Competition Law Association, June 12, 2012

“The IP & Competition Law Interface:
Part I: Role of Competition Authorities in IP Matters”

Cleary Gottlieb

EU and US perspective
Should antitrust law enjoin injunctions?

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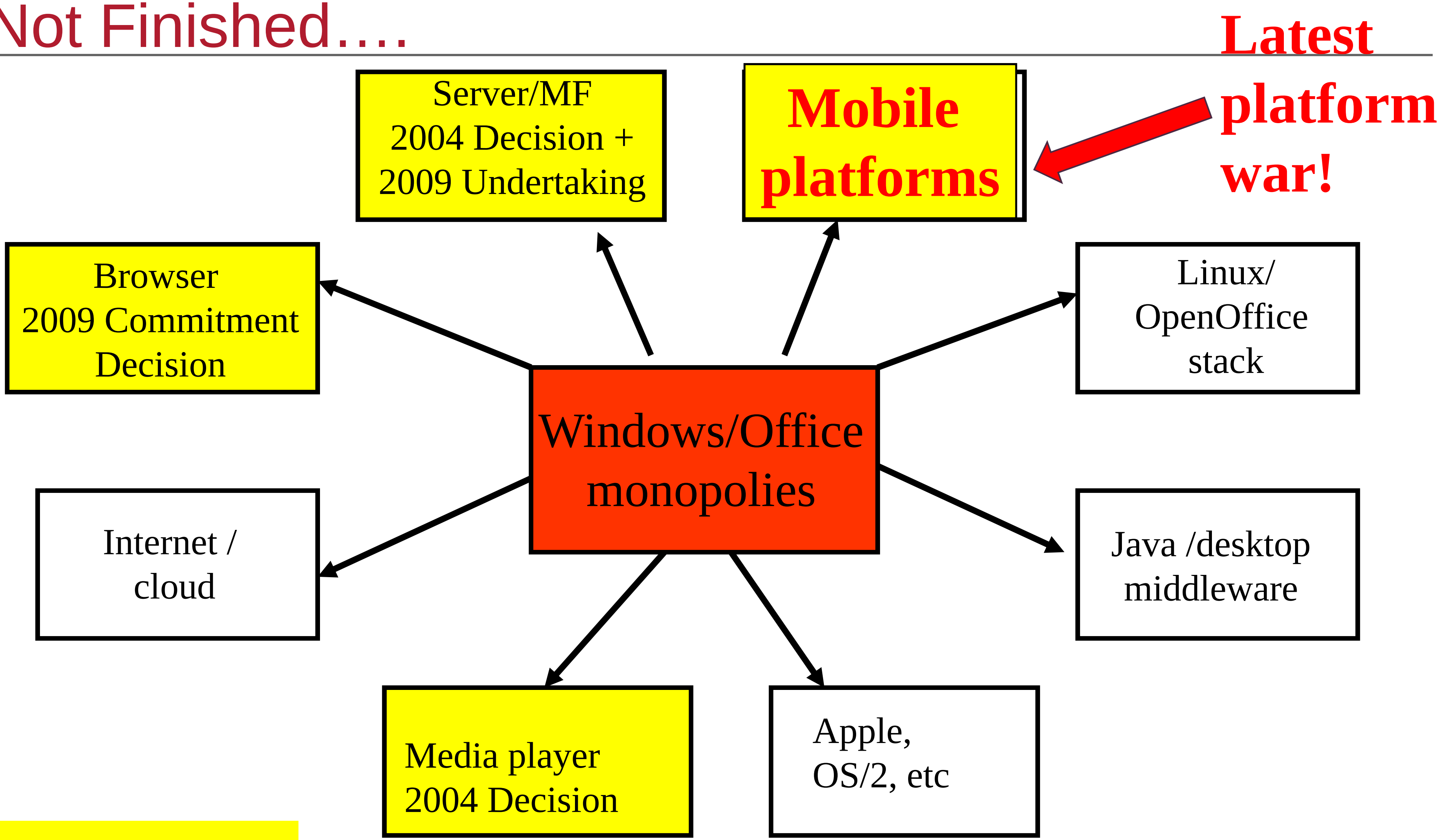
Cleary is counsel to various parties in cases involving these issues, eg *IBM, Google (but not in Mosaid case), adversarial parties in Rambus, Microsoft, Qualcomm*, etc. Comments and positions are personal/do not bind the firm or its clients. Thoughts are work in progress.

1. IP and Competition -- 3 waves of cases

IP and Competition -- 3 waves of cases

- Leveraging of power (1st wave of cases)
  - Owner of *de facto* standard may use power to block interoperability, killing competition and innovation in neighbouring markets, and to stifle platform competition
  - Example: *Microsoft* case, *Apple settlement*
- Standards capture (2nd wave of cases)
  - Owner of essential patent for cooperative standard may gain power, and once lock-in has occurred, charge excessive fee or monopolize downstream market
  - Example: *Rambus* case, *IPCom*, *Qualcomm* (but most complaints settled)
  - See Harhoff ,"The Strategic Use of Patents" (2007 ENTR/05/82)
- Use of legitimately acquired Standard Essential Patents (3rd wave)
  - Owner of essential patent for cooperative standard may use SEP to seek injunctions against rivals. Is that legitimate?
  - Example: *Samsung, Motorola*
- <u>Is the EC now riding the wrong wave? If so, what should it do?</u>

1st Wave – Microsoft Platform Threat cases Not Finished….



