Briefing Paper on Antitrust Issues Related to "Patent Assertion Entity" Business Models

1. Introduction

As the United States continues to develop as an innovation-driven, knowledge-based economy, issues at the intersection of intellectual property and antitrust law, including the growth of the so-called "PAE" or "patent assertion entity" business models and the unique issues posed by "SEPs" or "Standards Essential Patents," have recently gained increasing attention. This intensified focus is reflected in Department of Justice (DOJ)/Federal Trade Commission (FTC) workshops, advocacy briefings with the International Trade Commission (ITC) and FTC consent decrees regarding injunctive relief for SEPs, proposed patent legislation, and the forthcoming Government Accountability Office (GAO) report on PAE litigation activity.

MOSAID recognizes that these issues are important and timely, but submits that the characterization of these matters by the anti-intellectual property crowd is based, to a significant degree, on hyperbole and semantics. For example, while some may label IP enforcement as a "tax on innovation" or the "raising of rivals costs," it may be more accurately characterized as securing fair compensation for the innovator by eliminating an unfair competitive advantage gained by an infringer. Which description is more accurate depends on the facts and circumstances of the particular conduct, not the ownership of the patents at issue.

In this paper, MOSAID provides background on the company's history and business operations, and addresses its 2011 acquisition of Core Wireless and a portfolio of approximately 2,000 patents and patent applications once owned by Nokia. The Core Wireless transaction has aroused the attention of Google (including Motorola Mobility) and others that are pushing for an expansive antitrust response to PAE activity, and to MOSAID, in particular. The paper concludes with a brief response to certain criticisms raised by opponents of PAE conduct, including those urging intervention by the DOJ and FTC with respect to the "outsourcing of patent enforcement by operating companies – companies that develop technology and sell products – to PAEs and the competitive implications of such activities," which they have labeled as "privateering."[1] As demonstrated below, those concerns – regardless of whether they have merit in the abstract or as applied to certain categories of "abusive" conduct – have no application to MOSAID or the Core Wireless transaction.

[1] *See* Comments of Google, Blackberry, Earthlink and Red Hat to the Federal Trade Commission and U.S. Department of Justice on Patent Assertion Entities.

2. About MOSAID

MOSAID is a 38-year-old company whose business has evolved to meet changing business conditions. Today, MOSAID specializes in the management, licensing, acquisition and development of intellectual property in technologies ranging from semiconductors to wireless communications. To our detractors, MOSAID is a PAE because most of its revenue is currently derived from licensing patented technology, including technology originally developed by others. While MOSAID does not accept the PAE moniker as an accurate description of its innovation-enhancing activities,[2] there is nothing about MOSAID's IP management activities that supports calls for an expansive view of antitrust intervention to address or seek to limit the pro-competitive technology transfer role our company plays by:

a. rewarding innovation and dynamic competition by securing compensation for the value of patented inventions from entities making unauthorized use of the patented technology; and by

b. making patented innovations more broadly available to those who need access to that technology without concerns for protecting its own operating business or limiting competition.

MOSAID's entry into the IP management and licensing business in 1999 reveals much about the changing nature of the IP economy, and the increasingly common divergence between the sources of high technology innovation and those low-cost producers who incorporate those innovations into "products." MOSAID developed its licensing expertise out of necessity when it found its own patented DRAM (Dynamic Random Access Memory) designs had been widely adopted by the semiconductor industry without permission or compensation. MOSAID was eventually able to secure patent license agreements with virtually 100% of the industry and thereby continue its R&D into advanced semiconductor memory technology. In the process of licensing its own technology, MOSAID developed expertise in identifying valuable patent portfolios and structuring license programs. Now, only six years after MOSAID made its first patent acquisition, it operates multiple patent licensing programs and counts many of the world's leading technology companies among its seventy (70) licensees.

