By Yann Ménière, 6 March 2012

Mobile industry in Google's cross-hairs

Though a late-comer to the mobile market, Google has nonetheless made a rather spectacular entrance. Android, its operating system for smartphones, is running on millions of mobile terminals manufactured by other companies under their own brands. The key to Google's success is the fact that Android is open-source, and thus freely distributed. This has allowed the likes of Samsung and HTC to close the gap with Apple by giving them free access to a software platform of comparable quality to that of iPhone. This winning formula, though, hides a serious weakness: it is based on the assumption that Google and its allies are actually the owners of the technology they are distributing. The fact is, however, that Google entered the mobile market with few or no patents – unheard-of in the industry.

Making up for lost time

Every smart-phone contains at a minimum hundreds of patented components. These are the fruits of decades of innovation by companies in the sector, who have contributed tens of thousands of patents. Manufacturing a mobile device without using other companies' patents is a gamble, so producers typically negotiate cross-licensing agreements, though sometimes only after costly legal proceedings. The upshot is that royalties can represent up to a quarter of the value of a smart-phone.

Phones carrying the Android OS are no exception. Google is not directly concerned, since it does not produce handsets, but it finds itself today being forced to watch helplessly as third-party patents come to light that cover technologies inside "Google phones". Indeed, manufacturers using the Android OS are currently involved in a number of lawsuits – starting with the conflict pitting Samsung against Apple in several different jurisdictions – and the main ones (Samsung, HTC, LG) have already accepted to pay Microsoft for technology they are using.

A realisation of the weakness of its position seems to have prompted Google to change tack, and last summer's bankruptcy of North American handset manufacturers gave it the opportunity it needed. Though Google missed out on Nortel's 6000 patents (which were bought by a consortium led by Apple and Microsoft), it has managed to buy Motorola Mobility, with its 17,000 patents, for twelve and a half billion dollars. Armed with such a portfolio, Google now has firepower comparable to that of the sector's other giants. Both competitors and competition authorities the world over are wondering anxiously how it will use these new weapons.

The "nuclear weapon" of essential patents

The "essential" patents acquired by Google are the focus of these concerns. They are "essential" because they cover two technological standards on which the entire mobile industry is dependent. The first is the H.264 codec, which allows videos to be viewed on different terminals (e.g. smartphones, tablets, PCs, DVD/Blu-ray players). The second is the Wi-Fi standard. These standards obviously need to be incorporated into all smartphones. This is why patent holders

traditionally commit to licensing their technologies on FRAND (fair, reasonable and non-discriminatory) terms when standards are under development. Players in the market realise that refusing to license is not a realistic option – the only question is what constitutes a "reasonable" royalty.

Motorola, like others, had made such commitments. But it rescinded them shortly before declaring bankruptcy – and in so doing, set a dangerous precedent. Pulling out of its FRAND commitments enabled the company to claim injunctive relief via the courts, forcing competitors accused of infringement to suspend production of the offending products – in other words, to shut down pending a court judgment. This "nuclear" weapon gave Motorola a big stick to impose its will. The upshot is that Microsoft, for example, is looking at licence fees of 2.25% of the final sale price of whole products – smartphones, Xboxes or PCs – for access to 50 patents contained in the H.264 standard, a rate that is a hundred times what MPEG-LA, a patent pool bringing together 29 firms, charges for 2300 other patents reading on H.264

Google, heir to Motorola's ongoing litigation, appears set to continue down the same path. Queried by the US Department of Justice recently, Google refused to rule out the use of injunctive relief for its new essential patents (in stark contrast to Apple and Microsoft, who were asked to make similar commitments in the context of the Nortel acquisition and complied with the requests). Its approach is difficult to understand since the company is anything but financially vulnerable. Whether it is just trying to shore up Android or really intending to hold competitors to ransom, the implications of its conduct are profound.

New rules of the game

This use of essential patents as a legal weapon is already prompting opponents of Google-Motorola to reply in kind, potentially triggering a tit-for-tat escalation that would be ruinous for the whole industry. Even worse, it undermines the credibility of FRAND commitments, and as a result the industry's ability to set common standards. The risk ultimately is that companies will be forced to retreat into their own proprietary ecosystems, each increasingly walled-off from the others. It goes without saying that this would be against interests of the six billion consumers who would be affected by such a course of events.

The stakes are high enough to have attracted scrutiny from a number of competition authorities. Almost simultaneously, the US Department of Justice and the European Commission issued warnings to Google regarding the use of essential patents in tandem with their respective approvals of the MMI acquisition (see video of Commissionner Almunia's interview on this topic). As if to reinforce the message, DG Competition has launched an investigation into possible abuse of injunctive relief by Samsung against Apple. With its submission of a formal complaint on 22 February, Microsoft has weighed in along the same lines.

Competition authorities, though, have neither the means nor the mandate to regulate the creation of standards and access to essential patents *ex ante*. If Google persists in its current approach, the sanctions those authorities would be able to bring to bear will not be adequate to address the fundamental problem. Instead, at the end of the day it will be for the mobile industry itself to put out the fire, by finding some viable means of preserving their common standards. What irony that it should be Google – self-proclaimed champion of the open Internet – that lit the fuse!