DEPARTMENT OF JUSTICE
Antitrust Division

JOEL I. KLEIN
Acting Assistant Attorney General

Main Justice Building
950 Pennsylvania Avenue. N.W.
Washington. D.C. 20530-0001
(202) 514-2401 / (202) 616-2645 (f)
antitrust@justice.usdoj.gov (internet)
http://www.usdoj.gov (World Wide Web)

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VIA FAX

Gerrard R. Beeney, Esq.
Sullivan & Cromwell
125 Broad Street
New York, NY 10004-2498

Dear Mr. Beeney:

This is in response to your request on behalf of the Trustees of Columbia University, Fujitsu Limited, General Instrument Corp., Lucent Technologies Inc., Matsushita Electric Industrial Co., Ltd., Mitsubishi Electric Corp., Philips Electronics N.V., Scientific-Atlanta, Inc., and Sony Corp. (collectively the "Licensors"), Cable Television Laboratories, Inc. ("CableLabs"), MPEG LA, L.L.C. ("MPEG LA"), and their affiliates for the issuance of a business review letter pursuant to the Department of Justice's Business Review Procedure, 28 C.F.R. § 50.6. You have requested a statement of the Department of Justice's antitrust enforcement intentions with respect to a proposed arrangement pursuant to which MPEG LA will offer a package license under the Licensors' patents that are essential to compliance with the MPEG-2 compression technology standard, and distribute royalty income among the Licensors.

I. The Proposed Arrangement

A. The MPEG-2 Standard

The MPEG-2 standard has been approved as an international standard by the Motion Picture Experts Group of the International Organization for Standards (ISO) and the International Electrotechnical Commission (IEC) and by the International Telecommunication Union Telecommunication Standardization Sector

("ITU-T"). It contains nine operative parts. Only Parts 1 (ISO/IEC 13818-1) and 2 (ISO/IEC 13818-2), which deal with systems and video, are relevant to the proposed activity.

Part 1, concerning systems, describes: (a) a syntax and semantics for combining separate video and audio bitstreams into a single bitstream, either a "program" stream for storage on a medium such as a digital video disk, or a "transport" stream, for transmission of multiple programs; and (b) a demultiplexer for breaking the bitstream down into its constituent video and audio bitstreams.

Part 2 describes (a) a common syntax and semantics of a bitstream containing compressed video, and (b) a decoder for decompressing the bitstream. MPEG-2 video compression allows considerable savings in the amount of data, and thus storage and transmission space, required to reproduce video sequences, by eliminating redundant information both within a particular image, as where a background is of all the same color, and between images, as where particular figures remain unmoved from one moment to the next.[1]

The video and systems parts of the MPEG-2 standard will be applied in many different products and services in which video information is stored and/or transmitted, including cable, satellite and broadcast television, digital video disks, and telecommunications. However, compliance with the standards will infringe on numerous patents owned by many different entities. Consequently, a number of firms that participated in the development of the standard formed the MPEG-2 Intellectual Property Working Group ("IP Working Group") to address intellectual property issues raised by the proposed standard. Among other things, the IP Working Group sponsored a search for the patents that covered the technology essential to compliance with the proposed standard and explored the creation of a mechanism to convey those essential intellectual property rights to MPEG-2 users.[2] That exploration led ultimately to an agreement among the Licensors, CableLabs and Baryn S. Futa

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[1]Notably, neither Part 1 nor Part 2 dictates a particular method for encoding video or programs into the specified syntax and semantics. Users of the standard are thus free to develop and use the encoding method they find most advantageous, while preserving the compatibility necessary to the integrity of the standard.

