Protecting Small Business Innovation

August 5, 2011

Association for Competitive Technology
1401 K Street, N.W.
Suite 502
Washington, D.C. 20005

Federal Trade Commission/Office of the Secretary
600 Pennsylvania Avenue, N.W.
Room H–135 (Annex X)
Washington, DC 20580

Re: Patent Standards Workshop, Project No. P11–1204

Dear Commissioners:

I write today on behalf of the Association for Competitive Technology ("ACT"). ACT appreciates the opportunity to respond to the Federal Trade Commission's Request for Comments and Announcement of Workshop on Standard-Setting Issues. ACT is the only U.S. organization focused on the needs of small business innovators. ACT advocates for an environment that inspires and rewards innovation, and helps its members leverage their intellectual assets to raise capital, create jobs, and continue innovating. ACT represents nearly 3,000 software developers, systems integrators, information technology ("IT") consulting and training firms, and e-businesses from across the country.

Intellectual property rights are critical to all innovative businesses, but they tend to be particularly important to smaller entities. ACT thus welcomes the opportunity to comment on the FTC's Patent Standards Workshop.

Introduction

ACT was started by a small group of IT entrepreneurs with the objective of having their interests represented in government. ACT is primarily made up of small business innovators ("SBIs"). These SBIs largely have the same interests with respect to governments and regulators: access, flexibility, and consistency. One of ACT's core principles is a consistent, predictable regulatory framework that provides SBIs flexibility in business models. Even when competing against other IT companies in the same market, IT companies often rely a diverse array of business models—conduct that exclusive rights are intended to facilitate.[1] Currently, there are four primary business models for software distribution and services: license software or sell subscriptions for software use, give away software to help sell hardware, give away software to generate service revenue, and give away software to sell advertisements and collect user data.[2] Within each of these business models, SBIs are competing with

[1] JONATHAN ZUCK & BRADEN COX, ASS'N FOR COMPETITIVE TECH., UNDERSTANDING THE IT LOBBY: AN INSIDER'S GUIDE 2 (2008), *available at* http://actonline.org/publications/files/rcpg61911proof.pdf.
[2] *Id.* at 6.

larger diversified entities. Larger diversified entities compete using more than one of these business models.

For example, a larger diversified entity may perform research and development that enables it to patent a particular technology. This entity may then implement the patented technology in a product that it designs, manufactures, and licenses or sells to consumers. Because the entity owns the patents necessary to make, use, and sell the technology, it may prohibit others from practicing that technology or may license the technology out to others. These entities have research-and-development budgets and legal budgets that dwarf similar budgets at SBIs.

But many studies show that SBIs are often very effective innovators. Consequently, many SBIs are also patent owners; and in order for these SBIs to compete effectively with larger diversified entities, any patents they own must be protected. Standards can be a driver of innovation as they allow competing products and services to offered by many companies, including SBIs, to interoperate within a technology sector. In the Information and Communication Technology ("ICT") sector, standards necessarily evolve at a rapid pace. Though some ACT members may be directly involved in developing these standards, others hesitate to participate because they are concerned that active participation in standards' development may negatively affect their intellectual property ("IP") rights. Standard setting organizations ("SSOs") that have IP policies that allow their members the flexibility of making a license commitment on reasonable and nondiscriminatory terms without onerous disclosure policies would help spur more SBIs to participate in standards' development.

SBIs are also consumers of IT solutions. In order to sustain any of the four IT business models discussed above, the SBI itself must use IT solutions. Many of these IT solutions implement standards. SSOs that have IP policies that allow their members the flexibility of making a license commitment on reasonable and nondiscriminatory terms without onerous disclosure policies provide the structure necessary to allow consumers of IT solutions that implement standards access to, flexibility with respect to, and consistency of these IT solutions.

The FTC Federal Register Notice discusses the issue of a patent hold-up "problem" at length and poses many questions that appear to be aimed at finding solutions to this "problem." From the perspective of ACT members, who are not convinced that there is a wide-spread patent hold-up problem, some of the solutions suggested by the questions would discourage risk taking and innovation, creating a less competitive environment within the ICT sector.

This letter focuses on why two of those proposed solutions would make the standards' development atmosphere more hostile for SBIs. The FTC suggests that *ex ante* disclosure of license terms will inject more certainty into the standards' development process, especially at the time alternative technologies are selected as part of a draft standard.[3] The FTC also suggests that *ex ante* joint negotiations of

[3] FTC Request for Comments and Announcement of Workshop on Standard-Setting Issues, 76 Fed. Reg. 28036, 28038 (May 13, 2011) ("What has been the experience of those SSOs that

licensing terms may also reduce patent hold-up "problems."[4] ACT members would oppose any policy requiring mandatory *ex ante* disclosure of licensing terms or mandatory joint negotiations of licensing terms because either policy would reduce an SBI's ability to negotiate flexible license agreements tailored to the specific circumstances surrounding each deal.

