

Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)	
Digital Broadcast Copy Protection)	MB Docket No. 02-230
)	
Implementation of Section 304 of the)	
Telecommunications Act of 1996)	CS Docket No. 97-80
)	
Commercial Availability of Navigation Devices)	
And Compatibility Between Cable System)	PP Docket no. 00-67
Consumer Electronics equipment)	

REPLY COMMENTS
OF THE AMERICAN ANTITRUST INSTITUTE
TO FURTHER NOTICE OF PROPOSED RULEMAKING IN DOCKET NO. MB 02-230 AND
SECOND FURTHER NOTICE OF PROPOSED RULEMAKING IN DOCKET NOS. CS 97-80
AND PP 00-67 (CONSOLIDATED FILING)

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I. Introduction and Statement of AAI’s Interest.

In its *Comments* to the *Further Notice of Proposed Rulemaking*¹ and the *Second Further Notice of Proposed Rulemaking*² in these proceedings, the American Antitrust Institute (“AAI”) described its interest as ensuring “that the Commission enhances consumer welfare to the greatest extent possible by minimizing competitive distortions in and among the consumer electronics (“CE”), information technology (“IT”), media, and related technology industries,” and urged the Commission “to undertake a

¹*Comments of the American Antitrust Institute*, (filed Feb. 13, 2004), to *Further Notice of Proposed Rulemaking, Digital Broadcast Content Protection*, MB Docket 02-230 (rel. Nov. 4, 2003)(hereinafter, “*Broadcast Flag RO&FNPRM*”). By Order (rel. Dec. 23, 2003) in this proceeding, the Commission extended the deadline for filing Reply Comments until March 15, 2004.

²*Comments of the American Antitrust Institute*, (Filed Feb. 13, 2004), to *Second Further Notice of Proposed Rulemaking, Implementation of Section 304 of the Telecommunications Act of 1996* (rel. Oct. 9, 2003)(hereinafter, “*Plug-and-Play 2dRO&2dFNPRM*”), *Commercial Availability of Navigation Devices and Compatibility Between Cable Systems and Consumer Electronics Equipment*, CS Docket No. 97-80 and PP Docket No. 00-67.

full analysis of the competitive effects of each of the numerous policy choices confronting it.”³ The purpose of these Reply Comments is to a) Summarize and elaborate upon the competition issues raised by the AAI in its initial *Comments* and briefly note the positions taken on these issues by some other commentators; b) Address the Commission’s authority to implement regulations intended, at least in part, to vindicate the values of a free market and fair competition; c) Review the pre-existing competitive conditions in the markets affected by the proposed Broadcast Flag and Plug-and-Play regulations as they relate to technology and other licensing in light of the *IP Guidelines*;⁴ d) Comment on the appropriate competitive standards to be applied in balancing intellectual property (“IP”) rights with sound antitrust and competition policy; and, d) Reiterate AAI’s recommendations for pro-competitive policy initiatives in this area.

Participation of the AAI in this proceeding is consistent with the published procedures and mission of the Institute. In particular, part of the AAI’s policy charter permits the expenditure of AAI resources on issues that are “important for consumers and competition” and that are “likely to involve new or particularly interesting legal or economic issues.”

II. Summary of Issues with Significant Competition Policy Implications.

Comments were solicited in the Broadcast Flag *FNPRM* on the nature of the process for approval of new content protection (“CP”) technologies.⁵ The AAI indicated its support for pre-established guidelines and procedures and for approvals to be made by an independent entity or the Commission. Several commentators concurred in the need for both guidelines and an independent

³The AAI is an independent research, education, and advocacy organization that supports a leading role for competition, as enforced by our antitrust laws, within the national and international economy. Background on the AAI may be found at www.antitrustinstitute.org, including participation in other matters involving the telecommunications and media industries. Funding comes to the AAI through contributions from a wide variety of sources. More than 70 separate sources each have contributed over \$1,000, some of which may have some interest in the outcome of these proceedings. A full listing is available on request.

⁴*Antitrust Guidelines for the Licensing of Intellectual Property*, Issued by the U.S. Department of Justice and the Federal Trade Commission, April 6, 1995, available at: <http://www.usdoj.gov/atr/public/guidelines/ipguide.htm>.