MOSAID acquires patents from a wide spectrum of IP owners, although mostly from large companies that have made substantial R&D investments over many years and that are seeking to realize additional value from their patent portfolios. These include patent portfolios in areas deemed no longer core to the inventor's future business plans. Both prior to and upon acquisition, MOSAID invests heavily to understand the technology and the patents. Indeed, MOSAID employs a substantial patent prosecution team, including engineers in the relevant technologies, that works to increase the quality of patent applications, and ultimately, the value of patents. In a typical transaction, MOSAID makes an outright acquisition of a patent portfolio, and then shares with the former patent owners/innovators part of the royalty stream

[2] MOSAID started as a semiconductor design firm and developed core semiconductor technology still used in DRAM memory. MOSAID remains actively engaged in its own R&D efforts, with a current focus on advanced Flash memory products. MOSAID has more than 700 patents issued and pending related to its Flash memory R&D program.

generated through licensing the portfolio to others. In this manner, MOSAID increases the value and liquidity of patent assets and by compensating the prior patent owners, supports those companies' R&D efforts or enables them to return capital from under-utilized assets to shareholders.

3. The Core Wireless Transaction

In September 2011, MOSAID purchased a company known as Core Wireless and its portfolio of approximately 2,000 wireless patents, which were originally held by Nokia. The majority of these acquired patents (approximately 1,200) were SEPs or Standards Essential Patents, meaning that for a company to practice the standard they would necessarily make use of the patented invention.[3]

Nokia had spent many years and invested many billions of dollars (estimated around $20 billion) in R&D into wireless communications technologies, resulting in a global leadership position and a substantial patent portfolio. No matter which brand of phone or tablet you utilize, virtually everyone that uses, makes or sells a wireless device today benefits from Nokia's many years of substantial investment in innovation. Because much of this technology has been incorporated into the relevant wireless standards (e.g., 3G or 4G Long Term Evolution (LTE) technology), rival mobile device manufacturers without decades of wireless heritage and without billions in risky R&D investments could take advantage of Nokia's technology and readily incorporate it into their own products and devices. Incorporation into a standard did not mean, of course, that the industry's use of Nokia's contributed SEP technology was intended to be "free." Rather, as is common with Standards Setting Organizations (SSOs), Nokia committed that if its patents were incorporated into the standard, it would license them on Fair, Reasonable and Non-Discriminatory (F/RAND) terms.[4]

It is critical to recognize the importance of appropriate economic incentives to support such innovative activity in the first place and the willingness of the inventor to participate in the SSO to make that technology available to others. The DOJ and US Patent and Trademark Office (USPTO) expressly recognized this point:

> DOJ and USPTO strongly support the protection of intellectual property rights and believe that a patent holder who makes such a F/RAND commitment should receive appropriate compensation that reflects the value of the technology contributed to the standard. It is important for innovators to continue to have incentives to

[3] Nokia had identified certain patents and declared them to the SSO as essential to practice the relevant standard (e.g., 3G or 4G LTE). Thus, for an entity to make a product compliant with the standard (e.g., a smart phone) and thus capable of interoperating with other standard compliant products, the manufacturer of that product would know in advance that it must make use of the patented technology incorporated into the standard.

[4] To avoid patent "hold-up" potential (e.g., by seeking to block rivals from implementing the standard or by seeking royalties based on the value of the technology *after* it has been incorporated into and is necessary to practice the standard) SSOs typically insist on commitments that the patent owner will license all users on F/RAND terms.

> participate in standards-setting activities and for technological breakthroughs in standardized technologies to be fairly rewarded.

In regards to the Core Wireless transaction, Nokia concluded that MOSAID's expertise in IP management and licensing would help it secure a financial return from its investment in developing the Core Wireless patent portfolio.

An element of the Core Wireless transaction that has gained attention is the role played by Microsoft. Although MOSAID is not privy to all the details, we believe that Microsoft's role is fairly straightforward and supports how the Core Wireless acquisition and MOSAID's role as a specialist in acquiring and maximizing the value of patent portfolios is pro-competitive. In February 2011, Nokia and Microsoft announced "a broad strategic partnership that would use their complementary strengths and expertise to create a new global mobile ecosystem" based on a Windows Mobile operating system. In April 2011, Nokia and Microsoft announced terms that included "[a]n agreement that recognizes the value of intellectual property" and payments by Microsoft to Nokia "measured in the billions of dollars." This Microsoft-Nokia venture constitutes an effort to create a third, viable mobile operating system to compete with the two dominant mobile operating systems, Apple's proprietary iOS (with approximately 40-45% market share) and Google's Android OS (with approximately 45-50% market share). As such, the Microsoft-Nokia venture appears plainly good for competition and good for consumer choice.

