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June 9, 2009

Via Electronic Filing and Electronic Mail

Marlene H. Dortch, Secretary
Federal Communications Commission
Office of the Secretary
445 12th Street, SW
Washington, DC 20554

Re: Ex Parte Presentation by Dolby Laboratories, Inc. Regarding the Petition for Rulemaking and Request for Declaratory Ruling Filed by the Coalition United to Terminate Financial Abuses for the Television Transition, LLC **(MB Docket No. 09-23)**

Dear Secretary Dortch:

Attached please find a memorandum summarizing the information and arguments presented by Dolby Laboratories, Inc. to Rosemary Harold, Rudy Brioché, and members of the Media Bureau including Eloise Gore, Mary Beth Murphy, Steven Broeckaert, Alison Neplokh, Kathryn Berthot, Neal McNeil, Robert Ratcliffe, Kiersten Kamman and Brendan Murray, on June 8, 2009, regarding the above-mentioned matter.

Sincerely,

Jeffrey Blumenfeld /MBT

Jeffrey Blumenfeld

cc: (via electronic mail)

Rosemary Harold
Rudy Brioché
Eloise Gore
Mary Beth Murphy
Steven Broeckaert
Alison Neplokh
Kathryn Berthot
Neal McNeil
Robert Ratcliffe
Brendan Murray

Ex Parte Presentation by Dolby Laboratories, Inc.

Regarding

The Petition for Rulemaking and Request for Declaratory Ruling Filed by the Coalition United to Terminate Financial Abuses for the Television Transition, LLC

MB Docket No. 09-23

I. Introduction

On June 8, 2009, Michael J. Biber of Dolby Laboratories, Inc. and Dolby counsel Jeffrey Blumenfeld and Brinkley Tappan (of Crowell & Moring LLP) met with Eloise Gore, Mary Beth Murphy, Steven Broeckaert, Alison Neplokh, Kathryn Berthot, Neal McNeil, Robert Ratcliffe, Kiersten Kamman and Brendan Murray of the FCC Media Bureau, Rosemary Harold (advisor to Commissioner McDowell) and Rudy Brioché (advisor to Commissioner Adelstein) to discuss the Petition for Rulemaking and Request for Declaratory Ruling filed by the Coalition United to Terminate Financial Abuses for the Television Transition, LLC ("CUT FATT"). This is a summary of the information presented during those meetings.

Dolby is primarily a research and development ("R&D") and licensing company, which, since its founding by Ray Dolby, has invented many of the audio technologies that create a superior user experience in movie theatres, home theatres and more recently, mobile applications. Throughout its four decades, and continuing today, Dolby has been a household name in consumer and professional audio products. Unlike large manufacturers that rely on the sale of consumer goods to support their product development, most of the revenues that support Dolby's ongoing R&D come from licensing its technology. Dolby is therefore in a position to offer a somewhat unique perspective on the process of licensing technology, and the impact of the regulations that relate to that process.

II. Procompetitive Incentives Guide Standards Setting and Patent Licensing

Built into both standards setting and patent licensing are incentives for companies to make choices that are in the best interests of consumers. Participants in standard-setting organizations have incentives to choose the best technologies for inclusion in a given standard. Likewise, patent owners have incentives to charge reasonable royalties for their technology, whether they contribute that technology to patent pools, or license it bilaterally. These incentives stem from the goal of encouraging widespread adoption and use of the technology at issue.

Manufacturers are incentivized to adopt interoperable technologies to ensure that their customers can use their products in combination with other products and components that maximize the value of the combination. Interoperability drives technology adoption by manufacturers, and as a result, drives availability of technology to consumers. Interoperability is achieved through standards.

Dolby regularly participates in standard-setting bodies, because it is in the company's interest to promote the interoperability of its own technology with other technologies. Standard-setting bodies necessarily include owners of different technologies engaged in the collaborative process of setting a standard for new technology. Their collective incentive is to include the best technologies in a given standard, because that will increase the chances that the standard will be widely adopted by both manufacturers and consumers. Each participant's desire to ensure widespread adoption of the standard means that there is "market-like" pressure within the group to optimize the set of technologies included in that standard. Naturally, consumers benefit from this process, because it ensures that the best available technologies are ultimately incorporated into the products that reach them.

