BINGHAM McCUTCHEN

Richard S. Taffet
Direct Phone: (212) 705-7729
Direct Fax: (212) 702-3603
richard.taffet@bingham.com

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Via facsimile and e-mail

Andrew J. Heimert, Esq.
Executive Director & General Counsel
Antitrust Modernization Commission
1120 G Street, N.W., Suite 810
Washington, DC 20005
Fax: (202) 233-0710

Bingham McCutchen LLP
399 Park Avenue
New York, NY
10022-4689

212.705.7000
212.752.5378 fax

bingham.com

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Re: Tentative Recommendation 17

Dear Mr. Heimert:

We submit this letter on behalf of QUALCOMM Inc. for consideration by the Antitrust Modernization Commission in connection with its deliberations of proposed recommendations regarding the antitrust laws. In particular, we address proposed Tentative Recommendation 17 as it relates to standard setting issues. We are aware that this proposed tentative recommendation has been the subject of modification at the last meeting of the AMC Commissioners held on January 11, 2007, and we believe significant progress has been made in clarifying its focus. As discussed below, however, we believe that ambiguity remains, and we therefore suggest alternative language for a tentative recommendation. We believe the alternative language accurately reflects a proper consideration of antitrust law and its interrelationship with intellectual property law principles. Most significantly, we believe the alternative language recognizes, as observed in the Preliminary Draft Outline of the AMC Report Introduction and Executive Summary, dated January 10, 2007, "the importance of intellectual property in promoting innovation and, accordingly, the need to incorporate this recognition into a dynamic analysis of competitive effects." (Preliminary Draft, at 2).

We request that you circulate this correspondence to the Commissioners for their consideration in advance of the next meeting at which Tentative Recommendation 17 will be discussed. We thank you in advance for your consideration of this matter.

Tentative Recommendation 17

We understand that Tentative Recommendation 17, as presented in the January 10, 2007 preliminary draft, was revised at the January 11th meeting. As a result, we understand that Tentative Recommendation 17 presently reads:

> *Negotiations with Intellectual Property rights owners by members of a standards setting organization with respect to royalties prior to the*

> *establishment of the standards, without more, should be evaluated under the rule of reason.*

We appreciate the efforts of the Commission in clarifying and reformulating this statement, and believe this revision represents a strong improvement over the prior proposed language. The current formulation of Tentative Recommendation 17, however, continues to be subject to ambiguities and uncertainties, and as such is likely not to provide effective guidance regarding the application of the antitrust laws to standards setting conduct.

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For example, the current proposed language encompasses conduct that should raise absolutely no antitrust issues. It is common that patent owners negotiate bilaterally with prospective licensees well before a standard is developed.[1] Such conduct does not involve concerted action as required to make out a Sherman Act Section 1 claim, and no evaluation under the rule of reason would be appropriate. The current Tentative Recommendation 17, however, suggests the contrary.

If Tentative Recommendation 17 is intended to address joint conduct in establishing licensing terms -- whether with respect to royalties or other terms -- the current formulation is incomplete. *First*, it is limited to the discussion of royalty terms. Patent licenses, however, contain many other terms, all of which have competitive significance. *Second*, the joint negotiation and setting of license terms, whether concerning royalties or otherwise, raises the same antitrust concerns whether such conduct occurs before a standard is established, when a standard is established, or after the standard is established. As currently drafted, Tentative Recommendation 17 only addresses *ex ante* negotiations. *Third*, and perhaps most significantly, the current proposed language of Tentative Recommendation 17 does not provide a full recognition of the antitrust issues that may exist in connection with joint negotiation of license terms in the standards setting context, and specifically omits a consideration of effects on dynamic competition.

Recently, Deputy Assistant Attorney General Gerald Masoudi observed that licensing freedom -- *i.e.*, the freedom of IPR owners and licensees to freely negotiate the terms of their specific license agreements -- is an important "step in a pro-growth IP and competition law regime."[2] Licensing freedom and flexibility is also procompetitive because it permits the effective integration of multiple technologies and facilitates the

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[1] *See* Submission of Richard J. Holleman, *Comments on Standards Setting and Intellectual Property*, FTC/DOJ Hearing on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy (April 10, 2002), at 2 ("[M]ore often than not, patent owners provide statements that if they have patents that are essential to implementation of the standard being developed they will license such patents on reasonable nondiscriminatory terms. Then, outside the activities of the SDO, individual standards participants are able to approach the patent holder to inquire of available licensing terms. The patent holder is also free to publicly state what its license terms will be.").

