

Before the
Federal Trade Commission
Washington, DC

In the Matter of

Motorola Mobility LLC and Google Inc.;
Analysis of Proposed Consent Order to Aid
Public Comment

File No. 121-0120

**COMMENTS OF
COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION**

Pursuant to the request for comments issued by the Federal Trade Commission (hereinafter ‘FTC’ or ‘the Commission’) and published in the Federal Register at 78 Fed. Reg. 2,398 (January 11, 2013), the Computer & Communications Industry Association (CCIA)¹ submits the following comments regarding the proposed consent decree.

These comments applaud the FTC’s objective but raise concerns that the Commission’s response to the SEP hold-up problem – insofar as it is a template for future conduct – threatens to:

- (1) exacerbate the patent arms race as newly vulnerable firms pursue more problematic defensive patenting strategies;
- (2) trigger additional litigation as rivals of those disadvantaged by the FTC’s decision seek to press their advantage over competitors whose defensive positions are dependent on FRAND-encumbered patents; and
- (3) prospectively, either (a) diminish incentives to standard setting; or (b) encourage standards participants to rewrite policies to approximate their prior understanding of FRAND licensing.

¹ CCIA is an international nonprofit membership organization representing companies in the computer, Internet, information technology, and telecommunications industries. Together, CCIA’s members employ nearly half a million workers and generate approximately a quarter of a trillion dollars in annual revenue. CCIA promotes open markets, open systems, open networks, and full, fair, and open competition in the computer, telecommunications, and Internet industries. A complete list of CCIA members, which includes Google, Inc., is available at <http://www.cciagnet.org/members>.

None of this is to say that the Commission should not enforce competition policy in the patent context, however. Rather, having unwound certain defensive strategies for coping with the malfunctioning patent system, the FTC must continue to draw attention to reforms needed in the patent system.

EXECUTIVE SUMMARY

CCIA applauds the overall thrust of the FTC's decisions in its investigations of Google and its subsidiary, Motorola Mobility, and appreciates the Commission's thoughtful effort to address the complex intersection of patents and competition law. These comments express reservations, however, regarding certain assumptions underlying the standard-essential patent (SEP) settlement with Motorola Mobility, and thus its ultimate effectiveness – particularly if this settlement is used as a baseline for future policy, without broader reforms of the patent system.

Specifically, we disagree with the Commission's assertion that “[i]f accepted by the Commission, the Proposed Order may set a template for the resolution of SEP licensing disputes across many industries, and reduce the costly and inefficient need for companies to amass patents for purely defensive purposes in industries where standard-compliant products are the norm.”²

Despite these contentions, commitments to license SEPs on FRAND terms had nothing to do with the start of the current patent wars. FRAND commitments have been and remain weak and ambiguous. Academic literature, standards bodies' deliberations and even the record of the numerous public hearings conducted by this agency going back more than a decade make this clear.

If the Commission seeks the root causes of the current litigation epidemic, it must look to the increased issuance of abstract and low-quality software and design patents, the expanded functionality of smartphones and the changing competitive structure of the mobile device market. These background conditions have contributed far more to the current litigation epidemic than a contractual understanding that has evolved little over the last three decades.

² Statement of the Federal Trade Commission, *In the Matter of Google Inc.*, FTC File No. 121-0120, January 3, 2013, available at <http://www.ftc.gov/os/caselist/1210120/130103googlemotorolastmtofcomm.pdf>.

The patent system – particularly as it interfaces with high-tech industries – is beset by numerous well-documented problems. Many of these problems were astutely documented by the FTC itself, nearly a decade ago.³ Far too many patents flood the high-tech marketplace. The smartphone alone has an estimated 250,000 patents that read on the technology embedded in it.⁴ Many of these patents are abstract, loosely defined, or invalid. This generates high transaction costs, and increases risk and uncertainty for all companies that develop and build high-tech products.

In response, technology companies have engaged in massive cross-licensing to diminish the potentially crippling level of risk and uncertainty foisted upon them by the ready availability of vague, low-quality patents. This solution – essentially, agreements between competitors to opt out of the patent system – reflects a real-world compromise that has also enabled standard setting to function free of disruption by major stakeholders. FRAND commitments, nonspecific as they are, have simply been folded into the cross-licensing process.

Standard-setting organizations (SSOs) must induce cooperation from a wide range of players, many of whom have divergent interests. The policies and practices of each reflect compromises necessary to allow each one to function. Some choose royalty free licensing. Some mandate more specific *ex-ante* patent disclosure. The fact that SSOs have developed customized policies by consensus should counsel the FTC to be cautious in altering the interpretations of terms agreed upon by all participants in a particular SSO. To the best we have been able to determine, no SSO has promulgated policies either for or against injunctive relief.

