March 28, 2013

Gleaning Insights from the Latest DOJ Guidance on Joint Licensing and Patent Pooling

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In a world of patent thickets, royalty stacking, and colossal infringement wars, there is a keen interest on the part of patent holders and potential licensees to find ways to make patent licensing more efficient, transparent, and certain. Intellectual Property Exchange International, Inc. (IPXI) created a business model that sought to address that need with a patent licensing exchange, which was designed to create a marketplace for rights in individual and packaged patent licenses.

In an effort to avoid antitrust issues, IPXI sought guidance from the Department of Justice (DOJ). The resulting business review letter,[1] issued on March 26, 2013, did not give IPXI the blessing it sought, but it does provide the latest guidance regarding the DOJ's view on several key issues faced by those involved in joint licensing and patent pooling. In particular, the IPXI business review letter gives guidance regarding:

- the inclusion of substitute patents in joint licensing or pooling arrangements;
- the importance of preserving patent holders' ability to independently license patents outside of a pool; and
- the need for a licensing agent to employ strict measures to ensure it does not market competing patents held by different patent holders.

A. IPXI'S PROPOSED BUSINESS: A PATENT LICENSING EXCHANGE

In its proposed patent licensing exchange, IPXI would:

- receive offers from patent holders for exclusive field-of-use licenses to their patents so that IPXI could sublicense them through its exchange;
- perform due diligence on the offered patents, including by examining the patents' validity and current infringement;
- determine market interest for sublicenses to the offered patents; and
- offer a unit license right (ULR), a standardized license conveying the rights to make, have made, use, sell, or offer for sale a single "consumable" unit of a product within a defined field of use, for the offered patents.[2]

Under the proposal, IPXI would make ULRs available through direct purchases on its primary market and would also maintain a secondary trading market on which ULRs could be traded by third parties. The ULRs offered on the primary market would be sold in three tranches, with the first two tranches discounted relative to the third, and

[1] Under 28 C.F.R. § 50.6, the DOJ Antitrust Division may review proposed business conduct and state its enforcement intentions in the form of a business review letter.

[2] U.S. Dep't of Justice Antitrust Division, Letter from William J. Baer, Assistant Attorney General, U.S. Dep't of Justice, to Gerrard R. Beeney, Sullivan & Cromwell LLP, re: Intellectual Property Exchange International, Inc. Business Review Request, at 2 (Mar. 26, 2013), *available at* http://www.justice.gov/atr/public/busreview/295151.htm (hereinafter "IPXI Business Review Letter").

potential follow-on tranches if there is residual demand.[3]

IPXI further proposed that a ULR would comprise either multiple patents from different patent holders, bundled together based on relevance to a particular field of use, or à la carte offerings from a single patent holder. IPXI's rules would require patent holders to make their patents available through both bundled and à la carte offerings unless the bundled ULR's field of use was coextensive with a published technical standard, in which case IPXI would not require an à la carte offering.[4]

In addition, IPXI proposed that it would not simultaneously list competing ULRs on its exchange, and would rely on its attorneys and staff to identify potentially competing ULRs based on the fields of use covered by each such ULR.[5]

IPXI's proposal also provided that the patent holder and IPXI could agree to enforce the ULR patents and that, if the parties decided to enforce the ULR patents, IPXI's recovery would be limited to attorneys' fees and amounts required to bring an infringer into compliance through purchases of ULRs.[6] IPXI's proposed rules permit the patent holder to offer total, partial, or no amnesty for acts of past infringement.[7]

Finally, IPXI included proposals to limit information sharing among exchange members, including proposals to prevent patent holders from discussing the price or quantity of ULR contracts in their offerings and to bar IPXI members and staff from disclosing confidential or material nonpublic information obtained through their role with IPXI.[8]

B. THE DOJ'S "GUIDANCE"

In its analysis of the proposed exchange, the DOJ recognized that the proposed exchange "could potentially generate efficiencies for the IP marketplace and encourage innovation."[9] In fact, the potential procompetitive benefits identified by the DOJ would address several of the shortcomings that frustrate licensing in the IP marketplace. The potential benefits included (i) reduced transaction costs for both licensors and licensees by replacing bilateral licensing negotiations with standardized, arm's-length transactions; (ii) increased price transparency for licenses, thus eliminating information asymmetries in the IP licensing market; and (iii) efficiencies such as reducing the time and expense required to separately license multiple patents within a field of use, reducing the number of stacked royalties, clearing blocking positions, and integrating technologies necessary to practice industry standards.[10]

The DOJ nonetheless declined to state its enforcement intentions, repeatedly stating that without specific facts regarding how the exchange would be implemented in practice, it is "unable to engage in the fact-intensive

[3] *Id.* at 5.

[4] *Id.* at 4.

[5] *Id.* at 4.