[2]The patent search and the use of an independent expert to conduct the search are discussed in greater detail below.

establishing MPEG LA as a Delaware Limited Liability Company.[3]

Each of the Licensors owns at least one patent that the IP Working Group's patent search identified as essential to compliance with the video and/or systems parts of the MPEG-2 standard (hereinafter "MPEG-2 Essential Patent" or "Essential Patent").[4] Among them, they account for a total of 27 Essential Patents, which are most, but not all, of the Essential Patents. Pursuant to a series of four proposed agreements, the Licensors will combine their Essential Patents into a single portfolio (the "Portfolio") in the hands of a common licensing administrator that would grant licenses under the Portfolio on a nondiscriminatory basis, collect royalties, and distribute them among the Licensors pursuant to a pro-rata allocation based on each Licensor's proportionate share of the total number of Portfolio patents in the countries in which a particular royalty-bearing product is made and sold.[5]

This arrangement is embodied in a network of four proposed agreements: (1) an Agreement Among Licensors, in which the Licensors commit to license their MPEG-2 Essential Patents jointly through a common License Administrator and agree on basic items including the Portfolio license's authorized fields of use, the amount and allocation of royalties, and procedures for adding patents to, and deleting them from, the Portfolio; (2) a Licensing Administrator Agreement between the Licensors and MPEG LA, pursuant to which MPEG LA assumes the tasks of licensing the Portfolio to MPEG-2 users and collecting and distributing royalty income; (3) a license from each Licensor to MPEG LA for the purpose of granting the Portfolio License; and (4) the Portfolio license itself.

B. MPEG LA

Pursuant to the Licensing Administrator Agreement, MPEG LA will: (1) grant a worldwide, nonexclusive sublicense under the

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[3]Amended and Restated Limited Liability Company Agreement of MPEG LA, L.L.C. ("LLC Agreement"). Previously CableLabs' executive vice president and chief operating officer, Baryn Futa is now Manager of MPEG LA.

[4]Each of the draft agreements submitted with your letter defines "MPEG-2 Essential Patent" as "any Patent claiming an apparatus and/or a method necessary for compliance with the MPEG-2 Standard [defined generally as the MPEG-2 video and systems standards] under the laws of the country which issued or published the Patent." E.g., MPEG-2 Patent Portfolio License ("Portfolio License"), § 1.18.

[5]Id., § 5.1.

Portfolio to make, use and sell MPEG-2 products "to each and every potential Licensee who requests an MPEG-2 Patent Portfolio License and shall not discriminate among potential licensees";[6] (2) solicit Portfolio licensees;[7] (3) enforce and terminate Portfolio license agreements;[8] and (4) collect and distribute royalties.[9] For this purpose, each MPEG-2 Licensor will grant MPEG LA a nonexclusive license under its Essential Patents,[10] while retaining the right to license them independently for any purpose, including for making MPEG-2-compliant products.[11]

The Licensing Administrator Agreement places the day-to-day conduct of MPEG LA's business, including its licensing activities, under the sole control of Futa and his staff. The other owners retain some control, however, over "major decisions," including approval of budgets and annual financial statements, extraordinary expenditures, entry into new businesses, mergers and acquisitions, and the sale or dissolution of the corporation.[12]

C. The MPEG-2 Portfolio

As noted above, the Portfolio initially will consist of 27 patents, which constitute most, but not all, Essential Patents. These 27 patents were identified in a search carried out by an independent patent expert under the sponsorship of the IP Working Group. Once the MPEG-2 standard was largely in place, the IP Working Group issued a public call for the submission of patents that might be infringed by compliance with the MPEG-2 standard. CableLabs, whose COO Futa was an active participant in the IP Working Group, retained an independent patent expert familiar with the standard and the relevant technology to review the submissions. In all, the expert and his assistant reviewed approximately 8000 United States patent abstracts and studied

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[6]Licensing Administrator Agreement, § 3.2.

[7]Id., § 3.1.

[8]Id., § 3.14. The Licensors, however, may veto a planned enforcement action or termination, by a vote of 2/3 of the licensors. Id.

[9]Agreement Among Licensors, § 2.1.