As part of the Microsoft-Nokia transaction, in May 2011 Nokia transferred a select portion of its patents into a Nokia trust and later into Core Wireless. From all appearances, this transfer of Nokia patents was made for the purpose of generating a separate revenue stream that would reward Nokia's substantial R&D efforts and reduce Microsoft's risk of repayment for its substantial investment in Nokia. In this regard, MOSAID's participation as an acquirer of those assets in a secondary market helped to facilitate this Microsoft-Nokia transaction by providing potential revenues from its licensing of the acquired portfolio.

Upon the closing of the Core Wireless acquisition, Microsoft issued the following statement:

> Over the years, Nokia has developed one of the world's highest-quality patent portfolios in the mobile phone industry, representing decades of innovation as a worldwide leader in the field. We are pleased to have secured a license to the Nokia patents now acquired by MOSAID for Microsoft's products and services. In return, we have a passive economic interest in the revenue generated from the licensing of those patents to third parties. The marketplace for intellectual property is incredibly dynamic today, and this agreement is an effective way to make these Nokia innovations available to the industry and to unlock the considerable value of this IP portfolio.[5]

[5]Statement of Horacio Gutierrez, Corporate Vice President and Deputy General Counsel, Microsoft (September 1, 2011).

MOSAID acquired Core Wireless and its patent portfolio from Nokia for a relatively small upfront purchase price.[6] In return, MOSAID makes all of the investment in maintaining the portfolio and bears all risks associated with the licensing and, when necessary, enforcement efforts. MOSAID solely determines its licensing and enforcement plans and shares the success of those efforts by returning approximately two-thirds (2/3) of any such revenues to Nokia and Microsoft.

4. Response to Common Criticisms of PAE Activity and So-Called "Privateering" Arrangements

MOSAID does not dispute that certain companies, whether practicing entities or PAEs, engage in conduct that is either abusive or lacking in pro-competitive justifications. Where such conduct is exposed, MOSAID favors vigorous enforcement activity under theories appropriate to remedy the particular abuses. Legal enforcement and legislative efforts, however, should be directed at the offending conduct and not based on generalizations based on the business structure of the patent holder.

One recurring theme at the DOJ/FTC Workshop on Patent Assertion Entity Activities, held in December 2012, was that with respect to so-called PAEs, as with any organization or practicing entity, there is no "one size fits all." As a result, MOSAID will address many of the basic criticisms leveled at PAEs and speak to their application to the Core Wireless transaction.

a) **PAEs Are a Tax on Innovation:** The argument is made that PAEs may assert their patents *ex post* on products that are already commercialized against "inadvertent infringers" who may pay a royalty to avoid the risks and costs of infringement litigation, but not gain any benefit from the technology itself.

   - This concern has no bearing on MOSAID's program to license the Core Wireless portfolio. The patents at issue are highly valuable, selected for the purpose of generating licensing royalties, and most are Standard Essential Patents. The patents necessary to practice the relevant standards are all disclosed and publicly available. Parties who made products that practice the standard, accordingly, are not "inadvertent" infringers but rather, knew prior to commercialization that they would be required to compensate the owners of the SEPs.

b) PAEs Target Small and Mid-Sized Companies and Exploit Litigation Costs to Extract Settlements: Related to the first criticism, above, is the notion that PAEs may target smaller companies or users of technology that lack the incentives or resources to defend against even "meritless" infringement action. Faced with the certainty of litigation costs, many such entities will pay settlements simply to avoid those costs.

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[6] As part of the transaction, MOSAID contractually agreed to abide by Nokia's prior F/RAND commitments to the SSOs, and other pre-existing license commitments for the portfolio.