Nor are standards bodies ignorant of the potential problems of their decisions, such as the potential for patent hold-up, that were identified by the FTC. They have been the topic of frequent academic debate, court rulings and internal negotiations within the standards bodies themselves. Like cross-licenses and patent pools, SSO policies and practices have been developed with the realities of patent proliferation and patent practices in mind and are designed to reduce risk and uncertainty. Imposing changes from the outside, particularly without addressing the risks that these consensual policies hedge against, is to upset the equilibrium that has been established.

³ Federal Trade Commission, “To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy,” October 2003, available at <http://www.ftc.gov/os/2003/10/innovationrpt.pdf>.

⁴ RPX Corp., Registration Statement (Sec. & Exch. Comm’n Form S-1), at 59 (Sept. 2, 2011).

By altering the framework for negotiated cross-licenses, and for the bilateral negotiating process in general, the FTC changes a much larger set of expectations and practices. In particular, by diminishing the prospect of injunctive relief the Commission's approach will disadvantage firms that contribute significant IP to standards development efforts vis-à-vis downstream standards implementers. This will likely result in diminished incentives to participate in standards bodies. Implementers who have relied on SEPs for defensive purposes report that they are now developing strategies to increase their pursuit of software and design patents – the type of patents that have proven the most controversial and present the technology industry with the most problems – in order to build more effective defensive portfolios to compensate for the diminished value of SEPs. Unbalancing the deterrent value of certain patent portfolios thus threatens to start a new arms race, and may well produce more litigation in the short- and medium-term as the aggressor companies seek to take exploit their advantage while their targets rebuild their defensive positions with vague software and design patents. Actions that encourage more speculative patenting, increase the likelihood of litigation, and diminish incentives to participate in SSOs will raise costs, divert resources from positive R&D, and ultimately harm consumers.

Furthermore, given that SSO IPR commitments are free to be adapted (and often are), reinterpreting a contractual term of art in a way that is unwelcome by the participants will simply result in SSOs that do not like the new injunction standards changing the language of their commitment to better approximate the original meaning, or lack thereof, of FRAND. Therefore, any reinterpretation of FRAND commitments will likely have little long-term effect, absent broad patent reform.

To foster competition and promote consumer welfare, the Commission should preserve the current carve-outs for defensive use (Section IV.F) and continue to pursue its pro-competitive examination of the patent system. Positioning this settlement as the blueprint for ending the current patent wars, however, may undercut momentum to undertake reforms that actually mitigate the epidemic of patent-related litigation. The Commission should continue to advance the extensive work it has undertaken over the past decade – through extensive reports and targeted enforcement actions – to highlight the wide range of patent problems that harm competition and innovation.

The FTC should continue its detailed examination of patent assertion entities (PAEs), which both exploit and feed the current problems in the patent system identified above. Furthermore, the Commission should use its extensive economic and legal expertise to revisit its pioneering work in 2002-2003⁵ regarding the anti-competitive effects of the current patent system.

Lastly, if the Commission decides to amend the current consent decree, it should ensure that companies could use SEPs in legitimate defensive ways with the end goal of encouraging competitive markets with a wide range of product offerings. From the perspective of equity, it would be unfortunate if the FTC's decision tips the scales of the current patent wars in the direction of companies asserting broad, ambiguous design and software patents that are essentially *de facto* standards and harms companies that have worked in good faith to create the actual standards on which all current mobile devices are built.

I. OBSERVATIONS ON HISTORICAL INTERPRETATIONS OF FRAND

A. The State of FRAND Before the Smartphone Patent Wars

The root causes of the escalation in patent litigation in mobile telecommunications markets have little to do with FRAND commitments. FRAND commitments have been ambiguous since their inception and the market players were mindful of this ambiguity. As discussed earlier, the nature of the FRAND commitment has been vigorously debated, the subject of numerous court cases, discussed in prominent SSOs and scrutinized by regulators. Although the potential for problems with patent holdup are quite clear, the record of the FTC's 2011 hearings reflects that wide scale abuse had not yet been a serious problem.⁶

⁵ "To Promote Innovation," *supra* note 3.

⁶ As Intel made clear in its 2011 FTC filing (prior to the outbreak of the current wave of smartphone patent litigation), "[o]nly a small number of disputes over the licensing of SEPs have arisen. Only a subset of those have been litigated, and even that handful of cases has highlighted the complexity and idiosyncrasy of each licensing situation" (Intel Corporation's Response to the Commission's Request for Comments in Connection with Its Patent Standards Workshop, Project No. P11-1204 (August 5, 2011), at 4-5, available at <http://www.ftc.gov/os/comments/patentstandardsworkshop/00042-80174.pdf>). Other commenters, including Alliance for Telecommunications Industry Solutions (ATIS), TIA, ANSI, Qualcomm, Microsoft, and industry analyst Keith Mallinson are a few of the commenters who also observed little or no problems related to FRAND abuse or holdup.

