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OVERSIGHT OF THE IMPACT ON COMPETITION OF EXCLUSION ORDERS TO ENFORCE STANDARD-ESSENTIAL PATENTS

HEARING

BEFORE THE

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OVERSIGHT OF THE IMPACT ON COMPETITION OF EXCLUSION ORDERS TO ENFORCE STANDARD-ESSENTIAL PATENTS

WEDNESDAY, JULY 11, 2012

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Committee met, pursuant to notice, at 9:40 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Patrick J. Leahy, Chairman of the Committee, presiding.

Present: Senators Leahy, Coons, Grassley, and Lee.

OPENING STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Chairman LEAHY. I apologize for being late. We go through a city that will spend millions of dollars to enforce parking meters and get fines to pay for speed cameras which mainly make out-of-town companies rich and so on, but they cannot coordinate their street lights when the street lights are broken, and I think they must have decided to have a meeting maybe next week to put somebody down there to direct traffic when main thoroughfares have a green light that will go on for 1 second and 10 minutes red.

Senator GRASSLEY. The problem probably is that they purposely do not coordinate them.

Chairman LEAHY. Well, I know the street lights are coordinated. They seem not to be coordinated to the benefit of either pedestrians or drivers, so I am not sure. Maybe there is some other reason. But be that as it may, I do apologize. It only took an hour and 40 minutes to go the 11 miles in here.

In recent months, we have seen a growing number of companies engage in what some are calling the next wave in the "tech patent wars." Companies that previously cross-licensed their technologies with other companies in the market are increasingly seeking to block their competitors instead. This has the obvious potential to harm consumers by preventing access to their favorite devices.

I have long championed the strong enforcement of our intellectual property laws because enabling inventors to profit from their work encourages innovation. Patent protection is particularly important even for my small State of Vermont. The Intellectual Property Organization recently announced that in 2011 Vermont again received the most patents per capita of any State in this country.

But when inventors and developers are willing to license their technologies to one another at reasonable rates, then you have this cross-fertilization of ideas that benefits us all. But I am concerned that the recent trend of seeking exclusion orders from the International Trade Commission rather than negotiating and seeking license fees is going to have the opposite effect.

Today's hearing focuses on the enforcement of standard-essential patents at the ITC. Standard setting is important. It may seem like a dry subject, but it allows different companies to have their products interoperate, giving us important developments like the 3G technology used in cellular phones. To participate in the standard setting, patent owners often agree to license their patents on reasonable terms.

In March, I wrote to the administration expressing concern that ITC exclusion orders can be misused to prevent rival technologies when holders of standard-essential patents fail to reach agreement on licensing terms. These orders pose a significant threat to competition and innovation, especially where competitors have developed products based on a mutual commitment to license standard-essential patents on reasonable terms. You assume you are going to be able to do it. You develop your product, and then all of a sudden you see the door slammed in your face.

Senator Lee and other Senators on this Committee have since written to the ITC expressing similar concerns. This is not a partisan issue. Patent reform is a bipartisan issue. We have an interest on both sides of the aisle in ensuring the patent laws promote innovation and competition.

The Department of Justice and the Federal Trade Commission play a vital role in protecting consumers and competition by enforcing our Nation's antitrust laws. But they also have an important role in advising on antitrust issues. Congress recognized that role when it required the ITC to consult with the FTC and the DOJ on competition issues. So I think today's witnesses will give the Committee a chance to further explore the competitive impact of ITC exclusion orders and whether more needs to be done, because it really is creating a lot of concern here on Capitol Hill, but it is creating an even greater concern to a lot of industries in this country.

Senator Grassley, I will yield to you.

STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Thank you very much. Mr. Chairman, thank you for holding this hearing on the competition impact of exclusion orders relative to standard-essential patents. Industry standards are crucial to allowing the myriad of electronic and mobile devices consumers use and rely on every day to interface and connect with other consumers and the Internet. Recently there have been questions and increased litigation over the way standard-essential patents are utilized and enforced.

When companies agree to contribute their patents to become an industry standard, they usually commit to making them available on fair and reasonable and non-discriminatory licensing terms. By having access to these standards, companies can create new technologies, products, and services, and the different electronic devices have the ability then to seamlessly interface for lower prices, better quality, and more consumer choice.

Consumers want to use different products and technologies made by different companies. They want choice and more options in what they buy or use, and they do not want to be limited to using devices or services from just one company. And it is not as expensive to exchange different kinds of devices when they can interoperate with each other. Competition is good for the consumer and the choice the consumer has and satisfaction as well as benefiting from innovation and technological advances.

Consequently, there is a real question as to whether it is anticompetitive or anticonsumer when standard-essential patent holders that have agreed to license their products under RAND terms seek injunctive relief against or exclude companies that have implemented their standard. Companies that have relied on standard-setting organization RAND agreements and incorporated standard-essential patents into their products expect to be able to negotiate reasonable royalties with patent holders.

At the same time, when there is patent infringement, we do not want to restrict the ability of patent holders to protect their products from infringers. We do not want to disincentivize participation in standard-setting bodies or hamper the ability of companies to generate new products and technology.

I am interested in learning more about what are the issues surrounding standard-essential patents and RAND commitments, what are the obligations of standard-setting-organization participants, as well as what is happening in the courts or even at the International Trade Commission. So I want to hear about what our extensive hold-up problem is and how it has and/or will impact innovation and competition.

I am interested in hearing more about how we can best balance the interests of standard-essential patent holders, standard-essential patent implementers, and consumers who use the products and standard-essential patents.

I will put the rest of my statement in the record. Thank you, Mr. Chairman.

[The prepared statement of Senator Grassley appears as a submission for the record.]

Chairman LEAHY. Thank you, Senator Grassley.

Our first witness is Joseph Wayland. He is the Acting Assistant Attorney General for the Antitrust Division. He was appointed to that in April. He joined the Department of Justice Antitrust Division in 2010. He was responsible for all the Division's civil litigation. He was also Chief Trial Counsel. Before joining DOJ, he was a partner in Simpson, Thacher & Bartlett and focused on complex business litigation. He was elected as a Fellow to the American College of Trial Lawyers in 2009. He previously served in the U.S. Air Force and has a law degree from Columbia.

Mr. Wayland, we are delighted to have you here. Please go ahead, sir.

STATEMENT OF JOSEPH F. WAYLAND, ACTING ASSISTANT ATTORNEY GENERAL, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, D.C.

Mr. WAYLAND. Thank you very much, Chairman Leahy and Ranking Member Grassley and members of the Committee. It is a pleasure to have this opportunity to discuss the Antitrust Division's experience with standard-essential patents.

The issues that I will discuss today involve three important inputs to our modern innovation-based economy: patent rights, competition, and jointly set standards. Antitrust and intellectual property function together to provide high-quality products and services at competitive prices and preserve strong incentives for the innovation that creates and improves those products.

Standards provide a range of benefits, from helping to protect public health and safety to promoting efficient resource allocation and production by allowing for interoperability among complementary products. Indeed, interoperability standards paved the way for the telecom networks and mobile computing devices that have become hallmarks of the modern age.

The Antitrust Division has worked closely with the FTC, the PTO, and other Federal agencies to better understand the interface between standards and antitrust and to promote intellectual property practices for standard-setting activities that preserve competition and protect consumers.

In particular, we have found that when a standard incorporates patented technology owned by a participant in the standard-setting process and that standard becomes established, switching can often become difficult, and the particular technology may gain market power. This creates the potential for patent holders to take advantage of that market power by engaging in one form of what is known as patent hold-up—excluding a competitor from a market or obtaining a higher price for its invention than would have been possible before the standard was set.

Patent hold-up can cause a number of problems such as inducing others to postpone or avoid incorporating standardized technology in their products, and consumers could be harmed if companies implementing a standard pass on the costs in the form of higher royalties.

Standard-setting organizations often try to limit opportunities for their participants to engage in hold-up through patent policies that set forth patent disclosure obligations and licensing commitments. The Antitrust Division has stressed that SSOs that set forth well-defined patent policy rules can effectively promote competition.

For example, the Division has issued business review letters in which we advised that SSOs may require or permit patent holders to disclose the most restrictive terms on which they are willing to license their essential technology in advance to provide notice to competitors of the terms on which they can compete and thus avoid unreasonable licensing terms that might harm the successful adoption and implementation of that standard.

The Antitrust Division has also pursued enforcement where appropriate. Notably, the Antitrust Division has conducted a number of investigations involving standard-essential patents involving mobile devices. In many of these investigations, the Division had concerns about F/RAND-encumbered standard-essential patents. Earlier this year, the Division closed its investigation of the acquisition of two significant patent portfolios: Rockstar Bidco's acquisition of patents and patent applications from Nortel, and Google's acquisition of Motorola Mobility patents and patent applications.

The Division's investigations focused on whether the acquiring firms would have the incentive and ability to exploit ambiguities in the commitments that sellers made to license their patents on F/RAND terms to hold up implementers of the standard and to obtain higher royalties from their competitors, particularly by using the threat of an injunction or exclusion order, or exclude them from the market entirely.

Although we concluded that the acquisitions of these patent portfolios were not likely to substantially lessen competition, the Division noted its concerns about the potential inappropriate use of F/RAND-encumbered standard-essential patents to disrupt competition and specifically limited our conclusion to the transfer of ownership rights and not to the exercise of those transferred rights. We have continued closely to monitor the use of F/RAND-encumbered standard-essential patents in the wireless device industry to ensure that they are not used to stifle competition and innovation in this important industry.

The Antitrust Division is also closely monitoring a number of pending matters before the ITC involving F/RAND-encumbered SEPs. The Division is concerned about the circumstances in which an exclusion order may be inappropriate, in particular, where a product implementing a standard has been determined to have infringed a valid F/RAND-encumbered patent that is essential to that standard. I commend the ITC for seeking the types of information necessary to evaluate whether the statutory public interest factors counsel against the imposition of an exclusion order in such cases. In an era where competition thrives on interconnected, interoperable network platforms, these considerations merit special attention.

That concludes my prepared remarks, Mr. Chairman. I would be happy to answer questions that the Committee may have.

[The prepared statement of Mr. Wayland appears as a submission for the record.]

Chairman LEAHY. Thank you.

Before we go to questions, because some of our questions will actually go to both the witnesses, we will ask Commissioner Ramirez to speak. She has served as a Commissioner of the Federal Trade Commission since 2010. Prior to that, Commissioner Ramirez was a partner in the Los Angeles office of Quinn Emanuel Urquhart & Sullivan—I know the law firm; I cannot believe I blanked on that—where she represented clients in intellectual property, antitrust, and trademark matters. Commissioner Ramirez clerked in the U.S. Court of Appeals for the Ninth Circuit, served as the Vice President and member of the Board of Commissioners for the Los Angeles Department of Water and Power, received her undergraduate and law degrees from Harvard.

Commissioner, we are delighted to have you here. Please go ahead.

STATEMENT OF THE HONORABLE EDITH RAMIREZ, COMMISSIONER, FEDERAL TRADE COMMISSION, WASHINGTON, D.C.

Ms. RAMIREZ. Thank you. Chairman Leahy, Ranking Member Grassley, and members of the Committee, thank you for the opportunity to testify on behalf of the Federal Trade Commission about the competitive effects of injunctive relief for infringement of standard-essential patents, including the impact of ITC exclusion orders.

These issues are currently front and center in the markets for smartphones and tablets where the risk of competitive harm from such orders can be especially acute. Complex, multicomponent products are the norm in IT markets. For example, a smartphone has hundreds of components and technologies that enable it to communicate over wireless networks, stream video, access the Internet, and perform all of the functions that consumers expect.

The vast majority of these components and technologies are covered by patents. A conservative estimate of the number of patents that could be in play in a smartphone is in the tens of thousands. Many of these patents are claimed to be essential to a standard.

Standards dictate the design of many parts of a smartphone. To make phone calls, a smartphone must be compatible with a cellular network. Standards make that possible. They also enable many other functions, such as wi-fi communications and video streaming.

Standards in the IT sector are typically set by standard-setting organizations, or SSOs, whose members include parties with a commercial stake in how the standard is written, such as patent holders, manufacturers, and large buyers. Through standard-setting organizations, these firms engage in a voluntary but formal process to reach consensus on technical standards that permit technologies to work together.

While incorporating patented technologies into a standard greatly benefits consumers, it also creates competitive risks. Patents that cover technology adapted into a standard can empower their owners to demand higher royalty rates and other more favorable licensing terms than they could have demanded before the standard was adopted. This conduct is known as "patent hold-up."

The risk of patent hold-up is inherent in the complex and time-consuming standard-setting process. A wireless communication standard can take a decade or more to complete and can run many thousands of pages. The final standard is often the result of heated battles between key industry players and is virtually impossible to change piecemeal. Once a technology is embedded in a standard, it is there to stay until the standard is revised, which can be many years down the road.

In addition, after a standard is published, firms begin to invest in products and technologies that are tied to the standard. As a result, owners of standard-essential patents that once faced competition may gain new found leverage solely as a result of the standard-setting process. After technology is adopted into a standard, companies must use that technology to make a standardized product.

To reduce the risk of patent hold-up, many SSOs require members to disclose patents that will read on the standard and to agree to license those patents on reasonable and non-discriminatory, or RAND, terms. RAND commitments are designed to mitigate the risk of hold-up and encourage competition among standardized products. But a royalty negotiation that occurs under threat of an injunction or exclusion order is weighted heavily in favor of the patentee—the very situation the RAND commitment was intended to combat.

In the face of an order that will block its products from the market, a company may have no choice but to accept the patentee's demands, reasonable or not.

Let me emphasize that this is more than a private dispute. Over time, hold-up restricts competition and distorts incentives to invest in standardized products and complementary technologies. The result for consumers will be higher prices, fewer choices, and inferior product quality. Hold-up also risks harming the standard-setting process.

The Supreme Court's decision in the eBay case reduced the risk of hold-up by making it difficult for standard-essential patent owners to obtain injunctions in Federal court. But while Federal courts are bound by eBay, the ITC is not. This raises concerns that some patent holders that would be unlikely to win injunctive relief in district court will file suit at the ITC to obtain import bans.

But the FTC believes that the International Trade Commission also has a way to limit the potential for hold-up. We think the ITC can and should take a RAND commitment on a patent into account under its public interest analysis before issuing an exclusion order. Under its existing authority, the ITC can prevent the owners of standard-essential patents from sidestepping their licensing commitments to the detriment of competition, innovation, and consumers. The ITC's recent Notice of Review in its Apple-Motorola investigation suggests that it may do just that.

Let me close by emphasizing that the FTC does not take the position that an exclusion order should never issue for standard-essential patents. We are instead advocating that the ITC prevent patentees from using a Section 337 investigation as a way to escape their RAND obligations. In our view, this position strikes the right balance between protecting the rights of patent holders and safeguarding the pro-competitive benefits of the standard-setting process.

Thank you, and I am happy to answer any questions you may have.

[The prepared statement of Ms. Ramirez appears as a submission for the record.]

Chairman LEAHY. Well, thank you. Following on that last thing, Commissioner Ramirez, I will ask you this, and then Mr. Wayland the same. The ITC has a statutory obligation to consider the effect on competitive conditions in the United States economy and United States consumers when it issues an exclusion order. What factors should the ITC consider in determining the effect that an exclusion order would have upon competitive conditions and American consumers in these cases?

Ms. RAMIREZ. I think that under the public interest analysis, which does emphasize the fact that the ITC has the ability to consider the impact of exclusion orders on competitive conditions in the U.S. economy as well as consumers, allows the ITC to take into consideration the hold-up problem that I addressed in my opening statement. So I think there is—under the existing authority of the ITC, there is ample room for them to take these issues into account. I believe that the ITC in its recent Notice of Review has indicated that it also agrees with that position because it asks questions posed to this very issue in its Notice of Review that raises the questions that you are asking today.

Chairman LEAHY. Would you agree with that, Mr. Wayland?

Mr. WAYLAND. I would, Mr. Chairman, and I also agree that the public interest standard gives the ITC the writ to look at harm to consumers, to consider whether the effect of an exclusionary order would be to inhibit competition, to raise prices, or otherwise limit innovations, sir.

Chairman LEAHY. Then let me ask you this. Back in, I believe, 2005, I think, when most of us just carried BlackBerrys in Washington, we were concerned that an injunction was going to prevent the BlackBerrys from working. Now, after that was resolved, the Supreme Court held that courts should weigh the same factors in patent cases that they do in other cases, where they issue an injunction rather than awarding damages.

Now, when I receive briefings about what is happening, I am wondering, are parties now going to the ITC to avoid the traditional four-factor judicial test? Mr. Wayland.

Mr. WAYLAND. Mr. Chairman, I cannot speak to the motivations of all the parties for seeking relief from the ITC, but we are concerned that that is happening. We are concerned that they are seeking to get a remedy outside of the Federal courts that the Supreme Court has recognized ought to be limited by the traditional limits on injunctive relief.

Chairman LEAHY. And, Commissioner, while I agree that you cannot understand each person's motivation, are you seeing enough of a trend that this appears to be a possibility?

Ms. RAMIREZ. Yes, and maybe it might help if I can just provide a little bit of context about the role that the ITC plays.

Section 337 of the Tariff Act of 1930 is a trade statute, not a patent statute, and so the way the statutory framework is set out, there is an expectation that once there is a finding of patent infringement, an exclusion order would almost in all circumstances issue. However, now that the ITC has been seeing an increasing number of lawsuits where patent holders may have made RAND commitments—and I think the ITC is really facing this issue squarely in two current pending investigations—the ITC is now looking to see whether it may be able to use its public interest analysis to take these issues into account.

We at the FTC believe that that is, in fact, the case, that notwithstanding the different statutory scheme that governs what the ITC has been directed to do by Congress, that it still has the discretion to take these issues into account.

Chairman LEAHY. We see a lot of companies going to the ITC rather than courts. Wouldn't it make more sense to go to courts, or the ITC might be a more favorable place?

Ms. RAMIREZ. Let me note that the ITC provides relief that is a bit distinct from what the Federal courts can provide. The Federal courts may provide injunctive relief. They also have the ability to provide damages.

The ITC, on the other hand, cannot award damages, but what it can do is it can issue an exclusion order that basically places a ban on imports. The order would essentially direct U.S. Customs to at the border stop infringing products that are coming into the country. So in certain circumstances, it can provide more effective relief than an injunction.

Chairman LEAHY. I understand that, but also under their statute that set them up, they are supposed to consult with both your departments on these. Do they consult with you?

Ms. RAMIREZ. I think that the ITC does consult with other Federal agencies from time to time. We at the Federal Trade Commission have only rarely weighed in, but we did weigh in recently in these recent investigations that are pending before the ITC because we did consider this to be an important issue, one that we believe is of first impression for the ITC, and we did submit a statement conveying our concerns and conveying our view that they do, in fact, have authority to address this under the public interest analysis.

Chairman LEAHY. And, Mr. Wayland, are they consulting with you, with DOJ?

Mr. WAYLAND. Mr. Chairman, they have invited comment through their process from agencies and the public generally, and there are a number of opportunities for the Department and agencies of the Government to be involved in the process along the way, yes. We are particularly concerned, Mr. Chairman, to get back to your question to Commissioner Ramirez, about the use of the ITC. We are particularly concerned that holders of F/RAND-encumbered patents would seek relief at the ITC because the relief there, as you have noted, is exclusionary, and the premise of a F/RAND commitment is that you will license your product, and the issue is at what price, not whether you will license.

Chairman LEAHY. And if I might, one more question, and I will put the rest of my questions in the record. But in 2011, the FTC requested comments. You published a report on the evolving IP marketplace aligning patent notice and remedies with competition. It referred to those companies that acquire a lot of patent portfolios. Their business model seems to be focused on purchasing and then asserting patents in litigation, not doing any inventing themselves but just having the patents available for litigation.

Now, when we passed the Leahy-Smith America Invents Act, we tried to reduce inefficiencies in our patent systems. We did address, to the extent we could, the question of patent trolls. But I still hear from companies in Vermont—and I think other Senators do from companies in their States—that are forced to spend an awful lot of money defending themselves in litigation.

Can we do more to stop the harassing of companies by people who just bought up the patents just for the sake of litigation?

Ms. RAMIREZ. I will refer to those companies as “patent assertion entities.” That is how we refer to them in our report. In our report, the FTC made various recommendations about ways that the rules in the patent system can be applied in a way that would reduce the problem of hold-up that does tend to incentivize the assertion of patents. And, in particular, let me highlight a couple of those issues with regard to remedies, which is the subject that we are talking about today.

One of the recommendations that we make is that it is very important for courts, when settling disputes, in awarding damages, to ensure that the compensation ends up properly aligning the reward for a patent right with the actual contribution that the IP technology makes rather than allowing for perhaps more compensation than the actual contribution—economic value of the IP technology. So, in other words, if a patent holder is seeking compensation for a very small component in a multicomponent product, you have to take that into account when you are establishing damages. And for some of the reasons that we see there being so much litigation, it seems to be that patent damages are outsized and larger than would be necessary to properly compensate for IP technology. So the idea would be that if you properly align the reward with the contribution that is being made, that is likely to reduce the incentives for parties to end up litigating in court.

Chairman LEAHY. Well, both my staff and I will followup with some other questions on this area. And whether they are called "patent trolls" or whatever they are, you understand the problem I am concerned about. An inventor, somebody who has worked hard, should be compensated for what they did. Somebody who simply buys up patents hoping to make money by litigation, I do not have a huge amount of sympathy for.

Senator Grassley.

Senator GRASSLEY. My questions will be directed to both of you, and I do not care who answers first.

The first issue I want to bring up, it is my understanding that our approach in this country to standard setting works in the vast majority of the cases. So two questions associated with that premise, and if that premise is wrong, do not be afraid to tell me.

Are we talking about a somewhat confined number of cases rather than a widespread problem with the current voluntary and consensus approach to standard setting? And if you believe that the patent hold-up problem is pervasive, what evidence do you have to support it?

Mr. WAYLAND. Mr. Grassley, I will begin the answer. I think our concern is not so much the volume of matters but the type of matters that are involved. So we are talking about transactions involving products that affect the lives of millions of consumers and involve billions of dollars of potential damages. That is somewhat new in the sense that, you know, blocking a particular cell phone application could cause consumer harm across millions and millions of people. So it is the type of the practice that we are concerned about as much as the volume.

Ms. RAMIREZ. Let me just say that I think there is considerable debate about how extensive this problem may be, but the fact of the matter is that we have seen an increased amount of patent litigation, and a number of companies have come to us at the FTC to say that patent hold-up is a concern. We have been very active in this area and have conducted research, and to the extent that we see it in the marketplace, we have offered recommendations that we believe can be used to alleviate the problem of patent hold-up.

Senator GRASSLEY. And then on a second question, is it the position of your agencies that the exclusionary orders should always be prohibited in standard-essential patent disputes where the standard-essential patent holder has committed to license on RAND terms? And let me phrase it another way. In other words, is it your opinion that there should be a blanket, one-size-fits-all, no-injunction, no-exclusionary-order rule for standard-essential and RAND-obligated patents?

Mr. WAYLAND. That is not the position of the Department of Justice. The general principles certainly should apply that in most circumstances the holders of F/RAND-encumbered patents should be able to negotiate or have a court determine the appropriate royalty. But there may be circumstances where a licensee or someone using a technology refuses to participate in a reasonable negotiation or may not be subject to the jurisdiction of the U.S. courts.

Ms. RAMIREZ. The majority of us at the FTC take a similar position. We think that there may be circumstances when an exclusion order may be appropriate. However, we think that most often when there is a RAND-encumbered standard-essential patent, the most likely outcome ought to be that an exclusion order does not issue, but it would depend on the particular facts of a case.

Senator GRASSLEY. We had a little bit of discussion between you and the Chairman on the International Trade Commission. I want to go back to that. A couple questions.

How much formal consultation goes on between your agencies and the International Trade Commission during the public interest analysis of a Section 337 case? And is the International Trade Commission taking your input serious in its decisionmaking process?

Ms. RAMIREZ. As Mr. Wayland noted, the ITC on a routine basis will invite public comment. As a formal matter, the FTC has not weighed in all that often. However, when it is appropriate—and recently we did feel that it was appropriate for us to weigh in on these issues—we did submit formal comments to the ITC.

