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A legal update from Dechert's Antitrust Group

"Unfairness" in Standard-Setting: Has the FTC Set a New Standard?

Key Questions for Clients to Consider

- **Clients Acquiring Patent Rights:** Have you adequately investigated the possibility that the patents might be subject to licensing commitments made to standards development organizations?
- **Clients Defending Standards-Based Patent Infringement Litigation:** Have you considered a possible misuse defense or antitrust counterclaim based on the patentee's conduct during the standards development process?

The Federal Trade Commission, by a 3-2 vote, recently issued a complaint and consent agreement with a patent-holder regarding conduct before a standard-setting organization ("SSO"). The complaint charged that Negotiated Data Solutions LLC ("N-Data")[1] unlawfully reneged on a promise made to an SSO by the prior owner of N-Data's patented technology in order to persuade the SSO to adopt that technology into an industry standard.

The prior owner, National Semiconductor Corporation ("NSC"), told the Institute of Electrical and Electronics Engineers ("IEEE")—an SSO that publishes an industry standard for computer connections to local area networks—that, if IEEE chose the technology for the standard, NSC would make it available to licensees for no royalty and a one-time fee of $1,000. N-Data later acquired the patents that covered this technology. Although N-Data knew of NSC's promise, it refused to honor it, and demanded royalties and higher fees from licensees.

The FTC describes N-Data's actions as "patent hold-up"—an exploitation of power over firms that practiced the standard and became "locked" into using N-Data's patented technology, because of the high cost of switching to alternative technologies after the standard was adopted. The FTC alleged that N-Data's conduct, if unchallenged, would injure consumers by increasing prices and royalties for products engineered under the standard, such as home computers, and would harm the credibility of IEEE's standard-setting process. In an unusual twist, N-Data was charged with violating both the antitrust and consumer protection provisions of Section 5 of the FTC Act for the same conduct.

The FTC order does not require monetary relief. With certain exceptions, it requires N-Data to adopt the terms that NSC promised in 1994 (paid-up, royalty-free license in exchange for one-time fee of $1,000).

Overriding Factor: The Standard-Setting Context

A decisive factor in the FTC's decision to bring this case undoubtedly was the standard-setting environment in which the challenged conduct occurred. The Commission pointed out more than once that merely breaching a licensing commitment would ordinarily not rise to the level of an unfair method of competition or an unfair act or practice. But to the agency, "the established public policy of supporting efficient standard-setting activities" added a critical dimension to the case,

[1] *In re Negotiated Data Solutions LLC*, FTC File No. 0510094 (Jan. 23, 2008), available at http://www.ftc.gov/opa/2008/01/ethernet.shtm.

justifying an admittedly "broad" Section 5 application in order to remedy the "hold-up" scenario, which the FTC characterized as a "particularly pernicious problem."

Questions and Implications for Patent Owners Participating in Standards Development

The Commission's enforcement action, with the added information provided by the dissenting commissioners, raises a number of troublesome questions for patent owners participating in standards development activities.

Can Antitrust Liability Be Imposed on a Patent Owner Who Has Not Violated the SSO's Rules or Procedures?

There was some question whether, in modifying its predecessor's patent licensing commitments, N-Data was in fact violating IEEE's rules or procedures. According to Commission Chairman Majoras, IEEE knew that its members sometimes changed their patent commitments and could have objected to N-Data's revisions, but instead accepted and published them without objection.

Imposing antitrust liability on a patent owner for activity within the standards development process that does not violate the SSO's rules or procedures—if in fact that was the case here—has significant policy implications. For example, many SSOs have explicit rules on patent disclosure that try to balance the benefits of disclosure against the practical limitations of searching through thousands of patents and patent applications in large research-intensive companies. Imposing in that setting a more demanding antitrust standard than the SSO's own rules could seriously interfere with the efficiency of the SSO's standards development process. One obvious problem the FTC's enforcement rationale creates for patent owners is uncertainty whether they can continue to rely on the SSO's rules and procedures as a safe harbor against potential antitrust liability.

What If the Assignee Had Acquired the Patent Without Notice of the Licensing Commitment?