⁵ *BF RO & FNPRM*, ¶61.

arbiter.⁶ Some commentators advocated continuation of the Commission's interim approval procedure with a transition to self-certification.⁷

The AAI does not object to self-certification based on experience gained in the administration of the interim approval procedures and on well-crafted criteria designed to mitigate the potential for competitive harm that may arise in the context of technology licenses for specifications that have not been fully vetted by recognized standards-setting organizations ("SSOs") and do not disclose relevant IP assets.

The Digital Transmission Licensing Administrator, LLP ("DTLA"), claims to support procedures and guidelines for the approval of CP technologies, yet it does not favor regulation of the terms of technology licenses, and even questions the necessity of the Commission's stated requirement that CP technologies should be made available on "reasonable and non-discriminatory" ("RAND") licensing terms.⁸ The Motion Picture Association of America ("MPAA") does not favor the establishment of guidelines and procedures for approval of new CP technologies at all, urging instead a "market-based" approach to approvals, suggesting, in essence, summary approval of current market incumbents.

The content providers have traditionally exercised *de facto* approval of digital CP technology. Presumably, aware that the content providers have been the *de facto* decision-makers for entry into the market for digital CP technology, the Commission has requested specific comment on whether the authority for initial CP technology approvals should be delegated to the content providers.⁹ The AAI opposes a regulatory regime in the form of "studios' choice" for selecting FCC-approved digital CP technologies. The MPAA recommends relying solely on "market-based" criteria for approval, asking in essence for an irrebuttable presumption in favor of the market *status quo*. The extent to which the market

⁶ See e.g., *Comments of the IT Coalition, BF RO & FNPRM* (filed Feb. 13, 2004), at 8.

⁷ See *Comments of Philips Electronics North America Corporation on Further Notice of Proposed Rulemaking, BF RO & FNPRM* (filed Feb. 13, 2004), at 5-8.

⁸ *Comments of Digital Transmission Licensing Administrator, LLC to Further Notice of Proposed Rulemaking, BF RO & FNPR* (filed Feb. 13, 2004), at 16.

⁹ *BF RO & FNPRM*, at ¶64.

for digital CP technologies is either monopolistic, or controlled by a tightly-knit group of cross-licensed participants, can be traced directly to the market power of the studios (especially when acting as a group).

It is misleading, therefore, to characterize CP technologies that have penetrated the market to some extent as a result of the support of and approval by content producers as a “market-based” selection. Rather, acceptance of such studio-approved CP technologies is the result of the market power of the content owners. The Commission would do nothing to further pro-competitive policies by establishing an approval process that is designed to give special treatment to the incumbent class of CP technologies.

By engaging in an approval process for digital CP technologies, the FCC has shifted the selection process from an implicit process controlled by the content providers to an explicit process controlled by Commission Rules. These rules impinge directly on entry into the business of developing and providing CP technology, implicating the Commission as gatekeeper for this sub-industry, and imposing some responsibility on the agency for the competitive conditions its entry criteria are likely to create.

In addition to the issue of entry, the Commission has also recognized other evidence of the market power of the content owners. The exercise of the studios’ market power on the adjacent market for digital CP technology and the potential for anticompetitive behavior by the studio-approved digital CP technologies, represents a competitive distortion based on an “essential facility” awarded by the content providers to CP technology firms, analogous to a “blocking patent” for the manufacture of “downstream” media products. This arrangement apparently was not severe enough to motivate adopters of the CP licenses to do anything other than “live with it” as a “fact of business life.” Moreover, the effect on competition in these relevant markets might not have been substantial enough to draw the attention of antitrust enforcement authorities, despite a contemporaneous inquiry by the FTC, DoJ, and others into how to draw the appropriate lines between IP rights and antitrust policy. Fortunately,

however, a full-blown legal case-in-controversy is not required in order to justify the adoption of regulatory measures designed to minimize anticompetitive consequences.

Several parties, including the AAI, favor the use of functional criteria as the basis for CP technology approvals.¹⁰ However, DTLA favors functional criteria as a basis for approval of CP technology only if “market-based” criteria are also employed. If functional criteria are reasonable and sufficient to implement the purposes of the rulemaking, what reason is there for DTCP or any other digital CP technology to fail to satisfy FCC promulgated functional criteria? The AAI would discourage a “dual-track proposal,” to ensure admittance of the incumbent when the real competitive objective is to achieve fair entry conditions for all.