1. Why Did FRAND Work Relatively Well in the Past?

If the potential for abuse existed prior to 2011, why did it not manifest itself more often? The simple answer is that standards negotiations are ongoing in one forum or another, and that the players are relatively constant and interact repeatedly with one another. Under these conditions, short-term gains from hold-up are offset by reputational concerns, at least among repeat players, and so the vast majority of companies abide by the spirit of the FRAND commitment. This fact pattern closely mirrors what would be predicted in a scenario of iterated action in game theory, which more closely parallels actual industry practices compared to static scenarios of hold-up postulated in some economic and legal literature.⁷

Unlike the threat of widespread FRAND abuse, the “repeat player” discipline is well documented anecdotally (and in aggregate). When Motorola was said to be unwilling to license its GSM patents under FRAND terms in the early 1990s, the company reported a significant loss of business. Motorola classified these assertions as lies, but was so troubled by them that they considered filing libel suits.⁸ The 2011 FTC hearing record is also replete with references to the disciplining power of the repeated game:

- Referencing a study that showed more than 50% of the SEP declarations in ETSI are made after the publication of the standard (not declaring SEPs prior to a standard publication would, in theory, dramatically increase the likelihood of hold-up), economist Anne Layne-Farrar stated that actual holdup was minimal because the participants are “repeat player[s].”⁹
- Naomi Voegtli, the Vice President of the Intellectual Property Strategy and Standards Group at the software firm SAP, stated: “If SAP backs off a FRAND commitment, our reputation is going to be tarnished, and also, it’s a public relations disaster, and SAP is a repeat player in a standard-setting organization. So, we want to maintain our integrity.”¹⁰

⁷ Richard Epstein, Scott Kieff, & Daniel Spulber, “The FTC’s Proposal for Regulating IP through SSOs Would Replace Private Coordination with Government Hold-up,” FTC Issues Agenda for Workshop to Explore the Role of Patented Technology in Collaborative Industry Standards, FTC Project No. P111204, Public Comments, at 23-24, available at <http://www.ftc.gov/os/comments/patentstandardsworkshop/00041-80171.pdf>.

⁸ Eric J. Iversen, “Standardization and Intellectual Property Rights: ETSI’s Controversial Search for New IPR-Procedures,” proceeding of the 1999 SIIT conference, at 7.

⁹ Federal Trade Commission, Patents Standards Workshop, “Tools to Prevent Patent ‘Hold-up,’” June 21, 2011, transcript at 42, available at <http://www.ftc.gov/opp/workshops/standards/transcript.pdf>.

¹⁰ *Id.* at 167-68.

- Larry Bassuk, Deputy General Patent Counsel at Texas Instruments, after stating that he believed that it is difficult for him to see how FRAND commitments are actually legally binding contracts stated: “[W]e’ve worked with one another in the past, we are going to work with one another in the future, we have got to honor our commitments, whether there is [legal] consideration there or not.”¹¹

In sum, because the gains of “defecting” and holding up market participants with an SEP do not outweigh the likely costs in the long run, few repeat players willingly burn long-term bridges for short-term gains.

2. When Did FRAND Fail?

Prior to the outbreak of the recent smartphone patent wars, SEP litigation was the exception, not the norm. However, there were several high-profile exceptions, including three cases in which the FTC took action: *Dell*,¹² *Rambus*¹³ and *N-Data*.¹⁴

These three cases share unique characteristics. Both the *Dell* and *Rambus* cases involved intentional deception. *Dell* was found to have “not inadvertently”¹⁵ failed to disclose a key patent when a clear alternative was available and *Rambus* left the standard negotiations and modified its patent applications to incorporate technology being discussed in the standard negotiations. In the *N-Data* case, N-Data acquired the SEP on the secondary market and blatantly revoked an explicit commitment by the prior owner to license its IP for an upfront \$1000 fee. All three of these cases involved either deception or outright repudiation of a prior commitment and were properly addressed by the competition agencies.¹⁶

Second, these companies were not subject to the repeated game discipline. *Dell*, although a major technology company, has principally been an “assembler” and not a major investor in R&D.¹⁷ Therefore, maintaining its credibility in SSOs was not a major concern.

¹¹ *Id.* at 156.

¹² *In re Dell Computer Corp.*, 121 F.T.C. 616 (1996).

¹³ *Rambus Inc. v. FTC*, 522 F.3d 456 (D.C. Cir. 2008).

¹⁴ *In the Matter of Negotiated Data Solutions LLC*, File No. 051-0094 (2008).

