

# The Nortel Patents and escalation of the software patent wars

## *Text as submitted*

How valuable are patents? And why? The answers are becoming clearer as a coalition outbid Google for the patent portfolio held by Nortel, Inc.

Nortel's portfolio included wireless, data networking, optical, voice, Internet and semiconductor technologies. The most important patents for smartphone firms were those related to the cell phone 4G standards such as long-term evolution (LTE).

There were more than 6,000 patents; about 2,600 were American. Because the patents go beyond software, many are enforceable worldwide.

On April 3<sup>rd</sup> Google began the bidding at \$900 million

The Nortel patents were sold at auction for US\$ 4.5 billion. On July 10<sup>th</sup> 2011 United States and Canadian judges approved the sale. The award was made to Rockstar Bidco LP owned by Apple Inc., Microsoft Corp., Research in Motion (Blackberry) Ltd. [RIM], EMC Corp., Ericsson and Sony Corp. Intel Corp. and RPX Corp., a non-practicing entity, also bid separately. The bidding went 19 rounds. Apple Inc. joined the Rockstar Group after round five.

## Value of the patents

ZDNet reported "Nortel said in announcing the patent auction, [the patents] would allow the owner to control and license technology used in Apple's iPhone, devices that run Google's Android operating system and even RIM's BlackBerrys."

Smartphone revenues were \$99 billion in 2010 with an average price of \$300. The 2011 market is estimated to be between \$150 and \$200 billion. Smartphones represented only a quarter of the market for cell phones by number sold.

Google's Android had 48% of smartphone market in second quarter 2011. 107.7 million units shipped. This was an increase of 73% over the previous year. Apple's iPhone market share was 19% up 4%. Microsoft decreased 1.9% to 5.8% of the market.

According to the New York Times:

Potential buyers secure two major benefits from adding patents. First, the new owner pays fewer royalties and can protect itself against lawsuits. More important, tolls can be levied on rivals.

Microsoft is asking Samsung to pay as much as \$15 for each device using Google's Android software because of accusations of infringement. With so many millions of phones being manufactured monthly, the cash can add up.

With more than 400 million phones predicted to be shipped this year. Microsoft could expect \$6 billion of license revenue this year if Samsung and others were to agree to pay the proposed license fee.

## Google initial bid an error?

The \$900 million bid by Google may have been a strategic error. Strategist and Nobel Prize winner, Tom Schelling, pointed out that being both strongest *and* aggressive may initiate an opposing coalition. The aggressive move by Google signaled bidding would exceed earlier estimates.

The bidding process saw coalitions emerging to share the costs of the patents, sharply raising the combined value and costs of the patents to the coalition over that of any individual partner.

According to Bloomberg, in April, following the initial Google bid, RIM considered leading a coalition to challenge the initial Google bid. As the bidding increased, the coalition and their contribution became larger until it outbid Google.

RIM paid \$770 million; Ericsson paid \$340 million, showing that the coalition considered value differently for each member. The combined amounts exceeded what any individual firm could pay.

Reuters reported

Google individually had bid up to \$3.4 billion for those patents before teaming up with Intel Corp, which on its own had bid up to \$3.1 billion, according to a source familiar with the matter.

They bid through \$4 billion and then tapped out, another source had told Reuters.

Google's teaming was late and ineffective. The lesson here is to consider opposing coalitions as well as individual firms. Otherwise the opposing power can be under-estimated.

## Google escalates differences

More information about the bidding came in a recent sharp and potentially damaging exchange of blogs.

Google Chief Legal Officer (CLO) David Drummond on August 3 blogged:

But Android's success has yielded something else: a hostile, organized campaign against Android by Microsoft, Oracle, Apple and other companies, waged through bogus patents.

They're doing this by banding together to acquire Novell's old patents (the "CPTN" group including Microsoft and Apple) and Nortel's old patents (the "Rockstar" group including Microsoft and Apple), to make sure Google didn't get them; seeking \$15 licensing fees for every Android device; attempting to make it more expensive for phone manufacturers to license Android (which we provide free of charge) than Windows Phone 7; and even suing Barnes & Noble, HTC, Motorola, and Samsung. Patents were meant to encourage innovation, but lately they are being used as a weapon to stop it.

Microsoft's General Counsel Brad Smith responded:

Google says we bought Novell patents to keep them from Google. Really? We asked them to bid jointly with us. They said no.

Microsoft then released a corroborating October 28, 2010 e-mail from Google General Counsel Kent Walker to Smith:

After talking with people here, it sounds as though for various reasons a joint bid wouldn't be advisable for us on this one. But I appreciate your flagging it, and we're open to discussing other similar opportunities in the future.