- This concern likewise has no bearing on MOSAID or its efforts to monetize the Core Wireless portfolio. The anticipated licensees to the Core Wireless portfolio are the manufacturers of the devices (primarily mobile phones and tablets) that practice the various standards. These entities have the resources and incentives to defend any licensing demands or litigation from MOSAID, as demonstrated by, among other things, the well-documented litigation brought by Google/Motorola; Samsung, Apple and others. To the extent that MOSAID were alleged to bring "meritless" claims, we are highly confident that the prospective licensees to the Core Wireless portfolio are well-positioned to defend their own interests.

c) **PAEs Sponsor Numerous Lawsuits and Seek Injunctions as a Threat to Extract Higher Royalties.** Much has been made of the growth of lawsuits filed by non-practicing entities (or PAEs) in recent years. Relatedly, the threat of an injunction or exclusion order from the ITC is cited as a reason that accused infringers will license from a PAE to avoid the risk of a sales ban or design-around costs, without regard to the value of the underlying patented technology.

- MOSAID is in the licensing, not litigation, business. It has filed a total of one lawsuit related to the Core Wireless portfolio and to date has not sought injunctive relief.[7] As the arguments related to invalidity or non-infringement of these SEPs appears weak, MOSAID is seeking to reach a commercial licensing arrangement that reflects the value of the technology contributed to the standard.

d) **PAEs Do Not Meaningfully Reward Innovation or Innovators.** It is a commonly held belief that PAEs do not support innovation (or do so only at the margins) because relatively little of the costs associated with IP monetization efforts are actually returned to the innovators.

- In the case of the Core Wireless acquisition, MOSAID will return approximately 2/3 of any licensing revenues to Nokia (ultimately split between Nokia and Microsoft according to their own predetermined arrangement).

e) **PAEs May Hide the Ownership of Patent Rights in a Manner That Harms Disclosure and Risk Mitigation:** Critics of PAEs cite the practice of certain PAEs to hold their patents in the names of "shell companies" as a tactic that makes it harder for companies to avoid the risks of post commercialization exploitation. They contend that this information asymmetry makes it harder to avoid inadvertent infringement or conduct meaningful licensing negotiations.

- Whether or not this practice is as widespread as suggested, MOSAID does not participate. MOSAID registers and holds all patents that it acquires in its own name. MOSAID believes that its licensing efforts are more likely to be successful

[7] As both the DOJ and FTC have recognized, it may be the case that an infringer has taken sufficient steps to demonstrate its unwillingness to take a license on F/RAND terms that an injunction may be necessary and appropriate.

when the prospective licensee can assess the scope and value of its portfolio. Also, because MOSAID can serve as a patent "clearinghouse," it is in our interest for parties seeking to acquire IP in a given area to be able to assess our holdings.

f) "Outsourcing" Patent Enforcement May Enable Exploitive Behavior: Critics of PAEs will point to arrangements whereby practicing entities (such as Nokia) transfer ownership of patents to a non-practicing entity or PAE (such as MOSAID) as enabling the PAE to engage in "exploitive" behavior that the original owner would not or could not have done. They will point to the absence of reputational concerns, the ability to evade commitments to standards bodies (e.g., F/RAND licensing), and the risk of royalty-stacking as theoretical concerns whereby the change in ownership to a PAE would make potentially exploitative behavior more likely or more successful.

- Rather than respond to each theoretical concern leveled against each theoretical transfer from an operating company to a PAE, MOSAID believes and agrees that *actual exploitive or abusive conduct* is the proper focus of any enforcement or legislative efforts – not a broadside attack on all entities engaged in IP management activities. MOSAID stands ready to answer for its own behavior, as opposed to its status as an alleged PAE. In the FTC's 2011 Report, "The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition," the Commission noted that "the harms associated with PAE activity are the harms associated with all *ex post* patent assertions against manufacturers that have independently created or obtained the technology. . . . "[8] In other words, both operating companies and PAEs have the *potential* to engage in the *same types* of exploitive conduct. Nobody would suggest condemning *all* operating companies seeking to exploit their patent rights because some of that conduct may be exploitive. This is true even though the vast majority of antitrust enforcement activity in this area has focused on allegedly exploitive conduct of operating companies – not PAEs, including most notably, Google/Motorola Mobility related to breaches of F/RAND obligations via injunction actions related to SEPs and unreasonable licensing demands.