¹⁵ Jorge Contreras, “An Empirical Study of the Effects of *Ex Ante* Licensing Disclosure Policies on the Development of Voluntary Technical Standards,” Nat’l Inst. of Standards and Tech. (2011), available at http://gsi.nist.gov/global/docs/pubs/NISTGCR_11_934.pdf.

¹⁶ Although the original decision against *Rambus* by the FTC was overturned on appeal, the European Commission filed a complaint against *Rambus* and eventually reached a settlement with the company. See: http://www.rambus.com/us/news/press_releases/2009/091209.html.

¹⁷ Joan Lappin, “What Exactly Does Michael Dell Have to Sell?,” *Forbes*, January 16, 2013, available at <http://www.forbes.com/sites/joanlappin/2013/01/16/what-exactly-does-michael-dell-have-to-sell>.

The two more recent examples, *Rambus* and *N-Data*, are more relevant. In the case of Rambus, the market was moving away from its RDRAM technology and its future as a viable force in the product and technology marketplace was dim.¹⁸ Faced with declining business prospects, Rambus's best option was to turn into a PAE that was no longer disciplined by having to conduct future standards negotiations with its industry peers.

N-Data, in the FTC's words, was a company "whose sole activity is to collect royalties in connection with a number of patents."¹⁹ As a pure PAE with no products or R&D activities, N-Data had no concerns about its future reputation and had no intention of ever participating in SSOs or negotiating with other market players for access to their patent portfolios.

As the three cases above illustrate, when the repeated game discipline was not applicable, competition authorities dealt with the problems discretely.²⁰ Furthermore, SSOs have largely tweaked their IPR policies to make it clear that patent commitments travel with the patents and that intentional nondisclosure of SEPs or patent applications is forbidden.

3. *Root Causes of the Current Smartphone Patent War*

The recent spike in smartphone patent litigation has little to do with the SEPs and the ambiguity surrounding FRAND commitments. Instead, the immediate cause of the current outbreak in litigation is the aggressive assertion of patents by relatively new mobile market entrants.

The root causes of the smartphone patent wars are the increasing flood of technology patents – particularly low quality software and design patents, the increased functionality of mobile devices and the changing wireless device market structure (specifically the asymmetry in profit margins and market shares).

¹⁸ Kraken, "Rambus: A Dying Company With Dying Patents," Seeking Alpha, Feb. 7, 2012, available at <http://seekingalpha.com/article/346701-rambus-a-dying-company-with-dying-patents>.

¹⁹ Federal Trade Commission, Negotiated Data Solutions LLC; Analysis of Proposed Consent Order to Aid Public Comment, 73 Fed. Reg. 5846, 5847 (Jan. 31, 2008), available at <http://www.gpo.gov/fdsys/pkg/FR-2008-01-31/html/E8-1801.htm>.

²⁰ Although ambiguous FRAND pledges are far from perfect, they have provided some assurances and courts have usually recognized them as preventing the worst types of patent abuse. As a result, patent assertion entities have largely acquired other patents, particularly non-SEP software patents, to use in their litigation campaigns. According to one author, "With the exception of IPRCom, which attempted to disclaim FRAND commitments previously made by Bosch, no instance has been identified of a PAE asserting an essential patent against a standards-compliant product" (Roger G. Brooks, "Patent 'Hold-Up' and the FTC's Campaign Against Innovators," 39 AIPLA Q.J. 451 (2011)).

- The increasing patent intensity in high-tech markets, particularly software, is a major contributing factor to the rise in patent litigation in the smartphone ecosystem. Although it is beyond the scope of these comments to fully document the software patent problem, this crisis has been exhaustively documented in both academic literature and business publications. Whereas most of the major legacy software industry came to life when software patenting was rare (and therefore didn't have to worry about patent litigation or portfolio building), over the last two decades the once frowned-upon (and still controversial) practice of software patenting has exploded. As early as 2009, almost 40,000 new software patents were being issued each year, and the rate at which they are being issued is steadily increasing.²¹ This flood is paralyzing the patent system and increasing the frequency of strategic patenting and opportunistic, rent-seeking behavior, including litigation. Furthermore, by their very nature, software patents are more likely to be broadly defined with poorly delineated borders. Therefore it is not surprising to find that software patents are much more likely to be involved in litigation than other patents.²²
- The increased functionality of smartphones and the incorporation of once distinct technologies, such as wireless Internet connectivity and a full-suite of software offerings, mean that wireless devices now potentially infringe a wide array of new patent fields and legacy patent portfolios. In fact, many of the current patent lawsuits in the smartphone space were initiated by legacy software companies who have entered the wireless market and are strategically using their legacy patent portfolios to their advantage.
- The rapidly changing wireless device market structure over the last 20 years is also a major contributing factor to the recent rise of smartphone patent litigation. During the 1990s and early 2000s as the mobile phone market took off, it was highly competitive. Market shares were in constant flux and the major manufacturers were also major contributors to the standards bodies, so patent portfolios tended to be relatively symmetric and SEP heavy. When Apple entered the mobile phone market with the

²¹ Christina Mulligan & Timothy B. Lee, "Scaling the Patent System," N.Y.U. Ann. Surv. Am. L. (forthcoming), at 15, available at <http://ssrn.com/abstract=2016968>.