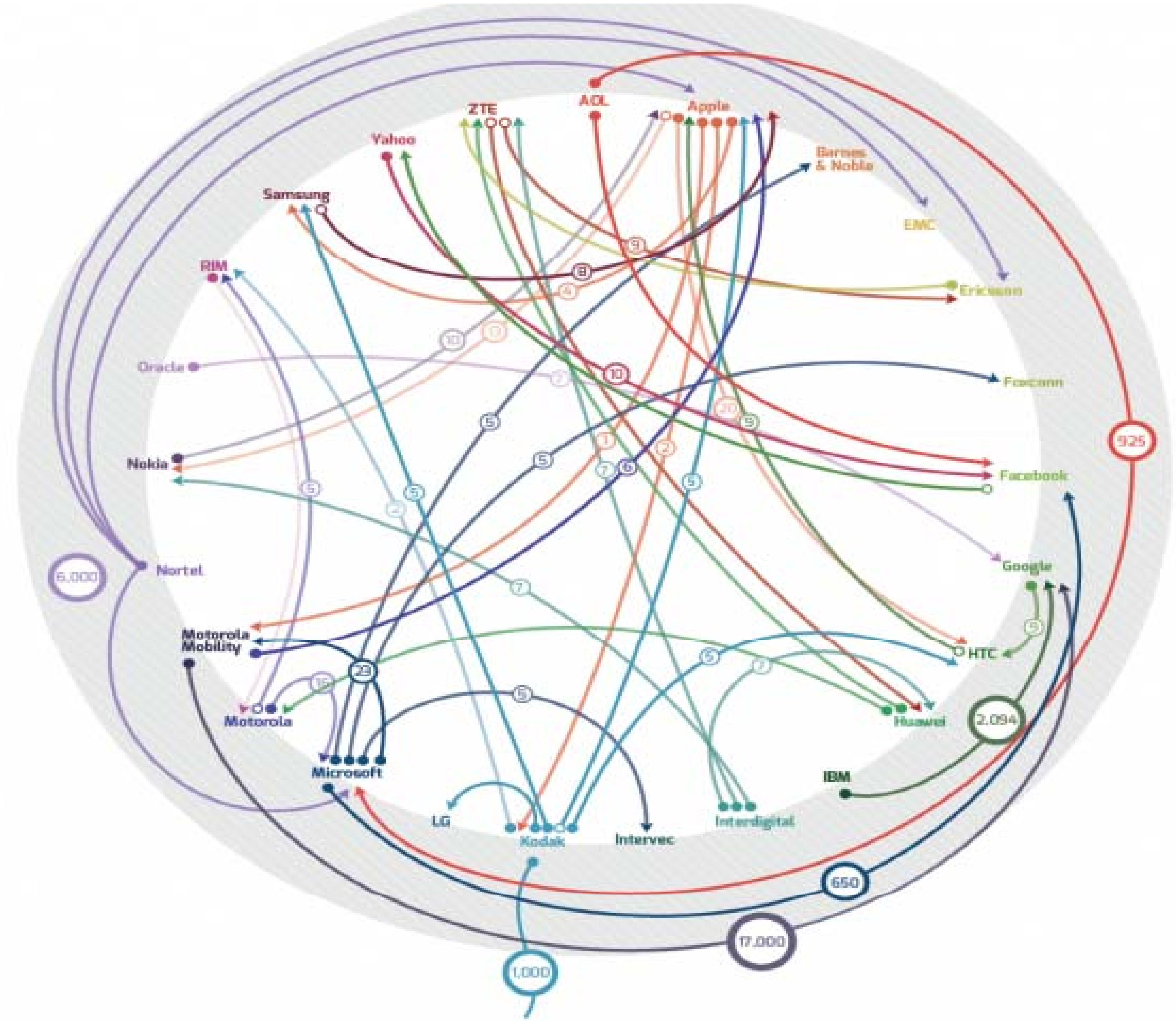
Yellow = EU cases

Exclusion tools: bundling, nondisclosure, price tying, standards abuse, limit doc. interchangability

2nd Wave -- Patent Ambush cases (e.g., *Rambus*)

- **Background**
  - Rambus participated in the standard-setting process for DRAMs
  - Rambus did not reveal during the standardization process its patents and pending patent applications
  - Following adoption of the standard, Rambus claimed its patents were infringed by the standard
  - Rambus then sought excessive royalties for their patents
- **Finding**
  - The “ex-post” exploitation of trust created by non-disclosure violates Article 102
- **Outcome**
  - The case was resolved by Rambus committing to license its DRAM products at capped rates for 5 years
- See also: European Commission Notice - Guidelines on the applicability of Article 101 TFEU to horizontal co-operation agreements, OJ C11/1, January 14, 2011,
- See also: FTC Report on issued in March 2011, *“The Evolving IP Marketplace”*, http://www.ftc.gov/os/2011/03/110307patentreport.pdf

3rd Wave – The Patent War cases



Regulators worried about strategic use of patents

- Monday, February 13, 2012

"*We have approved the acquisition of Motorola Mobility by Google because, upon careful examination, this transaction does not itself raise competition issues. Of course, the Commission will continue to keep a close eye on the behaviour of all market players in the sector, particularly the increasingly strategic use of patents*"

-- Joaquín Almunia, European Commissioner for Competition

"*In light of the importance of this industry to consumers and the complex issues raised by the intersection of the intellectual property rights and antitrust law at issue here, as well as uncertainty as to the exercise of the acquired rights, the division continues to monitor the use of SEPs in the wireless device industry, particularly in the smartphone and computer tablet markets. The division will not hesitate to take appropriate enforcement action to stop any anticompetitive use of SEP rights.*"

-- US Department of Justice

As soon as MMI merger was cleared, Apple and Microsoft complained against MMI

- Friday, February 17, 2012

"*On February 17, 2012, MMI received a letter from the European Commission… notifying it that the Commission has received a complaint against MMI by Apple regarding the enforcement of MMI's standards-essential patents against Apple allegedly in breach of MMI's FRAND commitments. Apple's complaint seeks the Commission's intervention with respect to standards-essential patents.*"

-- Motorola Mobility SEC filing

- Wednesday, February 22, 2012

"*Earlier today, Microsoft filed a formal competition law complaint with the European Commission (EC) against Motorola Mobility and Google.*

Motorola has broken its promise. Motorola is on a path to use standard essential patents to kill video on the Web, and Google as its new owner doesn't seem to be willing to change course."