The fact that N-Data had knowledge of the licensing commitment before it acquired the patent made it relatively easy for the FTC to impose liability and a remedy for breaching that commitment. But what if N-Data had acquired the patent without notice of the licensing commitment? There are situations in which a bona fide purchaser of a patent right, even without notice, remains subject to the patentee's prior commitments—a license being one example.[2] Whether such a principle could be applied to a patent holder's licensing commitments to SSOs is sufficiently unclear to warrant some care by purchasers of patent rights to address in due diligence and in the contract license possible commitments made to SSOs by previous owners. These commitments may take the form of unambiguous undertakings, as in N-Data, or more commonly commitments to license on reasonable and non-discriminatory (RAND) terms or at zero royalty (RAND-Z).

Is *Ex Ante* Conduct Becoming a Fertile Ground for Patent Misuse and Antitrust Counterclaims?

This case joins the FTC's *Dell*, *Unocal*, and *Rambus* cases as yet another initiative in the Commission's effort to articulate legal obligations for patent holders who participate in standards development.[3] Each of these legal obligations threatens to become a trap for unwary patent owners when they enforce their intellectual property rights. It is not far-fetched to anticipate that defendants in standards-related patent infringement cases will soon be routinely combing the records of the standards development process—as they presently comb the patent prosecution record—for evidence of "misfeasance" by the patent owner, which can then be labeled misuse or leveraged into an antitrust counterclaim.

Is the FTC Being Too Cavalier about the Threat of Follow-On Private Class Actions?

The Commission filed its complaint solely under Section 5 of the FTC Act, which confers no private right of action. However, Section 5 embraces all practices that violate the Sherman and Clayton Acts, which do pro-

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2 *Sanofi, S.A. v. Med-Tech Veterinarian Products, Inc.*, 565 F.Supp. 931, 939 (D.N.J. 1983).

3 *Rambus, Inc.*, Dkt. No. 9302 (Feb. 5, 2007) (decision on remedy), available at http://www.ftc.gov/opa/2007/02/070502rambus.htm; (Aug. 2, 2006) (decision on liability), available at http://www.ftc.gov/os/adjpro/d9302/index.shtm; *Union Oil Co. of California*, Dkt. No. 9305 (July 7, 2004) (decision on remand), available at http://www.ftc.gov/opa/2004/07/unionoil.shtm; *Dell Computer Corp.*, 121 F.T.C. 616 (1996).

vide for treble damages. For this reason, respondents in FTC cases have often suffered the experience of protracted private class actions triggered by an FTC enforcement action, whether filed under competition or consumer protection theories.

This case, however, may represent the first time the FTC has publicly acknowledged that such exposure might be a relevant factor in exercising its prosecutorial discretion. The majority decision, in discussing the potential social cost of an unfounded enforcement action, refers to "the low likelihood that a Commission consent order will be followed by a valid antitrust-based class action suit" in this case—a factor which dissenting Commissioner Kovacic characterized as "important" to the majority's decision to sue.

The FTC's treatment of this issue is subject to at least three criticisms. First, as Commissioner Kovacic points out, many states have "little FTC Acts" which do provide private rights of action for conduct that would violate Section 5, but not the antitrust laws. Second, it is not uncommon for plaintiffs to re-frame a Section 5 complaint into a viable complaint under the Sherman, Clayton or, in an advertising case, the Lanham Act. Most importantly, whether a class action claim ultimately proves "valid" is beside the point because antitrust class actions never get to trial. The social cost comes from the litigation expenses and the unwarranted amounts paid in settlement. The Commission has specifically solicited public comment on this issue, suggesting that the debate may not be entirely closed.

Does N-Data Put the FTC on a "Slippery Slope" of New and Unpredictable Legal Rules?

Chairman Majoras' dissent suggests that the agency's failure to identify a "meaningful limiting principle" to distinguish conduct that is "unfair" from that which is not puts the agency on a "slippery slope" toward imposing liability for evading contractual commitments "without a concurrent determination that the conduct violates the Sherman Act." Time will tell whether the Chairman's prediction comes true. It is immediately certain, however, that the FTC has a strong policy interest in keeping a watchful eye on this area. Accordingly, patent holders involved in standard-setting must be cognizant of their place in the FTC's spotlight, and proceed with prudence and understanding about the possible implications not just of their own representations, but also those of their predecessors.

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/antitrust.

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