The AAI also advocated that the Commission adopt regulatory policies that maximize interoperability and ensure cross-permissions from incumbents publicly offering to license CP technology, and measures to promote the interoperability of competing forms of digital CP technologies and regulations to create suitable incentives for access by downstream products. The competitive implications raised by this issue affect DTV products in the CE and IT industries. The component and networked nature of DTV equipment used by consumers makes the success or failure of CP technologies and the products that incorporate them particularly susceptible to a failure of interoperability or lack of access to incumbent technologies. The kind of competitive distortions that typically affect such markets are consumer “lock-in,” “first mover advantage” and “market tipping.”

While there is no competition policy consideration that arises directly out of the consolidation of these proceedings, the AAI favors of a unified regime for approvals of broadcast flag and plug-and-play (DFAST) approvals for administrative convenience. Numerous competition policy and other practical regulatory issues are common to both proceedings. The principal argument against consolidation appears to be that DFAST adopters must give effect to a greater range of encoding rules because of the stricter compliance rules for certain classes of programming carried on CATV systems. The AAI believes such differences in encoding rules (and in the perceived higher value of the programming delivered by CATV

systems) to be an insignificant impediment, if an impediment at all, to a common framework for administration of CP technologies for all digital video delivery modalities.

With respect to encryption at the source by cable operators, the AAI took no position at the time of its initial comments. However, this issue does have competitive effects on the market for CP technologies. To promote competitive entry of alternative CP technologies (*i.e.*, assuming the FCC wishes to follow pro-competitive policies toward both the CP technology product market and innovation market), the Commission should encourage as large a demand pool for Broadcast Flag-compliant equipment as possible and CATV should not be permitted to encrypt basic tier cable carrying broadcast content at the head-end if the result is to weaken the market demand for broadcast flag compliant products.

Finally, the Commission has requested comment on the likely effect of its regulations on the development of software demodulators. The AAI supports measures designed to minimize deleterious effects on innovation and on technologies that can lead to new, competitive products and services.

III. The FCC Has Both the Authority and the Duty to Address the Competition Policy Issues.

The FCC does and should exercise its regulatory authority to achieve pro-competitive results in deciding the foregoing issues. The FCC's publicly stated goal for competition is based on a "sound competitive framework for communications services" designed to "foster innovation and offer consumers meaningful choice in services," with such a "pro-competitive" framework to be promoted domestically and overseas."¹¹ The FCC's statutory "public interest" standard requires the Commission to consider the competitive impact of its regulations.

In both the Broadcast Flag and Plug-and-Play proceedings, the Commission expressed concern with, as it stated, "one industry segment exercis[ing] a significant degree of control over decisions regarding the approval and use of content protection and recording technologies in DTV-related

¹⁰ *BFRO & FNPRM*, ¶62.

¹¹ See www.fcc.gov/competition/

equipment.”¹² In the Broadcast Flag context such inter-segment control includes the vertical exercise of the market power of the content providers over downstream digital CP participants and, in turn, the market power of the owners of approved digital CP technologies over manufacturers of CE and IT equipment who are both competitors and downstream buyers.

The criteria adopted by the Commission for approval of Broadcast Flag CP technologies on an interim basis demonstrate the jurisdictional competency for and practical scope of the Commission’s potential rulemaking in furtherance of its competition policy goals. Although the Commission (in *BF RO & FNPRM*, at ¶62) addresses the issue of functional criteria, renewability, and interoperability, it also made clear that interim approvals will be based in part on:

a technology’s licensing terms, including its compliance and robustness rules, change provisions, approval procedures for downstream transmission and recording methods, and any relevant license fees.

With respect to “publicly offered” CP technology, the Commission has made clear that such licensing is to be on a RAND basis and that licenses “will not be unreasonably withheld from parties.”

Finally, the Regulatory Flexibility Act of 1980 (“RFA”), 5 U.S.C. 603 (as amended) requires the FCC to undertake an evaluation of the economic impact of its regulations, in particular the effect on small businesses. Unfortunately, no comments were filed on the Initial Regulatory Flexibility Analysis published with the *Notice of Proposed Rulemaking* in the Broadcast Flag docket. As a result, the Commission has certified compliance with the RFA, including a description of its consideration of significant alternatives considered in reaching its proposed approach, specifically including the use of performance standards rather than design standards.¹³ The issue of functional criteria bears directly on whether performance rather than design standards should be the approach adopted in these recommendations. AAI suggests that this aspect of the rulemaking is still pending, and therefore that the RFA analysis of the effect of the Commission’s approach on small business cannot be concluded prior to the collection of comments and the proposal of specific regulations.