-- Dave Heiner,

Vice President & Deputy General Counsel,
Standards & Antitrust Group, Microsoft

2. Apple and Microsoft's complaints against Samsung and Motorola

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Essence of complaints: No Injunctions on SEPs

- *"Motorola promised to license its standard-essential patents on RAND terms, not to enjoin those ready and willing to pay a RAND rate. It should not be able to wield the massive leverage of exclusionary relief against enormously popular consumer products to extract royalties or other value that far exceeds its technological contribution to the standard."*
  - Microsoft, Public Interest letter to ITC, June 6, 2012

- *"The international standards system works well because firms that contribute to standards promise to make their essential patents available to others on fair, reasonable and nondiscriminatory terms. Consumers and the entire industry will suffer if, in disregard of this promise, firms seek to block others from shipping products on the basis of such standard essential patents."*
  - Microsoft's Support for Industry Standards, February 8. 2012 at http://www.microsoft.com/about/legal/en/us/IntellectualProperty/iplicensing/ip2.aspx

Radically different position from a year ago…

- "*The existence of a RAND commitment to offer patent licenses should not preclude a patent holder from seeking preliminary injunctive relief or commencing an action in the International Trade Commission just because the patent holder has made a licensing commitment to offer RAND-based licenses in connection with a standard.* … *Any uniform declaration that such 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.*"

  – Microsoft's letter to the FTC of June 14, 2011, p. 13, available at http://www.ftc.gov/os/comments/patentstandardsworkshop/00009-60523.pdf.

Conditions for Finding of Abuse of Dominance

Same as in refusal to license cases (*Magill, IMS Health, Microsoft*)

- Dominance
- Refusal to license
- Exceptional circumstances, including
  - indispensability
  - serious threat of elimination of all effective competition
  - consumer harm in the form of suppression of innovation
- Absence of objective justification

Apple and Microsoft complaint (1): Dominance?

- Market Definition:
  - *"each SEP can be considered as a separate market in itself as it is necessary to comply with a standard and thus cannot be designed around, i.e. there is by definition no alternative or substitute for each such patent."* (MMI Clearance Decision, para. 61)
  - Makes sense under the SSNIP test, since no substitute technology

- Dominance:
  - ""*the power … to behave in an* "*appreciable extent independently of its competitors, its customers and ultimately of the consumers*" allowing the firm to "*prevent effective competition being maintained on the relevant market*"*.*
  - EC in MMI Clearance: *"market power <u>can</u> be conferred by a single SEP"*

- But is a "monopolist" always dominant?

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Importance of Countervailing Power

- If licensee has no / smaller portfolio: SEPs convey dominance
- But if licensee has an equivalent/larger portfolio, especially if it contains SEPs and patents essential for de facto standards => countervailing power and "mutually assured destruction"
- This is recognized in past cases (Case M.5529 – *Oracle/Sun*, fn. 458)
  - "*Large patent pools are understood to ensure "peace" between the big players in the industry by credible threatening the IP equivalent of "mutually assured destruction"* = balance leads to countervailing power
  - *[But:] "[J]ust because the big companies may never go too far with their patents with each other and worldwide technologies such as the Internet doesn't mean that smaller companies or open-source developers won't be attacked. They will be. [...] Just the mere threat is enough to stop a company from developing or marketing a program if it doesn't have the legal protection or deep pockets needed to fight a patent battle in the courts."*

    = imbalance leads to dominance

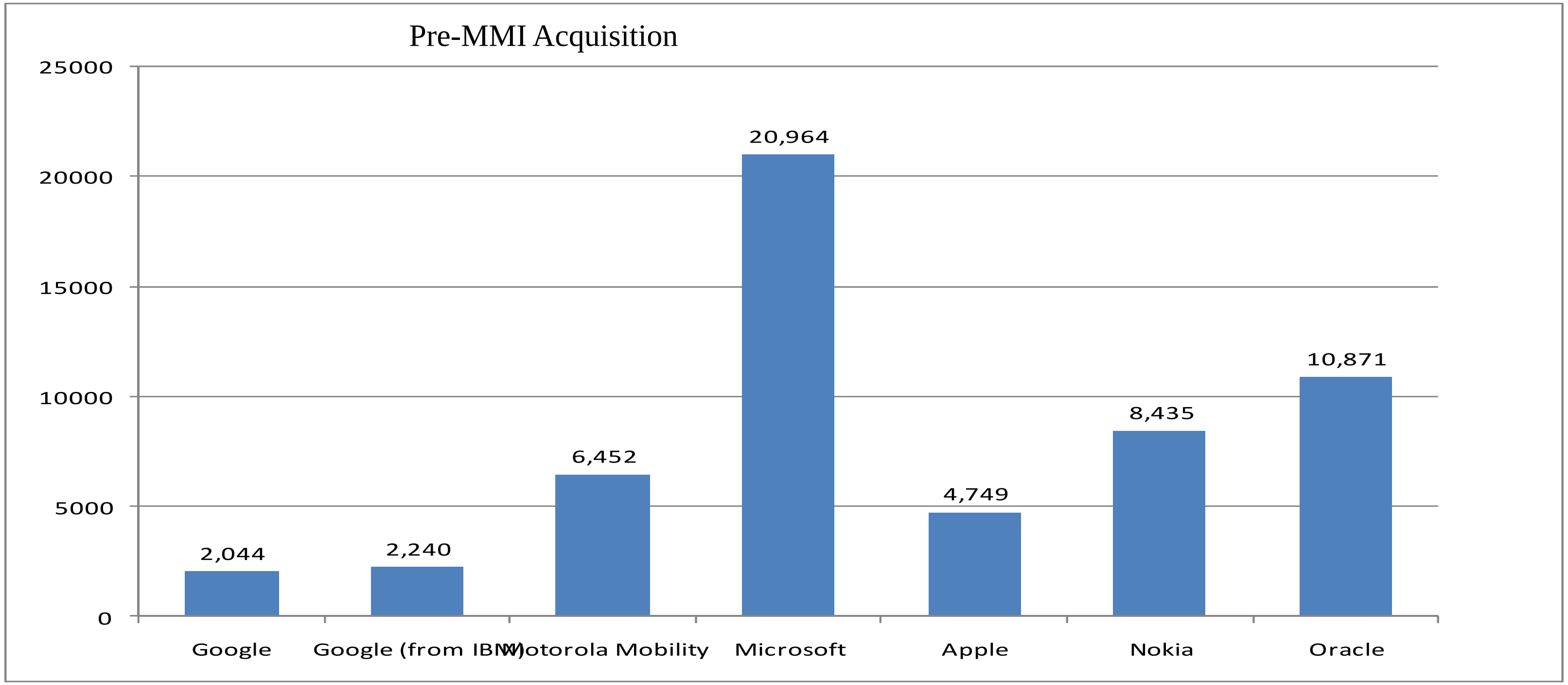
Formula for Deterrence

- Credible Deterrence =
  Perceived Ability x Perceived Intent to cause harm

- Perceived intent to exclude Android:
  – Steve Jobs: *"I'm going to destroy Android, …. I'm willing to go thermonuclear war on this." "I will spend my last dying breath if I need to, and I will spend every penny of Apple's $40 billion in the bank …"* (Jobs, 2011)
  – Steve Ballmer: *"Android is not free."*