I believe that these will be taken into account. It remains to be seen what the ultimate outcome is in these pending investigations. We intend to be following closely what the ITC does. However, as I mentioned earlier, the ITC did issue a Notice of Review in the Apple-Motorola case where it indicated that it is certainly taking these issues into account because it had very specific questions that were directed at these issues and these concerns that all of you have raised. So I am glad to see that the ITC is taking these issues very seriously.

Senator GRASSLEY. Before you answer, Mr. Wayland, additionally can the process be improved in any way?

Ms. RAMIREZ. I think the process does allow for consultation, and we are happy to consult with the ITC. In connection with our IP report, we did also consult with them. So we work very collaboratively with other Federal agencies, and I think the existing process does allow for that.

Senator GRASSLEY. Mr. Wayland.

Mr. WAYLAND. Similarly to the FTC, Mr. Grassley, the Department of Justice does not typically submit comments directly to the ITC in the process, but we do monitor the process, and we consider whether it is appropriate at any particular time to submit our views. And with respect to the standard-essential patent cases now before the ITC, our views are publicly known. We have issued a closing statement with respect to the acquisitions of patent portfolios recently that make clear our concerns about SEPs.

In addition, we recognize and appreciate the ITC's list of questions that they have raised which mirror the concerns that the FTC and we have raised previously.

Senator GRASSLEY. Thank you.

Thank you, Mr. Chairman.

Chairman LEAHY. Thank you.

Senator Coons.

Senator COONS. I want to thank Chairman Leahy and Ranking Member Grassley for convening this hearing on this important, somewhat complex issue around intellectual property rights enforcement and how we can best strike a good balance.

Mr. Wayland, I appreciated the interplay in your prepared remarks, your prepared statement today, recognizing the historic importance of protecting intellectual property rights but the tension with the procompetitive slant of our antitrust laws, but also the benefits of standard setting and how those three can interplay in a way that in rapidly emerging technologies can have dramatic benefits for consumers and for American innovation and competitiveness.

Commissioner Ramirez, thank you also for your prepared comments. I am sorry I was at a meeting with the new President of the World Bank, and so I am joining this hearing a little late.

If I might, first to Commissioner Ramirez, after experiencing issues with nondisclosure, including in the Rambus case, standard-setting organizations have adapted by strengthening disclosure requirements. What work is being done at the SSO level with respect to requiring a no-injunctions promise of some kind as part of participation in emerging standards?

Ms. RAMIREZ. Thank you for your question. I think it is an important one to be asking. Let me just note that there are thousands of SSOs, and we do monitor what is happening, and, in fact, both the Department of Justice and the FTC do act as observers in one particular SSO. However, they are private organizations, and I know that a number of them just have a wide range of different policies.

So we are keeping an eye on this. I know that this issue has garnered much recent attention, and I know that they are looking into this question. I believe that companies have gone to ETSI, which is a European standard-setting organization, to pose the question about whether or not making a RAND commitment will still enable a patent holder to obtain an injunction. So it is an issue that I know is being discussed at great length.

Senator COONS. Do you have any input on whether it would help advance competitiveness, innovation, and open market were there to be some increased frequency with which there was not just full disclosure but also some requirement of a no-injunction commitment or participating standard?

Ms. RAMIREZ. I think what we focus on is we urge them to have rules that are clear, but we have not taken any formal position about what particular policies should be adopted by SSOs.

Senator COONS. Does the FTC have any reaction to Judge Posner's recent advice to district courts to calculate RAND royalties on the basis of the value of the patent prior to being adopted as a component or critical piece of a standard? And does that view align with the position taken by the FTC in your 2011 report?

Ms. RAMIREZ. Yes, we were actually very pleased to see Judge Posner's view on this issue because it is very much in line with the position that we took in our 2011 report, meaning that the RAND value should be the value that would be negotiated prior to the adoption of any particular standard so that you could really arrive at what the true economic value of the technology is.

Senator COONS. Thank you.

Mr. Wayland, we are, of course, discussing things that, as Commissioner Ramirez pointed out, are global in scope, these technology advances, the standard-setting organizations are not just U.S.-specific, and in my view, Chairman Leahy and this Committee and the Senate made a significant step forward in aligning our patent system with the world by adopting a first-to-file system.

Could you comment on any steps being taken by other countries to address the issue of injunctions for SEPs? And what work is the FTC and the DOJ doing to help the world come to some common standard that strikes you as appropriate in terms of achieving both pro-consumer competitive opportunities but also appropriately respecting intellectual property rights?

Mr. WAYLAND. One of the priorities of this administration's antitrust policy, Senator, has been to increase international cooperation among antitrust authorities, and particularly with respect to standard-essential patents and intellectual property issues, we have worked closely, particularly with the European Commission, on specific matters and on general policy principles.

In the recent review of the acquisition of patent portfolios, which we issued a public statement on, at the end of the statement we noted that our work came only after close consultation with the European Commission and other antitrust authorities. There is a shared concern among antitrust authorities about these issues, a shared concern that we provide consistent guidance to companies operating in this area. So I think there has been a substantial amount of work, and we are actively involved in seeking international cooperation on this issue.

Senator COONS. That is encouraging.

Could you clarify, Mr. Wayland, whether the Department takes the view that there are unique harms in seeking injunctions against rival technologies where a patent holder is seeking advantage not through just licensing fees but through the exclusion of a competitor from an emerging market segment?

Mr. WAYLAND. Yes, Senator, we think there are very important harms that arise. These are harms that we are concerned about in all of our antitrust investigations, that is, increased prices that consumers have to pay and the exclusion of technology that would encourage or increase innovation in particular products.

As I said in my response to Senator Grassley earlier, we are particularly concerned in standard-essential patents in telecommunications, mobile devices, that an exclusion order could affect a wide, wide range of consumers who are buying a cell phone or a tablet. An exclusion of any particular product like an Xbox or an Android-based phone could seriously impact consumers.

Senator COONS. As the father of 13-year-old twin boys who are, without preferring any particular brand, really interested in Xbox imports, I will suggest that the impact of innovation is felt in many homes and at many levels. I will simply put it that way. [Laughter.]

Without asking you to comment on any specific investigation, what circumstances is the Department watching to determine when seeking an injunction on a RAND-encumbered patent would actually violate antitrust laws? Is that something you feel comfortable commenting on?

Mr. WAYLAND. Obviously, Senator, I cannot comment on specific investigations, but we apply our standard analysis in these cases, which we look at market power, what sort of power the holder of the patent or the standard-essential patent might have. We look at the effect on consumers, the potential of harm, and the exclusionary effect of the conduct.

Senator COONS. And last, if I might, would you just comment on how given in your prepared statements you recognize the historic importance of intellectual property rights and their protection, often seeking an injunction is the most effective way to protect intellectual property rights? How do you strike an appropriate balance between respecting and protecting intellectual property rights, sometimes through seeking an injunction, and ensuring pro-consumer competitiveness in the marketplace, a robust and open marketplace where contractual agreements are followed and where we get the best possible quality, service, and products for consumers at the most reasonable price?

Mr. WAYLAND. As a general matter, Senator, we spend a lot of time thinking about that issue, the intersection of intellectual property rights and antitrust and where the right balance is in any particular circumstances.

With respect to standard-essential patents, which we are talking about today, we think the promise made by the holder of the patent to license on F/RAND terms really tips the balance in favor of seriously questioning why an exclusion order would be appropriate in any circumstance. What happens is the holder of the F/RAND-encumbered patent has promised to license the product on fair and reasonable terms and has recognized that money is a proper compensation for the use of the patent by a licensee or other user.

Senator COONS. Did you have any comment then on the question I previously asked to Commissioner Ramirez about Judge Posner's view on what is the appropriate basis on which to assign a royalty given that sometimes these F/RAND standards are silent on exactly what is the appropriate percentage?

Mr. WAYLAND. I think generally we share Commissioner Ramirez's view of Judge Posner's decision, and the appropriate way to calculate the value of the patent on the basis of the underlying technology.

Senator COONS. Does the Department take the position in your view that the ITC should follow the eBay standard? Or do you believe that the ITC public interest consideration already incorporates some of the core elements of an eBay-like standard?

Mr. WAYLAND. We think the public interest factors that the ITC should consider do incorporate the same sorts of concerns that the eBay court recognized.

Senator COONS. Forgive me, I was too interested in the topic. I have gone well over my time, with my apologies to the Senator from Utah.

Thank you very much to the panel.

Chairman LEAHY. Thank you, and I appreciate the Senator from Utah being here, as I noted in my opening statement his strong interest in this.

Senator Lee, delighted to have you here. Take whatever time you need.

Senator LEE. Thank you very much, Mr. Chairman. And I want to thank you, Chairman Leahy and also Ranking Member Grassley, for putting this hearing together. This is, as you know, an issue that has long been of concern to me.

I was wondering whether either of you were of the opinion that an agreement to license an SEP on fair, reasonable, and non-discriminatory terms is itself effectively a commitment to non-exclusivity?

Mr. WAYLAND. As a general matter, yes, that is the whole point. You get the benefit of joining the standard-setting organization which provides a market that you might not otherwise have in return for a commitment to license.

Senator LEE. OK. So if that is the case, if so, doesn't that arguably make an exclusion order inappropriate in this circumstance? In other words, once somebody has agreed to non-exclusivity, is an exclusion order an appropriate remedy?

Mr. WAYLAND. In general, Senator, we agree that it would not be an appropriate remedy, but we do not think it is appropriate to have a blanket rule saying no exclusion ever because there may be circumstances in which an exclusion order is appropriate. As I said earlier, perhaps an entity that is not subject to the jurisdiction of the U.S. courts or that otherwise will not participate in a reasonable F/RAND setting process.

Senator LEE. Right, right. But you would not see a problem with a rule that would say absent such special circumstances, such as those that you have identified, that an exclusion order would be inappropriate?

Mr. WAYLAND. The general concept we would agree with. The devil is in writing the details of any rule, but yes, I think the general principle that exclusion orders would not be appropriate where the parties are trying to reach an agreement on F/RAND terms.

Senator LEE. OK. Would your analysis on that point change at all if an SSO specifically said as part of its SEP agreement framework this does not amount to an agreement of non-exclusivity? Would that change your analysis?

Mr. WAYLAND. I am not sure I understand the question.

Senator LEE. Or that it does not amount to a waiver of any right to seek an exclusion order, that you are not—that no one is agreeing to waive their right to pursue an exclusion order by agreeing to this? Would that change your analysis?

Mr. WAYLAND. It would not change it in the sense that the commitment is the same, the holder of the patent of the technology has agreed to license, and trying to cull back on that agreement with some language I am not sure changes the general principle that we support.

Senator LEE. OK. Commissioner Ramirez, do you have anything to add to or subtract from what he said in response to my questions there?

Ms. RAMIREZ. The position of the FTC would be very similar. Again, we do not think that there ought to be a blanket rule. The majority of us on the Commission do not think that. And, furthermore, we also think that the courts using the eBay test are well positioned to look at the particular facts of a case to decide what is appropriate; and, similarly, that the ITC can do the same under its public interest analysis.

I would say, however, that we do think that in most cases an exclusion order or an injunction would be inappropriate if there is a RAND commitment that has been made in a standard-essential patent.

Senator LEE. OK. And, Commissioner, is there also a risk here that if the ITC does not issue exclusion orders in this context, that could devaluate these kinds of patents? We want to protect the rights of patent holders, obviously. Is there a risk of that if the ITC were to say we are not going to issue exclusion orders in this area?

Ms. RAMIREZ. I agree with you that it is important to protect the rights of patent holders, but, again, one has to strike the appropriate balance, balancing that against competition. I do not believe that, if the ITC were to elect not to issue an exclusion order, that would denigrate the value of the patent because the patent holder would still have a remedy in the district court to obtain damages.

Senator LEE. So there would be no downside to doing that?

Ms. RAMIREZ. Well, unless you have a situation where perhaps the district court did not have jurisdiction over a foreign defendant, for instance, and then maybe the ITC would be the only one who would have jurisdiction over the imported goods. That is a situation that Mr. Wayland discussed. So, again, it would depend on the particulars of a case, but generally speaking, there would be a remedy available in the Federal courts.

Senator LEE. OK. So let us assume for purposes of discussion here, assume arguendo that we are dealing with a circumstance in which the value of the patent could be diminished by virtue of the non-availability of an exclusion order. Could that risk of devaluing the patent be mitigated by a rule that would say such exclusion orders might be available only where an SEP holder has somehow violated its F/RAND commitments?

Ms. RAMIREZ. I agree that would be a factor to take into account. Again, I guess I would take issue with this notion that the patent would be devalued. The situation that we are discussing is one where the patent holder has voluntarily made——

Senator LEE. It is hard to endorse the hypothetical.

Ms. RAMIREZ [continuing]. The RAND commitment. So just keeping that in mind, once you make a RAND commitment, you are saying that there is a commitment to license on RAND terms. And I do believe that the position that the FTC is articulating and the one that the Department of Justice is articulating attempts to strike the right balance by saying do not say never. There may be circumstances where it would be appropriate to issue an exclusion order, if, you know, there is a potential licensee that is acting in bad faith, for instance, or where there may not be a remedy in district court. So I think the general principle that we are taking strikes the right balance between the rights of a patent holder and competition.

Senator LEE. But it is certainly going to be difficult or maybe even impossible to conclude that those circumstances might exist, that is, circumstances where it might be appropriate for an exclusion order to issue where you can determine that the SEP holder has violated the SEP holder's F/RAND commitments.

Ms. RAMIREZ. I guess I am not sure that I understand why you think it would be impossible to make the determination. I think courts would be well positioned, I mean, they make decisions about disputes every single day. So I believe that they would be well positioned to assess the facts of a particular case and take into account any licensing commitment that has been made during the standard-setting process.

Senator LEE. Right.

Ms. RAMIREZ. So I understand the concern. However, I do feel that courts can take this into account and can make an appropriate decision. For instance, Judge Posner did that in his analysis in that Apple case in Illinois.

Senator LEE. And I certainly was not trying to suggest that a court could not do that. I was just trying to drill down on the question. If, in other words, there were a rule in place that said an exclusion order is not appropriate where you have got an SEP holder that has not honored the SEP holder's F/RAND commitments, whether that would be a manageable standard that you think would work.

Ms. RAMIREZ. I think the standard that would work is the one that we are advocating, which is not to have a bright-line rule but, rather, to say these are things that you ought to take into account and, you know, generally speaking, I think it would be in most cases that it would be inappropriate to issue injunctive relief. But, again, there might be circumstances where that is not the case.

Senator LEE. OK. Mr. Chairman, I know my time has expired. Have I got time for one more question?

Chairman LEAHY. Of course.

Senator LEE. OK. Mr. Wayland, I read a letter that was issued in February 2012. It is a letter closing an investigation into Google's acquisition of Motorola's patent portfolio. And in that same letter, this February 2012 letter, the Antitrust Division stated that it "will not hesitate to take appropriate enforcement action to stop any anticompetitive use of SEP rights."

Can you give us some sense as to what circumstances might warrant such enforcement action and, perhaps more importantly, what the Division might consider an appropriate type of an enforcement action?

Mr. WAYLAND. Senator, we look at the facts and circumstances of transactions and activities by SEP holders to determine whether there is a violation of any antitrust laws. We are particularly concerned about efforts that attempt to exclude competitors from entering markets, and to that extent, we are looking at a number of transactions. I cannot comment on the specifics of ongoing investigations, but we are serious about looking at how SEP holders are using the power that they have.

One of the critical factors, Senator, is our examination of the market power that might be attributed to any particular holder of SEP patents.

Senator LEE. OK. Thank you very much. Thank you both for your testimony.

Thank you, Mr. Chairman.

Chairman LEAHY. Thank you, and we will put a statement in the record from Senator Durbin.

[The prepared statement of Senator Durbin appears as a submission for the record.]

Chairman LEAHY. I will also leave the record open until close of business for any other questions to be submitted for the record, and I appreciate both of you being here. I do have several questions for the record that we will give you, and my staff will followup with you on that.

[The questions of Chairman Leahy appears under Questions and Answers.

Chairman LEAHY. Thank you for taking the time. It is amazing the amount of interest I have in this subject from my State, but certainly from other States, too. Thank you.

Mr. WAYLAND. Thank you, Mr. Chairman.

Ms. RAMIREZ. Thank you.

[Whereupon, at 10:39 a.m., the Committee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

Responses to Questions for the Record to Commissioner Ramirez
July 11, 2012 "Oversight of the Impact on Competition of Exclusion Orders to Enforce Standard-Essential Patents" Hearing

Responses to Questions for the Record from Chairman Patrick Leahy

1. **The Department of Justice and Federal Trade Commission have both expressed concern about the potential anti-competitive effects that may result when a patent holder that has committed to license its standard-essential patents (SEPs) on reasonable and non-discriminatory (RAND) terms seeks an exclusion order at the ITC, instead of disputing the reasonable terms of the license in court. What is the significance of the RAND commitment in the context of SEPs?**

   A: A RAND commitment is significant because it reflects a commitment by a patent holder to license its intellectual property on RAND terms, which would include a duty to negotiate in good faith. In the standard setting context, prior to the adoption of a standard, alternative technologies compete to be included in the standard on the basis of features, quality, or price. Often there are a number of technologies with similar attributes available for inclusion in the standard; and, while it may be possible for standard setting organization (SSO) members to negotiate licenses for SEPs before a standard is adopted, this is not a realistic option for many firms. These negotiations may take a significant amount of time, and the people who build the technical standard are often not the same people who negotiate licenses.[1] Instead, SSO members more often delay this decision and require that the owner of the technology agree to license SEPs on RAND terms as a *quid pro quo* for the inclusion of their patents in a standard. RAND commitments are thus designed to mitigate the risk that a patent holder will exploit market power it acquires when its technology is embedded in a standard by providing assurances that if an implementer needs a license to the SEP at a later date, a license will be available on reasonable and non-discriminatory terms.

2. **If the ITC were to find that issuing a traditional exclusion order would have a harmful effect on competitive conditions in the U.S. economy or harm American consumers, in your view are there other potential actions that the ITC could consider consistent with its statutory obligations?**

   A: Yes, I believe the ITC has a range of remedies available to it to give effect to its statutory obligation to consider "competitive conditions in the United States economy . . . and United States consumers[,]"[2] and to refrain from imposing Section 337 remedies in conflict with the public interest. For example, the ITC could find that Section 337's public interest factors support denial of an exclusion order if the holder of the RAND-encumbered SEP has not complied with its RAND obligations, which would include a duty to negotiate with potential licensees in good faith. Alternatively, the ITC could delay the effective date of its

[1] *See* Doug Lichtman, *Understanding the RAND Commitment*, 47 Houston L.R. 1023, 1028 (2010) ("Standard-setting is a process run by engineers, not lawyers. . . . The RAND commitment thus simplifies the conversation, allowing the engineers alone to run the show until the technical details are fully selected and documented.").

[2] 19 U.S.C. §§ 1337(d)(1), (f)(1).

Section 337 remedies until the parties mediate in good faith for damages for past infringement and/or an ongoing royalty for future licensed use, with the parties facing the respective risks that the exclusion order would (i) eventually go into effect if the implementer refuses a reasonable offer or (ii) be vacated if the ITC finds that the patent holder has refused to accept a reasonable offer.

3. **Some suggest that, given the potential for anticompetitive abuse, the authority of the ITC to issue exclusion orders should be limited in cases involving SEPs that holders have committed to license on RAND terms. Even if a blanket rule is not appropriate, are there steps that should be taken to clarify when it is appropriate for the ITC to issue an exclusion order in a case involving an SEP?**

   A: I think that Section 337 gives the ITC sufficient flexibility to consider how an exclusion order can cause hold-up, raise prices, and decrease innovation as the basis for denial of an exclusion order. ITC investigations are highly fact specific, and I believe the ITC is well positioned to consider these economic issues as part of its public interest analysis.

4. **Could the concerns you have described about the potential anti-competitive effects of exclusion orders in the context of SEPs also arise in non-SEP cases where a patent holder seeks an exclusion order to enforce a patent that it has previously committed to license on RAND terms?**

   A: Yes. There may be other situations where a patent owner acquires bargaining power based solely on an implementer's investments in complementary technologies, even where a technology standard is not at issue. For example, the threat of injunctive relief for infringement of a patent covering a minor technology embedded in a complex multicomponent product can give the patent owner undeserved leverage in licensing negotiations. Hold-up outside of the standard setting context also raises risks for competition, innovation, and consumers. While seeking injunctive relief in the face of a RAND promise to an SSO raises particularly strong risks to competition and innovation, the Commission is concerned about all situations where the threat of an injunction permits an infringer to exploit market power based on the complementary investments of others.

5. **I have worked hard to ensure that our patent and antitrust laws are strong and provide for companies and individual inventors to feel secure in their investments. Where patent laws grant limited monopolies, the antitrust laws work to prevent monopolistic behavior. One of the ways that the Leahy-Smith America Invents Act modernized our country's patent system was to deter patent trolls. Unfortunately, we continue to see patent troll activity in Vermont, which deters investment and innovation. Do you see a way to further discourage patent trolls through the competition laws? Put another way: Because patent trolls often function by seeking to extend their monopoly rights beyond the limited contours of the patent, is it possible that a patent troll's use of frivolous lawsuits to extend its monopoly violates the antitrust laws?**

   A: The increased litigation activity of what we call "patent assertion entities" (PAEs) raises a number of difficult questions. Because the PAE business model has the potential to exacerbate the risks associated with patent hold-up, I share your concern. But while certain conduct by PAEs may implicate the antitrust laws, the solutions to the problem of patent hold-up need to go beyond antitrust. For example, in our 2011 Report, "The Evolving IP Marketplace,"[3] the Commission proposed a number of flexible reforms to the patent rules, and the way they are applied, that are aimed at reducing the incentives for PAEs, and all marketplace participants, to engage in patent hold-up. These include, among others, the recommendation that courts should ensure that damage awards reward the economic contribution of the technology at issue and not its hold-up value. We appreciate your leadership in the area of patent reform and would be pleased to work with you to explore these and other possible solutions to your concerns.

__Responses to Questions for the Record from Ranking Member Charles E. Grassley__

1. **In your opinion, does the International Trade Commission have sufficient statutory authority to stay the imposition of an exclusion order contingent on an infringing party's commitment to abide by an arbitrator's determination of the fair value of a license? If it does, do you believe that the International Trade Commission is using that authority appropriately?**

   A: Yes, I believe the ITC has the authority to stay for a certain period of time the imposition of an exclusion order contingent on an infringing party's commitment to abide by an arbitrator's determination of the RAND value of a license. I see this as inherent in the ITC's authority to withhold an injunction order that would be contrary to the public interest. I note also that the ITC has previously exercised discretion in staying the imposition of exclusion orders based on competitive conditions in the United States, such as when it delayed the effective date of an exclusion order for four months after finding that HTC had infringed valid Apple patents.[4] The circumstances in the example you cite are different, but the core principle is that the ITC has the authority to stay its exclusion orders.

2. **Some are concerned that a broad denial of remedies in disputes involving standard-essential patents in Section 337 proceedings would produce adverse and unintended consequences. Do you agree? For example, some are concerned that a no-injunction, no-exclusion order policy would result in giving a potential licensee little incentive to bargain in good faith, because by litigating the case it can avoid payment of royalties until the litigation is over, if not longer. Do you agree with these concerns? Why or why not?**

   A: As noted in its prepared testimony, the Commission does not advocate a blanket "no-injunction/no-exclusion order" rule. Rather, a majority of my fellow Commissioners and I are of the view that the ITC should take RAND commitments made by patent owners into account when deciding whether an exclusion order is in the public interest. We think federal district courts should do the same under the *eBay* test when determining whether to award patent holders an injunction. I believe our position strikes an appropriate balance between

[3] *See generally* Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition*, available at http://www.ftc.gov/os/2011/03/110307patentreport.pdf.

[4] *Certain Personal Data and Mobile Communications Devices and Related Software*, Notice of the Comm'n's Final Determination Finding a Violation of Section 337 at 3 (Dec. 2011).

the strong public interest in enforcing IP rights on one hand and the equally strong public interest in promoting competition on the other.