²² See James Bessen, "A Generation of Software Patents," Boston Univ. School of Law, Law and Econ. Research Paper No. 11-31, June 21, 2011, available at <http://ssrn.com/abstract=1868979>.

iPhone, Apple became the untouched market leader for smartphones. Until very recently Apple commanded the majority of the market share and virtually all the profit. In the process it was well compensated for its contributions, which were largely integration, software and design advances.²³ However, when an open source operating system which could be implemented by many hardware manufacturers (but had relatively little patent protection) proved to be an effective competitor, incentives changed. Faced with the commoditization of the smart device (a market trajectory that is common and healthy in most tech markets) that threatened to cut into its huge profit margins, Apple pressed its patent advantage. As a result, vertically integrated hardware manufacturers, such as Samsung and Motorola, were forced to use their SEP-heavy portfolios defensively—portfolios full of patents and technology that had helped build the underlying communications protocols that Apple utilizes in its devices.

B. Positive Aspects of FRAND Ambiguity

The chaotic nature of the patent system, particularly as it interfaces with technology and software markets, has also been well documented. Massive patent thickets exist around the core technologies that comprise the modern smartphone. Patent aggregator RPX estimates that 250,000 patents may read on the semiconductors, storage technology, protocols, transmission methods, displays and software that comprise a modern smartphone.²⁴

The sheer number of patents, coupled with uncertainty as to the validity of the patents and questions regarding the underlying essentiality of declared SEPs, mean that simplistic economic assumptions of patent jurisdiction break down. If licenses were negotiated

²³ “I have predicted a marked trend of increasing value with the intangibles in mobile devices—including embedded and aftermarket software predominating over hardware—since Apple’s 2008 3G iPhone launch. The success of the iPhone including its Apps store proves my point. The iPhone leads the smartphone market and has a manufacturing cost around just one third of its \$600 average wholesale pricing (before operator subsidies to consumers). Gross profit margins approaching 60% provide a significant return on investments in software, brand and distribution, while Apple largely relies on the essential IP developed and contributed to mobile standards by others.” Keith Mallinson, “A Compendium of Industry and Market Analysis Articles on Intellectual Property in Mobile Communications Standards,” Response to FTC Request for Comments on the Practical and Legal Issues Arising for Incorporation of Patented Technologies in Collaborative Standards, Patent Standards Workshop, Project No. P11-1204, June 12, 2011, at 19-20, available at <http://www.ftc.gov/os/comments/patentstandardsworkshop/00007-60459.pdf>.

²⁴ RPX Corp., Registration Statement, *supra* note 4.

individually or even at the individual standard level – and the validity and essentiality of all questionable patents were formally tested – transaction costs would be astronomical.

In the face of the uncertainty resulting from these pervasive problems, technology companies have developed a host of strategies – including patent pools and cross-licensing. And standard-setting bodies have developed rules, norms and understandings that allow them to function reasonably well.

In standards-dependent industries such as telecommunications and hardware, innovative companies – particularly vertically integrated companies that have significant R&D operations but receive most of their revenue from product sales – are faced with two competing imperatives. The first is to be active participants in industry standards, not only to get their IP incorporated into the standard for the purpose of royalty generation, but also to be on the cutting edge of industry technology and as far along the learning curve as possible.

However, in a world where ‘everyone infringes everyone else,’²⁵ vertically integrated firms that also produce products have a second imperative. They must assemble large defensive portfolios in order to protect themselves from opportunistic patent attacks by their rivals.

Standards participants developed several core strategies for dealing with these competing goals. Upstream innovators, whose primary output was R&D and patents, participated in SSOs and had robust licensing programs that sought to fully monetize their SEPs. Vertically integrated firms that both produced significant levels of R&D but still received a majority of their revenue from selling actual products often adopted one of two strategies that were commonly regarded by the industry as being within the confines of a FRAND agreement.²⁶

- The first strategy, which has been referred to as the “let sleeping dogs lie” strategy, involves firms contributing their R&D to standards, acquiring SEPs and then sitting on them.²⁷ Companies that engaged in this strategy were content to let others use their SEPs,

²⁵ See Federal Trade Commission, “To Promote Innovation,” *supra* note 3, at ch. 3, at 34-37, 51-54.

²⁶ See *infra* notes 28-29 (citing testimony from FTC June 21, 2011 Patents Standards Workshop, “Tools to Prevent Patent ‘Hold-up’”).