- Perceived ability: depends on patent asymmetry

Dramatic Imbalance pre-MMI acquisition in favour of Apple and Microsoft



Sources: Thomson Innovation database of granted U.S. patents issued or assigned to respective companies as if March 2012 (other than Motorola Mobility, which is taken from internal data). Thomson Innovation counts may not include patents held in different corporate names.

Notes: (1) Google acquired 2,240 patents from IBM in various purchases in 2011, roughly at the same time as the MMI acquisition – Apple and MSFT are licensed to all or most of these patents, respectively

(2) Microsoft and Apple statistics do not include their respective portions of the Rockstar (Nortel) or CPTN (Novell) acquisitions

(3) Oracle total is a conservative estimate of patents assigned to Oracle or Sun Microsystems

The Patent Arms Race Exacerbated Imbalance -- CPTN Purchase of Novell Patents

- CPTN (12/2010): Microsoft, Apple, EMC, and Oracle
  882 Novell patents for $442M = $500,000 per patent
- DOJ and German BKartA reviewed
- Concern: Novell Patents could be used to block Linux platform
  - Could assist Microsoft in maintaining Windows desktop dominance
  - Could also affect Android (based on Linux)
  - No countervailing power – situation of patent asymmetry
- Negotiated solution found for MSFT (not Apple):
  - Microsoft to sell all Linux patents (although allowed to keep a license)
  - All patents remain subject to GNU Open Source

DOJ: "the deal would jeopardize the ability of open source software, such as Linux, to continue to innovate and compete in the development and distribution of server, desktop, and mobile operating systems, middleware, and virtualization products."

Rockstar Purchase of Nortel Patents made it worse

- Rockstar (6/2011): Microsoft, Apple, RIM, etc 6,000 Nortel patents, estimated at $900 million bought for $4.5 billion = $750,000 p/patent
- Not notified in EC; Only DOJ reviewed,
- Concern: Nortel Patents could be used to block Android
  – Microsoft already licensed to the Nortel patents! Suggests offensive motive
- Effect: Patents kept from Google's, and patent imbalance increased
  – Cleared after Apple and Microsoft promised not to seek injunctions on SEPs
  – Rockstar then kept patents; became jointly operated PAE (circumvention?) http://www.wired.com/wiredenterprise/2012/05/rockstar/
- Microsoft bought 800 AOL patents for $1.056 billion in April 2012

"Why is the portfolio worth five times more to this group collectively than it is to Google? Why are three horizontal competitors being allowed to collaborate and cooperate and join hands together in this, rather than competing against each other?"
-- Robert Skitol, American Antitrust Institute

Google's Answer: Buying Motorola (2011)
Step Towards Patent Balance

- Google bought Motorola Mobility (MMI)
  - Price: **$12.5 billion** ($40/share)
  - Portfolio of **6,000 patents** to protect Android and Open Handset Alliance

- Merger approved in Feb 2012. Review conclusions:
  - *"documents on the file show clearly that Google's rationale for the transaction is to create "patent balance" in the smart mobile device industry and to preserve the ability of Android OEMs to compete and innovate free from the costs and uncertainties of litigation and litigation threats." EC, para 118*

- Google promise to comply with Motorola's FRAND promises and apply German *Orange Book* procedure worldwide

MMI Clearance Decision confirms countervailing power of Apple, Microsoft

- *"Google would gain little from extracting large licence fees from its competitors whilst at the same time leaving its Android OS open to attack."* para 119
- *"Google will have to take into account the threat of counter-suits for patent infringement from companies like Microsoft and Apple prior to engaging in behaviour that could significantly impede effective competition."* para. 128
- *"Google will have to take into account the large complex patent portfolios (which often lack transparency) held by its competitors and the probabilities of success of any counter-suits by these competitors in its commercial considerations, together with the ability to design around any invoked non-SEPs and the cost of litigation"* para. 148

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SSO Letter further curbs Google power to use SEPs

- Google sent a letter to 14 SSOs reconfirming it would continue to license Motorola's "standard-essential patents" on FRAND terms

- Google subscribes to MMI's existing commitments to license MMI's essential patents on FRAND terms
  - Google will honor MMI's 2.25% FRAND royalty rate
  - Google will make an all-cash license option available subject to standard-specific reciprocity on the part of the prospective licensee

- Google will not seek injunctive relief against a "willing licensee" – even if royalty is disputed – if licensee
  - commits to license-in MMI standard essential patents on FRAND terms
  - pays into escrow royalties based on MMI's 2.25% FRAND rate pending review
  - makes reciprocal agreement to limit its ability to seek injunctive relief for its standard essential patents reading on the same standards

- Reflects holding in *Orange Book* judgment of German Supreme Court

Google's SEP Commitments vs. Apple's, MSFT's

	Google	Apple	Microsoft
Covered Standards	All SEPs acquired from MMI for all standards	"Cellular" standards only - not, e.g., 802.11 (WiFi)	"SEPs Not specified
Covered SSOs	14 SSOs	ETSI only	SSOs Not specified
Royalty Rates	Will honor MMI's historic maximum 2.25% royalty level	General statements regarding "appropriate" royalty calculations, but no commitment to Nortel's historic royalty levels	Not addressed; no commitment to Nortel's historic royalty levels
Transfers (e.g. to PAEs)	Will use "best efforts" to ensure that transferees abide by FRAND commitments	No commitments	Will require transferees to abide by FRAND commitments
Limits on Required Grant-Back Licenses	Patents essential to same standard only	No commitments	Patents essential to same standard only
Injunctive Relief	Only where infringer has been unwilling to accept FRAND license	Would not seek injunctions on SEPs if others reciprocate	Will not seek injunctions on SEPs
Nature of Commitments	Binding and irrevocable	Conditional on "other parties" agreeing also on royalty base;	Unilateral statement, potentially revocable