3. **I'm also told that patent holders would be less likely to participate in the standard-setting process if, by doing so, they are forced to give up certain legal remedies for their patents. Do you agree?**

A: I am not convinced that this would happen to any appreciable degree. Let me first note that a patent holder makes a RAND commitment voluntarily, and it does so in exchange for having its technology included in a standard. As a general matter, I think it is important that patent holders who make such commitments abide by them. It is possible that some patent holders could decide to stay out of SSOs and thereby avoid having to give a RAND commitment that could limit their right to injunctive (or exclusion order) relief. But we have little basis for determining whether this will occur frequently or whether standard-setting will be harmed. SSO participation yields considerable benefits to patent holders – not the least of which is the ability to effectively sponsor a firm's own technology – and it is by no means clear that withdrawals will be frequent. While critics argue that if withdrawals do occur, standard-setting activities will be undermined, standard setting efforts may well be threatened if RAND protections covering SEPs are breached.

4. **Do you believe that standard-setting organizations should be able to write their own IPR policies and, with their members, decide to include or exclude RAND commitments, as well as waive or not waive injunctive relief? Do you agree that the government should not be directing these activities, and rather the market will help determine what policies a standard-setting organization will adopt?**

A: I do believe that SSOs should be able to write their own IPR policies. SSOs deal with diverse technologies and serve a variety of businesses with a broad range of business models. One size of IPR policy will not necessarily fit all, and SSOs should be able to tailor their policies to their particular needs.

That said, it is not necessarily in the interest of SSO members to protect consumers from the effects of patent hold-up. To the extent that SSO members covering an entire industry all incur high royalties associated with hold-up and simply pass them on to their customers, SSO members will lack full incentives to guard against hold-up. If private protections are continually left vague and incomplete, government may have a role.

5. **How do you ensure that your enforcement activities with respect to standard-essential patents do not end up as price setting? How do you avoid using your enforcement authority to favor one business model over another, or avoid picking winners and losers among standards?**

A: Commission law enforcement actions thus far have been limited to instances where a patent holder has allegedly engaged in deceptive conduct or has reneged on a prior commitment in order to foster an opportunity for hold-up. Actions of this nature do not favor any particular non-deceptive business model or pick winners or losers among standards. Relief following a finding of a violation in these circumstances is designed to restore the competition that otherwise would have prevailed or honor a pricing commitment that was previously made. Similarly, advocacy or enforcement activity linked to violation of a RAND commitment would be grounded in the bedrock of what the patent holder has already agreed to do.

6. **Exclusion orders are especially important to U.S. innovators whose standard-essential patents are being infringed by foreign manufacturers with no legally sufficient presence in the U.S. to warrant federal court jurisdiction. Isn't it appropriate for standard-essential patent holders to be able to seek exclusionary relief against foreign infringers? Wouldn't we just be weakening important trade enforcement remedies if we completely took away the ability of U.S. companies to seek such relief at the International Trade Commission?**

   A: As I stated at the hearing, while I believe that injunctive relief in most cases should be unavailable for infringement of a SEP covered by a RAND commitment, neither I nor the majority of my fellow FTC Commissioners believes that there should be a blanket rule that applies in all cases. One likely exception would cover foreign manufacturers with an insufficient presence in the United States to support federal court jurisdiction. In that instance, a foreign infringer could not be pursued for damages in a U.S. district court, and an ITC exclusionary order might be warranted.

   I do note, however, that recent controversies involving ITC exclusion orders and RAND-encumbered SEPs have involved respondents with substantial business ties to the United States. If a respondent is subject to the jurisdiction of U.S. courts, then a patent holder has recourse beyond an ITC exclusion order. More broadly, I do not believe that denying an exclusion order when the holder of a RAND-encumbered SEP has not complied with its RAND obligations weakens trade-enforcement remedies. Those remedies are already designed to protect the public interest, and consideration of the harm that could flow from hold-up should be an important element of that analysis.

7. **What are the possible consequences of Congress requiring the International Trade Commission to consider the traditional four-factor equitable test for injunctive relief in deciding whether to grant an exclusion order for a patent law-based Section 337 violation? Is there any reason why the International Trade Commission should not be subject to the same standard for injunctive relief as the federal courts that was articulated in the U.S. Supreme Court's *eBay v. MercExchange* opinion?**

   A: The Commission has not taken the position that the *eBay* test as such ought to be imported into the ITC's public interest analysis. In *Spansion v. ITC*, 629 F.3d 1331 (Fed. Cir. 2010), the Federal Circuit noted that the statutory underpinnings for relief in Section 337 actions are different from those in federal district court suits for patent infringement, and, for that reason, held that *eBay* does not apply to ITC remedy determinations. I do not disagree with the Federal Circuit's holding. Rather, I believe that the ITC currently has the authority and obligation to take RAND commitments, and patent hold-up concerns more generally, into account as part of its public interest analysis, specifically in its consideration of the impact of an exclusion order on the competitive conditions in the U.S. economy and on U.S. consumers.

Responses to Questions for the Record from Senator John Cornyn

1. **Does the Department of Justice (DOJ) or Federal Trade Commission (FTC) support changes to the International Trade Commission's 337 process, where standard-essential patents (SEPs) are concerned? Why or why not? If DOJ or FTC supports changes, what are they?**

   A: The Commission believes that the ITC, under its current Section 337 authority, has the ability to consider the potential harm to competition associated with exclusion orders for infringement of standard essential patents. Specifically, Section 337 allows the ITC to consider "competitive conditions in the United States economy" and "United States consumers" in deciding whether to grant an exclusion order. In our view, this allows the ITC to weigh whether an exclusion order is likely to harm competition by allowing a patent holder to evade its RAND commitment and exploit market power earned solely through the standard setting process. However, if the ITC determines that its public interest authority is not flexible enough to allow this analysis, then Congress should consider amending Section 337 to give the ITC the flexibility to take these important competitive issues into account.

2. **Some take the position that making ITC exclusion orders unavailable to SEP holders that make "RAND" commitments would leave them open to infringement by foreign manufacturers outside the jurisdiction of U.S. district courts. Are you aware of instances of that occurring? If so, please detail them.**

   A: As the Commission stated in its prepared testimony, we believe that injunctive relief in most cases should be unavailable for infringement of a SEP covered by a RAND commitment. However, a majority of my fellow Commissioners and I do not take the position that there should be a blanket rule denying exclusion orders in all cases involving SEPs. One likely exception would cover foreign manufacturers with an insufficient presence in the United States to support federal court jurisdiction. In that instance, a foreign infringer could not be pursued for damages in a U.S. district court, and an ITC exclusionary order might be warranted.

   But I do note that recent controversies involving ITC exclusion orders and RAND-encumbered SEPs have involved respondents with substantial business ties to the United States. If a respondent is subject to the jurisdiction of U.S. courts, then a patent holder has recourse beyond an ITC exclusion order. More generally, I do not believe that denying an exclusion order when the holder of a RAND-encumbered SEP has not complied with its RAND obligations weakens trade-enforcement remedies. Those remedies are already designed to protect the public interest, and consideration of the harm that could flow from hold-up should be an important element of that analysis.

3. **The Wall Street Journal reported recently on the spread so-called "patent troll" litigation tactics, including licensing of patents by technology companies for the**

apparent purpose of litigation. Does the FTC or DOJ view this as a problem? Why or why not?

A: The Commission is continuing to study the activities of what we call patent assertion entities, or "PAEs." Because the PAE business model has the potential to exacerbate the risks associated with patent hold-up, we are concerned about reports of increased litigation by PAEs. In our 2011 Report, "The Evolving IP Marketplace,"[5] the Commission proposed a number of reforms to the patent rules, and the way they are applied, that are aimed at reducing the incentives for PAEs, and all marketplace participants, to engage in patent hold-up. Among the recommendations we made is that, in awarding damages in patent infringement actions, courts should ensure that damages reward the economic contribution of the technology that is at issue and not its hold-up value.

4. **In its 2011 report, "The Evolving IP Marketplace," the FTC suggests that the ITC interpret its "domestic industry" standing requirement to exclude "ex post" licensing activity directed primarily at extracting rents. To the best of your knowledge, has the ITC taken this recommendation into account?**

A: The ITC appears to be grappling with the application of its domestic injury requirement to pure licensing activities. It is my understanding that the ITC has suggested on two separate occasions in the last two years that two types of licensing activities might "exploit" a patent sufficiently to support a finding of domestic industry: (1) licensing activities that encourage technology transfer; and (2) licensing activities that are solely revenue-driven.[6] More recently, however, the ITC explained that, "[a]lthough [Section 337] requires us to consider all 'licensing' activities [for purposes of the domestic industry requirement], we give [complainant's] revenue-driven licensing activities less weight."[7]

Our 2011 Report recommended that the ITC should consider whether only those licensing activities that make productive use of the patent, such as those that promote technology transfer, should be deemed to satisfy the domestic industry requirement. By revisiting the scope of the domestic industry requirement, the ITC may lessen the risk that an ITC exclusion order could generate hold-up by a patent assertion entity whose activities are directed solely towards extracting rents. I am pleased to see that the ITC appears to be looking closely at this issue.

5. **In its 2011 report, the FTC states that the ITC could utilize the public interest factor to incorporate concerns about patent hold-up. As the report notes, as of publication the ITC had only employed that factor to bar an injunction on three occasions. Since the report, has the ITC taken the FTC's suggestion into account; and how?**

[5] *See generally* Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition*, available at http://www.ftc.gov/os/2011/03/110307patentreport.pdf.

[6] *See Certain Video Game Systems and Controllers*, 337-TA-743, Comm'n Op. at 9 (Apr. 14, 2011); *Certain Coaxial Cable Connectors*, Inv. No. 337-TA-650, Comm'n Op. at 49-50 (Apr. 14, 2010).

[7] *Certain Multimedia Display and Navigation Devices and Systems*, Inv. No. 337-TA-694, Comm'n Op. at 25 (July 22, 2011).

A: Yes. The ITC has recently confirmed that it is examining concerns about patent hold-up in the context of RAND-encumbered SEPs as part of its public interest analysis. In late June, the ITC issued a Notice of Review in an investigation involving Apple products in which it sought briefing from the parties on eight RAND-related topics, including whether: (1) "the mere existence of a RAND obligation preclude[s] issuance of an exclusion order[;]" (2) a patent owner that has refused to offer or negotiate a license on RAND terms should be able to obtain an exclusion order; and (3) a patent owner should be able to obtain an exclusion order if it has offered a RAND license, and that license has been rejected by the alleged infringer.[8] It therefore appears that the ITC is looking carefully at these important issues.

<u>Responses to Questions for the Record from Senator Amy Klobuchar</u>

1. ***Role of Agencies* – How can the Justice Department and FTC use tools already at their disposal to help ensure that standard-essential patents are treated appropriately in order to balance the objectives of protecting patent holders, promoting innovation and providing the best products and services to consumers?**

   A: Particularly in the information technology sector, standards are critical to ensuring interoperability between products and technologies, which spurs both competition and innovation. But, as we have seen over the years, the standard setting process can be manipulated in various anticompetitive ways. We are continuing to monitor developments in the standard setting area to protect against harm to competition and the competitive process. For example, the Commission has over 15 years of experience challenging abuses in the standard setting arena. The Commission has also devoted significant policy resources to understanding how to maximize the procompetitive benefits of standards while mitigating the anticompetitive potential for hold-up. The Commission will continue to rely on its enforcement and policy expertise to ensure that standard setting serves the interests of consumers.

2. ***Negotiating RAND Terms* – Questions have been raised as to whether or not bilateral negotiations to arrive at RAND terms and conditions are the most effective way to manage standard-essential patents.**

   What is your view on this issue? In your opinion, are there alternative approaches that could work to ensure both access to these patented technologies and fair compensation to the patent holders?

   A: RAND commitments are designed to mitigate the risk of patent hold-up and encourage investment in standardized technology.[9] After a RAND commitment is made, the patent

[8] *In re Certain Wireless Communication Devices*, Inv. No. 337-TA-745, Notice of Commission Decision to Review in Part a Final Initial Determination Finding a Violation of Section 337 at 4-5 (June 2012).

[9] See U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Enforcement and Intellectual Property Rights Promoting Innovation and Competition* at 46-47, available at http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf.

holder and the company that wants to implement the technology will typically negotiate a royalty, or, in the event they are unable to agree, they may seek judicial determination of a reasonable rate. But, as your question recognizes, even though RAND commitments are intended to reduce hold-up, they can sometimes be manipulated in various ways that may lead to inefficiencies or the lessening of competition.

The Commission is examining policies that would ensure access to standardized technologies and fair compensation to patent holders. For example, in our 2011 Report, "The Evolving IP Marketplace," [10] the Commission recommended flexible reforms to the patent system aimed at reducing the incentives for firms to engage in patent hold-up, including in the standard setting context. The Commission's June 2011 workshop, "IP Rights in Standard Setting: Tools to Prevent Patent 'Hold-up,'" addressed licensing strategies following the implementation of a standard, including the significance of commitments to license patents on RAND terms.

While there are no easy answers to the questions you raise, the Commission is committed to continuing to maximize the procompetitive benefits of standard setting and standardized technology, and we look forward to continued dialogue on this issue.

<u>Responses to Questions for the Record from Senator Michael S. Lee</u>

1. **Your testimony suggests that your agency has concerns about the availability of ITC exclusion orders for standard essential patent ("SEP") holders who make and subsequently violate a commitment to license their SEP on reasonable and non-discriminatory (RAND) terms. Would legislative reform of 19 U.S.C. § 1337 limiting or eliminating the ITC's authority to grant an exclusion order of an SEP-infringing product when the SEP holder has violated its RAND commitment properly enforce this principle? Under what circumstances, if any, might such statutory language be inappropriate?**

   A: Yes, the Commission is concerned that a patentee might make a RAND commitment as part of the standard setting process and then escape that obligation by seeking an exclusion order for infringement of the RAND-encumbered SEP. But we do not believe legislative reform of the ITC's statutory scheme is necessary. In our view, the ITC currently has authority under Section 337 to prevent a SEP owner from using the ITC process to avoid its RAND obligations. Section 337 allows the ITC to consider the public interest, and specifically "competitive conditions in the United States economy" and "United States consumers," in deciding whether to grant an exclusion order. This allows the ITC to consider how an exclusion order can lead to patent hold-up and associated harms to competition, innovation, and ultimately consumers. However, if the ITC determines that it cannot take these considerations into account under its public interest authority, then

[10] *See generally* Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition*, available at http://www.ftc.gov/os/2011/03/110307patentreport.pdf.

Congress should consider whether to amend Section 337 to give the ITC more flexible authority.

2. **In your testimony, you said you did not support a bright-line rule that exclusion orders should never be available for an SEP-holder who has violated a RAND commitment. Could you briefly outline a situation where an SEP-holder, in violation of a RAND commitment, would be entitled to an exclusion order without raising competition concerns?**

A: ITC investigations are highly fact-specific, and though likely rare, there may be circumstances where an exclusion order is appropriate in matters involving RAND-encumbered SEPs. For example, an exclusion order may be appropriate where the implementing firm has refused to engage in good faith negotiations with the patentee, or where a foreign infringer is not subject to district court jurisdiction. Barring an exclusion order under those circumstances would impose restrictions on the patentee's exercise of its rights that go beyond the scope of its voluntary RAND commitment.

3. **Some American innovators have expressed that limiting exclusion orders will devalue SEPs by incentivizing licensees to negotiate in bad faith and rely on lengthy federal court litigation to determine a reasonable royalty. These industry members believe that, *ex ante*, this will lower investment in innovation and industry standards. In your testimony you seem to have suggested that you do not think limiting the availability of exclusion orders will devalue SEPs because RAND commitments have already been made. How do you respond to innovators who claim that limiting SEP holders' ability to enforce their patents at the ITC will cause innovators to be less aggressive in developing new technologies that benefit the standard?**

A: Although limiting the availability of exclusion orders for RAND-encumbered SEPs could have some effects at the margin on licensing conduct, I believe many aspects of patent damages law will encourage implementers to seek reasonable licenses in a timely manner. An implementer that fails to negotiate a license faces the very considerable expense of litigation. It also risks paying higher damages after a patent has been determined to be valid and infringed than would have been negotiated while the patent rights remained in dispute, and it may be exposed to claims for an increased damage award for willful infringement. The argument also fails to account for the fact that SSO participation yields considerable benefits to a patent holder, including the ability to effectively promote its own technology for incorporation into the standard. Firms that have their technology embedded in a standard typically face many more licensing opportunities than firms with technologies that are not selected for a standard. Given these benefits, and the fact that the patentee has agreed to monetize its IP through broad licensing, I am not convinced that limiting exclusion orders will deter firms from either innovating or willingly contributing technology to standards.

4. **A variety of patent holders argue that RAND commitments have been over-simplified, and that this commitment traditionally involves reciprocity—meaning that both patent holders and potential licensees agree to negotiate in good faith.**

a. **Is this your understanding of RAND?**

A: Yes. I believe that when negotiating toward RAND royalties, both the potential licensor and the potential licensee have a duty to negotiate in good faith.

b. **What remedies should be available to SEP holders if an infringing product's producer is not negotiating in good faith?**

A: In the event that they are unable to agree, the parties may seek judicial determination of a reasonable royalty rate. In rare circumstances, it may be appropriate to obtain an injunction from a district court or an exclusion order from the ITC. In the case of a district court, *eBay*'s equitable test provides a framework for deciding whether an injunction would be appropriate. I believe the ITC can perform a similar analysis under its public interest authority.

5. **Some American innovators argue that federal district court actions alone are insufficient to address patent infringement claims, because the parties can only litigate a relatively small number of patents in one action and litigation often takes many years to resolve. Patent holders note that, by contrast, the ITC provides relatively quick resolution that brings parties to the negotiating table to work out the terms of broad cross-licensing agreements.**

a. **In your view are the remedies available in federal district court sufficient to incentivize firms to avoid litigation and privately negotiate cross-licensing deals?**

A: It is important to remember that both parties to a lawsuit have an incentive to settle disputes to avoid litigation costs. In my view, the remedies available in federal court and the ITC impact not just the likelihood of settlement, but also the terms. My concern is that where SEPs are at issue, the threat of injunctive relief gives the patentee the leverage to extract royalty terms that reflect market power acquired solely through the standard setting process rather than the economic contribution of the technology. I believe the position the Commission has taken—that both the ITC and district courts should take patent hold-up into account when they are evaluating the propriety of awarding injunctive relief—strikes the right balance between the protection of IP rights and competition.

Responses to Questions for the Record Submitted to
Joseph Wayland, Acting Assistant Attorney General,
Antitrust Division, U.S. Department of Justice
From the July 11, 2012 Hearing
Before the Committee on the Judiciary
United States Senate
Entitled
"Oversight of the Impact on Competition of Exclusion Orders to Enforce Standard-Essential Patents"

Questions from Senator Michael S. Lee

1. Standard-setting organizations ("SSOs") require companies holding potential standard-essential patents to make commitments to license the patents on a reasonable and non-discriminatory basis if they are included in the standard. Your testimony suggested that an exclusion order may be inappropriate in many instances where an SEP holder as made a commitment to license a patent on reasonable and non-discriminatory ("RAND") terms, and that in principle a RAND commitment might be thought of as a commitment to license on a non-exclusive basis. In the past, SSOs have proposed and implemented rules stating that RAND commitments precluded the right to seek exclusion orders, but these proposals and implementations were opposed by SSO members and withdrawn. Suppose that an SSO explicitly states that a commitment to RAND licensing does not constitute a waiver of a standard essential patent ("SEP") holder's right to seek an exclusion order from the ITC, and this statement is accepted by both the potential SEP holder and potential SEP users during the standard-setting process. Under these circumstances, would an ITC exclusion order for a RAND-encumbered SEP still present anticompetitive concerns?

   Answer: **Depending upon circumstances, when a standard incorporates patented technology and becomes established, the patent holder may acquire market power because it can be difficult and/or expensive to switch to a different technology. As a result, the owner of that patented technology may be able to obtain royalty payments that are based on the costs and delays of switching. Such hold-up can harm innovation, result in inefficient efforts to evade it, and impose higher prices on consumers. Depending upon how they are structured, RAND commitments can provide assurances to those implementing the standard that access to the patented technologies through licenses will be available, decreasing the risk of hold-up. Even if an SSO's policy preserves the ability to seek an exclusion order at the ITC, the ITC might determine issuing an exclusion order would be inconsistent with the public interest.**

2. SSOs require companies to make RAND commitments before the standards are selected. The exact requirements of a RAND commitment vary by SSO and apply to specific SEPs. In your written testimony, you suggest that the Antitrust Division's investigations into possible anticompetitive conduct from recent patent acquisitions has focused on what you describe as "the

incentive and ability to exploit ambiguities in the commitments the sellers made to license their patents on F/RAND terms . . ."

a. What specifically do you consider to be an anticompetitive exploitation of ambiguities in a RAND commitment?

Answer: **The Antitrust Division's analysis of proposed royalty fees to license standard-essential patents depends on the facts of each specific case, and each case presents complex legal and economic factors that do not lend themselves to a general approach, particularly in cases involving standard-setting and the intersection of antitrust and patent law and policy. However, as a general matter, efforts to expand the exclusionary scope of the patent beyond the voluntary restrictions agreed to by the patent holder as part of the standard-setting process have the potential to raise competition concerns.**

b. Are there other ways in which SEP holders may exercise their intellectual property in an anticompetitive fashion, beyond exploiting ambiguous RAND commitments?

Answer: **Patent holders, like owners of other forms of property, can violate the antitrust laws if they use their property to engage in collusive or exclusionary conduct. The antitrust agencies' IP Guidelines, U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (1995), lay out the framework the Antitrust Division follows in analyzing the competitive effects of licensing agreements. Additional guidance is available in U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION (2007). In the vast majority of cases, the Division evaluates the impact on competition of a licensing restriction under the rule of reason. Each case requires fact-specific analysis to resolve the complex legal and economic issues that the Division encounters when applying the antitrust laws to intellectual property rights. Licensing restrictions related to RAND-encumbered standard-essential patents that might raise concerns include, for example, restrictions designed to raise rivals' costs or to compel prospective licensees to grant the SEP holder the right to use the licensee's differentiating intellectual property.**

3. A variety of patent holders argue that RAND commitments have been over-simplified and that this commitment traditionally involves reciprocity—meaning that both patent holders and potential licensees agree to negotiate in good faith.

a. Is this your understanding of RAND?

b. What remedies should be available to SEP holders if an infringing product's producer is not negotiating in good faith?

Answer: **I believe that the RAND commitment implies negotiations in good faith by both parties. SSOs and their members rely on RAND commitments to facilitate bilateral licensing negotiations necessary to successfully implement a standard and to provide assurances to implementers of the standard that the patented technologies will be available to parties willing and able to license them on reasonable terms. In most cases, parties are able to agree on licensing terms. If the potential licensee has not negotiated in good faith and the parties cannot reach an agreement, the patent holder may seek to enforce its patent rights in the district court and the ITC.**

4. Some American innovators argue that federal district court actions alone are insufficient to address patent infringement claims, because the parties can only litigate a relatively small number of patents in one action and litigation often takes many years to resolve. Patent holders note that, by contrast, the ITC provides relatively quick resolution that brings parties to the negotiating table to work out the terms of broad cross-licensing agreements.

   a. In your view are the remedies available in federal district court sufficient to incentivize firms to avoid litigation and privately negotiate cross-licensing deals?

Answer: **I believe that in many instances the remedies available in federal district court appear to provide appropriate incentives for firms to negotiate cross-licensing agreements. Additionally, having the ITC process available may be important in certain instances.**

Questions from Senator John Cornyn

1. Does the Department of Justice (DOJ) or Federal Trade Commission (FTC) support changes to the International Trade Commission's 337 process, where standard-essential patents (SEPs) are concerned? Why or why not? If DOJ or FTC supports changes, what are they?

Answer: **The Administration has not developed a position as to whether reforms to section 337 are necessary or appropriate. The Administration would of course be happy to work with the Committee in the future if it considers legislative changes.**

2. Some take the position that making ITC exclusion orders unavailable to SEP holders that make "RAND" commitments would leave them open to infringement by foreign manufacturers outside the jurisdiction of U.S. district courts. Are you aware of instances of that occurring? If so, please detail them.