²⁷ See Jorge Contreras, “Rethinking RAND: SDO-Based Approaches to Patent Licensing Commitments,” ITU Patent Roundtable, Geneva, at 9 (Oct. 10, 2012), available at http://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1030&context=fac_works_papers (“...many patent holders engaged in standards development do not actively seek to license or enforce their SEPs. These companies have been termed ‘sleeping dogs’, and are generally believed to hold SEPs primarily for ‘defensive’ purposes (i.e., to use in counterclaims should they be sued for patent

often without charge, as long as they themselves were not subjected to any demands. If approached with a license demand, or threatened with infringement lawsuits, they would use their SEPs (as well as other non-SEPs when appropriate) to negotiate broad cross-licensing agreements with the primary intention of maintaining their “freedom to operate” in the product market.²⁸ This discouraged lawsuits and reduced the actual royalty burden of the standard, as many, if not most, of these companies never actually charged others for the SEP royalties they were entitled to.

- A second but similar strategy practiced by vertically integrated firms involves active pursuit of cross-licensing involving bundles of SEPs and non-SEPs designed to achieve product market freedom.²⁹ As individual products often encompass hundreds of

infringement, or as bargaining chips in licensing negotiations with other patent holders). Vendors are loathe to approach sleeping dogs for licenses, as doing so could ‘wake’ these companies and result in royalty obligations that otherwise would not have materialized. Thus, it is a common strategy to let these sleeping dogs lie.”)

²⁸ See Federal Trade Commission, Patents Standards Workshop, “Tools to Prevent Patent ‘Hold-up’”, June 21, 2011, transcript at 154:

“...the way that vertically integrated companies that both contribute technology to standards and also implement disorders [sic], monetize if you will, their contributions to standards, is often through getting defensive positions that can create design freedom for them, and the classic way people do a lot of defensive patenting in the tech industry, and when people talk about, you know, patentees versus innovators – or, sorry, innovators versus implementers, I think that distinction is often overlooked, what what’re you’re getting out of participation in standards development is often design freedom.”

Statement of Gil Ohana, Senior Director for Antitrust and Competition for Cisco Systems. *See also id.* at 218:

“Now, there may be issues in, you know, how far defensive suspension should apply. And I think those thing need to be dealt with on a case-by-case basis. I think there is a reasonable possibility here. I know when we’ve kind of faced this in the past, we’ve asked ourselves the question of, you know, well, yeah, if you want to litigate against me, then that has a different value to me than if you’re willing to sign a non-assert. So, you know, the way this plays out could be very different, and it shouldn’t be something that is blanketly dismissed.”

Statement of Earl Nied, Program Director of Standards and Intellectual Property Rights for Global Public Policy Group at Intel Corp.

²⁹ *Id.*; *see also id.* at 50:

“...the decision is going to be more than just about essential patent claims, vis-à-vis, a single standard. It’s going to be about your product, look at the different patent holders? Do I already have a licensing agreement with them? Do we have a longstanding détente, you know, what is their business model? Are they the type of patent holder that makes RAND commitments at standards bodies but don’t proactively seek licenses, they sort of use their patents defensively, so when someone sues them with some intellectually property they’ll go and pull out the stuff that

standards³⁰ (and the distinction between SEPs and non-SEPs was often unclear), vertically integrated firms sought to minimize transaction costs by seeking a bundle of licenses that allowed both parties freedom to operate, at least in respect to one another. As many of these vertically integrated companies did not have major licensing programs, a pure cash-for-SEP license was likely of little interest.³¹ If their counterparty insisted on taking just an SEP license, and wasn't willing to agree to non-assertion clauses or broad cross licensing, the licensor firm viewed it as reasonable to charge higher FRAND rates to compensate for failure to include the other valuable contractual provisions. It is important to note that this strategy, which often resulted in zero-fee (or a small one-way balancing fee) cross-licenses, also minimized the royalty burden on the standard.

If competition agencies or courts significantly rein in the bilateral negotiating flexibility currently embedded in FRAND commitments, the delicate equilibrium struck over the last several decades that allowed firms to actively participate in SSOs while maintaining a path to defend themselves from a poorly functioning patent system will be disturbed. And there is no guarantee, particularly given the unchecked tide of broad, overlapping, and questionable patents, that the new equilibrium will be better for either consumers or innovation.

II. SECOND-ORDER PROBLEMS THAT CAN RESULT FROM ALTERING FRAND FLEXIBILITY

Without broader patent system reforms, tightening FRAND commitments and limiting injunction freedom can create more problems. Firms that participate in SSOs and use their SEPs primarily to achieve “freedom to operate” will find themselves in a more vulnerable position and

they, you know, where they made a licensing commitment at a standards body? I mean, there's all these different business models.”

