriety technology (technology A), could be severely hampered if it lost its ability to refuse to contribute its technology to a standard. In these circumstances, members of an SSO, realising that technology A is the most superior technology, could submit it to the SSO and apply for standardisation (even if they have no IPR relating to the technology). If the SME could not object to the inclusion of technology A and was instead required to provide licenses on FRAND terms, it would be left with a weaker IPR protection through no fault of its own.

It is Ericsson’s view that SSOs should continue to request FRAND commitments from holders of IPR which may potentially read on a standard. It should be open to such an IPR holder to decide for itself whether or not it wishes to provide a FRAND commitment. If it does not wish to do so, the SSO should decide whether it is appropriate to suspend work and look for viable alternative technologies which are not blocked by the relevant IPR.

Paragraph 284 -285: Assessing the FRAND commitment

Paragraphs 284 and 285 of the Draft Guidelines note that the imposition of excessive royalties in breach of a FRAND commitment may reflect an abuse of market power and could constitute an infringement of Article 102. The Guidelines therefore seek to provide guidance on the factors that might be taken into account when determining whether the levels of royalty rates charged by a patent holder are fair and reasonable in relation to a particular standard.

It is Ericsson’s view that there are a number of issues with the benchmarks proposed by the Draft Guidelines for assessing whether royalty fees imposed are unfair and unreasonable. In particular, the proposals to (i) compare ex ante and ex post licensing fees and (ii) rely on ex ante disclosures may only be useful in a relatively straightforward standard-setting context where the technology is limited in scope, and where the patent ownership profile is known or predictable and relatively stable. Such proposals are unlikely to work for complex dynamic standards.

³ Clause 6(1) of the ETSI Intellectual Property Rights Policy.

⁴ Clause 6(3) of the ETSI Intellectual Property Rights Policy.

The ICT sector and the telecoms environment is characterised by complex, dynamic standards with broad technical scope, involving substantial numbers of technology contributions and long evolution cycles over many years. In 3GPP, for example, tens of thousands of technical documents are submitted each year in relation to the development of telecoms standards. It is a continuously evolving process where important on-going R&D is carried out in parallel with the standardisation process. The number of essential patents granted to SSO members will typically remain at a relatively low level in the early years of the standardisation process. As a result, many licensors and licensees will not have a clear picture of the strength of the relevant essential patent portfolios relating to a given standard until a number of years after the first release of the relevant standard. Furthermore, many of the patents claimed to be essential in relation to a standard may not be essential and the granted claims may be much narrower in scope than those in the patent application. Moreover, it may be the case that a third party has already invented the claimed technical solution (prior art) in which case no patent will be granted.

The vast majority of licensing in respect of such complex standards takes place some years after the first official release given that prior to the adoption of the standard, it is uncertain (i) which patent applications will be granted, (ii) the scope of such granted patents, (iii) which patents will read on the standard and also (iv) who will own the essential patents. In these circumstances, it is generally not possible to make reliable and consistent comparisons of the licensing fees charged by a company ex ante with those charged after the industry has been locked in. These circumstances also give rise to serious issues with the proposals to rely on unilateral ex ante disclosures, which are considered in further detail below in relation to paragraph 287 of the Draft Guidelines.

Ericsson considers these issues to be highly complex and in need of further industry reflection before such detailed guidance is adopted.

Paragraph 286: Transfer of FRAND commitment

Ericsson welcomes the Commission's proposal that there should be a requirement on all IPR holders who provide a FRAND commitment to take all necessary measures to ensure that any company to which the IPR owner transfer its IPR is bound by that commitment. This requirement would improve the FRAND system and especially the problems associated with the increasing number of non-practicing entities who acquire essential patents with a view to obtaining substantial royalties that are inconsistent with FRAND terms.

Paragraph 287: Unilateral ex ante disclosures of most restrictive licensing terms

Paragraph 287 of the Draft Guidelines states that an SSO that requires or allows IPR holders to unilaterally disclose their most restrictive licensing terms ex ante, including maximum royalty rates, would not breach Article 101(1) as long as the SSO's IPR rules do not allow for joint negotiation or discussion of licensing terms. According to the Draft Guidelines, such unilateral ex ante disclosures would be one way for SSO members *"to take an informed decision based on the disadvantages and advantages of different alternative technologies, not only from a technical perspective but also from a pricing perspective."*

It is Ericsson's view that ex ante disclosures are unlikely to work in respect of complex dynamic standards. Detailed reasons in support of this view are set out in the attached Ericsson contribution paper, which was originally submitted to the DG Enterprise and Industry in January 2009 [*attached with this submission*]. In summary, it is difficult for patent owners to get a good understanding ex ante of which patents are likely to be essential to the standard and who will own

them. Disclosures made in this context would not reflect any competitive process and could not therefore be equated to a negotiated rate achieved in arm's length negotiations prior to the adoption of a standard. Furthermore, since unilateral ex ante disclosures only concern individual royalty rates, they could not guarantee that the cumulative royalty rate paid by implementers of the standard would be reasonable. In fact, experience shows that when a lot of individual rates are aggregated, the cumulative figure is unlikely to be commercially viable since companies will seek to maximise their ex post negotiating position by disclosing high royalty rates. This problem is exacerbated as the number of licensors grows and more and more individual rates have to be aggregated.