Answer: **The Antitrust Division is not aware of an ITC case that presented that factual circumstance, but issuing an exclusion order in such cases may be appropriate.**

3. The Wall Street Journal reported recently on the spread of so-called "patent troll" litigation tactics, including licensing of patents by technology companies for the apparent purpose of litigation. Does the FTC or DOJ view this as a problem? Why or why not?

<u>Answer</u>: **Any effort by a patent owner to harm competition by improperly extending the exclusionary scope of its patent, whether it is a patent assertion entity or not, may violate the antitrust laws. Hold-up involving such patents can discourage innovation by making it riskier for firms that want to invest in making products that comply with a standard or that are complements to such products. The Antitrust Division is aware of the concerns expressed about the role of patent assertion entities generally and about their possible use by operating companies for the purpose of litigation, and continues to look into the potential for such tactics to harm competition.**

<u>Questions from Senator Chuck Grassley</u>

1. In your opinion, does the International Trade Commission have sufficient statutory authority to stay the imposition of an exclusion order contingent on an infringing party's commitment to abide by an arbitrator's determination of the fair value of a license? If it does, do you believe that the International Trade Commission is using that authority appropriately?

<u>Answer</u>: **The ITC is the expert on its own processes and procedures, but the ITC has stayed the imposition of an exclusion order in certain circumstances, such as during an appeal to the U.S. Court of Appeals for the Federal Circuit. It is certainly possible that the ITC would have the authority to stay its actions in other circumstances. *See, e.g., Certain Semiconductor Chips with Minimized Chip Package Size and Products Containing Same*, Inv. No. 337-TA-605, Comm'n Op. at 3-4 (May 27, 2008) (The ITC determines whether to stay an investigation pending reexamination of a patent at the PTO based on "(1) the state of discovery and the hearing date; (2) whether a stay will simplify the issues and hearing of the case; (3) the undue prejudice or clear tactical disadvantage to any party; (4) the stage of the PTO proceedings; and (5) the efficient use of Commission resources.").**

The Administration has not yet developed a position on whether additional statutory powers for the ITC would be desirable or appropriate. The Administration would of course be happy to work with the Committee in the future if it considers legislative changes.

2. Some are concerned that a broad denial of remedies in disputes involving standard-essential patents in Section 337 proceedings would produce adverse and unintended consequences. Do you agree? For example, some are concerned that a no-injunction, no-exclusion order policy would result in giving a potential licensee little incentive to bargain in good faith, because by

litigating the case it can avoid payment of royalties until the litigation is over, if not longer. Do you agree with these concerns? Why or why not?

Answer: **The ITC has sought public comment on this issue. The Administration would like to consider those comments and any ITC response before taking a position on this issue.**

3. I'm also told that patent holders would be less likely to participate in the standard-setting process if, by doing so, they are forced to give up certain legal remedies for their patents. Do you agree?

Answer: **Although many factors may influence a firm's participation in the standards-setting process, there is significant value to a firm in participating in standard-setting processes and having its patented technology incorporated in a standard. Collaboratively-set industry standards may substantially reduce transaction costs by helping firms avoid wars between competing standards. Patent holders may get a first-mover advantage by being the company most competent to implement the technology, or a firm may seek to offer products and services that complement the standard. In any event, firms that participate may be more likely to have their technology included in the standard and are able to seek royalties for products that infringe the valid patented technologies they have promised to license. Due to the significant benefits of collaborative standard-setting and the benefits of having a firm's technology being included in a standard, we believe that patent holders should continue to have incentives to participate in the standard-setting process.**

4. Do you believe that standard-setting organizations should be able to write their own IPR policies and, with their members, decide to include or exclude RAND commitments, as well as waive or not waive injunctive relief? Do you agree that the government should not be directing these activities, and rather the market will help determine what policies a standard-setting organization will adopt?

Answer: **In our experience, the Antitrust Division has found that determining which IP policies to adopt is primarily a private matter for SSOs, so that industry can benefit from experimentation with different costs and benefits. However, the Division is ready to enforce the antitrust laws against standard-setting activities that violate the antitrust laws, and we have been active in providing guidance to the standard-setting community regarding aspects of their IP policies that affect competition. In May 2010, the Division explained that an important factor in SSO IP policies is clarity. IP committees of SSOs that ensure that the meaning of a RAND commitment is clear could further reduce incentives for patent holders to hold up implementers of a standard after it is set, reduce opportunities for disagreement between the parties to a license, and benefit U.S. consumers by strengthening the standard-setting system while respecting the rights of patent holders. The Division also has advised SSOs that requiring or permitting members to disclose their most restrictive licensing terms before a standard is set could**

preserve competition, and therefore would lessen the risk of violating the antitrust laws.

5. How do you ensure that your enforcement activities with respect to standard-essential patents do not end up as price setting? How do you avoid using your enforcement authority to favor one business model over another, or avoid picking winners and losers among standards?

<u>Answer</u>: **As stated in the U.S. DEP'T OF JUSTICE, ANTITRUST DIVISION POLICY GUIDE TO MERGER REMEDIES (June 2011), the Division's "central goal is preserving competition, not determining outcomes or picking winners and losers."** ***Id.*** **at 3. The Antitrust Division enforces our nation's antitrust laws and advocates for the policies that best preserve competition and innovation. The Division evaluates the factual circumstances of each transaction that we review. Our goal is to ensure that antitrust and intellectual property law policies work together to provide U.S. consumers with high-quality products and services at competitive prices while preserving the incentives to create these products and services and bring them to market. For example, the Division has advised standard-setting organizations that they may engage in discussions of licensing terms before a standard is set in order to preserve competition between alternative technologies and avoid hold-up. Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice, to Michael A. Lindsey, Esq. (counsel for IEEE) (April 30, 2007); Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice, to Robert A. Skitol, Esq. (counsel for VITA) (Oct. 30, 2006); U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION, CH. 2 (2007).**

6. Exclusion orders are especially important to U.S. innovators whose standard-essential patents are being infringed by foreign manufacturers with no legally sufficient presence in the U.S. to warrant federal court jurisdiction. Isn't it appropriate for standard-essential patent holders to be able to seek exclusionary relief against foreign infringers? Wouldn't we just be weakening important trade enforcement remedies if we completely took away the ability of U.S. companies to seek such relief at the International Trade Commission?

<u>Answer</u>: **The ITC determines the appropriate circumstances for issuing exclusion orders. The Department believes that the ITC may tailor its relief in a manner that protects patent holders' rights in individual cases while taking into consideration the impact on consumers and on the competitive conditions in the United States economy. There may be a variety of circumstances in which an SEP holder who has made a RAND commitment may be justified in seeking an exclusion order from the ITC (including, as I stated at the hearing on July 11, "where a licensee or someone using a technology refuses to participate in a reasonable negotiation or may not be subject to the jurisdiction of the U.S. courts"). There may also be circumstances in which making a RAND commitment under an SSO's policies would appear to be at odds with seeking an ITC exclusion order against a licensee willing and able to take**

a license on RAND terms. Thus, the appropriate steps for determining whether the ITC should issue an exclusion order would depend on the facts of each specific case.

7. Could you discuss in greater detail how you reached your conclusion that Apple/Google/Microsoft's recent acquisitions of standard-essential patents would not harm innovation and competition in the wireless device industry?

<u>Answer</u>: **After thorough investigations in both matters, the Antitrust Division concluded that neither acquisition was likely to substantially lessen competition for wireless devices. In particular, the Division determined that neither Research in Motion nor Microsoft was likely to use any standard-essential F/RAND-encumbered patents from the Nortel portfolio to harm their rivals by excluding them from the markets or charging supracompetitive royalties, because they would be unable to attract a sufficient number of customers to purchase their smartphones to make up for the loss of licensing revenue. In addition, the Division found that Microsoft previously entered cross-license agreements with the majority of its Android-based OEM competitors and that its newly acquired patents would be included in these agreements.**

With respect to Google, there was evidence that Motorola Mobility had a long history of licensing its F/RAND-encumbered standard-essential patents and had been engaged in extended disputes with Apple, Microsoft, and others before Google sought to acquire the company and its patent portfolio. The Division did not believe that transferring ownership of the patents from Motorola to Google would substantially change that practice. Moreover, while the Division was investigating these transactions, Apple stated in a letter to the European Telecommunications Standards Institute (ETSI), the body that develops many wireless standards in Europe, that the company would not use F/RAND-encumbered standard-essential patents to exclude rivals from the wireless market by seeking injunctions for infringement. Similarly, Microsoft posted a public statement on its website explaining that it would not seek injunctions or exclusion orders based on F/RAND-encumbered standard-essential patents. Google also publicly revealed its licensing policy, stating that it would not seek injunctive relief in disputes involving future license revenues provided that the potential licensee (a) forgoes certain defenses such as challenging the validity of the patent; (b) pays the full disputed licensing amount into escrow; and (c) agrees to a reciprocal process regarding injunctions. The Department's Closing Statement on this matter, which sets forth its analysis in greater detail, is available at www.justice.gov/atr/public/press_releases/2012/ 280190.htm.

8. What standard, if any, would you apply in assessing whether a particular proposed royalty fee to license standard-essential patents would not be considered "fair" and "reasonable"? That is, what would the Antitrust Division consider to be an "anticompetitive use of standard-essential patent rights" in the absence of the patent holder seeking injunctive relief in federal court or an exclusion order from the International Trade Commission?

Answer: **Patent holders, like owners of other forms of property, may violate the antitrust laws if they use their property to engage in collusive or exclusionary conduct. The antitrust agencies' IP Guidelines, U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (1995), lay out the framework the Antitrust Division follows in analyzing the competitive effects of licensing agreements. Additional guidance is available in U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION (2007). In the vast majority of cases, the Division evaluates the impact on competition of a licensing restriction under the rule of reason. Each case requires fact-specific analysis to resolve the complex legal and economic issues that the Division encounters when applying the antitrust laws to intellectual property rights.**

Licensing restrictions related to RAND-encumbered standard-essential patent rights that might raise concerns include, for example, restrictions designed to raise rivals' costs or to compel prospective licensees to grant the SEP holder the right to use the licensee's differentiating intellectual property.

Determining whether a particular royalty fee is fair and reasonable is a fact-specific determination. As a general rule, the Antitrust Division believes that remedies for patent infringement should align the reward of the invention with the value of the invention.

9. You testified that Apple/Google/Microsoft each made public statements that demonstrated their commitments to their standard-essential patent licensing policies, which was apparently an important factor in closing your investigation into the acquisitions of standard-essential patents by these companies. How will you hold these companies accountable if they do not fulfill their promises in this regard?

Answer: **The Antitrust Division took the statements by Apple, Microsoft, and Google into account when evaluating the transfer of the various patent portfolios. The Division concluded that the acquisitions of these patent portfolios were not likely to substantially lessen competition, but the Division indicated concerns about the potential inappropriate use of F/RAND-encumbered standard-essential patents to disrupt competition and specifically limited our conclusion to the transfer of ownership rights and not to the exercise of those transferred rights. We have continued to monitor closely the use of F/RAND-encumbered standard-essential patents in the wireless device industry, particularly as they relate to smartphones and computer tablets, to ensure that they do not stifle competition and innovation in this important industry.**

<u>Questions from Senator Amy Klobuchar</u>

1. *Role of Agencies* – How can the Justice Department and FTC use tools already at their disposal to help ensure that standard-essential patents are treated appropriately in order to balance the objectives of protecting patent holders, promoting innovation and providing the best products and services to consumers?

<u>Answer</u>: **The Antitrust Division is committed to enforcing the antitrust laws while respecting the rights granted to patent holders under our patent laws. The Division investigates both acquisitions of standard-essential patents as well as issues relating to how they are or will be used and it will act to prevent harm to competition where appropriate. In addition, the Division engages actively in competition advocacy, including advising Standard Setting Organizations (SSOs) and their members on ways to limit opportunities for hold-up after a standard is set in a manner that preserves competition and promotes innovation without running afoul of the antitrust laws.**

2. *Negotiating RAND Terms* – Questions have been raised as to whether or not bilateral negotiations to arrive at RAND terms and conditions are the most effective way to manage standard-essential patents.

What is your view on this issue? In your opinion, are there alternative approaches that could work to ensure both access to these patented technologies and fair compensation to the patent holders?

<u>Answer</u>: **Although bilateral negotiations to arrive at RAND terms and conditions may sometimes break down, I believe overall they have been effective in enabling most entities to implement and use standards after they have been set. At the same time, there may be other measures SSOs could take to facilitate more efficient licensing, such as promoting ex ante disclosures of the most restrictive licensing terms. In 2007 the Antitrust Division, together with the FTC, advised SSOs in a joint report that antitrust law generally should not bar SSOs from engaging in ex ante licensing negotiations, and that the antitrust agencies likely would evaluate such activities under the rule of reason. *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION (2007). The Division also advised two standard-setting organizations that they may engage in discussions of licensing terms before a standard is set in order to preserve competition between alternative technologies and avoid hold-up. Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice, to Michael A. Lindsey, Esq. (counsel for IEEE) (April 30, 2007); Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice, to Robert A. Skitol, Esq. (counsel for VITA) (Oct. 30, 2006).**

Questions from Senator Patrick J. Leahy

1. The Department of Justice and Federal Trade Commission have both expressed concern about the potential anti-competitive effects that may result when a patent holder that has committed to license its standard-essential patents (SEPs) on reasonable and non-discriminatory (RAND) terms seeks an exclusion order at the ITC, instead of disputing the reasonable terms of the license in court. What is the significance of the RAND commitment in the context of SEPs?

   Answer: **Depending upon circumstances, when a standard incorporates patented technology and becomes established, the patent holder may acquire market power because it can be difficult and/or expensive to switch to a different technology. As a result, the owner of that patented technology may be able to obtain royalty payments that are based on the costs and delays of switching. Such hold-up can harm innovation, result in inefficient efforts to evade it, and impose higher prices on consumers. Depending upon how they are structured, RAND commitments can provide assurances to those implementing the standard that access to the patented technologies through licenses will be available, decreasing the risk of hold-up. Even if an SSO's policy preserves the ability to seek an exclusion order at the ITC, the ITC might determine issuing an exclusion order would be inconsistent with the public interest.**

2. If the ITC were to find that issuing a traditional exclusion order would have a harmful effect on competitive conditions in the U.S. economy or harm American consumers, in your view are there other potential actions that the ITC could consider consistent with its statutory obligations?

   Answer: **The ITC is the expert on its processes and procedures, but the ITC has a range of options arising from the public interest factors it must consider as part of its statutory mandate, from denying an exclusion order altogether to fashioning more tailored, limited relief. The ITC's prior decisions reflect its flexibility in fashioning an appropriate remedy. *See, e.g., Certain Baseband Processor Chips And Chipsets, Transmitter And Receiver (Radio) Chips, Power Control Chips, And Products Containing Same, Including Cellular Telephone Handsets*, 72 Fed. Reg. 32,682, Inv. No. 337-TA-543 (June 7, 2007) (exclusion order applying only to infringing product models not on sale in the U.S. market as of the order's effective date, thus allowing continued public access to existing models) and *Certain Personal Data And Mobile Communications Devices and Related Software*, 76. Fed. Reg. 80,402, Inv. No. 337-TA-710 (Dec. 19, 2011) (exclusion order limited to certain infringing smartphones and implementation of order delayed to permit transition to non-infringing alternatives); *See also Certain Semiconductor Chips with Minimized Chip Package Size and Products Containing Same*, Inv. No. 337-TA-605, Comm'n Op. at 3-4 (May 27, 2008) (listing factors the ITC considers when determining whether to stay an investigation pending reexamination of a patent by the PTO).**

3. Some suggest that, given the potential for anticompetitive abuse, the authority of the ITC to issue exclusion orders should be limited in cases involving SEPs that holders have committed to license on RAND terms. Even if a blanket rule is not appropriate, are there steps that should be taken to clarify when it is appropriate for the ITC to issue an exclusion order in a case involving an SEP?

Answer: **There may be a variety of circumstances in which an SEP holder who has made a RAND commitment may be justified in seeking an exclusion order from the ITC (including, as I stated at the hearing on July 11, "where a licensee or someone using a technology refuses to participate in a reasonable negotiation or may not be subject to the jurisdiction of the U.S. courts"). There may also be circumstances in which making a RAND commitment under an SSO's policies would appear to be at odds with seeking an ITC exclusion order against a licensee willing and able to take a license on RAND terms. Thus, the appropriate steps for determining whether the ITC should issue an exclusion order would depend on the facts of each specific case.**

4. Could the concerns you have described about the potential anticompetitive effects of exclusion orders in the context of SEPs also arise in non-SEP cases where a patent holder seeks an exclusion order to enforce a patent that it has previously committed to license on RAND terms?

Answer: **Similar concerns could arise outside the context of a standard-essential patent; in general, however, the potential for a "work-around" in the non-SEP context may be greater and therefore may lessen the potential for anticompetitive effect. Concerns about anticompetitive effects would be heightened in circumstances in which it is demonstrated that compliance with a standard requires that a product incorporate a particular technology covered by asserted claims of an SEP and does not allow for the use of non-infringing alternatives.**

5. I have worked hard to ensure that our patent and antitrust laws are strong and provide for companies and individual inventors to feel secure in their investments. Where patent laws grant limited monopolies, the antitrust laws work to prevent monopolistic behavior. One of the ways that the Leahy-Smith America Invents Act modernized our country's patent system was to deter patent trolls. Unfortunately, we continue to see patent troll activity in Vermont, which deters investment and innovation. Do you see a way to further discourage patent trolls through the competition laws? Put another way: Because patent trolls often function by seeking to extend their monopoly rights beyond the limited contours of the patent, is it possible that a patent troll's use of frivolous lawsuits to extend its monopoly violates the antitrust laws?

Answer: **Any effort by a patent owner to harm competition by improperly extending the exclusionary scope of its patent, whether it is a patent assertion entity or not, may violate the antitrust laws, and allegations of such actions merit investigation. Regardless of a patent owner's business model, we note that patent holders that engage in sham litigation will not be protected by the *Noerr-Pennington* doctrine and are subject to the antitrust laws. The Antitrust Division is aware of the**

concerns expressed about the role of patent assertion entities generally and about their possible use by operating companies for the purpose of litigation, and continues to look into the potential for such tactics to harm competition.

SUBMISSIONS FOR THE RECORD

Written Statement of

THE AMERICAN ANTITRUST INSTITUTE

Before the
SENATE JUDICIARY COMMITTEE

Hearing on
OVERSIGHT OF THE IMPACT ON COMPETITION OF EXCLUSION ORDERS TO ENFORCE STANDARD-ESSENTIAL PATENTS

July 11, 2012

Chairman Leahy, Ranking Member Grassley, and members of the Subcommittee: The American Antitrust Institute (AAI) is an independent non-profit consumer organization devoted to enhancing the role of competition in the economy and sustaining the vitality of the antitrust laws.[1] We believe that competition benefits consumers and the economy by lowering prices, promoting innovation, elevating customer service, and enhancing the choices available to consumers.

For many years America has muddled through with three separate regimes that collectively shape the competitive structure of our industries. Please picture an equilateral triangle with a silo situated at each corner. These silos are three legal regimes: antitrust, intellectual property, and international trade. To an unfortunate extent, each regime has developed and operated separately. Each works within its own statutory and regulatory framework, each is associated with a separate occupational sociology, each has its own

[1] AAI is managed by its Board of Directors with the guidance of an Advisory Board consisting of more than 130 prominent antitrust lawyers, economists, and business leaders. The Board of Directors alone has approved this written testimony; individual views of members of the Advisory Board may differ from AAI's positions.

values, special interests, and political oversight. So long as intellectual property played a relatively unimportant role in our economy, so long as most of trade was not conducted by global mega-corporations in highly concentrated global industries, so long as antitrust, trade, and IP did not constantly bump up against one another, the competition triangle managed to function.

But something has dramatically changed. Picture the triangle again-- only this time fill up the space enclosed by the triangle with global high technology companies, companies with names like Microsoft, Google, Apple, Cisco, IBM, Samsung, Sony and the like. And recognize that the way they do business and the way governments oversee and regulate them require their constant collision with all the sides of the triangle. There is a mismatch between the three legal regimes and the facts of today's most important economic life. Reform has rather suddenly come to appear essential.

In particular, the current crisis in standards results from the emergence of an essentially unplanned system of Mutual Assured Destruction, in which the major high technology companies accumulate large portfolios of patents that are intended to be used as both offensive and defensive weapons against competitors, indeed as bargaining chips for assuring access to essential patents and protection against claims of infringement.

This system has three grievous faults. First, it is enormously wasteful of resources, including both the resources to purchase portfolios of intellectual property, and also expensive, time-consuming, attention-demanding litigation to utilize or protect these portfolios.[2] Second, it creates a barrier to entry to innovations from companies that do not already own a large portfolio and would therefore find themselves at high risk that their

[2] In a current "high-stakes patent infringement trial pitting Apple Inc. against Samsung Electronics Corp." before the International Trade Commission, Apple was represented by a 70-lawyer team from Wilmer Cutler Pickering Hale and Door and Quinn Emanuel Urquhart & Sullivan. "In the months leading up to trial, Wilmer lawyers deluged the court with documents—for example, when the judge asked for a simple chart, lawyers submitted a 3,000-page filing." "According to patent analyst Florian Mueller, Apple and Samsung are currently opponents in about 50 patent suits spanning 10 countries and four continents, fighting for dominance in the $100 billion-plus global smartphone market." Jenna Greene, "In Apple fight, sharp elbows," The National Law Journal, June 25, 2012. http://www.nlj.com.

entry product would be attacked as infringing someone's patent, or perhaps hundreds of patents. The risk would deter investment. Third, it enables and incents and has therefore led to proliferation of patent holdup conduct and resulting corruption of open standards initiatives that would otherwise promote more competitive market outcomes.

But Mutual Assured Destruction has another flaw that has almost literally blown up the system. This flaw has been given a nasty nickname: patent trolls. It also has a more neutral name, non-practicing entities ("NPEs") that we will use. When organizations buy up patents, not to utilize them in productive output but to use them as assets upon which they can demand monopoly rents by attacking companies on patent infringement grounds, *without having to worry about return fire*, something new and potent has been injected into the armory.

The AAI has been listening to a wide variety of companies and experts on the overlap of antitrust and intellectual property. In keeping with the subject matter of this hearing, but providing somewhat enlarged scope, we offer the following dozen observations with regard to standards and competition policy. We begin with the point most responsive to the title of these hearings.

1. FRAND should imply a waiver of the right to seek an injunction against a user of the standard.

An injunction is not an appropriate remedy for SEP infringement as a matter of both good law and good policy. In deciding the Apple/Motorola case in Illinois just a few weeks ago, Judge Posner noted that the Supreme Court requires a plaintiff seeking an injunction on a patent infringement claim to first establish that monetary damages are inadequate to compensate for any alleged injury.[3] Yet when a SEP owner makes a FRAND commitment, it has implicitly acknowledged

[3] *See* Apple, Inc. v. Motorola, Inc., No. 1:11-cv-08540, at 21 (N.D. Ill. Jun. 22, 2012) (citing eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388, 391-92 (2006)).

that a reasonable royalty is adequate compensation for a license to use the patent.[4] Monetary damages are therefore adequate compensation for infringement of a FRAND-encumbered SEP. Moreover, monetary damages avoid the disproportionate outcomes and public harm that can result from injunctive relief. Particularly where an infringer benefits by infringing on a patent that accounts for only a small component of a device, and the effect of an injunction is to remove the entire device from the market, the penalty imposed on the infringer far outstrips the benefit the infringer enjoys for infringing, not to mention the harm caused to the SEP-owner.[5] The result is a punitive rather than compensatory remedy that provides a windfall to the SEP-owner and unnecessarily deprives the public of access to the affected device and competition in the affected market.[6]

SSO rules should make clear that the provider of a FRAND commitment in the course of a standard development proceeding waives any right to seek either injunctive relief in court or an exclusion order at the International Trade Commission. The AAI endorses the FTC's ITC comments[7] and the legislative advocacy of the ITC Working Group.[8]

More specifically, AAI believes that the ITC should (a) rarely if ever issue an exclusion order in the case of a product infringing a standard-essential patent that is subject to an ex ante FRAND Commitment (sole exceptions being circumstances where the infringer has refused to accept a license on clearly fair and reasonable terms or has clearly refused to negotiate in good faith toward that

[4] *Id.* at 19.