Statement of Amy Marasco, General Manager for Standards Strategy at Microsoft.

³⁰ Brad Biddle *et al.*, “How Many Standards in a Laptop? (And Other Empirical Questions),” available at http://standardslaw.org/How_Many_Standards.pdf.

³¹ Insofar as SEPs may prospectively provide less design freedom and flexibility to operate, SEP-heavy market participants may be incentivized to institute more aggressive licensing programs. This will ultimately raise prices for consumers.

will be forced to adopt new defensive strategies.³² This new temporary vulnerability could also encourage more short- and medium-term lawsuits.

A. Increase in Problematic Defensive Patenting Strategies

If making a FRAND commitment forecloses injunctive relief against an adversary – even when one is already being enjoined by that same adversary – some industry participants have likened this to “IP suicide.”³³ As a result, major SEP holders will be forced to divert engineering and legal resources to rebuild a commitment-free, defensive patent portfolio. This patenting will likely be less productive than standard-essential patenting activity, where the R&D time is focused on actual technological solutions. Preferred non-SEP defensive patents may not be patents related to one’s own products and services, but patents that read on competitors’ products or anticipate where competitors are heading.³⁴ More specifically, firms will likely seek patents in

³² See testimony discussed, *supra* notes 28-29. Furthermore, ambiguous interpretations of FRAND have given that large technology companies the ability to participate in thousands of standard setting exercises each year. Dispatching legal personnel to each effort would be onerous and inefficient as the majority of these standards never attain commercial significance. Ambiguous FRAND commitments allow companies to punt more complex licensing decisions further down the road while allowing the engineers to focus on crafting the best standard possible from a technological perspective. Although the downside of this is a higher theoretical risk of holdup, reputational concerns and the promise of future interactions largely discipline repeat standards players to negotiate in good faith. If FRAND declarations are interpreted as preventing bilateral negotiating discretion surrounding patents declared as essential, companies will need to do more thorough *ex-ante* examination of those declarations, which could slow that standard setting process down and limit the number of SSOs or working groups that individual companies could participate in.

³³ See Federal Trade Commission, Patents Standards Workshop, “Tools to Prevent Patent ‘Hold-up’”, June 21, 2011, transcript at 223:

“But all of that taken into consideration, I’ve heard that making a RAND commitment should not be akin to IP suicide, in that if you have been sued in a defensive posture, if someone’s coming after you with an injunction, that that then kind of takes the handcuffs off the RAND commitment because it’s – your business is getting shut down if you don’t – aren’t able to use every thing that’s in your arsenal. So, I would say in that situation, maybe there is some room, because you’re saying, ‘Look, how is it you can shut me down and I can’t shut you down?’ That seems counter-intuitive, also.”

Statement of Sarah Guichard (Senior Director of Patents and Standards Strategy with Research in Motion).

³⁴ This strategy is common for companies building defensive portfolios. A concise description is available in a Mondaq article from 2012: “*Defensive Reasons*: Here, Patents are registered purely for defensive purposes. They are the ones that cover something that a competitor may possibly practice or is already practicing. That is, such patents safeguard the business by providing protection from litigation.” Mrinalini Gupta, “India: Defensive Patents... Bombs For Future Business Battle,” Mondaq, November 30, 2012, available at <http://www.mondaq.com/india/x/208990/Patent/Defensive+Patents+Bombs+For+Future+Business+Battle>. For a more detailed description of strategic defensive patenting, see: James

areas that have proven strategically effective in the courtroom in the recent wave of smartphone litigation, such as broad, ambiguous design and software patents.³⁵ Unfortunately, these are also the areas in which patenting has proved most problematic and controversial in the last decade.

B. More Litigation in the Short- and Medium-Term

As SEPs have been asserted almost exclusively defensively (whether infringement counterclaims or counterattacks in other venues or along other product lines) in the current epidemic of smartphone litigation, SEP constraints will strengthen the hand of instigators who clearly have no qualms about aggressively invoking their IP. Besides those two discrete problems that are likely to flow from significantly altering the meaning of FRAND commitments, there is a distinct possibility that the intensity of the smartphone wars could actually *increase* in the short- and medium-term. As restocking a defensive portfolio free of FRAND encumbrances will take time and considerable capital, there is an incentive for rivals unencumbered by FRAND commitments to push their patent advantage in the near term.

C. Standards Participants Will Adapt to New FRAND Injunction Limitations

1. Standard Bodies Are Free to Change IPR Commitments

The ambiguity inherent in FRAND commitments is not a new issue. Academics, lawyers, competition regulators, standard setting participants and SSO officials have long grappled with how to interpret “fair,” “reasonable,” and “nondiscriminatory.”³⁶ For better or worse, no uniform policy or clarification of the commitment has proliferated.