[10]License from Licensor to Licensing Administrator, §§ 2.1-2.5, 2.8. Three of the Licensors, Columbia University, Fujitsu, and Mitsubishi, each own only one Essential Patent.

[11]Agreement Among Licensors, § 2.8.

[12]LLC Agreement, § 7.03.

about 800 patents belonging to over 100 different patentees or assignees. No submission was refused, and no entity or person that was identified as having an essential patent was in any way excluded from the effort in forming the proposed joint licensing program.

The proposed agreement among the Licensors creates a continuing role for an independent expert as an arbiter of essentiality. It requires the retention of an independent expert to review patents submitted to any of the Licensors for inclusion in the Portfolio[13] and to review any Portfolio patent which an MPEG-2 Licensor has concluded is not essential or as to which anyone has claimed a good-faith belief of non-essentiality.[14] In both cases, the Licensors are bound by the expert's opinion.[15]

The Portfolio's composition may also change for other reasons. A patent will be deleted promptly from the Portfolio upon a final adjudication of invalidity or unenforceability by a tribunal of competent jurisdiction in the country of its issuance.[16] The expiration of a Licensor's last-to-expire Portfolio patent, or a final adjudication of invalidity or unenforceability of its last remaining Portfolio patent, terminates the Licensor's participation in the Portfolio and the Agreement Among Licensors.[17] Each MPEG-2 Licensor may terminate its participation in the Portfolio license on 30 days' notice; however, all existing Portfolio licenses will remain intact.[18]

D. The Portfolio License

The planned license from MPEG LA to users of the MPEG-2 standards is a worldwide, nonexclusive, nonsublicensable license under the Portfolio patents for the manufacture, sale, and in most cases, use of: (1) products and software designed to encode

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[13]Agreement Among Licensors, § 6.1.

[14]Agreement Among Licensors, § 2.4.2.

[15]However, they need not consult the expert if they agree unanimously in good faith that a submitted patent is an Essential Patent, id., § 2.4.1, or that a Portfolio patent is not essential, id., § 6.1.1.

[16]Id., § 2.5. Although the Licensing Administrator Agreement does not explicitly direct MPEG LA to do so, we understand that Essential Patents will be deleted from the Portfolio as they expire.

[17]Id., § 7.1.

[18]Id., § 2.3.

and/or decode video information in accordance with the MPEG-2 standard; (2) products and software designed to generate MPEG-2 program and transport bitstreams; and (3) so-called "intermediate products," such as integrated circuit chips, used in the aforementioned products and software.[19] The license grant to use encoding-related products and software for recording video information on a "packaged medium," e.g., encoding a motion picture for copying on digital video disks, is separate from the other grants for the same products and software.[20]

The Portfolio license expires January 1, 2000, but is renewable at the licensee's option for a period of not less than five years, subject to "reasonable amendment of its terms and conditions."[21] That "reasonable amendment" may not, however, increase royalties by more than 25%.[22] Each Portfolio licensee may terminate its license on 30 days' written notice. The per-unit royalties are those agreed upon in the Agreement Among Licensors, but they are subject to reduction pursuant to a "most-favored-nation" clause.[23] The royalty obligations are predicated on actual use of one or more of the licensed patents in the unit for which the royalty is assessed.[24] The Portfolio license imposes no obligation on the licensee to use only the licensed patents and explicitly leaves the licensee free independently to develop "competitive video products or video services which do

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[19] Patent Portfolio License, §§ 2.1-2.5. The intermediate product license grant as to intermediate products limits the right to use such products to internal development and testing purposes. Id., § 2.1.

[20] Id., § 2.4. Whereas most of the royalties are set at $4.00 per licensed product, the royalty for use of encoding products for packaged-medium recordings is measured by the production of packaged media. For packaged media recordings directed to "personal, family or household" use, the royalty is $.04 per packaged medium times the number of "MPEG-2 Video Events" recorded on it. Id., § 3.1.6.1. For MPEG-2 Packaged Media directed to commercial channels such as rental and broadcast, the royalty is $.40 per packaged medium times the number of "MPEG-2 Video events" thereon. Id., § 3.1.6.2.