[5] *Id.* at 25.

[6] *Id.*

[7] United States International Trade Commission investigation N. 337-TA-745 and 337-TA-752. Third-Party United States Federal Trade Commission's Statement on the Public Interest (June 6, 2012).

[8] See http://www.law.com/jsp/lawtechnologynews/PubArticle1.TN.jsp?id=1332124164159.

license outcome); and (b) take due account of effects on competition, effects on consumers and the public interest generally in exercising its authority to issue exclusion orders in all cases, similar to the manner that district courts now do so under the mandate of eBay Inc. v.MercExchange, L.L.C., 547 U.S. 388 (2006).

2. Coordination is essential.

To the maximum extent feasible, the Department of Justice and the Federal Trade Commission should promulgate the same approach. Joint guidelines following the model of the Horizontal Merger Guidelines would be an appropriate vehicle. The International Trade Commission, US Trade Representative, and the US Patent and Trademark Office should all have an important say in the development of these guidelines. In addition, however, given the global nature of so many issues, the U.S. agencies should work as closely as possible with the European Commission and other major trading nations to maximize international consistency.

3.The basic goal is to achieve better balance between competition and exclusion.

A consensus on basic objectives seems to be within reach. The basic understanding would be that the exclusionary power of intellectual property can provide an important incentive for innovation, but that without appropriate limitations, IP can become a mechanism that not only facilitates monopolistic waste in the economy but actually inhibits innovation. The consensual goal is to find a socially beneficial balance between competition and exclusion.

4. Standard setting organizations are crucial to achieving balance.

Standards for interoperability and access are crucial to the development of high technology, most evident at the moment in the evolution of mobile smartphones. The primary institution for developing standards is the standard-setting organization ("SSO"), a self-governing mechanism for the members of an industry to come together to make critical technical decisions about the future of their industry. Overwhelmingly, these are discussions among engineers and their function is positive, but when antitrust investigations have focused on SSOs, it has become clear that they have a potential for anticompetitive abuse. Once a standard is agreed upon, it is often too late for the industry to switch to another direction. Thus, it is appropriate for government to focus on best practices for SSOs and, as a matter of priority, especially on standard-essential patents (SEPs).

5. Antitrust must play a larger role in the functioning of SSOs.

The Standards Development Organization Advancement Act of 2004 ("SDOAA") mandates application of the antitrust "rule of reason" rather than any stricter antitrust rule or scrutiny for SSOs' "standards development activity," defined to include "actions relating to [a SSO's] intellectual property policies." [9] It also enables SSOs to avoid the treble damages remedy that would otherwise be automatic for any antitrust violation[10] and to obtain an award of the costs of suit including reasonable attorneys' fees against any antitrust claimant if the claim against the SSO was "frivolous, unreasonable, without foundation, or in bad faith." [11] The statute thereby protects or exempts SSOs from central aspects of the antitrust laws that apply to many other kinds of concerted activity among competing enterprises.

[9] Pub. L. No. 108-237, 118 Stat. 661, 15 U.S.C. §§ 4301-02.

[10] 15 U.S.C. § 4303.

[11] 15 U.S.C. §§ 4304-05.

This Act was intended "to encourage disclosure by intellectual property rights owners of relevant intellectual property rights and proposed licensing terms"; it "further encourages discussion among intellectual property rights owners and other interested standards participants regarding the terms under which relevant intellectual property rights would be made available for use in conjunction with the standard or proposed standard."[12] In short, the Act sought to incent SSOs to experiment with new policies and practices that would increase ex ante transparency about intellectual property rights and associated license terms, thereby reducing risks of ex post anticompetitive patent holdup outcomes.

In the immediate aftermath of that enactment, two SSOs -- VITA and IEEE -- adopted new policies of that very kind, both of which received antitrust comfort under DOJ's Business Review Procedure.[13] To our knowledge, however, few if any other SSOs have even begun to move in any similar direction. In short, all too many SSOs have been slow to embrace any such effort or even to consider the continued adequacy of their longstanding patent policies as protections against patent holdup outcomes in their standards. It is thus not surprising that there has been a dramatic increase in patent holdup conduct and associated litigation over the eight years since enactment of the SDOAA. In short, it appears that the SDOAA has failed to incent SSOs in the desired direction. Indeed, by reducing antitrust exposure, it may well have had the opposite effect.

Accordingly, AAI suggests that Congress now consider (a) repeal or revision of the SDOAA in conjunction with (b) a Congressional statement of intent that the antitrust authorities and courts should apply the principles of *American Society of Mechanical Engineers v. Hydrolevel Corp.*,[14] to the standard-essential patent situation. The Supreme Court there established an SSO's strict antitrust liability in

[12] 150 Cong. Rec. 3657 (June 2, 2004).

[13] See DOJ's 2006 letter to VITA counsel, http://www.justice.gov/atr/public/busreview/219380.htm; and DOJ's 2007 letter to IEEE counsel, http://www.justice.gov/atr/public/busreview/222978.htm.

[14] 456 U.S. 556 (1982).

circumstances where anticompetitive harm occurs as a result of the SSO's failure to implement procedures aimed at preventing abuse of its processes. As the Court said, "a standard setting organization . . . can be rife with opportunities for anticompetitive activity"; "a rule that imposes liability on the standard setting organization -- which is best situated to prevent antitrust violations through abuse of its reputation -- is most faithful to the congressional intent that the private right of action deter antitrust violations."[15] Congress should accordingly confirm its support for applying those precepts to the situation here at issue: an SSO's failure to implement effective safeguards against patent holdup outcomes from its proceedings should result in that SSO's liability for the resulting anticompetitive effects.

6. The concept of F/RAND itself needs to be standardized.

It is not uncommon for SSOs to require that any participant in a standard-setting process who owns a patent that reads on the proposed standard has an obligation to identify the patent and/or agree to license it on a fair, reasonable, and non-discriminatory basis. Europeans abbreviate this as a FRAND commitment, Americans as "RAND", or increasingly as "F/RAND". As a first step in clarifying the concept, we propose recognizing that all three abbreviations have essentially the same general meaning and can all therefore be referred to as "FRAND".

Unfortunately, FRAND has no agreed-upon minimal meaning, which leads to expensive, drawn out, and largely unnecessary litigation. AAI calls attention to the following areas in which the provision of a minimal standard meaning would resolve many of the problems of SEPs: unreasonable price; other unreasonable conditions; assuring that subsequent owners are bound by prior owners' commitments; arbitration of disputes; and limitations on the use of injunctions.

[15] *Id.* at 571-73.

7. FRAND implies meaningful ex ante transparency on both price and non-price license terms.

Although it is not feasible to establish perfect rules on what price for licensing a SEP would be fair and reasonable, some minimal standards are appropriate. AAI agrees with the FTC's promotion of two principles. First, the determination should rest on ex ante incremental value rather than ex post total market value. Second, the royalty base should be the smallest affected component rather than the entire device.

Because FRAND commitments are today so generally vague that they do not provide adequate protection against holdup conduct, SSOs should be required to move in the direction of ex ante disclosure of proposed or maximum license terms. (A SEP owner should not be required, however, to specify a royalty rate when it is not in fact looking for royalties and therefore commits not to assert its SEPs against any implementer of the standard in question.)

8. FRAND implies that non-price conditions to license a SEP be reasonable.

With current vagueness, SEP owners sometimes demand overly broad grantback provisions. AAI believes it is inconsistent with a FRAND commitment for the SEP licensor to demand a grantback covering licensee patents beyond those that are essential to the same standard implicated by the licensor's patents. It is unreasonable for the SEP owner to demand a higher royalty for the license to its SEPs than it is willing to pay as a royalty for SEPs within the scope of the required grantback. There should always be a "cash-only" option available to any licensee in lieu of any grantback demand. Where defensive termination provisions or covenants not to sue are functionally similar to grantback provisions, they too should not be "unreasonably" broad.

9. FRAND implies that acquirers of SEPs should be required to fully adhere to prior owners' public commitments to SSOs or others to license on FRAND terms.

It is essential to a balanced SSO process that FRAND commitments be maintained, even if the SEP is later transferred. AAI believes that a new SEP owner's enforcement activity in a manner inconsistent with an applicable FRAND commitment may constitute "exclusionary conduct" in violation of Section 2 of the Sherman Act and Section 5 of the FTC Act. Moreover, a patent portfolio's acquisition that may enable or facilitate this kind of exclusionary conduct can, on that basis, be challenged as a violation of Section 7 of the Clayton Act. (SSOs can assist in this regard by clarifying that participants making FRAND commitments during their proceedings thereby promise to condition any sale of the covered patents on the purchaser's promise to abide by the same commitments.)

10. FRAND should imply a commitment to arbitrate disputes on the application of the FRAND commitment.

The disproportionate leverage that a patent owner has in the interpretation of a FRAND commitment rests largely on the time and expense of reaching a solution via litigation. If a SSO's rules or legislation were to require that a FRAND commitment automatically includes an agreement to arbitrate disputes over the interpretation of the FRAND commitment, the dynamics would change in a substantial way, with the overall result that a FRAND commitment would be given weight it does not currently carry.

> 11. Resolution of standards issues should include consultations with foreign jurisdictions, in an effort to achieve the maximum feasible global consistency.

The issues being aired in these hearings are of concern to many of our trading partners. For example, in 2011, the European Commission adopted in final form its Guidelines on the Applicability of Article 101 of the Treaty to Horizontal Co-operation Agreements.[16] Section 7 of the Guidelines addresses requirements for "standardization agreements" to avoid violation of Article 101. Note in particular that par. 283 expressly requires that the SSO's rules ensure access to the standard on FRAND terms; par. 285 says that, to ensure the effectiveness of the FRAND commitment, "there would also need to be a requirement on all participating IPR holders who provide a commitment to ensure that any company to which the IPR owner transfers its IPR . . . is bound by that commitment, for example through a contractual clause between buyer and seller." Par. 286 says the IPR policy "would need to require good faith disclosure, by participants, of their IPR that might be essential for the implementation of the standard under development."

Par. 289 says in "case of a dispute, the assessment of whether fees charged for access to IPR in the standard-setting context are unfair or unreasonable should be based on whether the fees bear a reasonable relationship to the economic value of the IPR" and "it may be possible to compare the licensing fees charged by the company in question for the relevant patents in a competitive environment before the industry has been locked into the standard (ex ante) with those charged after the industry has been locked into the standard (ex post)." Par. 290 says "Another method could be to obtain an independent expert assessment of the objective centrality and essentiality to the standard at issue of the relevant IPR portfolio. . . .

[16] See C.11/56, Official Journal of the European Union 14.1.2011.

The royalty rates charged for the same IPR in other comparable standards may also provide an indication for FRAND royalty rates." Par. 299 promotes ex ante disclosures of most restrictive licensing terms including maximum royalties.

The proposed guidelines published for comment in 2010 flatly prohibited ex ante "joint negotiation" of license terms. In response to objections from several companies that that prohibition was in conflict with US FTC and DOJ guidance in their 2007 IP Report that said such joint negotiation should be assessed under the rule of reason, the EC dropped the prohibition altogether and simply omitted the whole subject from these final guidelines.

AAI urges the US government to make every effort to provide comparable guidance. To the extent possible, US and EC guidelines should be substantively similar.

US authorities and US consumers should be concerned when SEP owners seek and obtain injunctions from courts in Germany; EC and Asian authorities and consumers should be concerned when SEP owners seek and obtain ITC exclusion orders. SSOs develop standards that define the shape and competitiveness of global markets regardless of where their working groups meet or the language in which they conduct their meetings. Patent holdup conduct directed against innovative entrants into new markets in Europe or Asia can adversely affect competition within the US as well as in their home countries. For all of these reasons, SEP-related problems demand global solutions. Public and private stakeholders throughout the world will need to deepen their dialogue about the desirable policies and remedies in this area.

12. Coalitions of leading competitors should not be permitted to purchase patent portfolios with an intent to exclude from the

market or otherwise seriously disable one or more non-included competitors.

An antitrust issue arose when the Rockstar group, consisting of three leading (and three other) mobile device operating system competitors, combined to bid five times as much as their competitor, Google, in order jointly to acquire Nortel's portfolio of patents. As the AAI wrote to the DOJ at the time, this "raises questions about the concerted intentions and objectives of the six consortium members that could not be achieved through independent bidding and eventual individual ownership or licensing of some or all parts of the patent portfolio at stake."[17] The acquisition was not challenged but a post-acquisition question is also raised because of Rockstar's apparently "new" status as an NPE owning 4,000 of the 6,000 Nortel patents and now committed to maximizing revenue from them. Congress should urge the antitrust agencies to aggressively investigate any coalition of leading competitors that appears to be formed or utilized for the purpose of disadvantaging an excluded rival such as by depriving it of access to an SEP.

We thank the committee for its consideration of these observations and recommendations.

[17] See AAI letter to Christine Varney, July 6, 2011, http://www.antitrustinstitute.org/sites/default/files/Nortel%20letter%20to%20DOJ.7.6.11.pdf.

Statement of Senator Dick Durbin
Hearing before the Senate Judiciary Committee
Oversight of the Impact on Competition of Exclusion Orders to Enforce Standard-Essential Patents
July 11, 2012

Mr. Chairman, thank you for holding this hearing. I appreciate the opportunity to submit a statement for the record.

In recent months a number of commenters have urged the U.S. International Trade Commission ("ITC") not to issue exclusion orders in cases where standard essential patents ("SEPs") have been found to be infringed. To justify their position, these commenters have typically cited concerns about the possibility of "patent hold-up" by holders of SEPs. While there is indeed always a possibility that such patent hold-up might occur, any calls to limit the availability of ITC exclusion orders for SEPs or to limit the use of the ITC as a forum for disputes involving imported products that allegedly infringe on SEPs should be made based on actual data that demonstrates that our current system has a problem – and not on the mere possibility of a problem. There is legitimate concern that any changes made to our current system in the absence of such data could unduly favor infringers and prove detrimental to innovators, consumers, and competition at large.

Our current system of patent protection, with ITC playing its key enforcement role, has a long history of working well to encourage innovation and stimulate competition. When complaints of unfair practices arise, case-by-case adjudication of such complaints, including adjudication by the ITC, has been effective in striking the right balance between the interests of patentholders, alleged infringers and the public. Any significant changes to the current system should be cautiously considered in order to ensure that this balance is not unsettled.

The complexities involved in maintaining this balance are evident when it comes to SEPs. When a company agrees to contribute its patented technology to an industry standard, the company commits to negotiate to license the patent on fair, reasonable and nondiscriminatory (F/RAND) terms. While in those negotiations there is always a possibility that a company that has made a F/RAND commitment will seek to use the availability of an exclusion order as leverage to try to obtain better licensing terms, there is an equivalent concern that without the availability of an exclusion order a company using a SEP will hold out for less-than-reasonable licensing terms or will simply infringe on the patent and engage in protracted infringement litigation in court while avoiding paying royalties until the litigation is over. In fast-moving sectors such as the consumer technology sector, such potentially bad-faith behavior by user companies could significantly harm patentholding companies or could incent patentholders not to participate in standard setting processes in the future. Competition and consumers could be detrimentally impacted as a result. For reasons such as these, we should tread carefully when considering changes to the current system of SEP enforcement.

As this Committee proceeds with its consideration of this issue, I hope we will ask for and obtain hard data from our witnesses and from other stakeholders. I also hope we will solicit the views of stakeholders who are not represented at the witness table today, such as the ITC, the Patent and Trademark Office, the U.S. Trade Representative, small technology companies, standard-setting organizations, and consumer groups. Such data and views will help inform our analysis as we consider potential changes to the current patent protection system.

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July 10, 2012

The Honorable Patrick J. Leahy
Chairman, Committee on the Judiciary
United States Senate
The Capitol
Washington, DC

The Honorable Chuck Grassley
Ranking Member, Committee on the Judiciary
United States Senate
The Capitol
Washington, DC

Dear Chairman Leahy and Ranking Member Grassley:

Google has long believed that patent reform is an important element of promoting innovation and competition, particularly in the high-tech sector. In light of the Committee's hearing this week, I wanted to share some thoughts about the enforcement of standard-essential patents and how Congress and regulators can best address the full range of potential harm facing U.S. consumers.

At the outset, we want to make clear that Google *agrees* with both the Department of Justice and the FTC that it is crucial that firms honor their commitments to license their essential patents on a fair, reasonable and non-discriminatory ("FRAND") basis. To that end, Google agrees that courts and the International Trade Commission (the "ITC") may consider whether a patentee has complied with its licensing obligation as a relevant factor in determining whether the public interest supports awarding exclusionary relief based on a standard-essential patent ("SEP"). For the reasons described in more detail below, Google believes the same analysis should apply to patents that are essential to *de facto* standards as well as formal ones. But at the same time, courts and regulators must avoid the temptation to adopt categorical rules that deprive patentees of the rights that Congress and the Patent Office conferred on them and that the patentees did not intend to relinquish through their FRAND licensing promises.

I. THE DELICATE BALANCE OF STANDARD SETTING

As the FTC has recognized, "[i]nteroperability standards can create enormous value for consumers by increasing competition, innovation, product quality and choice."[1]

[1] Third Party United States Federal Trade Commission's Statement on the Public Interest, *In re Certain Wireless Communication Devices, Portable Music & Data Processing Devices, Computers & Components Thereof*, Inv. No. 337-TA-745, June 6, 2012, at 2.

"Industry standards are widely acknowledged to be one of the engines driving the modern economy. Standards can make products less costly for firms to produce and more valuable to consumers. They can increase innovation, efficiency, and consumer choice; foster public health and safety; and serve as a fundamental building block for international trade."[2] And, as *Wired* magazine put it, "[w]e take . . . standardization for granted, but without standardization, there would be no mass production or mass communication. Which is to say, without standardization there wouldn't be a modern economy."[3]

Widely accepted, open standards have also allowed for the rapid development and adoption of new technology. For example, the European Telecommunications Standards Institute ("ETSI") is an SSO created to devise unified telecommunications standards for the European Union (many of which have subsequently become global standards). ETSI's decision to adopt the unified GSM standard in 1989 was responsible for the rapid growth of the digital mobile network in Europe. The percentage of mobile phone users using the digital network in Europe rose from 4% in 1992 to over 90% in 1998.[4] By contrast, over the same period the United States did not adopt a unified standard, and the growth of digital mobile phone use suffered as a result: digital mobile phones began to be used only in 1995, and in 1998 the percentage of mobile phone subscribers using digital cellular phones was still below 30%.[5]

Much, but not all, of that standard setting is undertaken by voluntary organizations with open admissions policies such as ETSI and the Institute for Electrical and Electronics Engineers ("IEEE"). These organizations, which include both innovators and implementers, set the ground rules for the standards development process. Since standards cannot succeed without both access to the necessary intellectual property rights and the willingness of firms to actually use the standard in the market, SSOs will typically seek to establish an IPR regime that balances the interests of innovators and implementers. If patentees feel they will not be able to obtain fair compensation for their inventions, they will not agree to license them according to the SSOs' rules. Conversely, if implementers are not confident that they will be able to license essential patents on reasonable terms, they will not make the complementary

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[2] U.S. Federal Trade Commission and U.S. Department of Justice, *Competitive Aspects of Collaborative Standard Setting*, June 9, 2010 submission to the Organization for Economic Co-operation and Development Competition Committee, available at http://www.justice.gov/atr/public/international/269554.pdf (internal citations and quotations omitted).

[3] James Surowiecki, *Turn of the Century*, Wired, Jan. 2002, available at http://www.wired.com/wired/archive/10.01/standards.html.

[4] World Trade Organization, World Trade Report 2005, at 38-39, available at http://www.wto.org/english/res_e/publications_e/wtr05_e.htm.

[5] *Id.*

investments necessary to bring standards-compliant products to market. Either result would disrupt the virtuous collaboration that yields the consumer benefits of standardization, which have long been recognized by both the FTC and Congress.[6]

Maintaining appropriate incentives for both implementers and innovators to participate in the standardization process is of critical importance. Google therefore agrees with the FTC's recent suggestion that a patentee's ability to obtain an injunction or exclusion order on a FRAND-encumbered patent could be foreclosed by a judicial determination that the patentee failed to comply with its obligation to make licenses to its SEPs available on FRAND terms.[7]

Yet Google also agrees with the FTC that an ITC exclusion order on an SEP may be proper where the patentee has met its FRAND obligation and the infringer is unwilling to take a FRAND license, at least absent evidence that the patentee affirmatively waived its right to exclusionary relief.[8] Tellingly, although SSOs have typically adopted rules requiring participants to disclose IPR that would be essential to proposed standards and to license essential IPR on FRAND terms, they have not adopted rules prohibiting the use of injunctions against implementers who refuse to pay FRAND rates.

There is nothing *preventing* SSOs from adopting more restrictive rules, however, if their members believe such rules would better accomplish their collective goals. For example, a minority of SSOs affirmatively require members to grant royalty-free licenses on specific terms for compliant implementations of a standard. Such a rule increases certainty (since there are no terms to be negotiated between the parties), but also requires patentees to decide whether they are willing to forego all compensation for their innovations in exchange for participation in the SSO. Each SSO's membership must decide for itself whether that trade-off makes sense for its purposes (or even for the purposes of a particular standard). The debate over such rules can reveal important information, such as when 12 to 14 innovator firms threatened to pull out of ETSI in 1993 if a new licensing rule was adopted that they believed would have imposed

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[6] *See* Standards Development Organization Advancement Act of 2004, 15 U.S.C. §§ 4301-06.

[7] Third Party United States Federal Trade Commission's Statement on the Public Interest, *In re Certain Wireless Communication Devices, Portable Music & Data Processing Devices, Computers & Components Thereof*, Inv. No. 337-TA-745, June 6, 2012, available at http://www.ftc.gov/os/2012/06/1206ftcgamingconsole.pdf.

[8] The FTC's statement that "the ITC could find that Section 337's public interest factors support denial of an exclusion order *unless* the holder of the RAND-encumbered SEP has made a reasonable royalty offer" suggests that an injunction would be proper as long as the patent holder had made a reasonable royalty offer. *See* Third Party United States Federal Trade Commission's Statement on the Public Interest, *In re Certain Wireless Communication Devices, Portable Music & Data Processing Devices, Computers & Components Thereof*, Inv. No. 337-TA-745, June 6, 2012, at 4 (emphasis added).

additional costs on them, which led to the proposed change being rejected.[9] But once a decision is made, the government's role should be to enforce the contractual agreement that the parties (through the SSO) actually reached, not to effectively rewrite their bargain to match a third party's view of what they should have agreed to.[10]

There is, nonetheless, good evidence that rules that permit injunctions in certain circumstances lead to successful standards that are accepted by both innovators and implementers. For example, between 1999 and 2010 there was a 2,700% increase in the number of patents declared to ETSI, which led to the rapid deployment of 2G, 3G and 4G, and the rapid decline of smartphone pricing.[11] All of this occurred during a period of time in which ETSI's IPR policy permitted innovators to obtain injunctions on their FRAND-encumbered patents. The clear benefits to consumers from those new standards suggest that policy makers should be cautious before upsetting the balance that the directly-affected stakeholders have struck for themselves.

Indeed, Microsoft itself has previously recognized that a "uniform declaration that [injunctive or exclusionary] relief would not be available if the patent holder has made a commitment to offer a RAND license for its essential patent claims in connection with a standard may reduce any incentives that implementers might have to engage in good faith negotiations with the patent holder." [12]

Nor does the theoretical availability of injunctive relief mean that it is a frequent occurrence. To the contrary, MMI's experience suggests the exact opposite: the overwhelming majority of licensees negotiate in good faith and are able to reach reasonable license terms without resort to litigation, let alone injunctive relief. MMI itself has concluded more than 50 bilateral SEP license agreements, providing further evidence that the current standardization system works.

