



# Google's Acquisition of Motorola Mobility

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In mid-August of 2011, Google surprised the mobile industry by announcing its intention to acquire the mobile handset and tablet maker Motorola Mobility (NYSE: MMI). At an acquisition price of \$12.5B, the deal offered a 63% premium over the market price for MMI, which had been operating at a net loss of 1.7% of sales. This transaction represented Google's largest acquisition to date.

The acquisition was a surprise to the industry because Google licenses its Android Operating System to MMI and many competing handset Original Equipment Manufacturers (OEMs) on equal terms. As such, does the acquisition signal a Google preference for the Motorola OEM in the future? Only time will tell the true story, but Google reassured competing OEMs that this was not the case and that motive for the acquisition was to prepare a mobile technology patent portfolio to deal with the threat of patent infringement suits from competitors such as Apple.

In fact, the background of Google's MMI acquisition not much short of a full-scale "Intellectual Property (IP) War" in the emerging mobile communications market centered around Google and Apple. Motorola Mobility holds 17,000 patents and has another 7,500 pending. And while patent quality is much more important than mere patent quantity, Apple is believed to have approximately 1,000 patents in this space, which happens to be about twice as many as Google had prior to the MMI acquisition.

Google's acquisition of MMI brings forward a number of interesting questions that affect the Innovation Economy:

1. Is this acquisition really all about IP, or are there other strategic business intentions?
2. Will Google move away from being primarily a horizontal provider of search and advertising to being a vertically integrated firm like Apple, or is the acquisition more about Google defending itself and its partners from IP litigation from Apple?
3. Given the MMI assets, (including \$3B in cash) and the market growth in mobile, what is a fair price for MMI with and without the patents?

4. What does this mean for the market pricing of IP in the future, or is the MMI acquisition simply a special case? What, if any, are the implications for IP pricing for earlier-stage firms?
5. Perhaps more fundamentally, does the system for protecting IP still serve the purpose of providing a relatively short-term competitive advantage to those who take the risks to innovate, or has the nature and purpose of IP evolved in a different direction?

## Today's IP Battlefield

Since the introductions of the iPhone and Android platforms, both Apple and Google have fiercely competed for mobile Internet smartphone users, a market previously dominated by RIM's Blackberry product. This competition is fundamental to the future of search, on-line shopping, virtual goods, games, and an ecosystem of data applications. In parallel with this competition for users, the new and incumbent players in the mobile space have become increasingly proactive in using legal measures to protect their investments and market share.

- *Value of IP:* Under the name Rockstar Bidco, Microsoft, Apple, and RIM recently purchased rights to Nortel's patent portfolio for \$4.5B. This purchase signals a new level of intensity in the battle for IP in the emerging mobile sector.
- *IP War:* Patent litigation in the mobile space has been increasing at 25% on a yearly basis over the past six years. Over the past year, 85 new lawsuits have been filed. Prominent recent cases have included:
  - Motorola vs. Apple: Motorola asked Moto smartphones to be cleared of Apple IP.
  - Microsoft vs. Motorola: To request royalties from Motorola on smartphones.
  - Oracle vs. Google: For use of Java on Android.
  - Apple vs. Samsung, Apple vs. HTC: For Android functions on products of these Google partner firms. Google is aiding HTC in its case by claiming that Apple is using its patent portfolio to create a monopoly that is against the interest of the consumer.
  - Additionally: 1) Motorola recently won a case in Germany in which Apple was held to have violated some of Motorola's IP. 2) Apple won an injunction to stop Samsung from selling Galaxy Tablets with the Android OS in Germany.
- *Market numbers:* Mobile is clearly one of the largest of emerging markets.
  - In the US, June 2011 numbers showed 323 million subscribers, with 29.7% of households being wireless only.<sup>1</sup>
  - Wireless revenues were \$164B of which \$55B is for wireless data services.<sup>2</sup>
  - As of November 2011, 43% of US phones were smartphones. Of smartphones, Android phones led with 40% market share, Apple at 26%, RIM at 23%, Microsoft at 5.8%, and Symbian at 2%.<sup>3</sup>

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<sup>1</sup> [http://files.ctia.org/pdf/CTIA\\_Survey\\_MY\\_2011\\_Graphics.pdf](http://files.ctia.org/pdf/CTIA_Survey_MY_2011_Graphics.pdf)

<sup>2</sup> [http://files.ctia.org/pdf/CTIA\\_Survey\\_MY\\_2011\\_Graphics.pdf](http://files.ctia.org/pdf/CTIA_Survey_MY_2011_Graphics.pdf)

<sup>3</sup> [http://blog.nielsen.com/nielsenwire/online\\_mobile/generation-app-62-of-mobile-users-25-34-own-smartphones/](http://blog.nielsen.com/nielsenwire/online_mobile/generation-app-62-of-mobile-users-25-34-own-smartphones/)