There are similar marketplace pressures driving licensors to offer reasonable and non-discriminatory ("RAND") licensing terms, whether those licensors are licensing directly or as participants in a patent pool. A patent becomes more valuable to its owner with widespread adoption of the standard of which it is a part, and the adoption of a standard generally will occur only when the licensing terms are attractive to manufacturers. Therefore, patent owners tend to offer reasonable licensing fees – whether licensing individually or through patent pools – because they want their technology to become widely adopted in the marketplace.[1] Mass adoption is the key to profitable licensing, and "over-priced" patents are hard to sell, as is true of any "over-priced" product. For this reason, companies involved in standards setting almost universally adopt a requirement of licensing under RAND terms.

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[1] In fact, Dolby frequently lowers its licensing fees (both in the individual context and as part of patent pools) when it believes that such a reduction is necessary to allow a manufacturer to offer a new product that would not otherwise reach the market.

Because of these dynamics, embodied in the resulting RAND licensing requirements, a company that tries to insist on unreasonable licensing fees will make itself an unattractive candidate both for collaboration in future standards setting forums – including for later generations of any given standard – as well as for collaboration in patent pools.

These same incentives apply even in the case of a "mandated" standard, such as the DTV standard. To put this issue in perspective, there are many standards that achieve such widespread acceptance that, as a matter of marketplace reality, most if not all manufacturers will adhere to that standard in their products; they are "de facto" standards. A de facto standard that has achieved this degree of market acceptance is, for all practical and analytical purposes, not much different from a "mandated" standard; in both cases all (or virtually all, in the non-mandated de facto standard) manufacturers will make products that comply with that standard. So the fact that a particular standard – in this case DTV – is "mandated" does not fundamentally change the analysis. Even where a standard is widely or universally practiced, the marketplace pressures still push licensors to reasonable pricing for the simple reason that if the IPR costs are too high, that will discourage manufacturers from making products, leading to fewer licensed products and a smaller volume of licenses. In turn, this will suboptimize the licensing revenue stream, with the result that licensors will be forced to reconsider and lower their prices. The marketplace would reflect this effect by offering a limited variety of products, from a limited number of manufacturers.

But conjecture is not required as to whether the described incentives are working properly in the case of DTV, because we have an actual marketplace, which conclusively makes that case: the marketplace for digital televisions is highly competitive and robust, as proven by the large number of manufacturers and wide variety of digital televisions available to consumers, and the rapidly dropping prices of those sets.[2]

Moreover, even if it were the case that one or more of the licensors were pricing their licenses at rates higher than reasonable and non-discriminatory – which is quite a different standard from "higher than the CUT FATT petitioners would like" – there are well-proven forums and mechanisms for resolving such disputes. These mechanisms – including state and federal courts, as well as the International Trade Commission – regularly deal with such disputes, as they are currently doing for VIZIO.[3]

The incentives to include the best technologies in a standard, and to license those technologies at reasonable rates, are entirely market-driven. No regulatory intervention is required to force patent holders to do these things, because it is in their economic interests to do so. Dictating pool participation and setting royalty rates, as CUT FATT proposes to do, would undermine these market-driven incentives both by forcing participation in what now works best as a voluntary

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[2] That reality also tends to indicate that this proceeding is more about manufacturers trying to improve their margins than it is about any effect on consumers.

[3] VIZIO is addressing this issue in those forums right now, and has been for several years. *See* Section V, below.

collaborative enterprise, and dictating royalties that may easily fail to reasonably fund continuing innovation. Thus, imposing the dramatic imperatives requested by the Petitioner would be directly contrary to consumer welfare, in both the short term and the long term.