[21] Id., § 6.1.

[22] Id.

[23] Id., § 7.7.

[24] Id., §§ 2.1-2.5.

not comply with the MPEG-2 Standard."[25]

The Portfolio license will list the Portfolio patents in an attachment.[26] It also explicitly addresses the licensee's ability, and possible need, to obtain Essential Patent rights elsewhere. The Portfolio license states that each Portfolio patent is also available for licensing independently from the MPEG-2 Licensor that had licensed it to MPEG LA[27] and that the license may not convey rights to all Essential Patents.[28]

The license's grantback provision requires the licensee to grant any of the Licensors and other Portfolio licensees a nonexclusive worldwide license or sublicense, on fair and reasonable terms and conditions, on any Essential Patent that it has the right to license or sublicense.[29] The Licensors' per-patent share of royalties is the basis for determining a fair and reasonable royalty for the grantback.[30] Alternatively, a licensee that controls an Essential Patent may choose to become an MPEG-2 licensor and add its patent to the Portfolio.[31] Failure to honor the grantback requirement constitutes a material breach of the license, giving MPEG LA the right to terminate the license unless the licensee has cured the breach within 60 days after MPEG LA sends it notice of the breach.[32]

A separate provision allows for partial termination of a licensee's Portfolio license as to a particular MPEG-2 Licensor's patents. Pursuant to Section 6.3, an MPEG-2 Licensor may direct MPEG LA to withdraw its patents from the Portfolio license if the licensee has (a) brought a lawsuit or other proceeding against the MPEG-2 Licensor for infringement of an Essential Patent or an MPEG-2 Related Patent ("Related Patent") and (b) refused to grant the MPEG-2 Licensor a license under the Essential Patent or MPEG-

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[25] Id., § 7.8. We understand this to mean that licensees are free also to develop technological alternatives to the MPEG-2 compression standard.

[26] Id., § 1.21.

[27] Id., § 4.3.

[28] Id.

[29] Id., § 7.3.

[30] Id.

[31] Id., § 7.4.

[32] Id., § 6.2.

2 Related Patent on fair and reasonable terms and conditions.[33] As with the grantback, the per-patent share of Portfolio license royalties is the basis for determining a fair and reasonable royalty for the licensee's patent.[34] Upon the withdrawal of the MPEG-2 Licensor's patents from the licensee's Portfolio license, the licensee may seek a license on the withdrawn patents directly from the MPEG-2 Licensor, which remains subject to its undertaking to the ISO and/or the ITU-T to license on fair and reasonable terms and conditions.[35]

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[33] Id., § 6.3. The Portfolio license, like several of the relevant documents, defines "MPEG-2 Related Patent" as "any Patent which is not an MPEG-2 Essential Patent but which has one or more claims directed to an apparatus or a method that may be used in the implementation of a product or a service designed in whole or in part to exploit the MPEG-2 Standard under the laws of the country which issued or published the Patent." Id., § 1.23. Read literally, this definition could encompass any patent capable of being employed in a product or service that exploits the MPEG-2 standard. At the extreme, it would take in any patent relevant not only to MPEG-2 applications but also to unrelated products, as well as patents on products or services that someone might build into an MPEG-2 Royalty Product -- for example, a patented informational display on a DVD player.

You have informed the Department, however, that such a broad, literal interpretation was not the intent of the drafters of the Patent Portfolio License and that your clients would construe the term "MPEG-2 Related Patents" to encompass only patents which, as applied, constitute implementations of the MPEG-2 standard. Further, you have told the Department that it is exceedingly unlikely that any Related Patent would have any utility for any application other than MPEG-2.

[34] Id.

