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THE AMERICAN ANTITRUST INSTITUTE

Before the

HOUSE JUDICIARY COMMITTEE

SUBCOMMITTEE ON INTELLECTUAL PROPERTY, COMPETITION, AND THE INTERNET

Hearing on

THE INTERNATIONAL TRADE COMMISSION AND PATENT DISPUTES

July 18, 2012

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

For many years America has muddled through with three separate regimes that collectively shape the competitive structure of our industries. Please picture an equilateral triangle with a silo situated at each corner. These silos are three legal regimes: antitrust, intellectual property, and international trade. To an unfortunate extent, each regime has developed and operated separately. Each works within its own statutory and regulatory framework, each is associated with a separate occupational sociology, each has its own values, special interests, and political oversight. So long as intellectual property played a relatively unimportant role in our economy, so long as most of trade was not conducted by global mega-corporations in highly concentrated global industries, so long as antitrust,

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

trade, and IP did not constantly bump up against one another, the competition triangle managed to function.

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

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

This system has three grievous faults. First, it is enormously wasteful of resources, including both the resources to purchase portfolios of intellectual property, and also expensive, time-consuming, attention-demanding litigation to utilize or protect these portfolios.[2] Second, it creates a barrier to entry and innovation by companies that do not already own a large portfolio and would therefore find themselves at high risk that their entry product would be attacked as infringing someone's patent, or perhaps hundreds of patents. The risk would deter investment. Third, it enables and incents and has therefore led to proliferation of patent holdup conduct and resulting corruption of open standards initiatives that would otherwise promote more competitive market outcomes.

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

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

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

1. Better coordination is essential.

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

2. The basic goal is to achieve better balance between competition and exclusion in the name of innovation.

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

3. Standard setting organizations are crucial to achieving balance.

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

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

Because standard-setting brings competitors together to work on an industry's future, there is always a risk of anticompetitive activity. The Standards Development Organization Advancement Act of 2004 ("SDOAA") mandates application of the antitrust "rule of reason" rather than any stricter antitrust rule or scrutiny for SSOs' "standards development activity," defined to include "actions relating to [an SSO's] intellectual property policies." [3] It also enables SSOs to avoid the treble damages remedy that would otherwise be automatic for any antitrust violation[4] and to obtain an award of the costs of suit including reasonable attorneys' fees against any antitrust claimant if the claim against the SSO was "frivolous, unreasonable, without foundation, or in bad faith." [5] The statute thereby protects or exempts SSOs from central aspects of the antitrust laws that apply to many other kinds of concerted activity among competing enterprises.

This Act was intended "to encourage disclosure by intellectual property rights owners of relevant intellectual property rights and proposed licensing terms"; it "further encourages discussion among intellectual property rights owners and other interested standards participants regarding the terms under which relevant intellectual property rights would be made available for use in conjunction with the standard or proposed standard."[6] In short, the Act sought to incent SSOs to experiment with new policies and practices that would increase ex ante transparency about intellectual property rights and associated license terms, thereby reducing risks of ex post anticompetitive patent holdup outcomes.

In the immediate aftermath of that enactment, two SSOs -- VITA and IEEE -- adopted new policies of that very kind, both of which received antitrust comfort under DOJ's Business Review Procedure.[7] To our knowledge, however, few if any other SSOs have even begun to move in any similar direction. In short, all too many SSOs have been slow to embrace any such effort or even to consider the continued adequacy of their longstanding patent policies as protections against patent holdup outcomes in their standards. It is thus not surprising that there has been a dramatic

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

[4] 15 U.S.C. § 4303.

[5] 15 U.S.C. §§ 4304-05.

[6] 150 Cong. Rec. 3657 (June 2, 2004).

[7] See Letter from DOJ to VITA counsel (Oct. 30, 2006), *available at* http://www.justice.gov/atr/public/busreview/219380.htm; Letter from DOJ to IEEE counsel (Apr. 30, 2007), *available at* http://www.justice.gov/atr/public/busreview/222978.htm.

increase in patent holdup conduct and associated litigation over the eight years since enactment of the SDOAA. In short, it appears that the SDOAA has failed to incent SSOs in the desired direction. Indeed, by reducing antitrust exposure, it may well have had the opposite effect.

Accordingly, the AAI suggests that Congress now consider (a) repeal or revision of the SDOAA in conjunction with (b) a Congressional statement of intent that the antitrust authorities and courts should apply the principles of *American Society of Mechanical Engineers v. Hydrolevel Corp.*, [8] to the standard-essential patent situation. The Supreme Court there established an SSO's strict antitrust liability in circumstances where anticompetitive harm occurs as a result of the SSO's failure to implement procedures aimed at preventing abuse of its processes. As the Court said, "a standard setting organization . . . can be rife with opportunities for anticompetitive activity"; "a rule that imposes liability on the standard setting organization -- which is best situated to prevent antitrust violations through abuse of its reputation -- is most faithful to the congressional intent that the private right of action deter antitrust violations."[9] Congress should accordingly confirm its support for applying those precepts to the situation here at issue: an SSO's failure to implement effective safeguards against patent holdup outcomes from its proceedings should result in that SSO's liability for the resulting anticompetitive effects.

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

It is not uncommon for SSOs to require that any participant in a standard-setting process who owns a patent that reads on the proposed standard has an obligation to identify the patent and/or agree to license it on a fair, reasonable, and non-discriminatory basis. Europeans abbreviate this as a FRAND commitment,

[8] 456 U.S. 556 (1982).