Support for this view is provided by the telecoms industry's experience with the NGMN IPR Initiative. Operators in the mobile telecoms industry sought to obtain an indication from essential patent owners as to what they would charge for licences to use patents declared essential for fourth generation mobile systems. In July 2007, NGMN announced that it had launched an initiative to deliver more transparency and predictability towards IPR costs associated with next generation mobile technologies. The aim of the initiative was to reveal indicative cumulative IPR costs for various standards in order to provide an early opportunity for technology customers to consider the IPR cost of potential next generation technologies in their decision-making process. The initiative required each participant to provide to an independent third party its main proposed licensing terms and conditions. Although the aggregate amount claimed is confidential, it is well known in the industry that the aggregate royalties claimed by the relevant IPR owners was wholly excessive and would be a substantial cost burden on both handset manufacturers and operators who wish to introduce higher quality services to consumers.

The fact that the NGMN IPR Initiative has failed to achieve fair and reasonable royalty rates for LTE is generally recognised across the European wireless communications industry. Indeed, Vodafone and France Telecom (Orange), who are two of the network operator members that run NGMN, have stated in their comments to Commission's White Paper on ICT Standardisation that the NGMN IPR Initiative system of ex ante declarations has not worked. For example, France Telecom states in its comments to the White Paper about the possibility of introducing a system of ex ante declarations:

"The legitimate objective of transparency and predictability cannot be guaranteed, on the contrary, such declaration could even lead to unreasonable royalty aggregations that could mislead the whole industry about the commercial viability of a standard implementation: example of the Trusted Third Party royalty aggregation process defined and run by the NGMN"

Similarly, Vodafone notes in its comments to the White Paper:

"For some years the Commission and other commentators (including Vodafone) have hoped that the industry participants and ESOs would themselves be able to resolve the problems of FRAND with minimal guidance from the Commission. Various efforts have been made to do this [footnote reference: "See, for example, the attempts by NGMN to require ex ante IPR declarations for LTE in 2007"], but none has produced the changes that are required if European standardisation is to safeguard Europe's competitiveness in ICT – and the interests of its consumers – in the years to come."

In light of the experience of the NGMN IPR Initiative, it is clear that a general system of ex ante unilateral disclosures will not improve the effectiveness of FRAND licensing for all standard setting scenarios. There is even a possibility that the Commission's endorsement of a general system of

ex ante disclosures risks legitimising the behaviour of companies who seek to rely on unchallenged excessive ex ante declarations to justify excessive royalty demands ex post.

To the extent that the Commission wishes to refer to unilateral ex ante disclosures in the draft Guidelines, it should be made clear that such systems are an option for considerations by SSOs and not a requirement under the competition rules.

Paragraph 288: Inclusion of substitute technologies

Paragraph 288 of the Draft Guidelines states that the inclusion of substitute technologies in a standard may limit inter-technology competition and that where *“a standard is composed of substitute technologies, the arrangement can in practice amount to foreclosure of competitors by excluding one potentially competing alternative technology from being included in a different standard.”* The paragraph therefore concludes that, as a general rule, the inclusion of substitute technologies in a standard is likely to give rise to restrictive effects on competition.

It is Ericsson’s view that this paragraph is at odds with the realities of standard setting. It is common for standards to contain optional features so that some technologies within the standard may be regarded as substitutes. The existence of such optional features means that the standard can be adapted for the particular needs of an implementing party while still providing the desired interoperability. However, the inclusion of such substitutes does not normally give rise to a restriction of competition since the inclusion of a technology in one standard does not mean that it cannot be used in another standard. For example, numerous solutions for accommodating packet data users in a cellular radio network were developed during the research and standardisation of GPRS (2.5 generation mobile standard) and several of those solutions have been re-used in subsequent systems, such as WCDMA, LTE, cdma2000 and WiMAX, which are competing mobile standards.

Ericsson therefore suggests that this paragraph is removed from the Draft Guidelines.