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Interim conclusion: No Dominance

- Both Apple and MSFT have both
  - Perceived intent and
  - Perceived ability to destroy Android
- Mutually Assured Destruction
  = incompatible with notion of dominance
  = incentive to cross-license
- SSO Letter further curbs Google's use of SEPs
  - This affects Google more than it affects Apple and Microsoft who have fewer SEPs. Theirs is a "cheap signal" in terms of "signalling games"

MMI/Google would be deprived of much. Incremental value = ***large*** for owners of ***small*** portfolios

Apple/MSFT give up little: Incremental value of patents in same area = ***small*** for ***large*** portfolio owners

Apple and Microsoft complaint (2): Refusal?

- No refusal to license
  - *4. Google commits to … negotiat[e] in good faith for a reasonable period …*
  - *7. After the negotiation period … Google will make a final offer of its FRAND license terms … The offer shall be open for at least 30 days…*
  - *8. … Google will not apply for injunctive relief against a willing licensee …. A counterparty qualifies as such a willing licensee if that counterparty:*
    - *has made, during the period described in Paragraph 7, (i) a binding and unconditional commitment to license …on FRAND terms offered by Google subject only to judicial review of the royalty level (including base and rate) or (ii) a binding and unconditional commitment to license all acquired MMI Essential IPR for the standards at issue on terms that Google cannot reasonably and fairly reject ….; and*
    - *… pays into an escrow account … a royalty for the acquired MMI Essential IPR …*
- SSO Letter reflects German Sup. Ct. *"Orange Book"* process

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Complaints (3): Exceptional Circumstances?

- indispensability ? -- unless patent invalid or declaration wrong

- serious threat of elimination of all effective competition ?
  - Even if injunction were issued, Android OEMs continue to compete fiercely
  - Injunctions are granted only briefly, only in a specific country
  - To be analysed on dynamic basis: in a situation of mutual deterrence, Google's goal, and the likely effect, is a cross-licence

- consumer harm in the form of suppression of innovation ?
  - No cross-license imposed (subject only to standard-specific reciprocity)
  - If cross-license is reached this will benefit innovation: EC found "*Google's rationale for the transaction is to create 'patent balance' in the smart mobile device industry and to preserve the ability of Android OEMs to compete and innovate free from the costs and uncertainties of litigation and litigation threats.*" (MMI Clearance Decision)
  - Particularly important in view of complainants' aggressive litigation

Apple and Microsoft complaint (4): Objective Justification

- Standards must be open and SEPS available to all interested parties
- Are injunctions on SEPs inconsistent with that principle? EC:
  - *"the seeking or enforcement of injunctions on the basis of SEPs is also not, of itself, anti-competitive. In particular, and depending on the circumstances, it may be legitimate for the holder of SEPs to seek an injunction against a potential licensee which is not willing to negotiate in good faith on FRAND terms."* (MMI Clearance Decision, para. 126)
- Balanced view in Google SSO Letter (and MMI practice): Injunctions should be allowed only in three exceptional cases:
  - 1. Reverse hold-up (licensee refusing cross-license SEPs on FRAND terms)
    - Limited to "same standard"? Or "same product"?
    - EC says former; past notices on patent pools suggest the latter
  - 2. Actual or anticipatory material breach of the license agreement
  - 3. Unwilling licensee

What is an "Unwilling Licensee"?

- Mere good faith disagreement on royalty level or key terms is not a sign of unwillingness
- *Orange Book* process is available to break logjam
- Licensee can avoid injunction by:
  – 1. Asking court to set royalty on FRAND basis, and
  – 2. Paying requested royalty into escrow or making counteroffer for escrow payment that licensor cannot reasonably reject
- Court will then set royalty rate and royalty base
  – But not other terms and conditions?
  – Challenge of validity or infringement? *Orange Book* allows licensor to terminate the license. See also TTBER

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US position (1) – W.D. Washington *MSFT v MMI*

- First offer need not be FRAND, but should not be blatantly unreasonable
  - "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. …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. (at 24)

- First offer in this case probably was FRAND
  - Motorola "received comparable royalty rates to those offered to Microsoft from other licensees for some, if not most, of its patents essential to the 802.11 Standard and the H.264 Standard," He expressly rejected Microsoft's argument that Motorola's offers were "*prima facie* blatantly unreasonable such that no reasonable person could find the offers were RAND." Id. at 26.
    - Order, Judge Robart, *Microsoft Corp. v. Motorola, Inc.*, Case No.10-CV-1823 (W.D. Wash. June 6, 2012) at 24.

US position (2) – FTC letter to ITC in *MMI v MSFT*

- First offer should be FRAND, and ALJ in this case thought it was not
  - "we are concerned that a patentee 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 could … den[y] an exclusion order unless the holder of the RAND-encumbered SEP has made a reasonable royalty offer. For example, … the ITC ALJ 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".
  - "... 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 patentee has refused to accept a reasonable offer.
    - FTC Letter to ITC, June 6, 2012, Investigation Nos. 337-TA-745 and 337-TA-752 (Game Consoles)

US position (3): injunction can be denied in equity

- *eBay/MercExchange*: 4-part equity test for injunctions
  - 1) plaintiff suffers irreparable injury
  - 2) remedies available at law (such as damage award) are inadequate
  - 3) balance of hardships between plaintiff and defendant; and
  - 4) the public interest harmed by a permanent injunction.
- Well suited for nuanced use in FRAND cases (but ITC not bound)
- Example: J. Posner denied Apple's request for injunctive relief : *"Because the parties believe that damages are an adequate remedy for the alleged infringements (though they failed to present evidence on damages strong enough to withstand summary judgment),and because injunctive relief would impose costs disproportionate to the harm to the patentee and the benefit of the alleged infringement to the alleged infringer and would be contrary to the public interest, I cannot find a basis for an award of injunctive relief."*
  - Apple v. Motorola Inc., 11-cv-8540, U.S. District Court, N.D.Illinois, June 7, 2012

Is an Excessive Royalty a Conditional Refusal?