[6] *Id.* at 5-6.

[7] *Id.* at 6.

[8] *Id.*

[9] *Id.*

[10] *Id.* at 6-7.

analysis necessary to assess the likely competitive effects"[11] or could not "prospectively assess the competitive impact" of various aspects of the proposal.[12] In other words, the DOJ was unwilling to predict the net competitive effects of the exchange and thus declined to give definitive guidance.

C. LESSONS LEARNED FROM THE DOJ'S "GUIDANCE"

Despite the DOJ's refusal to state its enforcement intentions, the business review letter still gives some guidance for those seeking to form joint licensing programs or patent pools. Recognizing the limits of business review letters, [13] what can we learn from the IPXI business review letter?

Approach Inclusion of Substitute Patents in a Patent Pool with Caution

The IPXI business review letter reinforces the need for caution when including substitute patents in a pool. In its prior business review letters regarding patent pools, one of the keystones was the limitation that only "essential" patents be included in the pool. To ensure that the pool is not being used as a price-fixing device or a means to limit competition between actual or potential competitors, the patent pools in the prior business review letters each required that the pooled patents be "essential" – i.e., patents that would be infringed by standard-compliant products and for which there are no viable substitutes.[14] Thus, the essentiality requirement ensures that the pool contains only complementary patents:

> Essential patents by definition have no substitutes; one needs licenses to each of them in order to comply with the standard. At the same time, they are complementary to each other; a license to one essential patent is more valuable if the licensee also has licenses to use other essential patents.[15]

As the DOJ explained, this requirement prevents a pool from limiting competition between pool members:

> An inclusion criterion broader than "essentiality" carries with it two anticompetitive risks, both arising from the possibility that the pool might include patents that are substitutes for one another and not just complements. Consider, for example, a situation in which there are several patented methods for placing DVD-ROMs into packaging – each a useful complement to DVD-ROM manufacturing technology, but not essential to the standard. A DVD-ROM maker would need to license only one of them; they would be substitutes for each other. Inclusion in the pool of two or more such patents would risk turning the pool into

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[11] *Id.* at 9.

[12] *Id.* at 10. The DOJ's response to a business review request will fall into one of three categories: (1) the DOJ does not presently intend to challenge the proposed conduct, (2) the DOJ "declines to state its enforcement intentions," or (3) the DOJ finds that it "cannot state that it would not challenge the proposed conduct if it is implemented." In the second case, the DOJ might or might not challenge the conduct if implemented. In the third case, such a challenge is probable. U.S. DEP'T OF JUSTICE, ANTITRUST DIVISION MANUAL at III-128 (5th ed., rev. 2012), *available at* http://www.justice.gov/atr/public/divisionmanual/chapter3.pdf.

[13] As explained by the agencies with regard to patent pools, "Business review letters inform parties of the Department's enforcement intentions based largely on the parties' description of the relevant facts before the proposed activity has commenced. . . . Investigations of conduct, by contrast, typically address whether a party is violating, or has violated, the antitrust laws. In an enforcement investigation examining a patent pool currently in effect, failure to incorporate all the safeguards set forth in the pooling business review letters will not automatically lead to the conclusion that a pool is anticompetitive. Rather, the Agencies will evaluate the particular facts and circumstances to determine whether the actual conduct has an anticompetitive effect." U.S. DEP'T OF JUSTICE AND FEDERAL TRADE COMMISSION, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION at 72-73 (April 2007) (hereinafter "2007 IP Report").

[14] *See, e.g.*, U.S. Dep't of Justice Antitrust Division, Letter from Joel I. Klein, Assistant Attorney General, U.S. Dep't of Justice, to Cary R. Ramos, Paul, Weiss, Rifkin, Wharton & Garrison, at 3 (June 10, 1999) ("6C DVD Business Review Letter").

[15] *Id.* at 11.

> a price-fixing mechanism.[16]

It also prevents a pool from foreclosing rival technologies:

> Inclusion in the pool of only one of the competing non-essential patents, which the pool would convey along with the essential patents, could in certain cases unreasonably foreclose the non-included competing patents from use by manufacturers; because the manufacturers would obtain a license to the one patent with the pool, they might choose not to license any of the competing patents, even if they otherwise would regard the competitive patents as superior. Limiting a pool to essential patents ensures that neither of these concerns will arise; rivalry is foreclosed neither among patents within the pool nor between patents in the pool and patents outside it.[17]

In a 2007 report, however, the DOJ and FTC recognized that the inclusion of substitute patents in a pool may be procompetitive. The agencies explained that they "continue to believe that pools consisting only of complementary patents are least likely to prove anticompetitive,"[18] but they "acknowledge, however, that it might be reasonable to include substitute patents in a pool in certain situations."[19] Whether the inclusion of substitute patents is anticompetitive "would depend, of course, on the facts."[20] Thus, the agencies stressed that the structure in the business review letters, which allowed for only essential patents, should not be construed as completely limiting:

> The Agencies' previous guidance should not be interpreted to exclude the possibility of including some substitute patents in the pool. The Agencies will consider the inclusion of some substitutes as one of the many factors in their rule of reason analysis of any pooling agreement.[21]

The IPXI business review letter sticks with that position. In the IPXI proposal, where the field of use is not coextensive with a technical standard, pooled patents could include all patents "reasonably relevant or beneficial" to the "ULR's field of use."[22] This definition would allow substitute patents in a pooled license.[23] Given that "IPXI cannot predict in advance the patents or markets that might be subject to a pooled ULR," the DOJ refused to state its enforcement intentions, stating that it "is unable to engage in the fact-intensive analysis necessary to assess the likely competitive effects" of the IPXI proposal.[24] In short, the DOJ seems to say that the analysis of whether substitute patents may be included in a pooled license must be done on a case-by-case basis.

Independent Licensing Remains an Important Safeguard

The IPXI business review letter also provides a lesson regarding the importance of preserving the ability of the patent holder to individually license its patents outside of a joint licensing or pooling arrangement. For pooled

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[16] *Id.* at 11-12.

[17] *Id.* at 11-12.

[18] 2007 IP Report at 77.

[19] *Id.* at 78.

[20] *Id.*

[21] *Id.*

[22] IPXI Business Review Letter at 4.

[23] *Id.* at 9.

[24] *Id.*

ULRs not related to a published technical standard, IPXI would require that each patent holder also offer its patents on an à la carte basis through a separate ULR.[25] IPXI would not require such an à la carte offering for pooled ULRs with a field of use coextensive with a published technical standard.[26]

In prior business review letters dealing with joint licensing programs, the DOJ has recognized that retaining participants' ability to license outside of the program was a "backstop" preventing foreclosure to potential competition in downstream markets.[27] The agencies also have recognized that allowing independent licensing outside of a pool license "permits innovators that invent around one or more pool patents to compete with the pool."[28]

In the IPXI business review letter, however, the DOJ also observed that the requirement that patents offered in a pooled ULR must also be offered in an à la carte ULR "would not provide for independent licensing for the licensed field of use outside of the exchange."[29] Because the patent holder and IPXI would jointly set the terms for the à la carte offerings, the DOJ was concerned that the parties may not "have incentives to agree to list the à la carte offerings on terms that compete with the pooled ULR."[30]

With regard to ULRs with a field of use coextensive with a published technical standard, the DOJ recognized that if all the pooled patents are complementary, the lack of independent licensing outside of the pool "may procompetitively lower the total royalty rate to licensees."[31] But the DOJ would not state its enforcement intentions because the ability to license outside of the field of use would vary based on the "scope and importance of any particular restriction on IPXI's licensed field of use."[32]

The lesson to be learned from this is that preserving the ability and incentive of pool participants to independently license pooled patents remains an important safeguard, at least when seeking to obtain a favorable business review letter.

Using a Single Licensing Agent Requires Strict Vetting of Potentially Competing Patents

Obviously, different patent holders using a single licensing agent to market competing patents would raise competitive concerns. IPXI sought to mitigate this concern by using its staff "to identify ULRs that compete through a review of their fields of use and whether they share 'equivalent functionality and equivalent achievement of business goals.'"[33] The DOJ recognized that if this approach "successfully identifies and excludes competing ULRs from IPXI's platform," it is unlikely that IPXI would facilitate competitive harm.[34] But the DOJ also noted that if "IPXI staff do not consistently identify and exclude competing ULRs, competitive risks

[25] Id.

[26] Id.

[27] U.S. Dep't of Justice Antitrust Division, Letter from Joel I. Klein, Assistant Attorney General, U.S. Dep't of Justice, to Garrard R. Beeney, Sullivan & Cromwell, at 13 (Dec. 16, 1998) ("3C DVD Business Review Letter").

[28] 2007 IP Report at 80.

[29] IPXI Business Review Letter at 9.

[30] Id. at 10

[31] Id.

[32] Id.

[33] *Id.* at 11.

[34] *Id.*

would remain."[35]

In short, the DOJ recognized that the competitive impact of IPXI's proposal turned on how well IPXI staff vetted potentially competing patents. This certainly does not close the door on the development of a platform such as IPXI, but the DOJ's "guidance" does call for any such platform to strictly scrutinize its patent offerings to ensure the platform does not market competing patents.

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When it comes to antitrust guidance from the agencies, sometimes non-guidance gives guidance. The IPXI business review letter, though never stating the DOJ's enforcement intentions, is a must read for any firm dealing with joint licensing programs, patent pools, or common licensing agents.

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[35] *Id.*