[2] Gerald F. Masoudi, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, *Intellectual Property and Competition: Four Principles for Encouraging Innovation*, Digital Americas 2006 Meeting, Intellectual Property and Innovation in the Digital World, Sao Paolo, Brazil (April 11, 2006), at 4-8.

introduction of new products and implementations -- all of which furthers the procompetitive goals of the standards process. Such procompetitive benefits are recognized in the DOJ/FTC *Antitrust Guidelines for Licensing of Intellectual Property* (April 6, 1995), at 4-5:

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> [I]ntellectual property licensing allows firms to combine complementary factors of production and is generally procompetitive . . . . Licensing, cross-licensing, or otherwise transferring intellectual property . . . can facilitate integration of the licensed property with complementary factors of production. This integration can lead to more efficient exploitation of the intellectual property, benefiting consumers through the reduction of costs and the introduction of new products. Such arrangements increase the value of intellectual property to consumers and to the developers of the technology. By potentially increasing the expected returns from intellectual property, licensing also can increase the incentive for its creation and this promotes greater investment in research and development.

Joint discussions, negotiations and setting of royalty and other licensing terms may reduce these procompetitive benefits and raise risks of collusive exercise of monopsony or oligopsony power.[3] For example, such collective conduct directed at establishing license terms may drive the value of IPR contributed for standardization below its optimal price and toward its marginal cost -- *i.e.,* zero. The Antitrust Division and Federal Trade Commission recognize the adverse competitive effects from such conduct. The DOJ/FTC *Horizontal Merger Guidelines*, explain that "[m]arket power also encompasses the ability of a single buyer (a 'monopsonist'), a coordinating group of buyers, or a single buyer not a monopsonist, to depress the price paid for a product to a level that is below the competitive price and thereby depress output. The exercise of market power by buyers ('monopsony power') has adverse effects comparable to those associated with the exercise of market power by sellers."[4] Agency joint venture policy also includes express recognition of the serious competitive risks associated with the exercise of buyer-side market power. A buyer collaboration -- which is what would exist if royalty and other license terms were collectively established in the standards setting context by a group comprised primarily of prospective licensees -- can "create or increase market power . . . or facilitate its exercise by increasing the ability or incentive to drive

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[3] *See* Daniel G. Swanson and William J. Baumol, *Reasonable and Nondiscriminatory (RAND) Royalties, Standards Selection, and Control of Market Power*, 73 Antitrust L.J. 1, 14 (2005) ("considerable risk" of creation or increase of monopsony power if a standards development organization plays an active role in royalty negotiations on behalf of potential licensees, particularly when participant licensees are a significant percentage of all prospective licensees); David J. Teece and Edward F. Sherry, *Standards Setting and Antitrust*, 87 Minn. L. Rev. 1913, 1955 (2003) ("One key issue concerning patents is whether the patent holder must announce the terms for a patent license in advance. If so, there are potential antitrust concerns. Typically, the other participants in the SSO are the most likely potential licensees for the patent. This raises the potential for collusive oligopolistic 'price fixing' in the technology market.").

[4] U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines* (issued April 2, 1992, revised April 8, 1997), at § 0.1.

[down] the price of the purchased product, and thereby depress output, below what likely would prevail in the absence of the relevant agreement."[5]

Indeed, at least in certain circumstances, case law supports the application of a *per se* rule to collusive buyers' cartels.[6] Moreover, even where a joint buying arrangement involves a procompetitive integration of assets or capabilities that brings it within the rule of reason, the Supreme Court has made clear that a purchasing cooperative may be unlawful where it possesses "market power or unique access to a business element necessary for effective competition."[7]

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In light of the foregoing, care must be taken to recognize the full scope of potential competitive effects -- both *pro* and *anti* -- that may arise in the standards context from joint discussion and negotiation of royalties and other license terms. A correct rule of reason approach would reflect such care. As explained by the Agencies in the *Collaboration Guidelines*:

> Agreements not challenged as per se illegal are analyzed under the rule of reason to determine their overall competitive effect. These include agreements of a type that otherwise might be considered per se illegal, provided they are reasonably related to, and reasonably necessary to achieve procompetitive benefits from, an efficiency-enhancing integration of economic activity.[8]

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[5] U.S. Department of Justice and Federal Trade Commission, *Antitrust Guidelines for Collaborations Among Competitors*, April 2000, at § 3.31(a). Competitor collaborations, including buyer collaborations, can also facilitate express or tacit collusion through "facilitating practices such as the exchange or disclosure of competitively sensitive information . . . . " *Id.* at § 2.2. *See also* § 3.31(b) ("Certain marketing, production, and buying collaborations, for example, may provide opportunities for their participants to collude on price, output, customers, territories, or other competitively sensitive variables.").