[35] Similarly, Sections 2.9 and 2.10 of the Agreement Among Licensors authorize each Licensor to instruct MPEG LA to withhold its Portfolio patents from any potential licensee that either: (1) has sued the Licensor for infringement of an Essential Patent or a Related Patent, and the Licensor has decided to counter with a claim of infringement of its Portfolio patents; or (2) has been sued by the Licensor for infringement of the Portfolio patents. We understand these provisions to apply only to ongoing litigation and not to authorize the vindictive withholding of Portfolio patents after the infringement suit has been resolved.

II. Analysis

A. The Patent Pool in General

An aggregation of patent rights for the purpose of joint package licensing, commonly called a patent pool, "may provide competitive benefits by integrating complementary technologies, reducing transaction costs, clearing blocking positions, and avoiding costly infringement litigation."[36] By promoting the dissemination of technology, patent pools can be procompetitive.[37] Nevertheless, some patent pools can restrict competition, whether among intellectual property rights within the pool or downstream products incorporating the pooled patents or in innovation among parties to the pool.[38]

A starting point for an antitrust analysis of any patent pool is an inquiry into the validity of the patents and their relationship to each other. A licensing scheme premised on invalid or expired intellectual property rights will not withstand antitrust scrutiny.[39] And a patent pool that aggregates competitive technologies and sets a single price for them would raise serious competitive concerns. On the other hand, a combination of complementary intellectual property rights, especially ones that block the application for which they are jointly licensed, can be an efficient and procompetitive method of disseminating those rights to would-be users.

Based on your representations to us about the complementary nature of the patents to be included in the Portfolio, it appears that the Portfolio is a procompetitive aggregation of intellectual property. The Portfolio combines patents that an independent expert has determined to be essential to compliance with the MPEG-2 standard; there is no technical alternative to any of the Portfolio patents within the standard. Moreover, each Portfolio patent is useful for MPEG-2 products only in

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[36]Department of Justice-Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual Property ("IP Guidelines"), § 5.5.

[37]*Id*.

[38]*Id*.

[39]*See*, *e.g.*, United States v. Pilkington plc, 1994-2 Trade Cas. (CCH) ¶ 70,842 (D. Ariz. 1994)(consent decree resolving antitrust suit against exclusive licenses premised on technology covered by expired patents).

conjunction with the others.[40] The limitation of the Portfolio to technically essential patents, as opposed to merely advantageous ones, helps ensure that the Portfolio patents are not competitive with each other and that the Portfolio license does not, by bundling in non-essential patents, foreclose the competitive implementation options that the MPEG-2 standard has expressly left open.

The continuing role of an independent expert to assess essentiality is an especially effective guarantor that the Portfolio patents are complements, not substitutes. The relevant provisions of the Agreement Among Licensors appear well designed to ensure that the expert will be called in whenever a legitimate question is raised about whether or not a particular patent belongs in the Portfolio; in particular, they seem designed to reduce the likelihood that the Licensors might act concertedly to keep invalid or non-essential patents in the Portfolio or to exclude other essential patents from admission to the Portfolio.

B. Specific Terms of the Agreements

Despite the potential procompetitive effects of the Portfolio license, we would be concerned if any specific terms of any of the contemplated agreements seemed likely to restrain competition. Such possible concerns might include the likelihood that the Licensors could use the Portfolio license as a vehicle to disadvantage competitors in downstream product markets; to collude on prices outside the scope of the Portfolio license, such as downstream MPEG-2 products; or to impair technology or innovation competition, either within the MPEG-2 standard or from rival compression technologies. It appears, however, that the proposed arrangement will not raise any significant competitive concerns.