- Motorola Mobility had an \$8.9B market cap, \$3B cash assets, and \$3.26B/quarter top-line revenue prior to its acquisition. Revenues included \$2.43B in mobile devices and \$0.83B in IPTV in the home segment. The firm operated at a net loss of \$90M in 2010, down from a loss of \$1.34B in 2009.
- Google's 2011 financials showed a \$200B market cap, \$42B in cash, \$10B/quarter top-line revenue, and 3.3B net earnings/quarter.
- After six years of discussion on how to fix the US patent system, the Leahy-Smith America Invents Act was passed by the Senate and signed into law by President Barack Obama on September 16<sup>th</sup>, 2011. The principal change in US patent law effected by Leahy-Smith was to switch the awarding of patents from the first-to-invent model historically in use in the US to a variant of the first-to-file model in use elsewhere in the world. With this law, patent applications filed on or after March 16, 2013 will be awarded on the new first-to-file basis. Leahy-Smith also provided for a new form of administrative proceeding to challenge patent validity and sought to restrict patent-infringement suits against multiple defendants.

### **Point of View: Patents as the Newest “Asset Class”**

As continuation of the smartphone litigation war suggests, Leahy-Smith is unlikely to reverse long-developing changes in how US businesses, both large and small, approach IP strategy.

- Traditional wisdom in many technology sectors had held that patents were only to be used for defensive purposes – they were the bargaining chips to trade with a plaintiff for a cross-license in the event of patent litigation. Although companies in slower-cycle and more capital-intensive industries (e.g., pharmaceuticals, materials science) have long invested heavily in IP protection as part of their business models, companies in fast-cycle and low-capital-intensity industries (e.g. software) typically had not needed to invest significantly in IP.
- In various technology sectors, a land-grab is now underway for extant patents – with the Google acquisition of MMI as a prime example – and firms have needed to become more aggressive in the pursuit and filing of new patents for their organically developed technology.
- Indeed, so-called non-practicing entities (NPEs; less flatteringly called “patent trolls”) have gained newfound prominence. Such entities’ primary apparent goal is to monetize existing patents by aggressively pursuing licenses or litigation with possible infringers. A classic example of an NPE is Round Rock Research LLC, a venture-backed company that purchased 4,200 patents from Micron Technology in 2010. A number of large patent holders, including Microsoft, Sony and Nokia, have spun off NPEs of their own.
- IP has thus proven to be an offensive weapon from which material revenues can independently be wrung as well as a defensive shield for a business providing goods and services distinct from the IP itself. As such, IP has emerged as an actual asset class, in many ways more like than different from a company’s real estate or cash holdings. .

It is in this environment specifically – where IP has evolved to become an asset class – in which a heretofore unlikely conflict has arisen between the Internet’s largest search provider and the world’s most successful purveyor of consumer products. Google’s \$12.5B acquisition of MMI is merely the first battle of what will doubtless be a long and unrelenting war played out on the battlefield of IP.

## **Appendix 1: Official Nortel Auction report on the Bidding Process of its IP Sale:**

An official report on the Nortel auction proceedings was submitted to the Canadian bankruptcy court by the appointed monitor, Ernst & Young. (Seventy-First Report, dated July 6, 2011). The following abstracts are from the initial narrative comments of the monitor's 322 page filing.

[http://investorshub.advfn.com/boards/read\\_msg.aspx?message\\_id=65039367](http://investorshub.advfn.com/boards/read_msg.aspx?message_id=65039367)

### **BIDDING PROCEDURES AND THE AUCTION**

17. Subsequent to this Honourable Court's approval of the Bidding Procedures and prior to the Bid Deadline, Nortel and/or its financial advisor, Lazard Frères & Co. LLC ("Lazard"), contacted 98 parties likely to be interested and able to acquire the Residual IP. Five interested parties executed supplemental confidentiality agreements, were provided access to the electronic data room, and completed further due diligence on the Residual IP. Ultimately, four parties (in addition to Ranger) indicated their interest in participating in the Auction, were deemed to be Qualified Bidders and submitted bids for the Residual IP. These parties were: (i) Apple Inc. ("Apple"); (ii) Rockstar Bidco, LP ("Rockstar"), a consortium of various technology companies; (iii) Intel Corporation ("Intel"); and (iv) Norpax LLC ("Norpax"), an affiliate of RPX Corporation.

18. In the period up to June 13, 2011, subject to the exclusivity provisions of the Stalking Horse Agreement, the above noted parties: i) were given access to the confidential data room; ii) accessed the data room; iii) engaged legal counsel and other advisors; and iv) participated in meetings and other discussions with management of Nortel and Nortel's advisors.