- 2.25% of device wholesale price = Excessive Royalty?
  - Value = Incremental benefit to licensee over next best alternative
  - MMI: royalty was known and accepted ex ante? Horiz. Guid., para. 289-290:
    - *"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 in (ex post) ... ex ante disclosures of licensing terms in the context of a specific standard-setting process.*" (50+ agreements)
  - Comparison with pool royalty rates not "consistent"? (*Sacem*)
    - Pool participants get value from royalties + profits from product enabled by standard supported by the pool. Looking only at pool royalty is not meaningful comparison
- Must royalty base be "smallest saleable component"?
  - MMI: Chipset price unrelated to incremental value of technology
- Demand for full portfolio cross-license illegal? Could be, unless
  - Licensor offers "cash-only" option, *i.e.,* cross-license limited to SEPs reading on the same standard/product ("Shapiro approach"), as MMI does
  - Licensor lowers royalty to account for cross-licenses offered (as MMI does)

Ex ante approach: *Microsoft v EC* (judgment 27 June)

- EC: Dominant firm deserves revenues attributable to its invention, but not "strategic value" (revenues deriving from *ex post* ability to exclude rivals from neighboring market). *Microsoft* 2004, para. 1008:
  - *"terms imposed by Microsoft [must] be reasonable and non-discriminatory… in particular: …*

    (ii) … remuneration should not reflect the "strategic value" stemming from Microsoft's market power…;

    (iii) …restrictions should not create disincentives to compete with Microsoft, or unnecessarily restrain the ability of the beneficiaries to innovate;

    (iv) … implementing the specifications will …constitute a significant investment, which … vendors will not incur if they have no assurance that the terms under which they can make use of the disclosed specifications will remain reasonably stable."

- Subject to appeal before General Court (Case T-167/08 *Microsoft v EC)*
  - *Judgment expected June 27*

Interim conclusion

- No need for this SEP case – Market can resolve the Patent War, as a result of patent purchases that lead to patent balance
  - Mutually Assured Destruction = incentive to cross-license
    - No dominance if countervailing buying power
  - Injunction justified in case of unwilling licensee – to bring about negotiations
  - *Orange Book* process can be used to resolve royalty disputes
- Should EC not focus on matters that market forces cannot resolve?
  - 1. Patent purchases that create imbalance and raise vertical concerns:
    - The purchase creates or increases patent **im**balance
    - Vertical concerns: patents provide ability and incentive to limit browser competition
  - 2. Use of PAEs as mercenaries in the Patent War
  - 3. Patent traps (*e.g.*, *Rambus* case) and imposition of restrictive T&Cs (*Icera v Qualcomm*)

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3. Asymmetric Warfare by Trolls and Use of Trolls as Mercenaries

Use of PAEs as Mercenaries

- Trolls are impervious to deterrence:
  - – No downstream business vulnerable to patent attack, therefore have freedom to extract (almost) all downstream profit from their victim
  - – Prospect of troll attack could discourage investment in innovation
- Example: Rockstar
  - – *Rockstar is a special kind of company. Because it doesn't actually make anything, it can't be countersued in patent cases. That wouldn't be the case with Apple or Microsoft if they had kept the patents for themselves.*
  - – *And because it's independent, it can antagonize its owners' partners and customers in ways that its owner companies could not. … Rockstar hasn't sued anyone yet, but Veschi expects that to happen too.*
    - – MacMillan, How Apple and Microsoft Armed 4,000 Patent Warheads, May 21, 2012

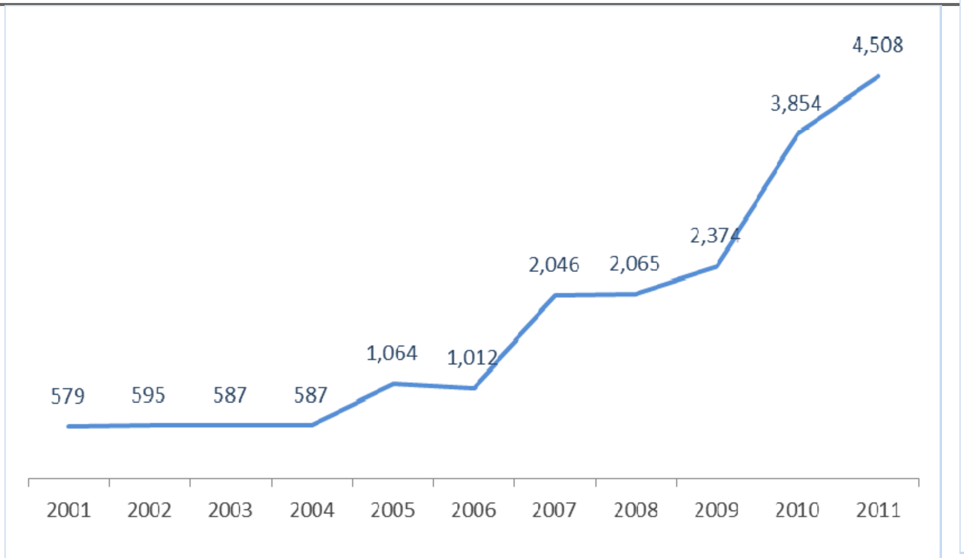
PAEs Incentives very different from producers'

- Transferring Patents to PAEs facilitates the exercise of market power, and enables hold-ups
  - Producers and PAEs have very different patent enforcement incentives
    - PAEs maximize only royalties; Producers do not
  - PAEs do not value patent cross licenses; Producers do
    - PAEs have no desire to share via cross license, which exclude ability of patent owners to extract "hold-up" royalties
  - PAEs do not fear patent counter-suits; Producers do
    - Transfers to PAE accordingly can undermine "patent peace."
  - PAEs do not participate in standard setting; Many Producers now do
    - Producers might forebear from aggressive) enforcement because SSOs in the future might not incorporate their technology.
    - PAEs have no such incentives.