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

Americans as “RAND”, or increasingly as “F/RAND”. As a first step in clarifying the concept, we propose recognizing that all three abbreviations have essentially the same meaning and can all therefore be referred to as “FRAND”.

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

6. FRAND should imply that ex ante negotiations on price are both legitimate and critical.

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

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

7. FRAND should imply that non-price conditions to license a SEP be reasonable.

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

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

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

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

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

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

An injunction is not an appropriate remedy for SEP infringement as a matter of both good law and good policy. In deciding the Apple/Motorola case in Illinois just a few weeks ago, Judge Posner noted that the Supreme Court requires a plaintiff seeking an injunction on a patent infringement claim to first establish that monetary damages are inadequate to compensate for any alleged injury.[10] Yet when a SEP owner makes a FRAND commitment, it has implicitly acknowledged that a reasonable royalty is adequate compensation for a license to use the patent.[11] Monetary damages are therefore adequate compensation for infringement of a FRAND-encumbered SEP. Moreover, monetary damages avoid the disproportionate outcomes and public harm that can result from injunctive relief. Particularly where an infringer benefits by infringing on a patent that accounts for only a small component of a device, and the effect of an injunction is to remove the entire device from the market, the penalty imposed on the infringer

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

[11] *Id*. at 19.

far outstrips the benefit the infringer enjoys for infringing, not to mention the harm caused to the SEP-owner.[12] The result is a punitive rather than compensatory remedy that provides a windfall to the SEP-owner and unnecessarily deprives the public of access to the affected device and competition in the affected market.[13]

SSO rules should make clear that the provider of a FRAND commitment in the course of a standard development proceeding waives any right to seek either injunctive relief in court or an exclusion order at the International Trade Commission. The AAI endorses the FTC's ITC comments[14] and the legislative advocacy of the ITC Working Group.[15] We are encouraged by signs that the ITC appears to be taking a serious look at whether it can become more flexible and less automatic in its use of exclusionary injunctions. We hope that the ITC will be able to apply the principles that the Supreme Court evoked in its *e-Bay* opinion[16] under its "public interest" authority. If not, Congress should be prepared to customize an appropriate application of these principles.

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

The issues being aired in these hearings are of concern to many of our

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[12] *Id*. at 25.

[13] *Id*.

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

[15] *See* Jan Wolfe, *Tech-Sector Working Group Wants 'Patent Trolls' Out of the ITC*, LAW.COM (Mar. 22, 2012), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202546503103&TechSector_Lobbying_Group_Wants_Patent_Trolls_Out_of_the_ITC.

[16] eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388 (2006).

trading partners. For example, in 2011, the European Commission adopted in final form its Guidelines on the Applicability of Article 101 of the Treaty to Horizontal Co-operation Agreements.[17] Section 7 of the Guidelines addresses requirements for "standardization agreements" to avoid violation of Article 101. Note in particular that par. 283 expressly requires that the SSO's rules ensure access to the standard on FRAND terms; par. 285 says that, to ensure the effectiveness of the FRAND commitment, "there would also need to be a requirement on all participating IPR holders who provide a commitment to ensure that any company to which the IPR owner transfers its IPR . . . is bound by that commitment, for example through a contractual clause between buyer and seller." Par. 286 says the IPR policy "would need to require good faith disclosure, by participants, of their IPR that might be essential for the implementation of the standard under development."

Par. 289 says in "case of a dispute, the assessment of whether fees charged for access to IPR in the standard-setting context are unfair or unreasonable should be based on whether the fees bear a reasonable relationship to the economic value of the IPR" and "it may be possible to compare the licensing fees charged by the company in question for the relevant patents in a competitive environment before the industry has been locked into the standard (ex ante) with those charged after the industry has been locked into the standard (ex post)." Par. 290 says "Another method could be to obtain an independent expert assessment of the objective centrality and essentiality to the standard at issue of the relevant IPR portfolio. . . . The royalty rates charged for the same IPR in other comparable standards may also provide an indication for FRAND royalty rates." Par. 299 promotes ex ante disclosures of most restrictive licensing terms including maximum royalties.

The proposed guidelines published for comment in 2010 flatly prohibited ex ante "joint negotiation" of license terms. In response to objections from several

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

companies that that prohibition was in conflict with U.S. FTC and DOJ guidance in their 2007 IP Report that said such joint negotiation should be assessed under the rule of reason, the EC dropped the prohibition altogether and simply omitted the whole subject from these final guidelines.

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

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

12. Coalitions of leading competitors should not be permitted to purchase patent portfolios with an intent to exclude from the market or otherwise seriously disable one or more non-included competitors.

An antitrust issue arose when the Rockstar group, consisting of three leading (and three other) mobile device operating system competitors, combined to bid five times as much as their competitor, Google, in order jointly to acquire Nortel's portfolio of patents. As the AAI wrote to the DOJ at the time, this "raises questions about the concerted intentions and objectives of the six consortium members that could not be achieved through independent bidding and eventual individual ownership or licensing of some or all parts of the patent portfolio at stake."[18] The acquisition was not challenged but a post-acquisition question is also raised because of Rockstar's apparently "new" status as an NPE owning 4,000 of the 6,000 Nortel patents and now committed to maximizing revenue from them. Congress should urge the antitrust agencies to aggressively investigate any coalition of leading competitors that appears to be formed or utilized for the purpose of disadvantaging an excluded rival such as by depriving it of access to a SEP.

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

[18] *See* Letter from the AAI to Christine Varney (July 6, 2011), *available a*t http://www.antitrustinstitute.org/sites/default/files/Nortel%20letter%20to%20DOJ.7.6.11.pdf.