This exchange shows how quickly escalation can occur.

Drummond's initial statement is an example of what may often be heard on university campuses. While Google has valid concerns about patents and innovations, a public accusation that names firms and employees makes future cooperation difficult. The full cited email between Walker and Smith shows much more mutual respect than Drummond suggests. Frank Shaw's release of the email makes the use of written communication questionable in the future.

TechCrunch, a computer industry news post, commented:

But [the email] sure makes Google look pretty stupid. And it reinforces something that many observers think about Google's position here: that they simply weren't taking the patent situation too seriously until recently, and now they're all up in arms about it.

One of the patent deals Drummond cited as evidence of an anti-competitive conspiracy was the CPTN consortium's bid for the Novell patents. The consortium of Microsoft, Apple, Oracle and EMC purchased the Novell patents, subject to restrictions. Google had the opportunity to join the transaction though it may not have provided needed protection to Google suppliers.

### The Novell patents

Earlier, 882 patents became available as part of a complex acquisition of Novell by Attachmate. Attachmate paid \$2.2 billion for Attachmate, but received \$450 million from a consortium named CPTN led by Microsoft. The consortium also included Apple, Oracle and EMC. The acquisition was amended to accommodate U.S. Department of Justice and the German Federal Cartel office conditions protecting open-source software. The portion of patents that Microsoft received would be sold back to Attachmate with a license to use the patents. In the allocation, EMC could not acquire any of the patents for virtualization software. All would be acquired under either a license (GNU) that restricts commercial use or the Open Invention Network (OIN) license for the Linux operating system. Attachmate participated in OIN.

The open-source culture has penetrated the smartphone market in several ways. There have been attempts to develop open-source both hardware and software of smartphones. Most commercial smartphones were based on open-source operating systems. These include Google's Linux based Android, Nokia's Maemo, later merged with Intel's project Moblin to form MeeGo, Hewlett-Packard's WebOS, and Berkeley Software Distribution (BSD) based, such as the Darwin-based Apple iOS.

This was an opportunity for Google to acquire patents. Now the patents are available to those who are willing to litigate Google for patent infringement.

CPTN purchased the Novell patents at an average cost of \$522,000. Facebook purchased 18 patents from Friendster for \$40 million at an average cost of \$2,200,000. This compares to the average price of a Nortel patent of \$7,500,000. Patents critical to high-value product lines such as smartphones are not inexpensive.

### IBM and consortiums

IBM has been a quiet consortium builder for decades. The Apache Foundation that creates open-source software was initiated by IBM. IBM and other companies support the Foundation by contributing the time of paid employees. But many of the members contribute because “they like to build things.” When the Linux operating system became important to a number of companies, IBM formed a coalition to support Linux development. IBM, Oracle, EMC, and Google and thirty others now sponsor the Linux Foundation.

IBM also donated the software and initial funds to the Eclipse Foundation providing a framework for software design, development, and testing. IBM, Google, Intel and six other firms sponsor this work.

To protect the Linux operating system, IBM founded the OIN patent protection group. Companies donate and OIN purchases patents that could prevent threats of litigation to members. OIN seeks licenses from those who are not members. Sony, IBM, NEC, Red Hat, Philips and Novell are members; Cisco and Twitter joined August 11, 2011. Oracle and Google were members, but may have discontinued their membership because of Oracle v. Google.

In 2005 IBM donated 500 patents to the open-source community, primarily in colleges and universities.

IBM has benefited from coalitions and the consortiums it has initiated or participated in. Google may want to add a similar dimension to their intellectual property strategy.

## Lessons

- One of the underlying causes of the “patent war” is, as Google asserts, low-quality patents. James Cross, writing in the July/August issue of IP Magazine, said: “Improving patent quality is a current policy objective of patent offices worldwide, and effective prior art searching is the key to achieving this objective”. He continues “Searching patent databases and the web is cheap, but reading obscure journals in a library is expensive”. Litigation of patents to determine quality and enforceability is neither effective nor cost-beneficial as compared to Cross’ patentability searches and IBM consortiums.
- To avoid the cost and delays of litigation, coalitions and consortiums should be negotiated; the IP team should lead.
- As evidenced by the Friendster, Novell, and Nortel patent acquisitions, intellectual property requires the development of a complete strategy. Military and political scientists, economists, and engineers may be needed in the team.

But will firms recognize the need for these services now rather than when it becomes too late to avoid confrontation, added product costs and delays, and complex and costly litigation?