1. Effect on Rivals

There does not appear to be any potential for use of the Portfolio license to disadvantage particular licensees. The Agreement Among Licensors commits the Licensors to nondiscriminatory Portfolio licensing, and the Licensing Administrator agreement both vests sole licensing authority in MPEG LA and explicitly requires MPEG LA to offer the Portfolio license on the same terms and conditions to all would-be licensees. Thus, maverick competitors and upstart industries

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[40]The Department presumes from the information you have provided us that the Portfolio patents are valid. Should this prove not to be so, the Department's analysis and enforcement intentions would likely be very different. As noted above, the Agreement Among Licensors provides for the deletion from the Portfolio of licenses held invalid or unenforceable.

will have access to the Portfolio on the same terms as all other licensees. The Portfolio license's "most-favored-nation" clause ensures further against any attempt to discriminate on royalty rates.[41]

Although it offers the Portfolio patents only as a package, the Portfolio license does not appear to be an illegal tying agreement. The conditioning of a license for one intellectual property right on the license of a second such right could be a concern where its effect was to foreclose competition from technological alternatives to the second. In this instance, however, the essentiality of the patents -- determined by the independent expert -- means that there is no technological alternative to any of them and that the Portfolio license will not require licensees to accept or use any patent that is merely one way of implementing the MPEG-2 standard, to the detriment of competition. Moreover, although a licensee cannot obtain fewer than all the Portfolio patents from MPEG LA, the Portfolio license informs potential licensees that licenses on all the Portfolio patents are available individually from their owners or assignees. While the independent expert mechanism should ensure that the Portfolio will never contain any unnecessary patents, the independent availability of each Portfolio patent is a valuable failsafe. The list of Portfolio patents attached to the Portfolio license will provide licensees with information they need to assess the merits of the Portfolio license.

2. Facilitation of Collusion

From what you have told us, there does not appear to be anything in the proposed agreements that is likely to facilitate collusion among Licensors or licensees in any market. Although MPEG LA is authorized to audit licensees,[42] confidentiality provisions prohibit it from transmitting competitively sensitive information among the Licensors or other licensees.[43] Further, since the contemplated royalty rates are likely to constitute a tiny fraction of MPEG-2 products' prices, at least in the near term, it appears highly unlikely that the royalty rate could be used during that period as a device to coordinate the prices of downstream products.

3. Effect on Innovation

It further appears that nothing in the arrangement imposes

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[41]Portfolio License, § 7.7.

[42]Licensing Administrator Agreement, § 3.15; Portfolio License, § 3.9.2.

[43]Portfolio license, § 5.1.

any anticompetitive restraint, either explicitly or implicitly, on the development of rival products and technologies. Nothing in the Agreement Among Licensors discourages, either through outright prohibition or economic incentives, any Licensor from developing or supporting a rival standard. As noted above, the Portfolio license explicitly leaves licensees free independently to make products that do not comply with the MPEG-2 standard and premises royalty obligations on actual use of at least one Portfolio patent.[44] Since the Portfolio includes only Essential Patents, the licensee's manufacture, use or sale of MPEG-2 products will necessarily infringe the Portfolio patents. By weeding out non-essential patents from the Portfolio, the independent-expert mechanism helps ensure that the licensees will not have to pay royalties for making MPEG-2 products that do not employ the licensed patents.

The license's initial duration, to January 1, 2000, does not present any competitive concern. While the open-ended renewal term of "no less than five years" holds open the possibility of a perpetual license, its competitive impact will depend substantially on whether any of the "reasonable amendments" made at that time increase the license's exclusionary impact. While the term "reasonable" is the Portfolio license's only limitation on the Licensors' ability to impose onerous non-royalty terms on licensees at renewal time, the 25% cap on royalty increases and the "most-favored-nation" clause appear to constrain the Licensors' ability to use royalties to exploit any locked-in installed base among its licensees.

Nor does the Portfolio license's grantback clause appear anticompetitive. Its scope, like that of the license itself, is limited to Essential Patents. It does not extend to mere implementations of the standard or even to improvements on the essential patents.[45] Rather, the grantback simply obliges licensees that control an Essential Patent to make it available to all, on a nonexclusive basis, at a fair and reasonable royalty, just like the Portfolio patents. This will mean that any firm that wishes to take advantage of the cost savings afforded by the Portfolio license cannot hold its own essential

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[44] Cf. United States v. Microsoft Corp., 1995-2 Trade Cas. (CCH) ¶ 71,096 (D.D.C. 1995)(consent decree resolving suit against, among other things, use of per-processor royalty for license of dominant operating system).