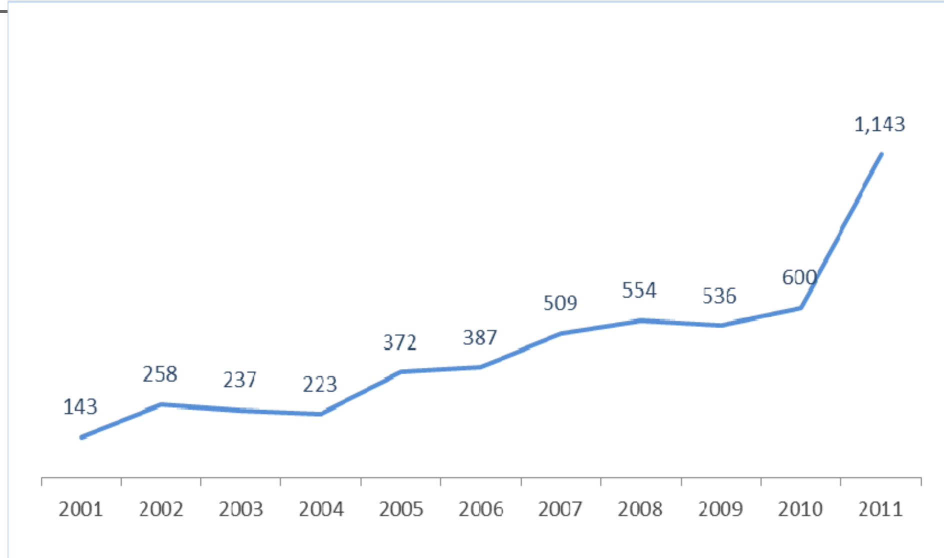
Patent Trolls: Too numerous to count

- Acacia Research Corporation
- Blackboard Inc.
- Intellect Wireless
- WebEx
- EpicRealm
- MobileMedia Ideas LLC
- Divine
- NTP
- Webvention LLC
- Digitude Innovations
- Lodsys
- MacroSalve
- Rembrandt Technologies
- IP Navigation
- Intellectual Ventures
- Smartphone Technologies
- Round Rock Research
- Interdigital
- Wi-Lan
- Papst Licensing GmbH
- Altitude Capital Partners
- Intertrust Technologies Corp.
- Rembrandt IP
- Innovative Sonic Ltd
- Alliacense
- IpVenture Inc
- Trontech Licensing
- Cheetah Omni LLC
- Oasis Research
- Patent Category Corp.
- St. Clair Intellectual Property Consultants
- Illinois Computer Research
- Innovation Management Sciences
- Enhanced Software
- Ferrara Ethereal LLC
- Steinbeck Cannery
- Dickens Coal
- Kipling Sahibs
- Sky Blue Interchange
- Steel Gray Server
- Midnight Blue Remote Access
- Engineering Inc
- Innovatio
- Kwon Holdings
- Tessera Technologies
- CSIRO
- Scenera Research LLC
- MicroUnity Systems
- Mosaid Technologies
- WARF
- Rockstar

Lawsuits Involving PAEs Are on the Increase



Operating Company Parties
in PAE Lawsuits Over Time



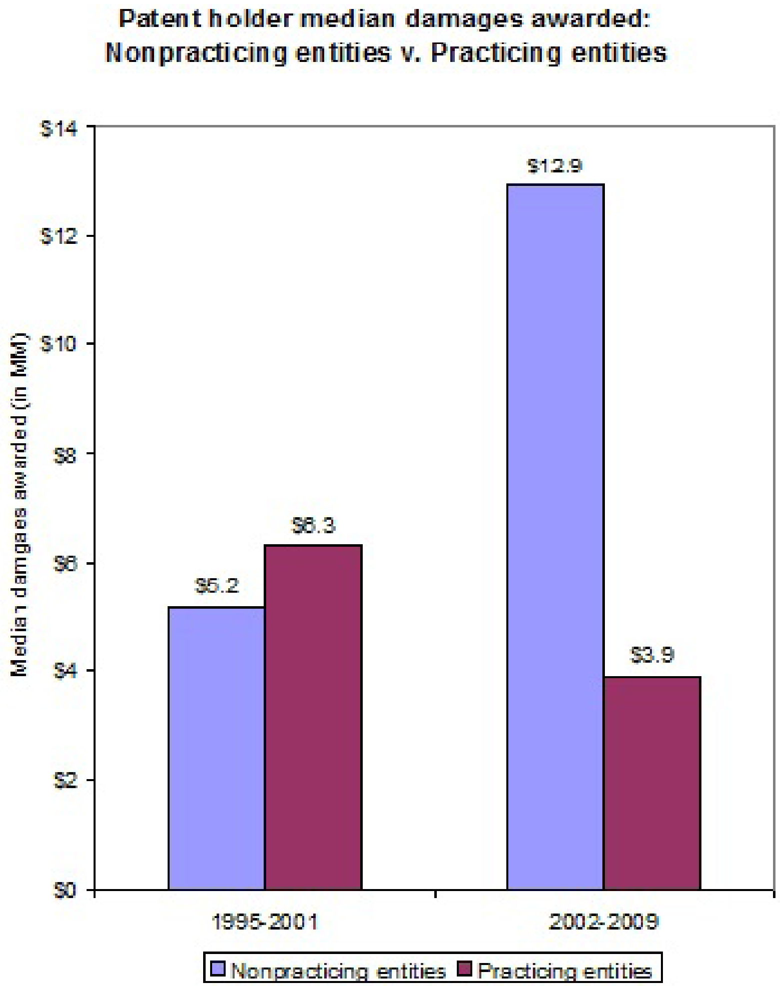
Patent Lawsuits Involving
PAEs Over Time

https://www.patentfreedom.com/about-npes/

- It can cost **millions of dollars** to defend a patent infringement suit. This forces most companies, especially small ones, to settle.
- Startup targeted by Troll: *"The settlement they wanted to get was just enough to put us in danger, but not to close us."*
  - When Patents Attack 22/7/2011: http://www.thisamericanlife.org/radio-archives/episode/441/transcript