3.3 Proposals for improvements to the FRAND system

The existing approach of requiring SSO members to commit to licensing on FRAND terms has generally served the telecoms industry well so far. However, since the SSOs’ IPR rules do not clearly specify what criteria must be met for royalty rates to be “fair and reasonable”, the current system could benefit from some improvement in order to reduce the risk that the economic benefits of standardisation are undermined by excessive and un-FRAND royalty levels.

As explained above, it is Ericsson’s view that the proposals regarding unilateral ex ante disclosures is unlikely to increase the effectiveness of the standard setting process for dynamic standards or result in competitive IPR levels.

As ETSI demonstrated in the context of the UMTS standard, an SSO can establish consensus as to how FRAND should be defined in relation to a particular standard prior to its official adoption. When WCDMA was provisionally selected in January 1998 for inclusion in the UMTS standard, ETSI members established the UMTS IPR Working Group in order to provide agreed guidelines for the FRAND licensing of UMTS essential patents. Following industry consultation, the UMTS IPR Working Group published recommendations which defined FRAND in the context of UMTS to

require a reasonable (single digit) aggregate royalty rate to be divided among the holders of essential patents based on the equality of essential patents.

These principles recognise that if the royalty levels for a standard are cumulatively too high, this adversely impacts and may negate the economic benefits of standardisation. It is therefore important when negotiating royalty rates that individual licensors take into account the cumulative royalty levels payable by licensees. A significant feature of any standard-specific definition of FRAND should therefore include the reasonable aggregate royalty rate range for standard compliant products.

The Draft Guidelines currently suggest that rules allowing for the *“joint negotiation or discussion of licensing terms in particular royalty rates”* may lead to a restriction of competition within the meaning of Article 101. However, it is clear that such practices could also have pro-competitive effects if SSO members were able to hold joint discussions with the objective of achieving a cumulative royalty rate that represents a fair balance between essential patent holders achieving a reasonable rate of return for their R&D investments and providing low input costs for the competitive downstream industry. The European Commission’s Technology Transfer Guidelines recognise that the development of such ex ante licensing frameworks (with maximum cumulative royalty rates) may be efficient and pro-competitive:

“Undertakings setting up a technology pool that is compatible with Article [101], and any industry standard that it may support, are normally free to negotiate and fix royalties for the technology package and each technology’s share of the royalties either before or after the standard is set. Such agreement is inherent in the establishment of the standard or pool and cannot in itself be considered restrictive of competition and may in certain circumstances lead to more efficient outcomes. In certain circumstances it may be more efficient if the royalties are agreed before the standard is chosen and not after the standard is decided upon, to avoid that the choice of the standard confers a significant degree of market power on one or more essential technologies.”

Ericsson does not propose that the Commission include such discussions within the “safe harbour” conditions envisaged by the Draft Guidelines. Rather it is proposed that the Commission should provide additional guidance on the principles that will be adopted to assess standard setting activities that do not fall within the proposed “safe harbour” conditions. In particular, Ericsson requests that the Commission provides guidance as to how the Commission will assess under Article 101(3) such joint discussions.

4. The Draft Regulation

Ericsson agrees that it is useful to have a block exemption regulation which encourages undertakings in their research and technological development activities. However, Ericsson would like to submit comments on the proposed Article 3(2) in the Draft Regulation, which states:

“The parties must agree that prior to starting the research and development all the parties will disclose all their existing and pending intellectual property rights in as far as they are relevant for the exploitation of the results by the other parties.”

It is understood that the aim of this provision is to provide greater clarity and legal certainty for companies undertaking joint R&D activities. However, it is Ericsson's view that the proposed provision may actually discourage collaborative research and development activities in Europe.

Although the aims of a research project might be clear prior to the start of the research and development activities, the ultimate results will normally be unknown at that stage. In these circumstances, it is impossible to determine the IPRs that will be relevant for the exploitation of the ultimate results of the project. Furthermore, the disclosure rule envisaged by Article 3(2) of the Draft Regulation is considerably more onerous than the corresponding IPR disclosure rules typically adopted in the context of standards setting. As noted above in relation to the comments on paragraph 281 of the Draft Guidelines, Clause 4 of the ETSI IPR policy contains limitations on the disclosure obligation such that members are:

- only required to use reasonable endeavours to make disclosures in a "timely fashion"; and
- do not have to conduct patent searches.

To the extent that the Commission proposes to retain some IPR disclosure provisions in the Draft Regulation, Ericsson suggests that the obligation in Article 3(2) should be limited in a similar manner to that described above in relation to Clause 4 of ETSI's IPR Policy. Without such limitation, there is a risk that the onerous IPR disclosure obligations envisaged by Article 3(2) will discourage parties from making use of the block exemption regulation to conduct collaborative research and development activities.