[45] Consequently, much of the section on grantbacks in the IP Guidelines is not directly applicable to this provision. The ultimate question, though, is the same: whether, by reducing licensees' incentives to innovate, the grantback causes competitive harm that outweighs its procompetitive effects. See IP Guidelines, § 5.6.

patents back from other would-be manufacturers of MPEG-2 products. While easing, though not altogether clearing up, the holdout problem,[46] the grantback should not create any disincentive among licensees to innovate. Since the grantback extends only to MPEG-2 Essential Patents, it is unlikely that there is any significant innovation left to be done that the grantback could discourage.[47] The grantback provision is likely simply to bring other Essential Patents into the Portfolio, thereby limiting holdouts' ability to exact a supracompetitive toll from Portfolio licensees and further lowering licensees' costs in assembling the patent rights essential to their compliance with the MPEG-2 standard.

In different circumstances, the right of partial termination set forth in Section 6.3 of the Portfolio license could raise difficult competition issues. That section provides that, on instruction from any Licensor, MPEG LA, pursuant to its obligations under the Licensing Administrator Agreement, shall withdraw from a particular licensee's portfolio license that Licensor's patent or patents if the licensee has sued the Licensor for infringement of an Essential Patent or a Related Patent and refused to grant a license on the allegedly infringed patent on "fair and reasonable terms."

Of course, a licensee's refusal to license an Essential Patent on fair and reasonable terms, as required by Section 7.3 of the Portfolio License, is grounds for termination of the Portfolio license altogether. Even though MPEG LA may choose not to exercise its right to terminate, a Licensor that has been denied a license may invoke the less drastic partial termination provision, which is mandatory on MPEG LA. Partial termination would force the licensee to negotiate with the Licensor as if the pool had never existed. Thus, while the partial termination right leaves the licensee no worse off than it was in the absence of the pool, it enforces the Essential Patent grantback, which, as discussed above, appears procompetitive.

The right of partial termination could have a very different impact on a Portfolio licensee that owns a Related Patent. No matter how attractive the licensee's patented implementation of the MPEG-2 standard may be, by definition the Related Patent will

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[46]Any non-manufacturing owner of an Essential Patent, in contrast, can still be a holdout, having no need for the Portfolio license.

[47]Improvements on MPEG-2 Essential Patents and technological alternatives to the Essential Patents would not be Essential Patents themselves and would not be subject to the grantback. Therefore, the grantback should not discourage their development.

not be essential to compliance with the standard. And, not being essential, the patent is not subject to the Section 7.3 grantback. If the Portfolio licensee that owns a Related Patent chooses not to license others to use its technology, those others may still have alternatives to choose from. But if a Licensor chooses to infringe the Portfolio licensee's Related Patent after having been denied a license, the Portfolio licensee's decision to sue for infringement could cause it to become unable, at least temporarily, to comply with the MPEG-2 standard.[48]

The MPEG-2 Licensor is not entirely unconstrained: Importantly, as you have pointed out, its undertakings to the ISO and/or the ITU-T obligate it to license on fair and reasonable terms. However, it is not clear that this general commitment alone deprives the Licensor of the ability to impair competition. The partial termination right may enable Licensors to obtain licenses on Related Patents at royalty levels below what they would have been in a competitive market. Consequently, the partial termination right may dampen licensees' incentives to invest in research and development of MPEG-2 implementations, undercutting somewhat the benefits of the openness of the MPEG-2 standard and the prospects for improvements on the Essential Patents.

