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*Before The United States Department of Justice Antitrust Division and the
Federal Trade Commission Joint Hearings on
Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy*

As a recipient of one of the principal Business Review Letters from the Antitrust Division that addresses patent or intellectual property pools,¹ MPEG LA is pleased for the opportunity to bring our licensing experience over the last five years to this discussion.

MPEG LA

First, some information about our company²:

MPEG LA's business is to offer fair, reasonable, nondiscriminatory access under a single license to patents that are essential for the use of standards-based or other platform technologies. Absent a pool license, users of the technology at issue would have to negotiate individual licenses under many patents with many patent holders in order to use these technologies. But, as a convenience to users who would like to acquire patent rights from multiple parties in a single transaction, MPEG LA offers a one-stop license. The MPEG LA license, however, is nonexclusive and does not preclude any party from negotiating bilateral licenses under one or more patents with any patent holder under whatever terms the parties to the license can agree. MPEG LA is itself neither a patent owner nor (except for securing the legal rights necessary to offer the license to others) a Licensee.

¹ Business Review Letter from Hon. Joel I. Klein to Garrard R. Beeney (June 26, 1997), available at <http://www.usdoj.gov/atr/public/busreview/1170.htm>.

² MPEG LA is headquartered in Denver, CO and has offices in Chevy Chase, MD and London, England. See <http://www.mpegla.com>

In July 1997 following issuance of the Division's Business Review Letter, MPEG LA began licensing a worldwide portfolio of patents that are essential for the international digital video compression standard known as MPEG-2. For the convenience of MPEG-2 users, MPEG LA's objective is to provide fair, reasonable, nondiscriminatory, worldwide access to as much MPEG-2 essential intellectual property as possible under a single license known as the MPEG-2 Patent Portfolio License. Independent patent experts in various jurisdictions evaluate patents for their essentiality. Since the program's inception, 13 new patent owners and more than 300 essential patents have been added. The MPEG-2 Patent Portfolio License has grown from the original 8 patent owners and 100 essential patents (25 patent families) to include more than 425 essential patents (100 patent families) in 39 countries owned by 20 companies and a leading university. Yet despite this enormous increase in value, the royalty rates have never increased and in fact, recently declined in response to marketplace needs.

MPEG-2

MPEG-2 refers to a fundamental technology underlying the efficient transmission, storage and display of digitized moving images and sound tracks on which high definition television (HDTV), Digital Video Broadcasting (DVB), direct broadcast by satellite (DBS), digital cable television systems, multichannel multipoint distribution services (MMDS), personal computer video, digital versatile discs (DVD), interactive media and other forms of digital video delivery, storage, transport and display are based.

MPEG-2 is an open technology, giving users a wide interoperable range of cost and quality options within the computation that compresses data to produce a video stream meeting the MPEG-2 standard, and as an open technology, anyone may have access to it. The MPEG-2 standard does not set hardware requirements; it is flexible within a broad functional range, thereby assuring the interoperability of myriad MPEG-2 applications. For example, MPEG-2 applies to conventional and HDTV quality formats of both "progressive scan video" used in computer screens and "interlaced video" used in television sets. It is used in all video formats adopted by the Advanced Television Systems Committee (ATSC) for standard and high definition television for U.S. broadcasts and in the Digital Video Broadcasting (DVB) standard used in Europe, North and South America, Africa, Asia and Australia.

The Success of MPEG-2

Widespread adoption of MPEG-2 technology has enabled the interoperability and implementation of digital video across myriad applications throughout the world. Today MPEG-2 video technology is used in some 300 million decode, encode and transport product units - and by 2006 is expected to increase by more than six-fold. Included are cable, satellite and terrestrial digital set-top boxes; digital television sets; DVD players; video game systems; personal computers; digital video recorders, encoders and multiplexers. And that doesn't even count the billions of DVD discs being produced. All told, through 2006, the estimated value of MPEG-2 products in the world market is projected to exceed half a trillion dollars - and that doesn't even begin to measure the

materials that go into the products, the services that surround them or the content that comes out. This is a vigorous market. Thousands of companies employing countless people in the US and around the world make products using or relying on MPEG-2 technology. MPEG-2 has made video communication interoperable, global, competitive, innovative and efficient.

Wide acceptance of the MPEG-2 Patent Portfolio License is recognized as having played a large role in the worldwide utility of MPEG-2. MPEG LA's MPEG-2 licensees, now more than 400, make most of the MPEG-2 products in the current world market. Like the MPEG-2 Standard, the MPEG-2 Patent Portfolio License encourages technological improvement, competition and innovation in and outside of the Standard. Licensees are free to develop competing products within or outside of the standard and in fact in addition to the variety of products that use MPEG-2, the marketplace utilizes many different video compression standards.

Nondiscrimination

There has been much discussion today on the characteristics that make intellectual property pools pro-competitive: defined fields of use, essentiality of patents, determination of essentiality, terms that are fair and reasonable, nonexclusivity, licensees and licensors should be free to develop competing products and standards, nondiscrimination, and confidentiality of competitively sensitive information from competing Licensors, to name a few. Apart from the fact that these characteristics promote the pro-competitiveness of an intellectual property pool, most of them are determined and assured by the marketplace itself.

For example, if a license is not well defined, the customer won't know what it is buying and simply won't buy it. Similarly, if license requires a royalty for non-essential patents, the customer who doesn't need them won't pay for them. A license with patents that have not been evaluated by an independent patent expert will lack credibility and be difficult to sell. Marketplace acceptance is the best gauge of fair and reasonable; if the royalty is too high or the license terms are perceived as unbalanced, users will opt not to take the license and will invest their money elsewhere. Every license must be priced to sell. In the end, we are dealing with very sophisticated users who have many market choices.