It is no accident that the firms that are petitioning the government to alter that successful status quo were not significant participants in the development of the standards in question. To the contrary, both Apple and Microsoft are dominant providers of proprietary operating systems who have invested little time and money in

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[9] Eric J. Iversen, *Standardization and Intellectual Property Rights: ETSI's Controversial Search For New IPR-Procedures*, in K. Jakobs, R. Williams (Eds.), *SIIT'99 Proceedings*, 1999, available at http://eprints.utas.edu.au/1297/1/Iversen_ETSI_2OO2.pdf.

[10] The same contract law principles dictate that while SSOs retain the freedom to change their rules prospectively, an effort to retroactively change the content of their members' licensing obligations still amounts to an improper attempt at *ex post* appropriation.

[11] *See* ETSI, *IPR Database Shows Explosive Growth, supra* n. 2.

[12] Microsoft Corp., Public Comment for the FTC Patent Standards Workshop, Project No. P11-1204 (June 14, 2011), http://www.ftc.gov/os/comments/patentstandardsworkshop/00009-60523.pdf.

contributing cellular standard essential patents.[13] Their clear incentive is to minimize the amount of money they pay to those who have invested billions in building open telecommunication protocols while maximizing the amount they can charge users of their own proprietary operating systems. These efforts, like prior rejected efforts to change ETSI's IPR policy to disfavor innovative SEP holders, threaten innovation and the ability of SSOs to incorporate robust technologies.[14]

II. THE IMPORTANCE OF *DE FACTO* STANDARDS

While collaborative SSOs play an important part in the overall standard setting system, and are particularly prominent in industries such as telecommunications, they are not the only source of standards. Indeed, many of the same interoperability benefits that the FTC and others have touted in the SSO context also occur when one firm publishes information about an otherwise proprietary standard and other firms then independently decide (whether by choice or of necessity) to make complementary investments to support that standard in their products.

Because proprietary or *de facto* standards can have just as important effects on consumer welfare, the Committee's concern regarding the abuse of SEPs should encompass them as well. For example, when Sony and Phillips adopted the Orange Book standard for re-writable CDs, they acted unilaterally (outside the framework of an SSO), yet many other firms soon invested in complementary technologies that relied on that framework. Similarly, Microsoft's dominance has allowed it to specify proprietary technologies, such as the FAT file system standard or the ActiveSync protocol for mobile synchronization with Exchange Server, which other firms must use if they want to fully interoperate with Microsoft's products. If Microsoft were to cut off access to those protocols (or provide it only on a discriminatory basis), consumers would unquestionably be harmed.

[13] In this context it is worth noting that Apple's November 11, 2011 letter to ETSI only commits Apple to not seeking injunctions on cellular standard essential patents and further permits Apple to seek injunctions even on those patents if the patentee seeks more than Apple wants to pay. In other words, it is nothing more than a promise not to seek an injunction if Apple gets what it wants.

[14] Recently, certain ETSI members proposed a change to ETSI's IPR policy to write "numeric proportionality" into the definition of FRAND – meaning that FRAND rates would be dependent on the share of declared SEPs owned by a firm – but ETSI rejected this proposal. Damien Geradin & Anne Layne-Farrar, *The Logic and Limits of Ex Ante Competition in a Standard-Setting Environment*, 3 Competition Pol. I'ntl 79, 88 (2007), available at http://www.iprinfo.com/tiedostot/Geradin.Helsingfors.pdf. Standard setting experts recognize that IPR policy changes such as this "would be a demotivator for innovation" and would distort the standard setting process. Damien Geradin, *Standardization and Technological Innovation: Some Reflections on Ex-Ante Licensing, FRAND, and the Proper Means to Reward Innovators*, ISSN 1572-4042, at 14-15 (June 2006), *available at* http://www.tilburguniversity.edu/research/institutes-and-research-groups/tilec/publications/discussionpapers/2006-017.pdf.

Moreover, in many cases, the designer of a proprietary standard has a strong incentive to encourage its adoption by other firms, which may lead it to commit to license its essential IPR on FRAND terms. Microsoft made just such a commitment in its Interoperability Principles and Interoperability Undertaking. When such a commitment encourages firms to adopt and utilize the standard instead of invest in competing technology, the same policy considerations that the FTC spelled out in its Public Interest Statement apply: the ITC should not grant exclusionary relief on patents that the patentee has refused to license on reasonable terms, in breach of an earlier promise. Indeed, one might argue that the harm to consumer welfare is more significant where a promise entrenches a proprietary as opposed to a collaborative standard. This is so because open collaborative standards are less likely to be used by a single dominant firm to reinforce power in an upstream, downstream, or adjacent market. In addition, open collaborative standards are subject to change by SSO members, as exemplified by the rapid introduction and replacement of telecommunication standards over the past two decades.

Other types of promises are susceptible to similar analysis. For example, where a firm pledges to avoid royalty stacking by licensing all of its SEPs for a certain capped royalty, it should not be permitted to circumvent that commitment by transferring some of the covered SEPs to third parties, especially where the transferring firm retains a share of the royalties collected by the transferee. Such a rule is consistent with the FTC's conclusion in *In the Matter of Negotiated Data Solutions LLC* (*N-Data*), where the Commission stated that a transferee that sought royalties in excess of the transferor's declared royalty rate violated Section 5 of the FTC Act.[15]

III. NEITHER GOOGLE NOR MMI HAVE VIOLATED THEIR FRAND OBLIGATIONS

In light of certain allegations that Apple and Microsoft have raised against MMI in the press and in complaints to regulators, I also wanted to take this opportunity to briefly address a few significant factual issues.

First, while the FTC's June 6, 2012 Statement on the Public Interest expressly stated that it takes no position on the facts regarding the 337 proceeding between Microsoft and MMI, it quoted with approval an ITC Initial Determination that "the royalty rate of Motorola of 2.25%, both as to its amount and the products covered, could not possibly have been accepted by Microsoft."[16] It is important to recognize, however, that the ALJ's Initial Determination relates only to the initial offer that MMI sent Microsoft in 2010, which reflected MMI's longstanding standard opening offer of 2.25% of the end-

[15] *In the Matter of Negotiated Data Solutions LLC*, File No. 051-0094, Analysis of Proposed Consent Order to Aid Public Comment ("Analysis to Aid Public Comment") at 7 (January 23, 2008).

[16] Initial Determination, Certain Gaming and Entertainment Consoles, Related Software, and Components Thereof, Inv. No. 337-TA-752 at 300 (Int'l Trade Comm'n filed May 11, 2012).

device implementing the standard, a rate that was well known in the industry for decades.

The ALJ made no determination regarding subsequent offers made by MMI in 2011 or Google in 2012, the most recent of which dramatically reduced the requested license from 2.25% of the desktop or notebook implementing Windows to a flat royalty of $0.50 for each copy of Windows (well below 2.25% of the price of Windows to OEMs).[17] MMI changed its offer because it realized after conversations with Microsoft that its standard offer might not apply to Microsoft's business model. MMI and Google's revised offers demonstrate that the threat of an injunction did not give MMI (or Google) unlimited power to charge whatever it wanted. They are also significant because courts have recognized that a party's compliance with its FRAND licensing obligations should be determined not by a firm's initial offer but by the firm's willingness to negotiate in good faith and to reach FRAND terms and conditions through bilateral negotiation.[18] Specifically, in denying Microsoft's motion for summary judgment that MMI's offered rate was not FRAND, the U.S. District Court for the Western District of Washington held:

> Because the IEEE and ITU agreements anticipate that the parties will negotiate towards a RAND license, it logically does not follow that the initial offers must be on RAND terms. Here, critical to the court is the observation that RAND terms cannot be determined until after a negotiation by the parties (or, in this case, after a court determines RAND terms because the parties cannot agree). . . . Thus, a requirement that the standard essential patent holder (here, Motorola) make unsolicited offers on RAND terms would frustrate this purpose by discouraging the standard essential patent holder to make initial contact with implementers for fear that it will later be sued for making an initial offer that is later determined as not RAND.[19]

Second, despite Apple's complaints to the contrary, MMI's request for a 2.25% royalty on the price of a handset, tablet or similar mobile device implementing MMI's SEPs is well within industry norms of reasonableness. For example, MMI's approach is

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[17] Susan Decker, *Google's Motorola Mobility Offers to End Microsoft Cases*, Bloomberg Businessweek, June 21, 2012, available at http://www.businessweek.com/news/2012-06-20/google-s-motorola-mobility-offers-to-settle-microsoft-cases.

[18] This approach is also consistent with the interpretation of a "reasonable royalty" as used in section 284 of the Patent Act, which courts have understood to refer to the amount that a willing licensor and a willing licensee, acting reasonably, would bargain for at arms-length. *See, e.g., GoLight, Inc. v. Wal-Mart Stores, Inc.*, 355 F.3d 1327, 1338 (Fed. Cir. 2004); *Maxwell v. J. Baker, Inc.*, 8 F.3d 1098, 1108-10 (Fed. Cir. 1996); *Mahurkar v. C.R. Bard, Inc.*, 79 F.3d 1572, 1579-81 (Fed. Cir. 1996); *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1554 (Fed. Cir. 1995) (en banc).

[19] Order, *Microsoft Corp. v. Motorola, Inc.*, Case No.10-CV-1823 (W.D. Wash. June 6, 2012) at 24.

quite similar to the licensing policies of Nokia (which charges 2% of the end-device implementing the standard), Alcatel-Lucent (which charges 2% of the end-device implementing the standard), Ericsson (which charges 1.50% of the price of the end-device implementing the standard) and Qualcomm (which charges 3.25% of the price of the end-device implementing the standard).[20]

Significantly, MMI did not immediately seek an injunction against Apple. To the contrary, MMI spent more than three years attempting to negotiate with Apple, which categorically refused to make a counter-offer.[21] It was only after Apple began its patent war against the Android ecosystem, suing patent-poor HTC in an effort to leverage a settlement or adverse judgment against MMI and other Android OEMs and making clear that it had no intention of paying FRAND royalties unless sued, that MMI first sued Apple in both district court and the ITC.[22]

Third, it is clear that neither Google nor MMI have taken actions prohibited by *N-Data*, *Rambus* or any other relevant precedents: they have not repudiated their FRAND obligations with respect to the patents in suit, nor have they increased the rates that they are seeking above that which SSO participants believed they would have to pay at the time they included MMI's technology as part of the applicable standards. Thus, the basic condition necessary for patent hold-up as described in the FTC's June 6, 2012 Statement on the Public Interest is simply not met: MMI has not sought "high royalty rates and other favorable terms, after a standard was adopted, that [it] could not credibly demand beforehand."[23]

In sum, Microsoft and Apple are simply claiming that MMI's initial requested royalty of 2.25% of the end-device implementing the standard is too high—notwithstanding the fact that MMI's rate has been consistent and well-known in the industry for the last twenty years and is within the range of other similarly situated

[20] *See* Eric Stasik, *Royalty Rates and Licensing Strategies For Essential Patents On LTE (4G)Telecommunication Standards*, les Nouvelles, 114-119, 116 Sep. 2010, available at http://www.investorvillage.com/uploads/82827/files/LESI-Royalty-Rates.pdf.

[21] Roger Cheng, *Apple to put iPads, iPhones back on shelves in Germany*, ZDNet, Feb. 6, 2012, http://www.zdnet.com/news/apple-to-put-ipads-iphones-back-on-shelves-in-germany/6342745 ("Motorola argued that it had approached Apple in 2007 with fair licensing terms and attempted to work out a deal for three years.").

[22] *Id.* ("Apple's refusal to negotiate in good faith, as well as their aggressive litigation campaign against Android, left Motorola Mobility with no option other than to seek to enforce the company's rights and patent portfolio . . .") (internal quotations omitted).

[23] Third Party United States Federal Trade Commission's Statement on the Public Interest, *In re Certain Wireless Communication Devices, Portable Music & Data Processing Devices, Computers & Components Thereof*, Inv. No. 337-TA-745, at 2, June 6, 2012, available at http://www.ftc.gov/os/2012/06/1206ftcgamingconsole.pdf.

companies. Even though the conditions for hold-up are not present, both Microsoft and Apple can bring breach of contract actions against Google and MMI if they believe that MMI has not complied with its obligation to license the patents at FRAND rates. But those are contract claims, not antitrust claims, and we should be careful before converting a simple breach of contract claim into an antitrust claim.[24] As a DOJ representative has explained, "[w]here genuine fraud, predation, or other objectively unreasonable conduct occurs, antitrust likely always will have a role in standard setting. But where conflict can be fairly characterized merely as a foreseeable disagreement over price, it would be odd and inefficient to federalize such disagreements through use of the antitrust laws and the imposition of treble damages."[25]

IV. THE COMMITTEE SHOULD EXPAND ITS INQUIRY

Although the Committee has so far focused its attention on FRAND-encumbered patents that have been formally declared to SSOs, Google respectfully suggests that it should expand its inquiry to include FRAND-encumbered patents that are essential to dominant proprietary standards—including but not limited to patents held by Microsoft. Violations of such FRAND commitments potentially pose an even greater harm to consumer welfare given the enduring nature of dominant proprietary standards.

Further, Google respectfully suggests that the Committee and the FTC should also expand their inquiries to include transfers of SEPs that enable patentees to violate anti-royalty stacking pledges. This is especially problematic both where the transfer is to a non-practicing entity ("NPE") that is immune from countersuit and where the patentee retains a share of the royalties collected by the transferee. Proscribing such transfers is squarely within *N-Data* and other controlling judicial and FTC precedent.

A. Microsoft Abandoned Licensing Negotiations to Sue on Its RAND-Encumbered ActiveSync Patents and Has Demanded Unreasonable Royalty Rates

In 2009, to address the European Commission's competition concerns raised in Case 39.294 *Microsoft*, Microsoft promised in its Interoperability Undertaking ("Undertaking") to disclose interoperability information for several of their products. In particular, Microsoft's Undertaking included a commitment to make available information that would enable non-Microsoft software products to interoperate with Microsoft's

[24] "The use of conventional antitrust language in drafting a complaint will not extend the reach of the Sherman Act to wrongs not germane to that act, even though such wrongs be actionable under state law." *Parmelee Transp. Co. v. Keeshin*, 292 F.2d 794, 804 (7th Cir. 1961).

[25] Gerald F. Masoudi, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, "Objective Standards and the Antitrust Analysis of SDO and Patent Pool Conduct," October 11, 2007.

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dominant email client and server products: Outlook and Exchange.[26]

To ensure that such information was realistically, not only nominally, available to third parties, Microsoft unequivocally made certain promises regarding the patents that may read on the interoperability information. First, Microsoft promised in the Undertaking that "access to and use of the Interoperability Information shall be subject to *reasonable and non-discriminatory terms*."[27] Additionally, Microsoft also promised that it would give at least 90 days' advance written notice before filing suit against vendors or developers of competing software products or their customers claiming that the implementation of the applicable Interoperability Information covered by the Undertaking infringes Microsoft's patents.[28]

Microsoft has clearly violated its RAND commitment with respect to ActiveSync. The ActiveSync protocol is Microsoft's proprietary protocol for enabling mobile devices to communicate with a Microsoft Exchange server to send and receive emails and synchronize personal information such as the user's calendar and contacts. As such, the ActiveSync protocol, as well as the patents reading on the protocol, is squarely covered by Microsoft's promises made in the 2009 Undertaking.

However, on October 1, 2010, Microsoft without prior notice that it was going to sue MMI brought a complaint against MMI before the ITC alleging infringement of several patents, including some that it claims cover the ActiveSync protocol.[29] This unannounced suit was clearly in violation of Microsoft's commitment to provide 90-day notice under the 2009 Undertaking.

Moreover, Microsoft's royalty demands for ActiveSync also violated their RAND commitments on these patents. Microsoft's strategy for licensing ActiveSync technology has involved offering very low royalty rates in the early years to companies like MMI in order to discourage manufacturers from developing competing technologies. Once users were further locked into Microsoft's Windows ecosystem, Microsoft dramatically increased rates. There is no question that such intentional and flagrant violations of Microsoft's RAND commitments have helped maintain Microsoft's market power in violation of both Section Two of the Sherman Act and Section Five of the FTC Act. Furthermore, as is evidenced by Microsoft's efforts to obtain an injunction based upon ActiveSync, it is clear that Microsoft's recent promise to forego injunctions on

[26] Microsoft, Microsoft Interoperability Undertaking, available at http://www.microsoft.com/en-us/news/presskits/eu-msft/docs/microsoftinteroperabilityundertaking16dec2009 (emphasis added).

[27] *Id.*

[28] *Id.*

[29] Complaint, Certain Mobile Devices, Associated Software, and Components Thereof, Inv. No. 337-TA-744 (Int'l Trade Comm'n filed Oct. 1, 2010).

standard-essential patents[30] was self-serving and hypocritical. Although Microsoft wants to deny the possibility of injunctive relief to SEPs incorporated into a collaborative standard-setting process—which are of less strategic value to Microsoft—it does not believe the same should apply to patents that are essential to the *de facto* standards that it intentionally helped to create, and which Microsoft seeks to exploit.

But there is no reason to treat FRAND commitments on *de facto* essential patents any differently than FRAND commitments on patents declared to SSOs. In both cases, FRAND commitments induce parties to invest in the standard and in both cases that investment may entrench the particular standard. Indeed, the only difference is that it is even harder for users to switch away from dominant proprietary standards given the inability of an SSO to discipline abuses by not adopting the patentee's technology in future standards. In this context, it is telling that Microsoft's Windows operating system has remained dominant over the last three decades, while these same three decades have seen a rapid change in the standards adopted by ETSI.

B. Firms Should Not Evade Their FRAND Obligations by Transfers to NPEs

As the FTC recognized in *N-Data*, a firm that acquires a patent subject to a FRAND commitment may violate Section 5 of the FTC Act if it knowingly breaches the FRAND commitments of its transferor or predecessor-in-interest and such repudiation was not anticipated before the market-wide adoption of the standard. Similar logic applies where firms make explicit promises not to stack royalties on their portfolio of SEPs and then split up the portfolio of SEPs among NPEs who seek royalties in violation of the transferor's anti-royalty stacking pledge. For example, a firm that pledges that it will not seek more than x% royalties for its portfolio of SEPs no matter how many standards are licensed should not be permitted to sell its portfolio to NPEs—or anybody else—who then seek x% for each standard that is licensed, if the transaction poses the requisite threat of anticompetitive effects. This is especially true where the transferor maintains an ownership interest in the royalties collected by the transferee.

Consider, for example, the case of Nokia, which in 2010 announced that it would license its SEPs for no more than 2% of the sales price of a licensee's end-user device "irrespective of the number of wireless standards deployed in such a device."[31] In other

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[30] Microsoft, Microsoft's Support for Industry Standards (Feb. 8, 2012), available at http://www.microsoft.com/about/legal/en/us/IntellectualProperty/iplicensing/ip2.aspx.

[31] Press Release, "Nokia Licensing Policy on Long Term Evolution and Service Architecture Evolution Essential Patents," Internet Archive (WayBackMachine) (July 2010-October 2010), http://web.archive.org/web/20101015065029/http:/www.nokia.com/press/ipr-information/statement/nokia-licensing-policy-on-long-term-evolution-and-service-architecture-evolution-essential-patents ("Currently, we expect Nokia's rate for devices that deploy LTE as the only wireless communication standard to be in a range of 1.5 percent from the sales price of an end-user device. However, a significant use of LTE is expected to be in connection with other wireless communication standards, such as GSM, UMTS and/or

words, Nokia committed itself to a royalty cap of 2% and no royalty stacking. This pledge, like others before it, was plainly designed to induce the adoption of Nokia's technology. By providing a legally binding commitment on which implementers justifiably thought they could rely for protection, Nokia convinced implementers that they could safely manufacture products reading on Nokia's IPR.

In September of 2011, Nokia transferred more than 1,200 SEPs declared essential to GSM, UMTS/WCDMA and LTE to an NPE named MOSAID Technologies Inc.[32] Because NPEs are immune from counter-suit and have no interest in cross-licensing or maintaining a good reputation before SSOs, they frequently charge royalties that are well in excess of the amount needed to incentivise innovation. Indeed, by some accounts the aggregate direct costs of patent assertion by NPEs amounted to $29 billion in 2011.[33]

Implementers who adopted Nokia's technology in reliance on Nokia's 2% royalty cap/no-royalty-stacking commitment now face the disturbing prospect of having to pay whatever royalty rate MOSAID decides to charge. And all signs point to MOSAID charging *a lot*. According to MOSAID, the acquired patents represent "one of the strongest standards-essential wireless portfolios on the planet," and will generate licensing fees on *"$500 billion in mobile device revenues*" over the next five years.[34] Indeed, Microsoft, which curiously has an ownership interest in the transferred Nokia patents, claims that this transaction "*unlocks* the considerable value" of the Nokia patents, which provides rather clear evidence that Nokia and Microsoft believe that MOSAID will be able to charge more for these patents than Nokia could prior to the transfer.[35] Even more disconcerting, manufacturers who refuse to accede to MOSAID's

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CDMA. When multiple wireless standards are used in the same end product, Nokia will follow similar principles in setting the royalty rate for Nokia patents essential to other standards. To avoid unfavorable effects of royalty stacking, Nokia will not charge royalties higher than 2.0 percent from the sales price of an end-user device for IPR that is essential to wireless communication standards irrespective of the number of wireless standards deployed in such a device.").

[32] See Press Release, "MOSAID Acquires 1,200 Nokia Standards-Essential Wireless Patents and 800 Wireless Implementation Patents", MOSAID, Sept. 1, 2011, http://www.mosaid.com/corporate/news-events/releases-2011/110901.php. According to MOSAID, the assigned portfolio contains 517 patents declared essential for 2G telecom standards, 925 for 3G and 169 for 4G. *See* Webcast, "MOSAID acquires 2,000 Nokia Wireless Patents", MOSAID Technologies, Sep. 13, 2011, http://www.youtube.com/watch?v=Bdq3_jtOy_E (at 2:10).

[33] *See* James E. Bessen and Michael J. Meurer, *The Direct Costs from NPE Disputes*, Boston Univ. School of Law, Law and Economics Research Paper No. 12-34, June 28, 2012, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2091210.

[34] MOSAID, Annual and Special Meeting of Shareholders 19-26 (Sep. 22, 2011), available at http://www.mosaid.com/corporate/investor-relations/AGM2011.pdf.

[35] Mary Jo Foley, "Microsoft Weighs in on Mosaid-Nokia Patent Deal", ZDNet, Sep. 2, 2011,http://www.zdnet.com/blog/microsoft/microsoft-weighs-in-on-mosaid-nokia-patent-deal/10523.

royalty demands may have their products enjoined from entering the country under Section 337.[36]

The MOSAID agreement harms implementers and consumers—and raises Nokia's and Microsoft's rivals' costs—for two distinct reasons. First, the agreement enables Nokia to evade its 2% licensing commitments by outsourcing its patents to an agent with a greater incentive and ability to assert those patents aggressively. MOSAID is required to "monetize the Assigned Patents and to maximize the Royalty."[37] MOSAID also must meet "royalty milestones" payable to Nokia and Microsoft, otherwise it must pay the difference through short fall payments. If the payments are not made, Nokia and Microsoft may force MOSAID to assign the patents to a third party. And, perhaps most flagrantly, MOSAID officials have confirmed that MOSAID will retain one third of the revenue generated by the transferred patents, leaving Nokia and Microsoft to share in the remaining two thirds.[38] Thus, Nokia maintains a direct, ongoing financial stake in these patents and can derive royalties in excess of its 2% commitment.