23. After consultation with the Monitor and representatives of the Committee, the Bondholder Group and the Joint Administrators, the Sellers determined that the highest or otherwise best starting offer was the bid received from Intel. Accordingly, on June 23, 2011, the Qualified Bidders were informed that this bid had been selected as the Starting Bid pursuant to the Bidding Procedures.

24. The Auction commenced at approximately 9:15 a.m. on June 27, 2011, at the offices of Cleary Gottlieb Steen & Hamilton LLP in New York, New York. In attendance at the Auction were representatives of the Sellers, the Monitor, the five Qualified Bidders, the Committee, the Bondholder Group, the Joint Administrators, and the French Liquidator.

25. The Intel bid was announced as the Starting Bid and the Qualified Bidders were advised that the minimum bid increment was set at \$5 million in accordance with the Bidding Procedures. The Qualified Bidders were also advised of certain rules and procedures with respect to the bidding process as set by the Sellers, including the requirement that each Qualified Bidder (other than one that submitted a bid deemed to be the Leading Bid in the immediately preceding round) submit a bid in each round in order to be eligible to continue to submit bids independently in the Auction.

The Sellers then adjourned the Auction to allow the other Qualified Bidders time to prepare written bids. During this adjournment, all four of the other Qualified Bidders submitted new bids. Following consultation amongst the Sellers, the Monitor and representatives of the Committee, the Bondholder Group, the Joint Administrators and the French Liquidator, the Auction was re-convened and the Sellers announced a new Leading Bid. The Sellers then asked for a second round of bidding, exercised their discretion (following consultation with the Monitor and representatives of the Committee, the Bondholder Group and the Joint Administrators) to increase the incremental net value threshold for bids to \$50 million from the initial threshold of \$5 million, and adjourned the Auction again to allow the other Qualified Bidders to prepare revised offers.

26. In the second round of bidding, three bids were received. Norpax did not submit a bid in the second round but elected to remain in attendance at the Auction in accordance with the Bidding Procedures. Following consultation among the relevant Nortel entities and their constituents as noted above, the Auction was reconvened, a new Leading Bid was declared, the incremental net value threshold was increased to \$100 million, and the Qualified Bidders were advised that Norpax had not submitted a bid and therefore the number of Qualified Bidders participating in the Auction was reduced to four. The Auction was adjourned again.

27. The Auction continued for a further seventeen rounds of bidding over the course of June 27, 28, 29 and 30, 2011. Rockstar did not submit a bid in the fifth round and in accordance with the Auction rules established by the Sellers was not permitted to submit further independent bids. Accordingly, the number of Qualified Bidders entitled to participate independently in the Auction at the conclusion of round five was reduced to three.

28. Following the fifth round, Apple, with the consent of the Sellers, had discussions with Rockstar regarding potential partnership opportunities. Following these discussions, Apple indicated it wished to partner with Rockstar and adopt Rockstar's transaction structure (including using Rockstar as the purchaser). The Sellers consented to this proposal and the balance of Apple's bids at the Auction adopted the Rockstar structure. Following the sixth round of the Auction, Intel indicated it was withdrawing and would not be submitting further independent bids in round seven or in subsequent rounds. At this point, the Sellers gave their consent to the two remaining Qualified Bidders, being Ranger and Apple, to discuss partnering opportunities with those Qualified Bidders who were no longer able to participate independently in the Auction (i.e., Norpax, Rockstar and Intel) upon providing prior written notice to the Sellers, it being understood that the Sellers had to consent to any partnering proposals. Following the eighth round of bidding, Ranger asked for and was granted consent by the Sellers to allow it to partner with Intel on specific conditions as read into the record at the Auction. Apple (in partnership with and using the Rockstar transaction structure) and Ranger exchanged counter-bids in rounds nine through 19 in increments of \$100 million dollars. The bidding in these rounds proceeded solely through increases to the cash purchase price (and confirming certain requisite points on the record) as the forms of sale agreement and ancillary transaction documents were substantially comparable from the Sellers' perspective.

29. In the nineteenth round, Apple (in partnership with Rockstar) presented a bid of \$4.5 billion, which bid was declared the Leading Bid. At the beginning of the twentieth round, Ranger requested and was granted an adjournment by the Sellers. The Auction was reconvened at approximately 6:45 pm on June 30, 2011, and Ranger indicated it would not make a further bid. The Sellers adjourned the Auction solely for the purpose of allowing the Sellers and the Purchaser to finalize and execute definitive documentation and the \$4.5 billion bid submitted by Apple (in partnership with Rockstar) was declared the Successful Bid.

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Note: The full filing, is a 322 page download. The monitor's actual report is the first 22 pages, the balance being a lot of copies of legal exhibits. if interested in can be accessed through the article posted by slocat: <http://paidcontent.org/article/419-why-google-and-android-must-deal-with-the-mobile-protection-racket/>

look for "That account was verified in a report (click for PDF) filed by a monitor from the Canadian court system that was made public on Wednesday."