III. There Are Procompetitive Limitations on Patent Pools

In addition to the aforementioned market-like pressure that bears on patent pools and keeps royalties reasonable, there are other constraints that also impact the way in which patent pools function. While these constraints have various sources, they all have a similar result: no properly-constituted patent pool package contains all the patents a manufacturer might want, and the marketplace deals effectively with this reality every day without any harm to consumers.

The first constraint, a practical one, is that licensing approaches are not uniform, even within a particular company. For example, Dolby licenses some of its technology directly, and licenses other technology through patent pools. This pattern is not uncommon. Therefore, as a practical matter, pools never include all of the patent owners with pool-eligible patents, due to the variety of business models under which patent owners operate.[4]

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[4] Regardless of whether a company chooses to license its technology directly, or as part of a pool, it has the same incentive to charge reasonable royalties, thereby promoting the widespread adoption of the technology. When such an incentive is present in either case, it is unclear why it would be necessary to force patent owners to join a pool in which they do not wish to participate, as CUT FATT requests the FCC to do, particularly when certain patent owners have determined not to participate for legitimate business reasons of their own.

The second constraint on patent pools is a developing body of antitrust policy and law, in the US as well as in other countries. These constraints stem from the fact that pool participants are frequently actual or potential competitors in innovation and technology markets, as well as in downstream product markets. Among the antitrust-based limitations, there are constraints on which patents can be included in a pool license. Inclusion of patents that do not meet the requirements under the antitrust laws has serious implications for pool participants, and indeed, for consumers.

Specifically, for patent pools organized around a standard, the package of patents included in a (collective) pool license is limited to those that are "essential." The term "essential" has come to be a term of art, indicating patents which are necessarily and unavoidably infringed by the practice of the standard, and for which there are no realistic alternative technologies. Under this definition, the technologies in essential patents are necessarily complements (rather than substitutes); therefore they collectively constitute a useful technology, rather than being competing technologies to achieve a given functionality.

Thus, properly-constituted patent pools are comprised only of "essential" patents, those for which there are no competitors, either inside the pool, or outside the pool. These determinations are made by patent attorneys in the role of patent referees who evaluate patents submitted for potential inclusion to determine whether they are "essential" under the legal test. These patent referees thus act as "gatekeepers" to ensure that a patent pool includes only essential patents.

Inclusion of only "essential" patents is an ongoing obligation of patent pools. Should the patent evaluator become aware of a competing technology that existed at the formation of a pool (and assuming both patents are valid), the patent that was included in the pool must leave the pool, because it will no longer be considered "essential."

This limitation to essential patents addresses the antitrust concerns that might arise from inclusion of a broader range of patents, particularly because it eliminates the risk of price-fixing by competitors inside a pool, or exclusionary conduct directed at competitors outside of a pool.

The inclusion of non-essential patents in a pool is prohibited because the patents in the pool would then represent technologies that compete with each other. Offering patents for competing technologies in a jointly-priced package would mean both that the owners of those potentially-competitive proprietary technologies are effectively agreeing not to compete on those technologies, and also that those owners are collectively pricing their competing technologies. Agreements not to compete, and price fixing, risk harm to consumer by artificially reducing competition and increasing the prices that consumers pay.

The inclusion of non-essential patents in a pool is also prohibited because of the possibility that one of the technologies in a pool patent might otherwise compete with a technology that is *outside* the pool, whether or not patented. The competitive risk here is that a company *outside* the pool offering a technology for which there is a competing patent *in* the pool may effectively be precluded from that opportunity;

its potential customers who are pool licensees will have a similar technology available to them in the package of pool patents. Such customers are much less likely to be willing to pay over and above their pool license fees for a non-pool technology that duplicates a function for which they already have a licensed technology solution. Therefore the owner of a competing technology outside the pool may be excluded from the market. By reducing the profitability of innovation, such exclusionary conduct can ultimately result in a reduction of the number of viable competitors, again leading to consumer harm in the form of less innovation and fewer consumer choices.

