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June 8, 2012

The Honorable Lisa R. Barton
Acting Secretary
U.S. International Trade Commission
500 E Street, S.W., Room 112
Washington, DC 20436

Re: *Certain Gaming and Entertainment Consoles, Related Software, and Components Thereof*, Investigation No. 337-TA-752

Dear Acting Secretary Barton:

On behalf of Microsoft Corporation ("Microsoft"), respondent in the above-captioned Investigation, we respectfully submit these comments to address the significant public interest issues raised by the ALJ's recommended exclusion and cease and desist orders and in response to the Commission's May 9, 2012 request for statements on the public interest.

The relief Motorola Mobility, Inc. and General Instrument Corporation (collectively, "MMI") seek would unduly harm consumers and competitive conditions in a $25-billion industry comprising video games, hardware, and accessories. Such relief would therefore conflict with the Commission's statutory mandate in light of "the effect of such exclusion upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers." 19 U.S.C. § 1337(d)(1); *see also id.* § 1337(f)(1).

Exclusion of Xbox—which reportedly accounted for 42% of all game consoles sold in March 2012 and has been the best-selling console for at least 15 months[1]—would reduce consumer choice and leave only one high-definition gaming console on the market. Moreover, exclusion would undermine the development and implementation of industry standards by

[1] "Xbox continues to reign amidst weak video game market" by Lance Whitney. April 13, 2012. Available at http://news.cnet.com/8301-10805_3-57413632-75/xbox-continues-to-reign-amidst-weak-video-game-market/ .

allowing a patentee who agreed to make its standard-essential patents available to all comers on reasonable and nondiscriminatory ("RAND") terms to ignore those commitments with impunity. All this harm would be inflicted to benefit a patentee that does not even participate in the gaming console industry.

A. Exclusion Would Substantially Limit Consumer Choice and Impair the Value of Consumer and Third-Party Investments in Xbox, Investments That Are Not Transferrable to Other Products

Exclusion and cease and desist orders should not issue where they would disrupt "competitive conditions in the United States economy," 19 U.S.C. § 1337(d)(1); *see also id.* § 1337(f)(1), and the relief requested here would do just that. Sony and Nintendo are Microsoft's major competitors, and only Sony offers high-definition gaming consoles. Any exclusion of Xbox would not only eliminate the only console produced and developed by a U.S. company but also reduce consumer choice. Moreover, between Xbox Live, games developed solely for Xbox, and the exclusive "Kinect" controller, Xbox offers U.S. consumers a unique gaming experience, to which buyers of new consoles would not have access.

Exclusion would also adversely affect consumers by reducing the value of their investments in Xbox. Each manufacturer's console has unique games, accessories, and on-line services, which are not interoperable. When consumers purchase a game platform, such as Xbox, they invest not only in the current features and games, but also those they expect to be developed in the future. But developers would have decreased incentives to invest in a market frozen by exclusion of the consoles. And consumers seeking a new or upgraded Xbox for their existing collection of games and accessories—which again are *not* compatible with Sony's Playstation or Nintendo's Wii—would be unable to obtain one. In short, the requested relief would leave many consumers with an expensive collection of products useless on any platform available for purchase.

The effect on welfare and competitive conditions is all the more acute for third-party retailers, game developers, and publishers, many of whom are concentrated in the United States and all of whose business models depend on Xbox sales. For example, half of Electronic Arts Inc.'s ("EA") $900 million in console game revenue in the most recent quarter came from Xbox.[2] The industry depends on competition; eliminating Xbox means eliminating not just an important innovator but also a reason to innovate—EA's development budget, for example, would no doubt suffer if there were no further sales of consoles to which half its products are targeted. Further, consumers who are unable to buy a replacement or upgraded Xbox console may forgo purchasing gaming systems altogether, to the detriment of retailers. Publishers and

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[2] *See* Electronic Arts Reports Q4 FY12 and FY12 Financial Results, May 7, 2012, http://investor.ea.com/releasedetail.cfm?ReleaseID=671113.

game developers who have invested in Xbox-specific development—for example, in games that use the Kinect controller, a device unique to Xbox—would be left without a market for the games they spent years perfecting. A cease and desist order would only exacerbate such harm by preventing Microsoft from supporting its retail and end user consumers. Simply put, the proposed orders would harm not just Microsoft but the entire Xbox marketplace.

A possible Xbox redesign would not avoid the economic harm to Microsoft and third parties. The console market is seasonal, and redesign in time for the holiday season, when the majority of consoles are sold, is unrealistic. Combining exclusion with a cease and desist order just before the holidays could be devastating for retailers, further hindering Xbox games sales when retailers are unable to offer the consoles required to play them. And product development cycles are lengthy, so the effects on public welfare, competitive conditions, and the production of like articles will extend far out into the future. *See* 39 U.S.C. § 1337(d)(1).

The harm to consumers and competitive conditions in the console market would come with no corresponding benefit to any domestic industry in which MMI actually competes. No consumer, left without the option of buying an Xbox, would buy MMI's phones or set-top boxes instead. [redacted] MMI therefore aims to remove the leading competitor from a market in which it has no presence, leaving only two companies, both non-U.S., offering game consoles. In these circumstances, allowing MMI to dismantle the console market would contravene the Commission's statutory mandate to protect U.S. industry. *E.g.*, 19 U.S.C. § 1337(a)(2).

B. Because MMI Made RAND Commitments, the Public Interest Forecloses Exclusionary Relief Here

Standard-Setting Organizations ("SSOs") develop technical standards to enable interoperability among complementary products. But once a standard is adopted, the owners of essential patents—patents necessarily practiced by any party who wishes to implement the standard—may seek to "hold up" implementation by enjoining the sale of standard-compliant products. That is what MMI seeks to do in this Investigation.

