Department of Justice

STATEMENT OF

JOSEPH F. WAYLAND
ACTING ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

REGARDING

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

PRESENTED

JULY 11, 2012

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Introduction

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

The issues I will discuss today involve three important inputs to our modern innovation-based economy: patent rights, competition, and collaboratively set standards. These inputs drive innovation in complementary, though different ways. In our system, antitrust and intellectual property policy function together to provide consumers with

high-quality products and services at competitive prices, while at the same time preserving strong incentives for the innovation that creates and improves those products.

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

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

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

and cloud computing.

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

Standard-Setting and Competition

The Antitrust Division has worked closely with our sister antitrust agency, the Federal Trade Commission (FTC), and with other federal agencies, including the U.S. Patent and Trademark Office, an agency of the Department of Commerce, to better understand the interface between standards and antitrust and to promote intellectual property practices for standard-setting activities that preserve competition and protect consumers. For example, in 2007, the Antitrust Division and the FTC issued a joint report on the intersection of intellectual property rights and competition that addresses a number of critical standard-setting issues. In particular, the agencies found that when a standard incorporates patented technology owned by a participant in the standard-setting process and that standard becomes established, switching in some cases becomes difficult

and expensive, and that the particular technology may gain market power. *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 35-36 (2007). This creates the potential for patent holders to take advantage of that market power by engaging in one form of what is known as patent hold-up, such as by excluding a competitor from a market or obtaining an unjustifiably higher price for its invention than would have been possible before the standard was set. This raises particular concerns when alternative technologies could have been included in the standard. Patent hold-up can cause other problems as well. For example, it may induce users to postpone or avoid incorporating standardized technology in their products. Consumers of the products using the standard could also be harmed to the extent that companies implementing the standard pass on higher royalties in the form of a higher price.

To reduce the occurrences of this type of opportunistic conduct, standard-setting organizations (SSOs) commonly include in their patent policies commitments from participants to license the patents they own that are essential to the standard (standard-essential patents) on "reasonable and non-discriminatory" (RAND) or "fair, reasonable, and non-discriminatory" (FRAND) terms. Participation in relevant standards bodies is voluntary, but in some cases the licensing commitment is a condition of participation in the standards body, or the license commitment may be voluntary or offer a mechanism for opting out of the obligation to license essential patents. (In the United States, SSO members commit to license all of their standards-essential patents on RAND terms, while in other jurisdictions SSO members commit to license such patents on FRAND terms. We use F/RAND to refer to both types of commitments as they are substantively the

same type of commitment.) SSOs and their members rely on F/RAND commitments to facilitate the bilateral licensing of patents that are needed to allow a standard to become successful and to provide assurances to implementers of the standard that the patented technologies will be available to those willing and able to license them. By participating in the standard-setting activities and making a F/RAND licensing commitment, some have argued that the patent holder foregoes its right to exclude where the standard is being implemented. In making the voluntary licensing commitment, a patent holder that also sells products and services related to the standard benefits from expanded marketing opportunities, and patent holders that focus on licensing their inventions benefit from an expanded source of revenue.

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

For example, in 2006 and 2007, we advised IEEE and VITA that requiring or permitting patent holders participating in a standard-setting process to disclose the most

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

The Antitrust Division's Investigations Involving Standard-Setting Activities

In addition to encouraging standard setting practices that benefit competition and consumers, the Antitrust Division has also pursued enforcement where appropriate. Notably, the Antitrust Division has conducted a number of investigations involving standard-essential patents involving mobile devices. The mobile-device industry is in technological transition, where smartphones are replacing previously dominant feature cell phones at lightning speed and new computer products, such as computer tablets, have been introduced into the market. Smartphones combine the best features of cell phones

with the features of computers that are most useful to mobile users, such as access to the Internet and email functionality. As a result, new technological innovators have displaced some established manufacturers of feature phones, and large portfolios of patents have been offered for sale. The Division had concerns about the F/RAND-encumbered standard-essential patents because wireless devices, including smartphones and tablets, typically implement a significant number of telecommunication and computer standards—including cellular air interface, wireless broadband, and video compression standards.

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

In both matters, the Division's investigations focused on whether the acquiring firms would have the incentive and ability to exploit ambiguities in the commitments the sellers made to license their patents on F/RAND terms to hold up implementers of the standard in a manner that would raise rivals' costs or foreclose competition, to the

detriment of consumers. For example, the acquiring firms might seek to raise rivals' costs by demanding higher licensing rates, compelling cross licenses to differentiating IP valued in excess of the F/RAND rate, charging licensees the entire portfolio royalty rate when licensing only a small subset of the patents in its portfolio, or seeking to prevent or exclude products that infringed these patents from the market altogether. We investigated whether the patent acquisitions would change the incentives or abilities of the new owners to obtain higher royalties from their competitors, particularly by using the threat of an injunction or exclusion order.

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

With respect to Google, there was evidence that Motorola Mobility had a long history of licensing its F/RAND-encumbered standard-essential patents and had been engaged in extended disputes with Apple, Microsoft, and others before Google sought to acquire the company and its patent portfolio. We did not believe that transferring ownership of the patents from Motorola to Google would substantially change that

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

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

they do not stifle competition and innovation in this important industry.

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

In seeking public comment, the Department of Justice believes the ITC should continue to gather the types of information necessary to evaluate whether the statutory public interest factors counsel against the imposition of an exclusion order. In considering this issue, the Department of Justice is concerned about the circumstances in

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

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