I would like to use the remainder of my time today to share some brief thoughts on one of these characteristics - nondiscrimination. Many people write about nondiscrimination but it is rarely defined. Yet, it raises several important issues.

First, how broadly should nondiscrimination apply across licensees?

To meet the needs of the marketplace, nondiscrimination must apply to licensees who are similarly situated. This means there can be no discrimination among those selling the same products in the same place in the distribution chain. It also means that parties that compete directly with each other should be treated on a nondiscriminatory basis.

Products with like functionality and application entering similar markets should be treated the same, and the royalty rates should be applied neutrally so the products themselves can compete on a level playing field.

Second, to what extent does nondiscrimination apply to both licensor and licensee?

We agree that licensors who are licensees should be treated the same as any other similarly situated licensee (whether or not a licensor). This means that they sign the same license agreement, are subject to the same terms and pay the same royalty rates as others. Some have questioned the practice in programs administered by others whereby licensors are licensed under terms different from those set forth in the portfolio license. MPEG LA does not engage in such practice in any of the license programs we administer, but our reasons for refraining from it are practical having to do with marketing and the perception of fairness rather than legality.

In MPEG LA's licensing programs, licensees pay the same royalties to MPEG LA whether or not they are patent owners. Licensees, of course, have the right separately to negotiate a license with any or all of the licensors under any and all of the patents under terms and conditions to be independently negotiated, but MPEG LA has nothing to do with such negotiations. If a licensee independently negotiates a license directly with a patent owner, that is a matter to be worked out directly between them. MPEG LA does not become involved in such negotiations, and any adjustments the parties may wish to make as a result of their bilateral license is a matter between them, not MPEG LA. We have maintained this policy not because we believe it is or should be legally mandated but because we have found that it is important to licensees to know that they will be treated the same and pay the same royalties as any other similarly situated licensee (whether or not a patent holder). If the licensing administrator is hesitant to provide that assurance, users are reluctant to sign. Licensees do not begrudge patent holders their right to collect royalties for their patents as long as that revenue stream is separate from the royalties they pay so that its fairness is apparent.

Those who argue that "special deals" for licensors raise legal or competitive issues, however, ignore the R&D costs borne by the patent holder, the patent holder's expectation of a reasonable return on its patents and the right to recoup it in whatever equitable and equivalent fashion they please. If a patent holder is paying less royalties than some party who did not incur the substantial R&D cost necessary to become a patent holder, is that truly discrimination? Even though it's not something we do, I think not.

Third, what does nondiscrimination mean?

We know that such matters as royalty rate, scope of license, grant-back, duration and MFN which directly affect the ability of competitors to compete with each other must be included. But, nondiscrimination is a delicate balance and taking one factor out of the equation may upset the entire equation. Take price, for example. Some advocate that there should be a right to a division of the package license for those who want it – in effect, that they should be able to take a license to some patents and not others and that it

is unfair to charge them for patents they claim not to need. But, what those who advocate for this are really saying is that they want a discounted royalty rate for the patents they want as a proportion of the package license.

MPEG LA offers only one license to everyone. Since each patent is essential, the royalty rate and thus the value is the same whether a licensee uses one or more patents. The license, in effect, conveys the intellectual property rights necessary to enter the field. If MPEG LA were required to follow the path of those who advocate a right to division, however, we would in effect be offering a customized license to everyone. And, wholly apart from the administrative impossibilities, the principle of nondiscrimination would become meaningless. For example, when does a division become discriminatory? Can a licensee choose patents in one country and not others? The MPEG-2 License has patents in 39 countries. How about choosing a shorter term? A longer term? Some parts of the standard but not others? Where does one draw the line? Eventually (and I might add, very quickly), the right of division would defeat the purpose for which the license is created, and the benefit of lowest unit rate transaction costs afforded by standards-based licensing would be lost to the marketplace. The substantial savings of transaction costs would be lost, and a pool licensing administrator would no longer be a facilitator of a pool license but merely a conduit for individual license negotiations.

If those who seek a division really want to take a license under some patents and not others, the marketplace has a way to deal with this better than a package license ever could - licensees can achieve the same result through individual license negotiations with patent owners. MPEG LA does not become involved in these bilateral relationships and does not net out royalties one against the other, but with the written authorization of both licensor and licensee, MPEG LA will provide assistance in the form of information concerning how much of the licensee's royalties to MPEG LA were paid on account of the particular licensor's patents, thereby enabling the licensor and licensee to make these adjustments for themselves if they choose to do so.

Some say that that the alternative to a pool license of bilateral licensing relationships is not real, only theoretical; and some say that the increased efficiency resulting from the increasing quantity of patents under one license means that they should have an increasing ability to divide them up. But, what they are really saying is not that negotiating individual licenses is more theoretical (in fact, pool licenses co-exist quite nicely with bilateral licenses enabling companies large and small to have nondiscriminatory access to essential patent rights), but that the pool license has become so attractive that it is an alternative that they cannot refuse. That is not the fault of the pool license; it is its pro-competitive goal. While certain licensees may prefer endless permutations of the pool license – a contradiction in terms in my view – principles of non-discrimination, reducing transaction costs, and encouraging the formation of patent pools to ease blocking positions, among other things, require that licensees should choose between standard pool licenses and customized individual licenses. With this choice available, no legal principle should require the offering of a patent pool in endless permutations. Besides, a regulated result should not be substituted for the independent judgment of the parties to individual negotiations, especially where the marketplace is not

only doing the job but doing it well. For example, in many cases, a bilateral license may be used to deal with multiple intersection points between two companies' intellectual property where the companies' needs extend beyond a particular set of essential patents for a given standard, and no one is in a better position to make those judgments than the parties themselves.