[6] *See Mandeville Farms v. Am. Crystal Sugar*, 334 U.S. 219 (1948) (finding *per se* unlawful an agreement among local sugar refiners to set the price at which the refiners would purchase sugar beets); *National Macaroni Mfrs. Ass'n v. FTC*, 345 F.2d 421 (7th Cir. 1965) (finding *per se* unlawful a trade association rule that fixed the percentage of durum wheat included in macaroni products produced by trade association members in order to depress market demand and price during a crop shortage).

[7] *Northwest Wholesale Stationers v. Pacific Stationery*, 472 U.S. 284, 298 (1985) (in a challenge to a joint purchasing arrangement, some showing must be made "that the cooperative possesses market power or unique access to a business element necessary for effective competition"); *cf. Addamax Corp. v. Open Software Foundation*, 152 F.3d 48, 52 (1st Cir. 1998) (rejecting plaintiff's claim that a joint venture among computer manufacturers to develop a new version of the Unix operating system was *per se* unlawful and caused the failure of its security software business, but cautioning that, in rejecting the plaintiff's claim, it was not holding that joint ventures are *per se* lawful or that a joint buying arrangement that creates a significant risk of forcing prices below competitive levels could not fail under the rule of reason).

[8] *Collaboration Guidelines,* at § 1.2.

This balancing approach is reflected in FTC Chairman Majoras's Stanford remarks of September 2005, where she explained that "joint ex ante royalty discussions that are *reasonably necessary* to avoid hold up do not warrant per se condemnation. Rather, they merit the balancing undertaken in a rule of reason review."[9] Moreover, the Supreme Court has made it absolutely clear that absent proof that a competitive restraint is narrowly tailored to address a particular competitive concern, and competitively justified on its own merits, it will not pass muster under the rule of reason.[10]

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Proposed Alternative Tentative Recommendation 17

Consistent with the foregoing discussion and authority, we respectfully submit that alternative language for Tentative Recommendation 17 would be appropriate. We propose the following:

> *In the standards context, the voluntary disclosure of potentially essential patents and license terms, and the bilateral discussion and negotiation of license terms between potential licensors and licensees, ordinarily should not raise antitrust concerns. Antitrust concerns may, however, arise where royalty rates and other license terms are discussed and negotiated jointly. Such conduct should, nonetheless, be appropriately treated under the rule of reason where, based on the particular facts and circumstances of each situation, there exists a demonstrated anticompetitive hold up problem, and it can be shown that the joint conduct is reasonably necessary to address that problem and achieve a procompetitive purpose. However, significant antitrust concerns may arise where joint discussions and negotiations facilitate or result in express or tacit collusion that fixes royalties or other license terms, in the absence of a clear showing that such conduct is reasonably necessary to achieve cognizable efficiencies that could not be achieved by practical, significantly less restrictive means, and that procompetitive benefits outweigh the anticompetitive effect. Absent such a showing, such conduct should be properly analyzed under a per se rule.*

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[9] Deborah Platt Majoras, Chairman Federal Trade Commission, *Recognizing the Procompetitive Potential of Royalty Discussions in Standard Setting*, remarks prepared for Standardization and the Law: Developing the Golden Mean for Global Trade, Stanford University (Sept. 23, 2005), at 7 (emphasis added).

[10] *See Nat'l Collegiate Athletic Ass'n v. Board of Regents of the Univ. of Oklahoma*, 468 U.S. 85, 117, 120 (1984) (holding NCAA's policy unlawful under rule of reason where there was "no evidence" that the policy was narrowly tailored to serve the interest of creating a "competitive balance," and instead curtailed output and blunted the ability of member institutions to respond to consumer preferences); *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 696-99 (1978) (holding unlawful under rule of reason engineering association's rule prohibiting members from submitting price information to prospective customers prior to the selection of an engineer, and rejecting association's contention that, if permitted to bid competitively, engineers would be tempted to submit deceptively low bids as "too broad" and not sufficiently "closely confined" to the "legitimate objective of preventing deceptively low bids").

This language, we believe, addresses the full scope of relevant standards development activities, and reflects a proper statement of antitrust legal principles applicable thereto. It further reflects the need to balance the interests of both static and dynamic competition, and thereby promotes consumer welfare as a whole.

Accordingly, we believe that, by adopting the foregoing proposed statement as a recommendation, the AMC would be providing highly significant, neutral and objective guidance in connection with the important issues now being addressed in the standards context.

Bingham McCutchen LLP
bingham.com

Again, we thank you in advance for your consideration of these points.

Sincerely,

Richard Taffet

Richard S. Taffet