Given that SSOs are voluntary consensus undertakings, the ambiguous FRAND commitments have proven to be useful in maintaining inclusive SSOs. This is particularly true in the mobile telecommunications world where the marketplace is complex, as it involves innovators, vertically integrated innovators with consumer products, and pure implementers.

Bessen, “Patent Thickets: Strategic Patenting of Complex Technologies,” March 2003, available at <http://ssrn.com/abstract=327760>.

³⁵ Charles Duhigg & Steve Lohr, “The Patent, Used as a Sword,” N.Y. Times, October 7, 2012, available at <http://www.nytimes.com/2012/10/08/technology/patent-wars-among-tech-giants-can-stifle-competition.html?pagewanted=all>.

³⁶ The record of the FTC’s November 6, 2002 hearings on “Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy” was littered with references to the ambiguous nature of the FRAND commitment. Carl Shapiro, the former DOJ Deputy Assistant Attorney General for Economics, summed up the consensus of the hearing when he said, “It just seems there’s a lot of running room between different interpretations of fair, reasonable and non-discriminatory when we’ve got complex terms and conditions that are integral to the whole process.”

Furthermore, because the IPR commitments of any SSO must be voluntarily agreed to up front, participants are free to alter the language or choose less (or more) restrictive venues to pursue standards collaboration. In fact, when the European Telecommunications Standards Institute (ETSI) tried to push a more restrictive IPR policy on its members, dissension arose in the ranks and the organization returned to a more lenient set of FRAND commitments when faced with the risk of defection.³⁷

As Intel noted in its comments to the 2011 FTC Patent Standards Workshop:

If the Commission were to define FRAND without requiring SSOs to apply the Commission's definition to FRAND licensing, it would accomplish little more than lexicon refinement because SSOs would be free – as they are now – to select the defined FRAND or some alternative licensing commitment or no commitment at all.³⁸

2. *If a New FRAND Interpretation Is Mandated, It Will Lead to Diminished Incentives to Participate in SSOs*

If contributing patents to a standard makes a company more vulnerable to attack, incentives to participate in the standards setting process will be diminished – at least at the margins. Although it is unlikely that standard setting will break down entirely, non-core standards can be harmed and some members may leave the process. While at least one study has highlighted the fact that more confining IPR rules did not have much of an effect on standards participation, it is important to note that those SSOs voluntarily chose those new rules (and the study only focused on one organization that changed its rules).³⁹ If new IPR rules are foisted upon standards bodies that have previously considered and rejected them (presumably because the incentives of the group are aligned differently than those bodies that have chosen stricter rules), then it is much more likely that more members will pull out or choose alternate standard setting options, such as overseas SSOs or looser consortia arrangements. It is also important to note that the less inclusive standards bodies are, the greater the likelihood that outside parties will have IP that reads on the standards. Being outside of the SSO, these parties will have no restrictions on how they exercise their IP rights vis-à-vis the standard.

³⁷ See generally Iversen, “Standardization and Intellectual Property Rights,” *supra* note 8.

³⁸ Intel Corporation's Response to the Commission's Request for Comments in Connection with Patent Standards Workshop, *supra* note 6.

³⁹ Jorge Contreras, “An Empirical Study of the Effects of *Ex Ante* Licensing Disclosure Policies on the Development of Voluntary Technical Standards,” Nat'l Inst. of Standards and Tech. (2011), available at http://gsi.nist.gov/global/docs/pubs/NISTGCR_11_934.pdf.

III. CONCLUSION

While the SEP hold-up problem should not be ignored, this discrete action to mitigate it will exacerbate other problems if it is not accompanied by a broad package of reforms aimed at remedying the broader problems in the patent system. Undercutting defensive strategies firms developed to cope with the underlying patent crisis will simply force firms into even more speculative and problematic patenting strategies. This will likely increase, rather than decrease, distortions and dysfunction in the patent system. Already, major technology firms spend more on patent litigation and defensive patent purchases than they spend on R&D.⁴⁰ This settlement, especially if it is used as a template for interpreting FRAND industry-wide, will only increase the need for firms to develop larger defensive portfolios and divert resources away from investments in R&D and innovation in real products and services.

To best promote consumers' interests and foster competition, the FTC should maintain its current carve-outs for defensive use found in section Section IV.F of the consent decree. To the extent that the Commission amends the decree or takes broader action to place confines on FRAND generally, it should carefully consider the second-order problems described in the above comments.

The FTC should continue its detailed examination of PAEs, which both exploit and feed the current problems in the patent system identified above, and use its policy staff and broad investigatory powers to highlight the root causes of the competitive problems created by general patent system dysfunction.

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February 22, 2013

⁴⁰ Duhigg & Lohr, "The Patent, Used as a Sword," *supra* note 35.