The net result of these legal constraints is, once again, that the package of patents available from a patent pool will contain only essential patents. Non-essential patents are not included in the package. And that benefits consumers, because it forces the owners of those non-essential patents to compete with each other to license them to companies practicing the standard. Licensees operate under these rules on a regular basis, seeking some patent from pools, where they exist, and others directly from patent owners.

A third constraint on patent pools, with a similar effect, is that, as a practical matter, there will often be many "non-essential" patents which a manufacturer will want to license for its standard-compliant products because they cover technologies for important product features. These technologies may be highly desirable – and even "necessary" – from a manufacturer's point of view, particularly where they are widely adopted by competing manufacturers, and thus become "must have" features in the product even though they are not part of the standard. Because of the constraints already described, patents for these "must-have" features will not be available through even the most inclusive patent pools, and must therefore be licensed from the individual patent holders.

Once again, this is an everyday reality of patent licensing, and one to which licensees have adapted successfully over the years. And once again, there is nothing about this issue that is unique to the case of DTV. DTV licensees license some patents from a pool, and other patents directly from their owners, just as in every other part of today's competitive electronics industry.

If, as CUT FATT proposes, patents for all ATSC-compliant technologies were included in a patent pool, it is quite likely that such a pool would violate the antitrust laws, because it would include essential and non-essential patents. It is close to facially absurd to argue that it is required by the public interest to mandate a patent pool structure and operation that violates the laws designed to promote consumer welfare. Indeed, it is difficult even to argue that it is *in* the public interest – specifically that it advances consumer welfare – to do so.

IV. The Market for Digital Televisions is Competitive and Robust

Even leaving aside the practical and legal hurdles to imposing mandatory pooling by all ATSC patent holders, there is no public policy imperative to do so. To the contrary, the current system is functioning quite well. The marketplace for digital televisions is robust and competitive, offering consumers an increasing variety of models, from a large number of manufacturers, at rapidly-declining prices.

Nothing about this is surprising. These are the logical results of the current system, which, as described above, incentivizes both the inclusion of the best technologies in the digital television standard and the setting of reasonable royalty rates by the relevant patent owners. Forcing all ATSC-compliant patents into a mandated patent pool risks altering and sub-optimizing these incentives by changing the current dynamics.

As in every highly competitive marketplace, each manufacturer must price according to the realities of the marketplace into which it sells, in this case a marketplace that demands low and decreasing prices. Each manufacturer must then continuously improve the efficiency of its operations, so that it can remain viable. Manufacturers facing that challenge would certainly see their margins improve if they succeeded in convincing a regulatory agency to mandate lower prices for one of the component parts they need to continue manufacturing, such as IP rights in this case. But improving manufacturers' margins is not a proxy for enhancing consumer welfare or advancing the public interest, and it is certainly not the function of the FCC.

Second, mandating an ATSC patent pool and setting its licensing rates would also stifle the rapid innovation that is a hallmark of this industry. Were licensing rates to be mandated by government fiat *ex post facto,* companies would shy away from devoting R&D budget to developing technologies that later might be swept into such a result. Patent holders already manage a delicate balance between rates low enough to promote widespread adoption of the technology while still providing for funding of ongoing innovation. The rapid innovation and falling prices that characterize the current market provide no compelling reason to tamper with this balance, and indeed provide every reason to avoid doing so.

V. The Forums for Litigating Patent Disputes Function Efficiently and Effectively

Finally, the Comments demonstrate – even from experience among ATSC licensors and licensees – that patent licensing also operates in a robust marketplace, with well-established and well-functioning forums and mechanisms for resolving disputes, including disputes about patent licensing policies and prices. Several companies involved in this proceeding are currently in patent litigation in various forums. For example, VIZIO (one of the CUT FATT members) and Funai (which opposes the Petition) are currently in patent litigation with each other over issues including antitrust, patent infringement, and RAND pricing.[5] Harris Corporation[6] is also currently in patent litigation related to the standards at issue in this proceeding. The experiences of these companies clearly demonstrate that the current system works.