¹² in the *BF RO & FNPRM*, at ¶52

IV. Competition Policy based on the Principles of the *IP Guidelines* and its Regulatory Implications.

In the *AAI Comments* (filed Feb. 13, 2004) to the *BF RO & FNPRM*, specific reference was made to the *IP Guidelines* (note 4, *supra*). AAI recommended that “the Commission should endeavor to fashion guidelines that closely track the considerations set forth in the *IP Guidelines*.” (*Id.* at 5.) The purpose of this section is to reiterate those principles,¹⁴ commenting thereafter about the existing digital CP IP landscape to which they should apply.

The integrated approach of the *IP Guidelines* aims toward the rational joint satisfaction of IP rights interests and antitrust policy, and embodies three basic principles. First, the same general antitrust principles for conduct involving IP apply as to conduct involving any other form of property. Second, there is no presumption of market power created by IP. Third, IP licensing is generally considered pro-competitive.

If the essence of property is the power to exclude, IP property rights clearly convey to the owner some power to exclude. The effect of antitrust principles is to place some limitation on the IP owner’s right to exclude. Licensing agreements should have a demonstrable pro-competitive justification; and any ancillary agreements, such as grantbacks, non-asserts, and advance agreements for the treatment of future patents, should be reasonably related to the pro-competitive justification and should not injure competition by creating disincentives to innovate. Overly broad grantbacks or non-asserts are anti-competitive because they destroy the incentive to innovate and take risks.

The *IP Guidelines* suggest certain indicia of pro-competitive licensing agreements. One is non-exclusivity and another is the freedom of adopters to license their own patents independently, without

¹³ 5 U.S.C. §603(c)(3).

¹⁴ The following three principles of the *IP Guidelines*, and numerous other issues raised are from Anthony, Sheila F., (2000) “Antitrust and Intellectual Property Law: From Adversaries to Partners” *AIPLA Quarterly Journal*, 28:1, p 1-___.

consent, grant, or non-assert against another party. They are ill-suited, however, to deal with licenses in which the actual IP remains unidentified.

Conclusion.

Two distinct inter-industry competitive effects worthy of the Commission's consideration are a) the vertical exercise of market power by the content providers and b) the "gatekeeper" market power of CP technology interests as licensors, end-users, and as competitors to "adopters."

With respect to the former, *i.e.*, between content owners and CP technology interests, the Commission has recognized that content owners have market power analogous to a patent pool, and thus control entry into the CP technology market.

1. With respect to the latter, digital CP technology interests have derivative market power as an "essential facility" for access to content owners' product analogous to the holder of a "blocking patent," who may exploit market power unfairly, particularly when compared to the standards of unfair dealing defined by the *IP Guidelines*. Adopters may have difficulties as outsiders competing with Licensor insiders who may share superior information. But adopters may also have problems *inter se* or as outsiders related to IP licensing terms that jeopardize their incentive to innovate. In particular, the combination of non-transparent technology licenses for CP technologies with grantbacks and non-asserts has the effect of stifling innovation, competition, and, therefore, potential future entry.

The AAI recommends the articulation of an appropriate standard by which to balance intellectual property rights and sound antitrust policies when a mandated, approved, or recommended technology has not been certified by a Recognized Standards-Setting Organization ("SSO").

Additional recommendations include facilitating application of the *IP Guidelines* by requiring disclosure of patents and prohibition on restrictive patent terms, avoiding design criteria where performance criteria will suffice, mitigating the insider/outsider problem and the minimization of the effect of the approval of CE or IT firms with an ownership or financial interest in the licensing of an approved CP Technology, and to establish a regime of independent license administration.

Finally, all parties should acknowledge that the additional market power conferred by approval by the FCC must be balanced against inevitable limitations on the incumbent's "power to exclude," by, among other safeguards, having to offer "RAND" terms and maintaining the absence of anticompetitive licensing practices.

Respectfully submitted,

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