PAE hold-ups can be a major threat to innovation

- PAEs have cost innovators **$500 billion** in lost wealth from 1990-2010
- The average patent lawsuit results in **$122 million** in lost wealth for defendant
- For each of past 4 years, PAEs have cost tech companies an average **$83 billion**
- PAEs begin asserting their patents relatively late in the patent term and frequently continue to litigate to the verge of expiration
- The very prospect of such a hold-up deters investments in bringing innovation to market



From March 2011 US FTC Patent Report "The Evolving IP Marketplace" p.247; Patent Freedom (2011); and J. E. Bessen, M. J. Meurer and J. L. Ford, The Private and Social Costs of Patent Trolls (SSRN ID: 1930272), p. 4 http://www.bu.edu/law/faculty/scholarship/workingpapers/2011.html

CLEARY GOTTLIEB

Use of PAEs as Mercenaries

- Strategic use of PAEs to raise rivals' costs – examples
  - MSFT and Apple transformed Rockstar into a PAE – 4,000 patents
  - Apple transferred patents to Digitude, to sue Android ecosystem
  - Not really new: MSFT attempt to sell 22 Linux patents to PAEs
    http://www.groklaw.net/articlebasic.php?story=20090908164954318

- Competition law questions arise
  - Article 101 TFEU, if there are agreements to raise rivals costs?
  - Merger Regulation, SIEC if transferred licensing business becomes invulnerable, and consumer harm if portfolio split creates prospect of dual monopoly rent
  - Art 102 TFEU, if excessive pricing, reduce innovation, or ignore seller's FRAND promise (N-Data; IPCom cases)

Outsourcing of SEP enforcement to PAEs leads to royalty-stacking – Two Effects

- 1. Circumvention of FRAND promise?
  - *Microsoft and Apple had promised to license many of their core wireless patents under reasonable terms to anyone who needed them. But the new company — Rockstar Consortium — isn't bound by the promises that its member companies made, according to Veschi. "We are separate," he says. "That does not apply to us."*
    - MacMillan, How Apple and Microsoft Armed 4,000 Patent Warheads, May 21, 2012
- 2. Transferring Patents to PAEs exacerbates cost-raising royalty stacking, even with a FRAND promise
  - SEP owner pledged to license a flat rate, say, 1%
  - Dividing portfolio among PAEs breaks this promise:
  - Now ***several*** entities (seller and PAEs) ***each*** may charge 1.0% for SEP where only one (Seller) did before – Cournot problem
  - Royalty stacking raises licensees' costs.

So what can be done to stop abuse?

1. Change IP laws?
   – FTC Report 2011: Limit damages to ex ante value (incremental value over next best alternative. (Left to the courts)
   – US replaced first-to-invent by first-to-file rule: fewer “submarine patents”
   – Make it easier to attack validity, infringement, ownership, etc?
   – Exhaustion rules (*LGE/Quanta*), fair use doctrine, patent misuse, laches
   – *eBay/MercExchange*: grant injunctions only where justified by equity
     – 1) plaintiff suffers irreparable injury
     – 2) remedies available at law (such as damage award) are inadequate
     – 3) balance of hardships between plaintiff and defendant; and
     – 4) the public interest harmed by a permanent injunction.
   – Better “public interest” review by U.S. ITC? (watch the X-Box case!)
   – Peer to patent – crowd sourcing of prior art review

So far, none of these solve the fundamental problem

So what can be done to stop abuse?

2. Encourage participation in contractual arrangements?
   - FRAND promises in standards (mutual restraint promises)
   - IPR pools and cross-licensing – PAEs have no incentives to do this…..
   - Extend Open Invention Network (OIN) to cover Android, use RPX? http://www.openinventionnetwork.com/

3. Use competition law to stop abuse of power, where PAEs
   - abuse the patent process (like *AstraZeneca*)
   - create patent thickets (like *LuK/Valeo*, TGI Paris, 26-1-2005)
   - abuse standards process (like *Rambus* or *IPCom*)
   - Attempt to avoid FRAND through transfer (*N-Data, IPCom*)
   - For group-financed PAEs: Art 101, "raising rivals' costs", "collective boycott"?
   - Apply 101 to joint targeting arrangements (*Rockstar, etc*)?

- These may offer solutions in some, not all, hold-up situations
- Take action against excessive fees in a patent hold-up (Art 102(a) TFEU)

Conclusion

Collective Defense? Cross-Licensing?

- The EC is barking up the wrong tree in SEP cases
  - In situation of mutually assured destruction there is no dominance
  - "Neutralizing SEPs" is not the answer: The Patent War continues with important non-essential patents, and patents reading on *de facto* standards
  - All that the SEP cases can achieve is partial disarming of one party, further upsetting the balance
- Only cross-licensing licensing can achieve patent peace
  - For Android, too late to achieve "peaceful co-existence" through "deterrence"
  - Can "Collective Defense" help to speed up patent peace? OIN
- Something must be done about the next problem:
  - Trolls! Especially if used to create a royalty stack and raise rivals' costs
  - Restrictive T&Cs (grantback networks creating barriers to entry downstream)

What is a FRAND Promise?

- A license or promise to license:
  - No actual or constructive refusal or termination of a license, no injunctive relief, if defendant is willing / able to pay, but disagrees on T&Cs. Exception: Refusal to cross-license (defensive suspension), material (actual/anticipatory) breach, unwilling licensee/refusal to negotiate. See Apple, Google, MSFT, Cisco letters 2012
  - Cases: *Orange Book* (D), *SK Kassetten* (NL), *Sony/LGE* (NL), *Samsung/Apple* (NL, EC)
- Fair and reasonable terms (102(a) & 101(3) TFEU)
  - rate that the IPR owner could obtain in ex ante inter-technology competition, unless the IP owner took anti-competitive action to diminish ex ante inter-technology competition
  - No monopoly rent -- not allowing IP owner to appropriate entire value of standard.
  - No Cournot stack of complementary patents (no multiple monopoly rents)
- Non-discriminatory –also *vis-a-vis* IPR-owner's own downstream business.
  - Same criterion as 102 EC(b) and (c) and 101(3)(b)
  - No restriction of downstream competition on the merits (no price-squeeze, no T&Cs that have the object or effect of restricting downstream competition, etc)
  - E.g., no lower fee if licensee purchases the licensor's downstream product
  - No restriction of upstream technology competition (no free NAP/pass-thru)