To prevent patent hold up and ensure that standards can be broadly implemented, SSOs rely on licensing commitments from patent holders like MMI. Before adopting a standard, an SSO will solicit and receive agreements that patent holders will not interfere with implementation but will instead license their patents on RAND terms. Patent holders promise to make their standard-essential technology available to all comers for a reasonable price and, in exchange, secure widespread implementation of their technology, a larger potential stream of royalties, and protection against near-term obsolescence, an ever-present risk in the fast-moving technology sector.

The requested relief would disrupt this basic scheme and thereby harm "United States consumers" and "competitive conditions" in the domestic economy. 19 U.S.C. § 1337(d)(1), (f)(1). MMI made RAND commitments with respect to four of the patents at issue, yet it has failed to meet its contractual obligation to license those patents for use in standard-compliant products. Instead, it has sought to enjoin the implementation of technologies it promised to license in order to exert improper leverage.

It is well-recognized that the breach of RAND commitments can be "anticompetitive conduct," because deception like that which the ALJ found MMI had practiced "harms the competitive process by obscuring the costs of including proprietary technology in a standard and increasing the likelihood that patent rights will confer monopoly power on the patent holder." *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 314 (3d Cir. 2007). Once firms "become locked in to a standard," the standard-essential patent holder can "demand supracompetitive royalties" or exert other improper leverage that would never have been available in the presence of alternative technologies, which are "by definition, eliminate[d]" by setting an industry standard. *Id.* A patent may confer a lawful monopoly, but deceptive RAND commitments go far beyond that, allowing the patentee to upset competitive conditions by extracting unlawful rents well in excess of the value of its patented technology—which even the mere threat of an exclusion order enables MMI to do.

Armed with the leverage of the proposed orders, MMI would be able to demand from Microsoft value exceeding even that of standards themselves—standards to which MMI contributes only a few among more than a thousand essential patents. Any exclusion order here would reward MMI for its anticompetitive activity, not the value of its patents—a fact that has caused concern for both U.S. and European antitrust authorities.[3] Congress has recognized that the public interest is not served by an exclusion order that rewards anticompetitive behavior. *See* S. Rep. No. 93-1298, 93d Cong., 2d Sess., 1974 U.S.C.C.A.N. 7186, 7330 (Where "an exclusion order would have a greater adverse effect on the public health and welfare [or] on competitive conditions in the United States economy . . . than would be gained by protecting the patent holder . . . such exclusion order should not be issued. This would be particularly true in cases

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[3] The European Commission recently announced two formal antitrust investigations to "assess whether Motorola has abusively, and in contravention of commitments it gave to standard setting organisations, used certain of its standard essential patents to distort competition in the Internal Market in breach of EU antitrust rules." European Commission, Press Release, Antitrust: Commission opens proceedings against Motorola, Apr. 3, 2012, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/345&format=HTML&aged=0&language=EN&guiLanguage=en. The Department of Justice has expressed concern about MMI's "aggressive history of seeking to capitalize on its intellectual property," including standard-essential patents, and has noted that "how Google may exercise its patents in the future remains a significant concern." *See* Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigations of Google Inc.'s Acquisition of Motorola Mobility Holdings Inc., Feb. 13, 2012, http://www.justice.gov/opa/pr/2012/February/12-at-210.html. And as the Commission is well aware from a filing of June 6, 2012, the Federal Trade Commission has expressed concern about this very case.

where there is any evidence of price gouging or monopolistic practices in the domestic industry.") (emphasis added).

Rewarding MMI's anticompetitive conduct will also harm the public welfare, the production of other standard-compliant articles, and U.S. consumers. 19 U.S.C. § 1337(d)(1), (f)(1). Well-functioning SSOs give consumers the benefits of convergence: products from different manufacturers become interoperable and often interchangeable substitutes for one another, giving consumers enjoy greater choice and reduced switching costs among products (which enhances competition). The "consensus-oriented private standard-setting environment" depends on reliable RAND commitments, *Broadcom*, 501 F.3d at 314, and without them it will be more difficult to develop standards and to encourage companies to implement them. Hold up like that engineered by MMI will make it difficult for potential SSO participants to justify the costs of the often-lengthy and complex standards process, including the costs of sharing technology and know-how with competitors. That same risk would likewise discourage implementation.

Even if MMI were a competitor in the gaming console market, it has promised to allow anyone, including its competitors, to practice its standard-essential technology so long as they are willing to pay a reasonable royalty. MMI has therefore given up the right to exclusionary remedies, at least against willing licensees like Microsoft.

Exclusion on the basis of the RAND-committed patents here would be especially inappropriate, for MMI may well be ordered within a matter of months to license those patents at a RAND rate to be set by the U.S. District Court for the Western District of Washington. *See Microsoft Corp. v. Motorola, Inc.*, No. 10-cv-1823 (W.D. Wash.). That court has stated its intention to determine RAND license terms at a trial to begin in mid-November 2012, and Microsoft has committed to accept a license on RAND terms. Microsoft, third-party retailers and developers, and the public should not be subjected to the harms of the requested relief when Xbox will likely be licensed in short order.

In short, an exclusion order here is contrary to the public interest.

Respectfully submitted,

Brian R. Nester

CERTIFICATE OF SERVICE

I hereby certify that copies of the **Letter to Acting Secretary Lisa R. Barton re Microsoft's Comments in Response to the Commission's May 9, 2012 Request for Statements on the Public Interest (Public Version)** were served on the following parties as indicated below on this 8th day of June, 2012 as indicated:

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