Mandatory *Ex Ante* Disclosure of Licensing Terms Will Discourage Participation by SBIs

An important goal of an SBI is to both procure and protect its IP. Many SBIs expend research-and-development funds in hopes of patenting a technology that may eventually become essential to the implementation of a particular standard. If the SBI holds patents that contain claims essential to a standard being developed under a mandatory *ex ante* licensing terms disclosure policy, the SBI participating in the SSO would be required to disclose and commit to its rates for such claims and most restrictive licensing terms.[5]

The tendency of any company faced with this situation would likely be to disclose a rate higher than it would eventually settle on in order to give it room to negotiate. The unintended consequence, however, of this higher-than-acceptable rate could be that the "buyers," the prospective implementers of the standard, would pressure the SBI to lower its rate. This collective pressure might be unreasonably coercive, especially when combined with a group decision to exclude the SBI's patented technology from the standard. In the case of an SBI, unlike a larger diversified entity, the vast majority of its research-and-development efforts and funding may be almost entirely limited to its proposed contribution to the standard. This possibility of coercive pressure has been recognized by the Department of Justice and the FTC as a competition concern.[6]

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require or allow ex ante disclosure of licensing terms? How frequently do ex ante disclosures of licensing terms occur? Why are ex ante disclosures of licensing terms not required or made?").

[4] *Id.* ("How frequently do ex ante multilateral negotiations of licensing terms occur? How are such negotiations conducted?).

[5] *See, e.g.*, Letter from Thomas Barnett, Assistant Attorney Gen., U.S. Dep't of Justice, to Robert Skitol, Esq., Drinker, Biddle & Reath, LLP 4 (Oct. 30, 2006), *available at* http://www.justice.gov/atr/public/busreview/219380.htm ("Under the proposed policy, each member of a working group must identify all patents or patent applications that he knows about and that he believes may become essential to the implementation of the future standard. In addition, working group members must declare the maximum royalty rates and most restrictive non-royalty terms that the VITA member company he or she represents will request for any such patent claims that are essential to implement the eventual standard.").

[6] *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 53 (2007), *available at* http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf ("Nonetheless, joint *ex ante* licensing negotiations may raise competition concerns in some settings. For example, such negotiations might be unreasonable if there were no viable alternatives to a particular patented technology that is

Mandatory *Ex Ante* Joint Negotiation of Licensing Terms Will Discourage Participation by SBIs

For reasons similar to those discussed above, ACT would oppose a policy of mandatory joint negotiation of licensing terms. If the SBI holds patents that contain claims essential to a standard being developed under a policy mandating *ex ante* joint negotiation of licensing terms, the SBI participating in the SSO would be required to participate in a group negotiation, possibly being subject to unreasonably coercive collective pressure from prospective implementers. For SBIs that have invested heavily in their proposed contributions, the risk that this collective pressure during joint negotiations will undervalue their contributions will discourage their participation in the SSO's standards' development process.

Neither "Solution" Takes the Manner in Which Patents are Licensed into Consideration

In addition to the issues discussed above, neither the mandatory *ex ante* disclosure of licensing terms nor the joint negotiation of licensing terms takes into consideration the types of licenses that an SBI may ultimately negotiate with individual implementers of the standard. These could include cross-licenses; portfolio licenses; licenses that include other types of terms such as reciprocal licensing, defensive termination, and licenses for related, though not essential, technology; and business deals in general. SBIs also recognize that many larger more diversified companies have little interest in seeking licensees for their patented technology and would prefer to simply sell or license their products and use their patents defensively or to obtain freedom to operate. Patent policies that would require these larger companies to post specific license terms and negotiate joint license arrangements for all implementers not only poses new infringement risks for SBIs that would not have been present in the absence of such requirements but also increases the costs for SBIs to participate and implement standards. Both mandatory *ex ante* disclosure of licensing terms and joint negotiation of licensing terms require time and resources of an SBI in evaluating the license terms and participating in a joint negotiation that are better spent developing products and executing its business plan, especially where the ultimate business

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incorporated into a standard, the IP holder's market power was not enhanced by the standard, and all potential licensees refuse to license that particular patented technology except on agreed-upon licensing terms. In such circumstances, the *ex ante* negotiation among potential licensees does not preserve competition among technologies that existed during the development of the standard but may instead simply eliminate competition among the potential licensees for the patented technology."); Hill B. Wellford, Council to the Assistant Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Address at the 2d Annual Seminar on IT Standardization and Intellectual Property China Electronics Standardization Institute: Antitrust Issues in Standard Setting (Mar. 29, 2007), *available at* http://www.usdoj.gov/atr/public/speeches/222236.htm ("SDO buyer-cartel behavior has the real potential to damage innovation incentives, and therefore is properly the subject of antitrust scrutiny.").

deal, if any is needed, between the larger company and the SBI likely will not arise out of these disclosures or negotiations.

Conclusion

For all of these reasons, ACT on behalf of its SBI members urges the FTC to affirmatively support the continued flexibility of relevant stakeholders to define the patent policy that best meets their needs and to respect the continued practice of bilateral negotiations over joint negotiations. Exclusive rights, like those conferred by patents, are designed and intended to permit entities to pursue a wide range of business models, and the models that prove to be most productive necessarily change rapidly as technology itself advances and evolves. Solutions that would tend to lock in approaches to standard setting that might seem optimal today may well become tomorrow's obstacles to continued innovation.

Sincerely,

Jonathan Zuck
President