Second, the MOSAID agreement fosters royalty stacking by atomizing Nokia's SEP portfolio. Even if MOSAID adhered to Nokia's promise not to charge a royalty greater than 2%, that would still represent a 100% increase over the price that implementers expected to pay for a license when, relying on Nokia's FRAND commitment, they decided to adopt the technology. Prior to Nokia's transfer to MOSAID, manufacturers expected to pay 2% for a license to *all* of the patents in Nokia's SEP portfolio. Now, even if MOSAID "honors" Nokia's 2% undertaking, both MOSAID and Nokia can collect that 2% from alleged infringers. Implementers thus face the prospect of paying a 2% royalty for a license to Nokia's (remaining) SEPs, and a further 2% royalty for a license to Nokia's (transferred) SEPs. Especially in light of Nokia's

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[36] Because the ITC has concluded that unproductive patent licensing alone may satisfy the domestic industry requirement of Section 337, MOSAID and other NPEs can receive exclusion orders banning the importation of products that they would likely not be able to enjoin were they to seek an injunction in district court—since it is unlikely that an NPE would satisfy the *eBay* factors. *Certain Coaxial Cable Connectors and Components Thereof and Products Containing Same* ("*Coaxial Cables*"), Inv. No. 337-TA-650, Comm'n Op. at 47-49 (April 14, 2010) (as cited in Veronica S. Ascarrunz, *Common Issues in Proving Domestic Industry at the ITC: Using Non-Manufacturing Versus Manufacturing Activities*, delivered at AIPLA Annual Meeting, October 20-22, 2011).

[37] These terms are indicated in documents filed by MOSAID with the Canadian Securities Administrators, which include redacted versions of a Confidential Share Purchase Agreement between Intellectual Property Asset Trust and MOSAID Technologies, Inc., Sept. 1, 2011, and a Confidential Royalty Participation Agreement between MOSAID Technologies Inc., Core Wireless Licensing S.a.r.l., Nokia Corp. and Microsoft Corp., Sept 1, 2011.

[38] See Diana ben-Aaron, "Nokia Transfers Part of Patent Portfolio to Canada's MOSAID", Bloomberg, Sep. 1, 2011, http://mobile.bloomberg.com/news/2011-09-01/mosaid-acquires-portfolio-of-nokia-patents-for-undisclosed-sum.

prior promises about limiting total per device royalties to "a modest single digit level,"[39] that increase from 2 to 4% represents a significant—and abusive—repudiation of Nokia's commitments. And if this practice is allowed, there is potentially no limit to the degree to which a patentee like Nokia could divide its portfolio, leading to an ever more prohibitive royalty stack.

Nokia's repudiation of its FRAND commitments in this manner constitutes a clear violation of Section 5 of the FTC Act under the principles articulated in *N-Data*. As in *N-Data*, Nokia and MOSAID's conduct is inherently oppressive and coercive. Nokia and MOSAID's conduct threatens to raise prices for an entire industry and undermine the standard-setting process. Even more egregious than in *N-Data*, this is not a case where the repudiation is the mere unilateral decision of an opportunistic transferee or successor-in-interest. Rather, the abuse in the instant case is being effectuated by a joint scheme between the *original* FRAND-obligated licensor (Nokia) and a third party transferee (MOSAID) brought in to help the licensor creatively repudiate its FRAND obligations. This conduct should be condemned under Section 5.

V. CONCLUSION

Google appreciates the Committee's interest in addressing the competition issues relating to FRAND-encumbered patents and hopes that it respects the delicate balance between implementers and innovators reflected in SSO polices as well as the FTC's June 6, 2012 Statement on the Public Interest. Furthermore, Google hopes that the Committee expands its focus to take into account the harm to consumer welfare caused by the transfer of FRAND-encumbered SEPs to NPEs and by the violation of FRAND commitments on patents that are essential to dominant proprietary standards.

Sincerely,

Kent Walker

cc: The Honorable Herb Kohl
The Honorable Dianne Feinstein
The Honorable Chuck Schumer
The Honorable Orrin G. Hatch
The Honorable Jon Kyl
The Honorable Jeff Sessions

[39] Press Release, "Industry leaders NTT DoCoMo, Ericsson, Nokia and Siemens, and Japanese manufacturers reach a mutual understanding to support modest royalty rates for the W-CDMA technology worldwide", Nokia, Nov. 6, 2002, http://press.nokia.com/2002/11/06/industry-leaders-ntt-docomo-ericsson-nokia-and-siemens-and-japanese-manufacturers-reach-a-mutual-understanding-to-support-modest-royalty-rates-for-the-w-cdma-technology-worldwide/.

The Honorable Dick Durbin
The Honorable Sheldon Whitehouse
The Honorable Amy Klobuchar
The Honorable Al Franken
The Honorable Christopher A. Coons
The Honorable Richard Blumenthal

The Honorable Lindsey Graham
The Honorable John Cornyn
The Honorable Michael S. Lee
The Honorable Tom Coburn

Senator Grassley's Statement for Judiciary Committee Hearing "Oversight of the Impact on Competition of Exclusion Orders to Enforce Standard-Essential Patents," July 11, 2012

Mr. Chairman, thank you for holding this hearing on the competition impact of exclusion orders relative to standard-essential patents. Industry standards are crucial to allowing the myriad of electronic and mobile devices consumers use and rely on every day to interface and connect with other consumers and the internet. Recently, there have been questions and increased litigation over the way standard-essential patents are utilized and enforced, so it's appropriate for the Committee to look into this issue.

When companies agree to contribute their patents to become an industry standard, they usually commit to make them available on fair, reasonable and non-discriminatory licensing terms, also known as "RAND" or "FRAND." By having access to these standards, companies can create new technologies, products and services, and the different electronic devices – like smart phones, computers and tablets – have the ability to seamlessly interface with each other. Other benefits include lower prices, better quality, and more consumer choice. Consumers want to use different products and technologies made by different companies. They want choice and more options in what they buy and use – they don't want to be limited to using devices or services from just one company. And it isn't as expensive to exchange different kinds of devices when they can all interoperate with each other. Competition is good for consumer choice and satisfaction, as well as for innovation and technological advances.

Consequently, there is a real question as to whether it is anti-competitive and/or anti-consumer when standard-essential patent holders, that have agreed to license their products under RAND terms, seek injunctive relief against or exclude companies that have implemented their standard. Companies that have relied on standard-setting organization RAND agreements and incorporated standard-essential patents into their products expect to be able to negotiate reasonable royalties with the patent holder. At the same time, when there is patent infringement, we don't want to restrict the ability of patent holders to protect their patents from infringers. We don't want to dis-incentivize participation in standard-setting bodies or hamper the ability of companies to generate new products and technologies.

I'm interested in learning more about what are the issues surrounding standard-essential patents and RAND commitments, what are the obligations of standard-setting organization participants, as well as what is happening in the courts and at the International Trade Commission. I'd like to hear about how extensive the "hold up" problem is, and how it has and/or will impact innovation and competition. I'm interested in hearing more about how we can best balance the interests of standard-essential patent holders, standard-essential patent implementers, and consumers who use products that incorporate standard-essential patents.

Mr. Chairman, I appreciate your holding this oversight hearing so we can gather information on standard-essential patents. This is an important topic with important ramifications, so we should be careful about how we proceed. Certainly we all want to make sure that competition is protected and promoted, consumers are not harmed, and the standard-setting process is not abused. But we also want to make sure that we don't take actions that will have unintended consequences, like overly restricting avenues of relief for property rights owners or weakening unfair trade remedies and enforcement tools.

I look forward to today's testimony.

Statement of Senator Patrick Leahy
Chairman, Senate Judiciary Committee
Hearing on "Oversight of the Impact on Competition of Exclusion Orders to Enforce Standard-Essential Patents"
July 11, 2012

In recent months, we have seen a growing number of companies engage in what some are calling the next wave in the "tech patent wars." Companies that previously cross-licensed their technologies with other companies in the market are increasingly seeking to block their competitors instead. This has the potential to harm consumers by preventing access to their favorite devices.

I have long championed the strong enforcement of our intellectual property laws because enabling inventors to profit from their work encourages innovation. Patent protection is particularly important for Vermont: the Intellectual Property Organization recently announced that in 2011 Vermont again received the most patents per capita of any state.

When inventors and developers are willing to license their technologies to one another at reasonable rates, the cross-fertilization of ideas benefits us all. But I am concerned that the recent trend of seeking exclusion orders from the International Trade Commission (ITC), rather than negotiating and seeking license fees, may have the opposite effect.

Today's hearing focuses on the enforcement of standard-essential patents at the ITC. Standard setting is important because it allows different companies to have their products interoperate, giving us important developments like the 3G technology used in cellular phones. To participate in the standard setting, patent owners often agree to license their patents to anyone on reasonable terms.

In March, I wrote to the administration expressing concern that ITC exclusion orders can be misused to prevent rival technologies when holders of standard-essential patents fail to reach agreement on licensing terms. These orders can pose a significant threat to competition and innovation, especially where competitors have developed products based on a mutual commitment to license standard-essential patents on reasonable terms.

Senator Lee and other Senators on this Committee have since written to the ITC expressing similar concerns. As with patent reform, this is a bipartisan issue. We have an interest on both sides of the aisle in ensuring the patent laws promote innovation and competition.

The Department of Justice and the Federal Trade Commission play a vital role in protecting consumers and competition by enforcing our nation's antitrust laws. They also have an important role in advising on antitrust issues. Congress recognized that role when it required the ITC to consult with the FTC and DOJ on competition issues that would be raised by the issuance of an exclusion order.

The testimony of today's witnesses will give the Committee a chance to further explore the competitive impact of ITC exclusion orders and whether more needs to be done to ensure consumers are not the victims of the tech patent wars.

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Prepared Statement of
The Federal Trade Commission

Before the
United States Senate Committee on the Judiciary

Concerning
"Oversight of the Impact on Competition of Exclusion Orders to Enforce Standard-Essential Patents"

Washington, D.C.
July 11, 2012

Chairman Leahy, Ranking Member Grassley, and Members of the Committee, thank you for the opportunity to appear before you today. I am Edith Ramirez, Commissioner of the Federal Trade Commission (FTC), and I am pleased to testify on behalf of the FTC to discuss the impact on competition of injunctive relief, including an International Trade Commission (ITC) exclusion order, to enforce standard-essential patents.[1] The testimony focuses on standard-essential patents (SEPs) that a patent holder has committed to license on reasonable and non-discriminatory (RAND) terms.[2] Simply put, the FTC is concerned that a patent holder may use the threat of an ITC exclusion order, or an injunction issued in district court, to "hold-up" or demand higher royalties or other more costly licensing terms after the standard is implemented than could have been obtained before its IP was included in the standard. Federal district courts have the tools to address this issue, by balancing equitable factors or awarding money damages,[3] and the FTC believes that the ITC likewise has the authority under its public interest obligations

[1] The written statement represents the views of the Federal Trade Commission. My oral presentation and responses to questions are my own and do not necessarily reflect the views of the Commission or of any other Commissioner.

Commissioner Rosch concurs in the submission of this testimony, but, as he has previously stated (see infra note 3), he is of the view that the issuance of injunctive relief, including an ITC exclusion order, is inappropriate where the patent holder has made a RAND commitment for a standard essential patent, even if the patentee has met its RAND obligation. In his view, a RAND pledge appears to be, by its very nature, a commitment to license; if so, seeking injunctive relief would be inconsistent with that commitment. Commissioner Rosch thus submits that if a court concludes that a party, or its predecessor in interest, made a RAND commitment with respect to a SEP, an injunction should be denied for that patent. He finds instructive the Supreme Court's eBay decision, which held that injunctive relief should be granted only when "monetary damages . . . are inadequate to compensate for [the] injury." eBay v. MercExchange, L.L.C., 547 U.S. 388, 391 (2006). He also believes that injunctive relief is arguably contrary to the public interest when a cross-license covered by non-SEP patents is sought because injunctive relief would seem to deter innovation in those circumstances.

[2] The Testimony uses the term RAND, but the analysis applies equally to intellectual property that a patent holder has committed to license on fair, reasonable and non-discriminatory (FRAND) terms.

[3] *See, e.g.,* Apple, Inc. v. Motorola, Inc., 2012 WL 2376664, at *12-13 (N.D. Ill. June 22, 2012) (Judge Posner, sitting by designation in the Northern District of Illinois, denied injunctive relief, in part, because a RAND royalty would provide all necessary relief to the holder of a standard-essential patent committed to RAND terms).

to address this concern and limit the potential for hold-up.[4] If the ITC finds that its public interest authority is not flexible enough to prevent hold-up, then Congress should consider whether legislative remedies are necessary.

To explain the Commission's position, this statement (1) outlines the common ground between intellectual property and competition law and the Commission's prior policy work in the IP arena; (2) describes the FTC's definition of hold-up in the standard setting context; (3) explains the potential for divergent outcomes in federal district court and ITC litigation; and (4) highlights concerns that the FTC recently presented to the ITC on this issue.

I. Intellectual Property and Competition Laws Work Together to Promote Innovation

Intellectual property and competition laws share the fundamental goals of promoting innovation and consumer welfare. Patents encourage investments in innovation by enabling the patent holder to prevent others from appropriating the value of its technology without compensation. Because the patent system requires public disclosure, it also promotes the distribution of scientific and technical information that would not otherwise occur. Competition stimulates innovation by creating an incentive for the pursuit of new or better products or processes. Companies may compete to be the first to market with a new technology, or they may invent new, lower-cost, ways to meet existing needs. Competition drives such innovation most effectively if patent law protects the innovator from those that would copy its innovation. Patent law serves its intended purpose if it protects such innovation and does not inadvertently serve as a barrier to it. Modern understanding of these two bodies of law recognizes that intellectual

[4] *See* Third Party United States Federal Trade Commission's Statement on the Public Interest filed on June 6, 2012 in *In re Certain Wireless Communication Devices, Portable Music & Data Processing Devices, Computers and Components Thereof*, Inv. No. 337-TA-745, *available at* www.ftc.gov/os/2012/06/1206ftcwirelesscom.pdf and in *In re Certain Gaming and Entertainment Consoles, Related Software, and Components Thereof*, Inv. No. 337-TA-752, *available at* http://www.ftc.gov/os/2012/06/1206ftcgamingconsole.pdf.

property and competition law can work together to bring new and better products, technologies, and services to consumers more efficiently and at lower prices.

For almost two decades, the Federal Trade Commission has recognized the tandem role of intellectual property and competition in its policy and enforcement efforts. For example, in 1995, the Commission and the Department of Justice issued enforcement guidelines that recognize that licensing intellectual property can facilitate integration of the licensed property with complementary factors of production, which can benefit consumers through the reduction of costs and the introduction of new products.[5] In 2003, the Commission issued its first major report on the patent system, focusing on the impact of patent quality on innovation and competition.[6] In 2007, the Commission and the Department of Justice jointly issued a report emphasizing the need to account properly for the pro-competitive benefits of patent rights in antitrust analysis and enforcement policy.[7] The 2007 Report addresses the potential for hold-up after technology has been chosen by an SSO, and discusses ways that SSOs can adopt policies to avoid or deter this result.[8] In our latest study in March 2011, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition*,[9] the Commission considered how patent

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[5] *See* U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Guidelines for the Licensing of Intellectual Property* (1995), *available at* http://www.ftc.gov/bc/0558.pdf.

[6] Fed. Trade Comm'n, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (2003) ("2003 Report"), *available at* http://www.ftc.gov/os/2003/10/innovationrpt.pdf. Justice Kennedy cited the 2003 Report in his concurrence in eBay v. MercExchange, L.L.C., 547 U.S. 388, 396 (2006).

[7] *See* U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Enforcement and Intellectual Property Rights Promoting Innovation and Competition* 46-47 ("2007 Report"), *available at* http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf.

[8] 2007 Report, Ch. 2.

[9] Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* ("2011 Report"), *available at* http://www.ftc.gov/os/2011/03/110307patentreport.pdf.

notice and remedies affect innovation, competition, and consumer welfare. In particular, we recommended a number of reforms to the laws associated with patent notice and remedies to limit the risks to innovation and competition that arise when patents are asserted after substantial investments are made to bring a product to market. We also recommended mechanisms that district courts and the ITC can use to mitigate hold-up when resolving disputes involving SEPs.[10] The 2011 report was based, in part, on a joint hearing co-sponsored by the Commission, the DOJ, and the Patent and Trademark Office.

The FTC's recent statement to the ITC builds on our earlier policy and enforcement efforts, in particular our competitive concerns with companies seeking injunctive relief for RAND-encumbered SEPs, and highlights the critical role that intellectual property and competition play in promoting innovation.

II. Standard Setting Organizations and the Potential for Hold-Up

Firms in the information technology and telecommunications industries frequently face the problem that hundreds, thousands, and sometimes hundreds of thousands of different claimed inventions need to work together in a single device and in multiple devices operating together within a system. They solve this "interoperability" problem through voluntary consensus standard setting conducted by SSOs. SSOs create standards that ensure that devices within a system will work together and communicate with each other in standardized, predictable ways. Such standards can create enormous value for consumers by increasing competition, innovation, product quality, and choice. However, incorporating patented technologies into standards also has the potential to distort competition by enabling SEP owners to use the leverage they acquire

[10] 2011 Report at 191-93 and 239-44.

as a result of the standard setting process to negotiate high royalty rates and other favorable terms after a standard is adopted that they could not have credibly demanded beforehand.

The possibility of patent hold-up derives from changes in the relative costs of technologies as a result of the standard setting process.[11] Prior to adoption of a standard, alternative technologies compete to be included in the standard, on the basis of features, quality, or price. Often there are a number of technologies, with similar attributes, available for inclusion in the standard; and while it may be possible for SSO members to negotiate licenses for SEPs before a standard is adopted, this is not a realistic option for many firms that may implement the standard. Instead, more often SSO members delay this decision and require that the owner of the technology agree to license SEPs on RAND terms as a *quid pro quo* for the inclusion of their patents in a standard. This makes it easier to adopt a standard, but also creates the potential for hold-up because it defers the negotiation on price until after the standard is adopted. Once a standard is adopted, an entire industry begins to make investments tied to the standard. Because it may not be feasible to deviate from the standard unless all or most other participants in the industry agree to do so in compatible ways, and because all of these participants may face substantial switching costs in abandoning initial designs and substituting a different technology, an entire industry may become locked in to a standard. This gives a SEP owner the ability to demand and obtain royalty payments much higher than might have been available prior to adoption of the standard because these rates need not be based on the true market value of its patents, but instead on the costs and delays of switching away from the standardized technology. In other words, as Judge Posner noted, "once a patent becomes essential to a standard, the

[11] Joseph Farrell et al., *Standard Setting, Patents and Hold-Up*, 74 ANTITRUST L.J. 603, 607-08 (2007).

patentee's bargaining power surges because a prospective licensee has no alternative to licensing the patent; he is at the patentee's mercy."[12] This is one form of "hold-up."

Hold-up and the threat of hold-up can deter innovation by increasing costs and uncertainty for other industry participants, including other patent holders.[13] The threat of hold-up also may reduce the value of standard setting, leading firms to rely less on the standard setting process and depriving consumers of the substantial pro-competitive benefits of standardized technology.

RAND commitments are designed to mitigate the risk of patent hold-up, and encourage investment in the standard.[14] After a RAND commitment is made, the patent holder and the company that wants to implement the technology will typically negotiate a royalty or, in the event they are unable to agree, may seek judicial determination of a reasonable rate. A patent holder may also seek an injunction from a district court, or an exclusion order from the ITC. A royalty negotiation that occurs under threat of an injunction or an exclusion order may be weighted heavily in favor of the patent holder in a way that is in tension with the RAND commitment. High switching costs combined with the threat of an exclusion order could allow a patent holder to obtain unreasonable licensing terms despite its RAND commitment, whether or not the invention is highly valuable on its own, because implementers are locked into practicing the standard. This is an even bigger problem when the hold-up creates a very high cost for a very small component of the overall product. In these ways, the threat of injunctive relief, including an exclusion order, may allow the holder of a RAND-encumbered SEP to realize

[12] Apple, Inc. v. Motorola, Inc., 2012 WL 2376664, at *11 (N.D. Ill. June 22, 2012).

[13] *See generally* 2011 Report and 2007 Report.

[14] 2007 Report at 46-47.

royalty rates that reflect patent hold-up, rather than the value of the patent relative to alternatives.[15] This can raise prices to consumers, distort incentives to innovate, and undermine the standard setting process.

III. Differences Between Injunction Analysis in Federal District Court and Exclusion Orders in the ITC

Until 2006, permanent injunctive relief was virtually automatic following a district court's finding of infringement. Courts followed a general rule, established by the Federal Circuit, in favor of granting injunctions based on a presumption of irreparable harm.[16] In a 2006 decision, *eBay v. MercExchange, L.L.C.*, a unanimous Supreme Court rejected the presumption of irreparable harm and other categorical approaches in favor of a case-by-case application of "traditional equitable principles,"[17] including requiring proof of the patent holder's irreparable harm and the inadequacy of money damages. Under *eBay*'s equitable analysis, it may be difficult for RAND-encumbered SEP holders to show that money damages are inadequate because they have already committed to license their intellectual property on RAND terms.

In a recent decision, Judge Posner, sitting by designation in the Northern District of Illinois, applied *eBay*'s equitable analysis to find that a patent holder would not be entitled to an injunction for infringement of a FRAND-encumbered SEP. "I don't see how, given FRAND, I would be justified in enjoining [the alleged infringer] from infringing the [patent-in-suit] unless

[15] *See Apple, Inc.*, 2012 WL 2376664, at *12 (quoting the FTC's explanation of the potential economic and competitive impact of injunctive relief on disputes involving SEPs).

[16] Richardson v. Suzuki Motor Co., 868 F.2d 1226, 1246-47 (Fed. Cir. 1989) (citations omitted).

[17] eBay v. MercExchange, L.L.C., 547 U.S. 388, 391 (2006). The Court listed four factors that a patent holder must satisfy to obtain an injunction: "A plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction." *Id.*

Apple refuses to pay a royalty that meets the FRAND requirement."[18] He continued, "[b]y committing to license its patents on FRAND terms, [the patent holder] committed to license the [patent--in-suit] to anyone willing to pay a FRAND royalty and thus implicitly acknowledged that a royalty is adequate compensation for a license to use that patent."[19] The patent holder, therefore, could not satisfy *eBay*'s requirement that money damages would provide inadequate relief.[20] Because a FRAND royalty would adequately compensate a patent holder, Judge Posner determined that an injunction was not warranted in that case.[21]

Although all federal district courts must follow the equitable *eBay* injunction analysis, the ITC, another venue in which patentees may litigate, does not.[22] That discrepancy has generated concern that the ITC now is attracting litigation by patent holders that are less likely to meet the requirements to obtain an injunction in federal court, potentially leading to hold-up and any related consumer harm.[23]

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[18] *Apple, Inc.*, 2012 WL 2376664, at *12; *see also eBay*, 547 U.S. at 400 (Kennedy, J., concurring) (noting that hold-up results when "an injunction, and the potentially serious sanctions arising from its violation, can be employed as a bargaining tool to charge exorbitant fees to companies that seek to buy licenses to practice the patent."); and Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297, 313-14 (3d Cir. 2007) (citing Daniel G. Swanson & William J. Baumol, *Reasonable and Nondiscriminatory (RAND) Royalties, Standards Selection, and Control of Market Power*, 73 ANTITRUST L.J. 1, 5, 10-11 (2005)) (commenting that lock-in creates the potential for anticompetitive effects and that "[i]t is in such circumstances that measures such as FRAND commitments become important safeguards against monopoly power").

[19] *Apple, Inc.*, 2012 WL 2376664, at *12.

[20] *Id.* at *13 (citing *eBay*, 574 U.S. at 391-92).

[21] *Id.*

[22] Spansion, Inc. v. Int'l Trade Comm'n, 629 F.3d. 1331, 1359 (Fed. Cir. 2010) ("Given the different statutory underpinnings for relief before the Commission in Section 337 actions and before the district courts in suits for patent infringement, this court holds that *eBay* does not apply to Commission remedy determinations under Section 337.").

[23] Use of the ITC as a venue for patent challenges has tripled in the last ten years. Colleen V. Chien, *Patently Protectionist? An Empirical Analysis of Patent Cases at the International Trade Commission*, 50 WM. & MARY L. REV. 63, 68 (2008). Sixty-five percent of those cases proceed simultaneously in federal

The ITC is a quasi-judicial, independent federal agency established by Congress with a wide range of trade-related mandates, among them intellectual property-based import investigations. Patent holders that believe imported products infringe their patents may file a complaint with the ITC under Section 337 of the Tariff Act of 1930. The statute prohibits unfair methods of competition, including patent infringement, from goods imported into the United States.[24] The ITC has *in rem* jurisdiction over the imported goods, which allows patent holders to bring cases against foreign defendants that might otherwise be outside the jurisdiction of U.S. district courts. After finding patent infringement, the ITC may issue a cease and desist order and an exclusion order. A cease and desist order prohibits a defendant from selling infringing imported articles out of U.S. inventory.[25] An exclusion order directs the U.S. Customs Service to bar infringing articles from entry into the United States.[26] ITC cease and desist and exclusion orders are subject to review by the President, or his designee the United States Trade Representative, and appealable to the Federal Circuit. The ITC cannot award monetary damages for past infringement.