This impact on the incentive to innovate within the MPEG-2 standard would be of particular concern were the partial termination right designed to benefit all portfolio licensees. In that event, the partial termination right would function much like a compulsory grantback into the Portfolio. Licensees that owned Related Patents would not be able to choose among and negotiate freely with potential users of their inventions. The licensees' potential return from their R&D investments could be curtailed drastically, and the corresponding impact on their incentive to innovate could be significant.

Here, however, the partial termination right, unlike the grantback, protects only the Licensors. Other portfolio licensees have no right under the pool license to practice fellow licensees' inventions. And the Licensors are likely to be restrained in exercising their partial termination rights because the development of Related Patents will enhance MPEG-2 and, thus,

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[48]Since, as noted in note 33 above, it is exceedingly unlikely that a Related Patent would ever have any utility outside the MPEG-2 standard, it is correspondingly unlikely that an owner of a Related Patent would ever have cause to sue an MPEG-2 Licensor for infringement of that patent in connection with the manufacture, use or sale of anything other than MPEG-2-related products or services. If Section 6.3 were used in response to such an infringement action, we could have serious concerns.

the value of the Portfolio. The long-term interest of the Licensors is generally to encourage innovation in Related Patents, not to stifle it.

Moreover, the partial termination right may have procompetitive effects to the extent that it functions as a nonexclusive grantback requirement on licensees' Related Patents. It could allow Licensors and licensees to share the risk and rewards of supporting and improving the MPEG-2 standard by enabling Licensors to capture some of the value they have added to licensees' Related Patents by creating and licensing the Portfolio.[49] In effect, the partial termination right may enable Licensors to realize greater returns on the Portfolio license from the licensees that enjoy greater benefits from the license, while maintaining the Portfolio royalty at a level low enough to attract licensees that may value it less. This in turn could lead to more efficient exploitation of the Portfolio technology.

Therefore, in light of both its potentially significant procompetitive effects and the limited potential harm it poses to Portfolio licensees' incentives to innovate, the partial-termination clause appears on balance unlikely to be anticompetitive.

III. Conclusion

Like many joint licensing arrangements, the agreements you have described for the licensing of MPEG-2 Essential Patents are likely to provide significant cost savings to Licensors and licensees alike, substantially reducing the time and expense that would otherwise be required to disseminate the rights to each MPEG-2 Essential Patent to each would-be licensee. Moreover, the proposed agreements that will govern the licensing arrangement have features designed to enhance the usual procompetitive effects and mitigate potential anticompetitive dangers. The limitation of the Portfolio to technically essential patents and the use of an independent expert to be the arbiter of that limitation reduces the risk that the patent pool will be used to eliminate rivalry between potentially competing technologies. Potential licensees will be aided by the provision of a clear list of the Portfolio patents, the availability of the Portfolio patents independent of the Portfolio, and the warning that the Portfolio may not contain all Essential Patents. The conditioning of licensee royalty liability on actual use of the Portfolio patents, the clearly stated freedom of licensees to develop and use alternative technologies, and the imposition of obligations on licensees' own patent rights that do not vitiate licensees' incentives to innovate, all serve to protect competition in the development and use of both improvements on,

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[49] See IP Guidelines, § 5.6.

and alternatives to, MPEG-2 technology.

For these reasons, the Department is not presently inclined to initiate antitrust enforcement action against the conduct you have described. This letter, however, expresses the Department's current enforcement intention. In accordance with our normal practices, the Department reserves the right to bring an enforcement action in the future if the actual operation of the proposed conduct proves to be anticompetitive in purpose or effect.

This statement is made in accordance with the Department's Business Review Procedure, 28 C.F.R. § 50.6. Pursuant to its terms, your business review request and this letter will be made publicly available immediately, and any supporting data will be made publicly available within 30 days of the date of this letter, unless you request that part of the material be withheld in accordance with Paragraph 10(c) of the Business Review Procedure.

Sincerely,

Joel I. Klein

Joel I. Klein

JIK/cjk