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[5] The factual descriptions of that litigation are drawn from Funai's Comments in this proceeding. Funai Comments at 3-6.

[6] Harris "does not take a stance on CUT FATT's specific recommendations" but does recommend Commission intervention and Commission mandates in patent licensing and litigation. Harris Comments at 2.

VIZIO is the subject of an International Trade Commission ("ITC") investigation stemming from a complaint filed in 2007 by Funai, under Section 337 of the Tariff Act of 1930, challenging the importation into the United States of Vizio-manufactured product that infringes Funai patents.[7] After a seventeen month investigation, the ITC determined that VIZIO's products in fact infringe a Funai DTV patent, and entered an exclusion order barring VIZIO from importing, selling, and distributing infringing products. In that proceeding, VIZIO also raised as defenses various RAND issues as to the licensing terms offered by Funai. Some of these RAND issue defenses were ultimately abandoned by VIZIO; the remainder were ruled on – against VIZIO – by the ITC.

It is easy to understand that VIZIO is upset that it lost. But it is the height of hubris – and irrationality – for VIZIO to insist that *because* it lost in fully and carefully considered ITC rulings, the FCC should replace the ITC in dealing with these patent issues.

VIZIO's litigation positions and outcomes are hardly equivalent to the public interest; indeed the public interest is not even implicated, much less offended, by a single litigant's loss in a single case. Thus, far from proving that the public interest compels the FCC to substitute itself for the ITC – or to mandate an outcome different from that arrived at by the ITC after applying its considerable institutional patent expertise in an investigation lasting one-and-a-half years – the

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[7] Funai points out in its Comments that it is only one of many patent holders who have filed complaints against VIZIO for patent infringement. Funai Comments at 3-4.

story of the Funai-VIZIO litigation forcefully demonstrates that the public interest is best served by allowing existing patent dispute forums to function without intervention by the FCC.

The history of the Harris patent litigation teaches exactly the same lesson. Harris is litigating against Rembrandt, a non-practicing owner of ATSC patents, which accused various cable providers and network television broadcasters who practice the ATSC standard – some of which use Harris ATSC equipment – of infringing Rembrandt patents.[8]

When it learned of the accusation, Harris sought a license to the Rembrandt patent on RAND terms. Rembrandt denied that it was bound by obligations to license on RAND terms, and further argued that it was not obligated to license the relevant patent at all. The Delaware state court – a common forum for patent litigation – found against Rembrandt on both issues, ruling that Rembrandt was obligated to license the patent in dispute to Harris, and was obligated to license it on RAND terms.

The current issue in the Harris-Rembrandt litigation, according to Harris, is that Rembrandt apparently insists it is entitled to royalties from the sale of all ATSC-compliant DTV equipment, regardless of whether the particular piece of equipment practices the Rembrandt patent. This issue is well within the competence and experience of the current patent litigation forums.

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[8] The factual descriptions of this litigation are drawn from the Harris Comments, *passim*.

The irony of Harris's insistence on the FCC mandating particular results as to common patent issues (which happen in this case to apply to ATSC patents) is this: Harris has *won* all the issues in the litigation to date, yet *still* insists that FCC intervention on patent issues is the only way to protect those practicing the ATSC standard. The most interesting point about the Harris-Rembrandt litigation is a point that Harris makes inadvertently: the real lesson is – as also in the Funai-VIZIO litigation – that the current forums for litigating patent issues work.

The Harris and Vizio cases are just two examples of how the current system is working. In addition to the ITC and the district courts, many patent issues are dealt with by competition authorities (in the US and around the world), or even by private contract. The system is multi-faceted, and already well-equipped to handle the issues raised in CUT FATT's petition.

VI. Conclusion

In conclusion, there is no marketplace failure to be addressed by regulation, either in the market for digital televisions, or in the systems for dealing with issues of patent licensing. From the standpoint of public policy, which is chiefly concerned with the effect on consumers, there is no justification for any regulatory intervention, much less a need for the drastic, draconian, and counter-productive measures requested by the Petitioner.