Section 337 provides a mechanism by which the ITC can limit the incidence of hold-up generated by an exclusion order and the harm to consumers that may result from such orders. It allows the ITC to consider "the public health and welfare, competitive conditions in the United

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district court. *Id.* at 64. *See also* 2011 Report at 239-240 ("Expanded use of the ITC and the parallel proceedings in district courts have led some commentators to raise concerns about inconsistent results in individual cases and incoherent development of patent policy.").

[24] 19 U.S.C. § 1337(a)(1)(A)-(B).

[25] 19 U.S.C. § 1337(f).

[26] Limited exclusion orders block importation of infringing articles by "persons determined by the Commission to be violating" Section 337. General exclusion orders ban the importation of any infringing goods, but such orders are available only in narrow circumstances. 19 U.S.C. § 1337(d)(1), (2); Kyocera Wireless Corp. v. Int'l Trade Comm'n, 545 F.3d 1340, 1356-58 (Fed. Cir. 2008).

States economy, the production of like or directly competitive articles in the United States, and United States consumers" in deciding whether to grant an exclusion order.[27] However, the ITC has rarely used this provision to deny an exclusion order.[28] Assertion of a patent against a standard in the presence of a RAND commitment, however, creates a particularly important scenario for considering the public interest, and Section 337's language should allow consideration of how an exclusion order can cause hold-up, distort "competitive conditions" by forcing negotiation under the shadow of switching costs, impair innovation, and harm "United States consumers." By incorporating these economic concepts into its remedy analysis, the ITC would move that analysis closer to that required in district courts by *eBay* and promote the beneficial and efficient operation of intellectual property and competition law.[29]

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[27] 19 U.S.C. § 1337(d)(1).

[28] Our research has revealed only three cases in the past 35 years in which the ITC has denied an exclusion order on public interest grounds. Those cases involved issues of public health or broad public interest. *See* Certain Fluidized Supporting Apparatus, Inv. No. 337-TA-182/188 (1984) (holding that it was not in the public interest to exclude specialized hospital beds for burn patients, when the domestic producer could not supply alternative beds within a reasonable time); Certain Inclined-Field Acceleration Tubes, Inv. No. 337-TA-67 (1980) (citing overriding public interest in basic atomic research using imported acceleration tubes that were superior to the domestic alternative); Automatic Crankpin Grinders, Inv. No. 337-TA-60 (1979) (finding that it was not in the public interest during the energy crisis of the late 1970s to exclude an automobile engine component that improved fuel economy, when domestic industry was unable to meet domestic demand); Sapna Kumar, *The Other Patent Agency: Congressional Regulation of the ITC*, 61 FLA. L. REV. 529, 567-68 (2009). More recently, the ITC limited an exclusion order in a setting where exclusion would decrease the effectiveness of first responders during an emergency. Certain Baseband Processor Chips and Chipsets, Transmitter and Receiver (Radio) Chips, Power Control Chips, and Products Containing Same, including Cellular Telephone Handsets, Inv. No. 337-TA-543 (2007).

[29] Commentators have highlighted the need to harmonize the remedial standards in the two venues. *See* Robert W. Hahn & Hal J. Singer, *Assessing Bias in Patent Infringement Cases: A Review of International Trade Commission Decisions*, 21 HARV. J.L. & TECH. 457, 486-90 (2008); Kumar, *supra* note 19, at 574-78.

IV. Potential Harm to Competition Arising from Exclusion Orders for Infringement of a RAND-Encumbered SEP

Consistent with the requirement of Congress that the FTC and ITC consult in 337 investigations,[30] on June 6, 2012, the FTC responded to the ITC's request for statements on the public interest in two Section 337 investigations.[31] The FTC explained the potential economic and competitive impact of injunctive relief for infringement of RAND-encumbered SEPs. Although the FTC rarely weighs in on ITC proceedings, it filed this statement because these investigations appear to present an issue of first impression for the ITC: the competitive implications of granting an exclusion order for infringement of a SEP that the patent holder has committed to license on RAND terms.[32]

The FTC agrees that an appropriately granted exclusion order preserves the exclusivity that forms the foundation of the patent system's incentives to innovate, and the threat of an exclusion order can provide a significant deterrent to infringement.[33] RAND-encumbered SEPs, which include commitments to license, require additional considerations before evaluating whether the exclusion order is appropriate because they present considerably different issues than patents that are not encumbered by a commitment to license. A RAND commitment provides evidence that the SEP owner planned to monetize its IP through broad licensing on

[30] 19 U.S.C. § 1337(b)(2).

[31] The FTC did not take a position on the facts of the investigations, or whether the ITC should issue remedies. The FTC also did not address whether seeking an injunction or exclusion order for RAND-encumbered SEPs would violate Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, or Sections 1 or 2 of the Sherman Act, 15 U.S.C. §§ 1-2.

[32] In its recent statement to the ITC, the FTC acknowledged that "the [ITC] has consistently held that the benefit of lower prices to consumers does not outweigh the benefit of providing complainants with an effective remedy for an intellectual property-based Section 337 violation." Certain Digital Television Products and Certain Products Containing Same and Methods of Using Same, Inv. No. 337-TA-617, Comm'n Op. at 16 (Apr. 2009). *See also* 19 U.S.C. § 1337(d)(1), (f)(1).

[33] *See* 2003 Report at 223-28.

reasonable terms rather than through exclusive use – and thus would not likely be irreparably harmed by money damages.[34] Consistent with the proper role of the patent system, remedies that reduce the chance of patent hold-up can encourage innovation by increasing certainty for firms investing in standards-compliant products and complementary technologies. Reducing hold-up also better aligns the reward from innovation with its true value to consumers. Remedies that reduce hold-up improve the working of the standard setting system and prevent the price increases associated with patent hold-up without reducing incentives to innovate.

ITC issuance of an exclusion or cease and desist order in matters involving RAND-encumbered SEPs, where infringement is based on implementation of standardized technology, has the potential to cause substantial harm to U.S. competition, consumers and innovation. The FTC expressed concern to the ITC that a patent holder can make a RAND commitment as part of the standard setting process, and then seek an exclusion order for infringement of the RAND-encumbered SEP as a way of securing royalties that may be inconsistent with that RAND commitment.

The ITC has a statutory obligation to consider "competitive conditions in the United States economy . . . and United States consumers[,]"[35] and to refrain from imposing Section 337 remedies in conflict with the public interest. The FTC proposed a range of remedies that would be consistent with this obligation. For example, the ITC could find that Section 337's public interest factors support denial of an exclusion order if the holder of the RAND-encumbered SEP has not complied with its RAND obligation, which would include a duty to negotiate with

[34] *Cf.* 2011 Report at 234-35 ("A prior RAND commitment can provide strong evidence that denial of the injunction and ongoing royalties will not irreparably harm the patentee.").

[35] 19 U.S.C. § 1337(d)(1), (f)(1).

potential licensees in good faith.[36] In the Initial Determination of Investigation No. 337-TA-752, the ITC administrative law judge found that, "the royalty rate of Motorola of 2.25%, both as to its amount and the products covered, could not possibly have been accepted by Microsoft."[37] While this approach may leave the patent holder without a remedy in the ITC, a remedy in district court would remain available. Alternatively, the ITC could delay the effective date of its Section 337 remedies until the parties mediate in good faith for damages for past infringement and/or an ongoing royalty for future licensed use, with the parties facing the respective risks that the exclusion order will (i) eventually go into effect if the implementer refuses a reasonable offer or (ii) be vacated if the ITC finds that the patent holder has refused to accept a reasonable offer.[38] The FTC urged the ITC to follow the requirements of Sections 337(d)(1) and (f)(1) and consider the impact of patent hold-up on competitive conditions and United States consumers in cases that address RAND-encumbered SEPs.

After the FTC filed its statement, the ITC indicated that it is particularly interested in the public interest issues concerning RAND commitments and exclusion orders. In late June, the ITC issued a Notice of Review in one of its investigations.[39] The Notice seeks briefing from the

[36] *See* 2011 Report at 243 ("Assertion of a patent against a standard, especially a patent subject to a RAND commitment, creates a particularly important scenario for considering the public interest in deciding whether to grant an exclusion order" before the ITC).

[37] Certain Gaming and Entertainment Consoles, Related Software, and Components Thereof, Initial Determination at 300 (May 2012); *see also id.* at 303 ("[T]he evidence supports Microsoft's conclusion that Motorola was not interested in good faith negotiations and in extending a RAND license to it.").

[38] There is precedent for such an approach at the ITC. In December 2011, the ITC found that HTC infringed valid Apple patents. "Based on consideration of competitive conditions in the United States economy," the ITC delayed the effective date of the exclusion order for four months "to provide a transition period for U.S. carriers." Certain Personal Data and Mobile Communications Devices and Related Software, Notice of the Comm'n's Final Determination Finding a Violation of Section 337 at 3 (Dec. 2011).

[39] Certain Wireless Communication Devices, Portable Music and Data Processing Devices, Computers and Components Therof, Notice of Commission Decision to Review In Part A Final Initial Determination

parties on eight RAND-related topics, including whether: (1) "the mere existence of a RAND obligation preclude[s] issuance of an exclusion order[;]" (2) a patent owner that has refused to offer or negotiate a license on RAND terms should be able to obtain an exclusion order; and (3) a patent owner should be able to obtain an exclusion order if it has offered a RAND license, and that license has been rejected by the alleged infringer.[40]

The FTC believes that the ITC has the authority under its public interest obligations to resolve all of these questions, and to deny an exclusion order if the holder of the RAND-encumbered SEP has not complied with its RAND obligation. If, instead, the ITC finds that its public interest authority is not flexible enough to allow this analysis, then Congress should consider whether it should amend Section 337 to give the ITC more flexible authority to prevent hold-up.

Thank you for this opportunity to share the Commission's views. We look forward to working with you on this important issue.

Finding a Violation of Section 337 at 4-5 (June 2012). Briefing by the parties on these questions is due on July 9, 2012. *Id.*

[40] *Id.*

Department of Justice

STATEMENT OF

JOSEPH F. WAYLAND
ACTING ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

REGARDING

"OVERSIGHT OF THE IMPACT ON COMPETITION OF EXCLUSION ORDERS TO ENFORCE STANDARDS-ESSENTIAL PATENTS"

PRESENTED

JULY 11, 2012

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Introduction

Good morning, Mr. Chairman and Ranking Member. It is a pleasure to have this opportunity to discuss the Antitrust Division's experience with standard-essential patents. I joined the Division in September 2010, as Deputy Assistant Attorney General for Civil Enforcement. At the end of April, I assumed the role of Acting Assistant Attorney General (AAG). Both former AAG Christine Varney and former Acting AAG Sharis Pozen provided strong leadership and vision for the Division's mission to protect and promote competition, and I hope to follow their lead.

The issues I will discuss today involve three important inputs to our modern innovation-based economy: patent rights, competition, and collaboratively set standards. These inputs drive innovation in complementary, though different ways. In our system, antitrust and intellectual property policy function together to provide consumers with high-quality products and services at competitive prices, while at the same time preserving strong incentives for the innovation that creates and improves those products.

Innovation is the key to economic growth in the United States. It creates new products and new jobs, and maintains our competitiveness in the global economy. As the Commerce Department reported in 2010, it is the introduction of new products and processes for making those products that has been responsible for three-quarters of the growth in the U.S. economy since World War II. Arti Rai et al., Patent Reform: Unleashing Innovation, Promoting Economic Growth & Producing High-Paying Jobs 2 (U.S. Dep't of Commerce, Apr. 13, 2010).

Patents have long played a central role in promoting innovation and economic growth by encouraging individuals and companies to apply their knowledge, take risks, and make investments in research and development. These efforts, in turn, have benefitted society as a whole by providing new and valuable technologies, lower prices, improved quality, and increased consumer choice. *See, e.g., 2010 Joint Strategic Plan on Intellectual Property Enforcement* 5 (June 2010), *available at* www.whitehouse.gov/ sites/default/files/omb/assets/intellectualproperty/intellectual_property_strategic_plan.pdf.

Competition also creates incentives for invention, innovation, and risk-taking by allowing competitors to profit from being at the forefront of technological change. The desire to improve existing products to maintain or gain market share pushes competitors to improve function, design, and production processes, while visionaries leap beyond existing know-how to introduce radically new products and services that transform the lives of consumers—inventions ranging from DNA testing and sequencing and microprocessors to anti-retroviral treatments, file compression, digital content streaming, and cloud computing.

Standards also drive our economy. Standards have a range of benefits, from helping to protect public health and safety to promoting efficient resource allocation and production by allowing for interoperability among complementary products. Standards are not new: For example, the adoption of standard gauge rails in 1866 eliminated network incompatibilities between the seven different types of rail gauge then in use and supported our nation's westward expansion. Today, standards underpin efforts to drive and deploy electronic vehicles, share and protect health information, and enable the use of smart grids for the delivery of electricity. Interoperability standards have also paved the way for the complex communications networks and sophisticated mobile computing devices that have become hallmarks of the modern age.

Standard-Setting and Competition

The Antitrust Division has worked closely with our sister antitrust agency, the Federal Trade Commission (FTC), and with other federal agencies, including the U.S. Patent and Trademark Office, an agency of the Department of Commerce, to better understand the interface between standards and antitrust and to promote intellectual property practices for standard-setting activities that preserve competition and protect consumers. For example, in 2007, the Antitrust Division and the FTC issued a joint report on the intersection of intellectual property rights and competition that addresses a number of critical standard-setting issues. In particular, the agencies found that when a standard incorporates patented technology owned by a participant in the standard-setting process and that standard becomes established, switching in some cases becomes difficult and expensive, and that the particular technology may gain market power. *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 35-36 (2007). This creates the potential for patent holders to take advantage of that market power by engaging in one form of what is known as patent hold-up, such as by excluding a competitor from a market or obtaining an unjustifiably higher price for its invention than would have been possible before the standard was set. This raises particular concerns when alternative technologies could have been included in the standard. Patent hold-up can cause other problems as well. For example, it may induce users to postpone or avoid incorporating standardized technology in their products. Consumers of the products using the standard could also be harmed to the extent that companies implementing the standard pass on higher royalties in the form of a higher price.

To reduce the occurrences of this type of opportunistic conduct, standard-setting organizations (SSOs) commonly include in their patent policies commitments from participants to license the patents they own that are essential to the standard (standard-essential patents) on "reasonable and non-discriminatory" (RAND) or "fair, reasonable, and non-discriminatory" (FRAND) terms. Participation in relevant standards bodies is voluntary, but in some cases the licensing commitment is a condition of participation in the standards body, or the license commitment may be voluntary or offer a mechanism for opting out of the obligation to license essential patents. (In the United States, SSO members commit to license all of their standards-essential patents on RAND terms, while in other jurisdictions SSO members commit to license such patents on FRAND terms. We use F/RAND to refer to both types of commitments as they are substantively the same type of commitment.) SSOs and their members rely on F/RAND commitments to facilitate the bilateral licensing of patents that are needed to allow a standard to become successful and to provide assurances to implementers of the standard that the patented technologies will be available to those willing and able to license them. By participating in the standard-setting activities and making a F/RAND licensing commitment, some have argued that the patent holder foregoes its right to exclude where the standard is being implemented. In making the voluntary licensing commitment, a patent holder that also sells products and services related to the standard benefits from expanded marketing opportunities, and patent holders that focus on licensing their inventions benefit from an expanded source of revenue.

The Antitrust Division has stressed that SSOs that set forth well-defined patent policy rules that minimize ambiguity can effectively promote competition. My predecessor, Christine Varney, explained that "[e]ven without saying what rules are best, it is at least plain that clearer rules will allow for more informed participation and will enable participants to make more knowledgeable decisions regarding implementation of the standard. Clarity alone does not eliminate the possibility of hold-up . . . but it is a step in the right direction." Christine Varney, Assistant Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Remarks as Prepared for the Joint Workshop of the U.S. Patent and Trademark Office, the Federal Trade Commission, and the Department of Justice on the Intersection of Patent Policy and Competition Policy: Implications for Promoting Innovation 8 (May 26, 2010).

For example, in 2006 and 2007, we advised IEEE and VITA that requiring or permitting patent holders participating in a standard-setting process to disclose the most restrictive terms on which they were willing to license their essential patents—that is, patents that were declared essential to the standard for uses implementing the standard—could preserve competition and avoid unreasonable licensing terms that might harm the successful adoption and implementation of the standard. Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice, to Michael A. Lindsey, Esq. (April 30, 2007), *available at* www.justice.gov/atr/public/busreview/222978.pdf (IEEE Business Review); Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice, to Robert A. Skitol, Esq. (Oct. 30, 2006), available at www.justice.gov/atr/public/usreview/219380.pdf (VITA Business Review). IEEE and VITA incorporated this element into their patent policies by creating options that seek to limit some of the ambiguity associated with commitments to license on F/RAND terms. I encourage other SSOs that want to revise their patent policies to seek ex ante review of them through our business review procedures if the proposed revisions could impact competition.

The Antitrust Division's Investigations Involving Standard-Setting Activities

In addition to encouraging standard setting practices that benefit competition and consumers, the Antitrust Division has also pursued enforcement where appropriate. Notably, the Antitrust Division has conducted a number of investigations involving standard-essential patents involving mobile devices. The mobile-device industry is in technological transition, where smartphones are replacing previously dominant feature cell phones at lightning speed and new computer products, such as computer tablets, have been introduced into the market. Smartphones combine the best features of cell phones with the features of computers that are most useful to mobile users, such as access to the Internet and email functionality. As a result, new technological innovators have displaced some established manufacturers of feature phones, and large portfolios of patents have been offered for sale. The Division had concerns about the F/RAND-encumbered standard-essential patents because wireless devices, including smartphones and tablets, typically implement a significant number of telecommunication and computer standards—including cellular air interface, wireless broadband, and video compression standards.

In February 2012, the Antitrust Division closed its investigations of the acquisition of two significant patent portfolios. The first involved Rockstar Bidco (a partnership that included Apple, Microsoft, Research in Motion, Sony, and Ericsson) and its acquisition of 6,000 patents and patent applications from Nortel at a bankruptcy auction. The Nortel portfolio also included a number of patents that Nortel had committed to license on F/RAND terms for uses associated with certain standards, including wireless standards. The second involved Google's acquisition of Motorola Mobility, a manufacturer of smartphones and tablet computers and the holder of 17,000 issued patents and 6,800 patent applications. Motorola had made commitments to several SSOs to license hundreds of these patents on F/RAND terms for uses related to the standards, which included both cellular air interface and Wi-Fi standards.

In both matters, the Division's investigations focused on whether the acquiring firms would have the incentive and ability to exploit ambiguities in the commitments the sellers made to license their patents on F/RAND terms to hold up implementers of the standard in a manner that would raise rivals' costs or foreclose competition, to the detriment of consumers. For example, the acquiring firms might seek to raise rivals' costs by demanding higher licensing rates, compelling cross licenses to differentiating IP valued in excess of the F/RAND rate, charging licensees the entire portfolio royalty rate when licensing only a small subset of the patents in its portfolio, or seeking to prevent or exclude products that infringed these patents from the market altogether. We investigated whether the patent acquisitions would change the incentives or abilities of the new owners to obtain higher royalties from their competitors, particularly by using the threat of an injunction or exclusion order.

After thorough investigations in both matters, the Division concluded that neither acquisition was likely to substantially lessen competition for wireless devices. In particular, we determined that neither Research in Motion nor Microsoft was likely to use any standard-essential F/RAND-encumbered patents from the Nortel portfolio to harm their rivals by excluding them from the markets or charging supracompetitive royalties, because they would be unable to attract a sufficient number of customers to purchase their smartphones to make up for the loss of licensing revenue. In addition, we found that Microsoft previously entered cross-license agreements with the majority of its Android-based OEM competitors and that its newly acquired patents would be included in these agreements.

With respect to Google, there was evidence that Motorola Mobility had a long history of licensing its F/RAND-encumbered standard-essential patents and had been engaged in extended disputes with Apple, Microsoft, and others before Google sought to acquire the company and its patent portfolio. We did not believe that transferring ownership of the patents from Motorola to Google would substantially change that practice. Moreover, while we were investigating these transactions, Apple stated in a letter to the European Telecommunications Standards Institute (ETSI), the body that develops many wireless standards in Europe, that the company would not use F/RAND-encumbered standard-essential patents to exclude rivals from the wireless market by seeking injunctions for infringement. Similarly, Microsoft posted a public statement on its website explaining that it would not seek injunctions or exclusion orders based on F/RAND-encumbered standard-essential patents. Google also publicly revealed its licensing policy, stating that it would not seek injunctive relief in disputes involving future license revenues provided that the potential licensee (a) forgoes certain defenses such as challenging the validity of the patent; (b) pays the full disputed licensing amount into escrow; and (c) agrees to a reciprocal process regarding injunctions. The commitments made by Apple and Microsoft substantially lessened the Antitrust Division's concerns about potential anticompetitive use of F/RAND-encumbered standard-essential patents. The Antitrust Division observed that Google's commitments did not provide the same direct confirmation of its F/RAND-encumbered standard-essential patent licensing policies.

Although we concluded that the acquisitions of these patent portfolios were not likely to substantially lessen competition, the Antitrust Division noted its concerns about the potential inappropriate use of F/RAND-encumbered standard-essential patents to disrupt competition and specifically limited our conclusion to the transfer of ownership rights and not to the exercise of those transferred rights. We have continued closely to monitor the use of F/RAND-encumbered standard-essential patents in the wireless device industry, particularly as they relate to smartphones and computer tablets, to ensure that they do not stifle competition and innovation in this important industry.

The Antitrust Division is also closely monitoring a number of pending International Trade Commission (ITC) matters involving F/RAND-encumbered SEPs. *See 19 U.S.C. §1337(b)* (directing the Commission to consult with the Department of Justice). In determining whether to issue exclusion orders, the ITC is directed to consider the "effect of exclusion upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers." *Id.* As the ITC has observed, these public interest factors "are not meant to be given mere lip service," but rather "public health and welfare and the assurance of competitive conditions in the United States economy must be the overriding considerations in the administration of this statute." *Certain Inclined Field Acceleration Tubes and Components Thereof*, Inv. No. 337-TA-67, USITC Pub. 1119, Comm'n Op., at 22 (Dec. 1980), *quoting* S. REP. 93-1298, at 197 (1974), *reprinted in* 1974 U.S.C.C.A.N. 7186, 7330. For example, the ITC could determine that an exclusion order is not in the public interest even where infringement is found because the value or importance of the infringed patent to the assembled good is dwarfed by the overall value of the assembled good or the patented aspect is not important to the operation of the good, and a broad exclusion order would be tantamount to denying the public the assembled good for a period of time.

In seeking public comment, the Department of Justice believes the ITC should continue to gather the types of information necessary to evaluate whether the statutory public interest factors counsel against the imposition of an exclusion order. In considering this issue, the Department of Justice is concerned about the circumstances in which an exclusion order may be inappropriate, in certain cases where a product implementing a standard has been determined to have infringed a valid F/RAND-encumbered patent that is essential to that standard. Federal courts have begun to consider the appropriateness of injunctive relief based on factors laid out in the Supreme Court's eBay decision and similar considerations could arise in ITC public interest determinations. Certain conduct outside of the standard setting context could similarly give rise to questions about the appropriateness of an exclusion order. In an era where competition thrives on interconnected, interoperable network platforms, these considerations merit special attention. For example, if the ITC concludes exclusion orders may be inappropriate in the scenarios described above, it may be appropriate for it to determine whether it has the authority to stay the imposition of an exclusion order contingent on the infringing party's commitment to abide by an arbitrator's determination of the fair value of a license.

This concludes my prepared remarks. I would be happy to answer any further questions the Committee may have.