- Moreover, many of the reasons offered to support the different incentives or abilities of PAEs to engage in such behavior lack any support, particularly with respect to the Core Wireless transaction. For example, it is an article of faith that operating companies, which are repeat players in SSOs, are less likely to engage in exploitive behavior than PAEs due to reputational harm. Yet, not only have operating companies heavily involved in standard setting activities been the targets of exploitative behavior allegations (e.g., Google; Samsung, etc.), but in the case of the Core Wireless transaction, Nokia's role as the source of the patent portfolio is widely known. In addition, contrary to the theory that transferees of portfolios may seek to evade F/RAND commitments, as a matter of contract, MOSAID agreed to comport with Nokia's commitments to the SSOs with respect to F/RAND obligations and otherwise. Any contractual remedy or

[8] *Id.* at 71.

limitation on Nokia's ability to exploit its SEPs would apply equally to MOSAID. Lastly, critics contend that where patent sales and transfer break apart a unified patent portfolio previously owned by one entity, it may allow the new owners to engage in "royalty stacking," whereby the sum total sought by each owner of a separate part of the portfolio exceeds that charged in connection with a unified portfolio. Again, this highly theoretical concern lacks foundation in the Core Wireless transaction. There is no claim that MOSAID has evaded any form of F/RAND commitment. Moreover, MOSAID's license demand is a fraction of Nokia'ls alleged self-imposed 2% "royalty cap" and far less than Google/Motorola Mobility has demanded for its "unified" portfolio.

- Finally, the potential licensees of the Core Wireless portfolio are some of the largest, most sophisticated entities in the world. They are adept at patent litigation and defending their interests. The volume of commerce at issue provides sufficient incentives to defend cases that they believe are non-meritorious, such that costs of litigation will not "force" them to take a settlement. At the end of the day, MOSAID (or any other PAE) cannot force these entities to accept a license – much less an exploitive or exorbitant license that they do not believe is a better option than their expected outcome in Court. There is no reason to believe that weak or invalid patents will not be exposed or that legitimate contractual or quasi-contractual defenses will not be vindicated.

g) Operating Companies Can Use PAEs to Target Their Rivals and Harm Competition via "Privateering" Arrangements: A final criticism of arrangements between PAEs and operating companies is that they may combine the "exploitative" conduct of a PAE with the competitive or exclusionary incentives of an operating company, such that the operating company may use the PAE to target their competition and "raise rivals' costs."

- First, in the Core Wireless transaction, MOSAID alone has sole authority to develop and engage in licensing and/or enforcement activities. Neither Nokia nor Microsoft exerts any control over MOSAID's decisions or activities, including with respect to "targets" of licensing efforts. While critics have pointed to the "royalty milestones" in the Core Wireless transaction, whereby if MOSAID has not generated certain revenues by a certain date, Nokia-Microsoft can compel MOSAID to transfer the portfolio to another, this provision does not change MOSAID's incentives to maximize the value of that portfolio. To the contrary, the milestone provision exists primarily to ensure that the Core Wireless portfolio is generating a minimum expected return.

- Second, as recognized by the Google submission, even if one were to indulge this theoretical concern of raising rivals' costs, "the exclusionary impact may be relatively larger when rivals are small and not well funded." In other words, a company with a dominant position may be able to make a new entrant less cost-competitive and thus, a less viable competitor. Such underfunded companies

may settle weak cases rather than pay the costs required to defend the litigation. As demonstrated above, no such concerns are present in this case.

5. Conclusion

As with operating companies, there may be PAEs that engage in abusive behavior that violate established legal standards, and based on that behavior, they should be held accountable. That is far different from condemning all entities that engage in the licensing and management of intellectual property assets that were originally developed by others. The focus of the patent and antitrust laws should be on the conduct of the patent holder, not on the characterization of their business model.

As IP specialists, MOSAID brings operating efficiencies to the market. We provide expertise in the management of patent portfolios and in generating financial returns from those assets that may be used to reinvest in innovation. MOSAID has skills and experience that are useful in bridging the gap between the inventor/rights holder and licensees in ways that rewards the inventor in the form of royalty participation and allows for widespread and unbiased dissemination of technology.

We reiterate that MOSAID is a licensing company. Our goal is to license our patents; not to restrict access to those patents. We succeed and innovators succeed, when the technology we license is valued and widely adopted by our licensees. MOSAID seeks to advance these objectives; not to exclude others from using the technology or to limit their success in implementing that technology.