Legal Backgrounder

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FTC INVOKES "UNFAIR COMPETITION" POWERS IN STANDARD SETTING DISPUTE

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In a 3-2 opinion, the Federal Trade Commission, on January 23, 2008, charged a patent owner with violating the FTC Act for allegedly imposing royalty rates above the amount the patentee's predecessor had negotiated with a standard setting organization ("SSO"). The FTC alleged that Negotiated Data Solutions LLC (N-Data), a non-producing purchaser and licensor of patents, violated the FTC Act by refusing to honor the licensing commitment to the SSO negotiated by its predecessor-in-interest. The previous owner of the patents supposedly committed to license the patents at a relatively low royalty rate to persuade the SSO to incorporate the technology embodied in the patents into industry standards.

According to the FTC's complaint, the conduct constituted both an unfair method of competition and an unfair or deceptive act or practice in violation of Section 5 of the FTC Act. The FTC, however, did not assert claims under the Sherman Act or Clayton Act – the primary federal antitrust statutes. The FTC's lawsuit against N-Data, particularly the decision to invoke the Commission's arguably broad authority to challenge unfair competition outside the contours of more conventional antitrust standards, represents a relatively aggressive enforcement bent. Along with its complaint against N-Data, the FTC issued for public comment a proposed consent order, to which the FTC and N-Data have agreed in principle, to settle the action.

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Background

N-Data purchased patents that the Institute of Electrical and Electronics Engineers (IEEE) previously had incorporated into its Ethernet standard. National Semiconductor Corp. (National) owned the patents at the time IEEE promulgated the Ethernet standard. National committed to an up-front, one-time royalty fee of $1,000 per license. The IEEE incorporated National's patents into its standard allegedly based on this commitment. The FTC alleged that when N-Data acquired rights to the patents, it revoked the previous licensing commitment made to IEEE and charged higher royalty rates.

The statement of the FTC, supported by Commissioners Harbour, Leibowitz, and Rosch, reflects a concern that standard setting bodies and the competitive efficiencies that they create could be destroyed if companies no longer trust or rely upon assurances made during the standard setting process. The Commission's decision to bring this enforcement action seems pretty clearly grounded upon a finding that N-Data had an absolute obligation to license the patented technology embodied in the Ethernet standard for the amount to which its predecessor-in-interest had committed. Rather than honoring that commitment, N-Data, according to the FTC, tried to exploit the economic leverage of its patents, which derived in large part from being incorporated into the Ethernet standard, and hold up the semiconductor and LAN equipment industries to extract much higher royalties than it was entitled to receive. The FTC cautioned that this type of patent hold-up conduct in the standards context, if it became widespread, would result in harm to consumers through increased prices and reduced consumer choice. Chairman Majoras and Commissioner Kovacic wrote dissenting statements.

The FTC serves as both an antitrust agency and a consumer protection agency. Section 5 of the FTC Act, 15 U.S.C. § 45, empowers the FTC to prevent "unfair methods of competition" and "unfair or deceptive acts or practices." The unfair competition prong typically implicates the FTC's power as an antitrust enforcement agency, while the unfair or deceptive trade practices prong typically implicates the FTC's rule as a consumer protection agency. In this enforcement action, the FTC invoked both the unfair method of competition and the unfair or deceptive trade practices prongs of Section 5. The FTC majority acknowledged that its action may be criticized as taking an overly expansive approach, particularly with respect to its authority under the "'unfair method of competition' prong of [FTC Act] Section 5." But the majority noted that its bases for bringing suit were not only justified by the circumstances but entirely consistent with U.S. Supreme Court precedent.

While acknowledging its expansive reading of the unfair competition prong of Section 5, the majority concedes the prong is subject to limiting principles. Those principles, according to the Commission's Analysis to Aid Public Comment, require that any violation that ventures beyond the more conventional antitrust proscriptions embodied in the Sherman or Clayton Acts must be based on a finding that the conduct is both anticompetitive and oppressive or coercive.

Chairman Majoras and Commissioner Kovacic objected to FTC's bringing of the action. Chairman Majoras criticized the majority for failing to identify any meaningful limiting principles that would indicate when alleged abuses in the standard setting context could legitimately be considered an "unfair method of competition." Chairman Majoras' dissent cautions that the FTC is heading down a slippery slope by invoking its unfair competition powers to enforce what look like contractual obligations. She cites similar policy concerns with the FTC invoking its consumer protection powers to protect the rights of sophisticated

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commercial actors, which have the wherewithal to protect their own interests if they feel aggrieved by the denial of access to inexpensive licenses.

Commissioner Kovacic's dissent criticizes the majority for failing to explain sufficiently its two theories of liability, *i.e.*, its unfair method of competition theory and its unfair or deceptive practices theory. According to his dissent, "When a public agency pleads alternative theories of liability, especially in a settlement with a party that appears to lack the means to threaten credibly to litigate, it should specify the distinctive contributions of each theory to the prosecution of the matter." Commissioner Kovacic suggests, however, that the majority offered only a muddled articulation, which seems to merge the two distinct prongs of Section 5 together. Moreover, Commissioner Kovacic took issue with the majority's decision to not assert a more conventional antitrust claim under the Sherman Act to help avoid spillover treble damage actions by private litigants. Although no private right of action exists under the FTC Act, Commissioner Kovacic points out that many states rely on FTC Act precedent as guidance for construing their "Baby FTC Acts." Therefore, to the extent the FTC majority was trying to limit follow-on private litigation by relying solely on FTC Act Section 5, the tactic would not necessarily accomplish its desired objective.

Proposed Settlement

To settle the FTC's action, N-Data agreed in a proposed consent order to restrictions on its ability to enforce its patents against parties using Ethernet technology. The order requires that, before initiating a patent enforcement action against an allegedly infringing party, N-Data must offer that party a patent license based on the original licensing commitment entered into by National and the IEEE.

Analysis

The FTC enforcement action against N-Data reflects an aggressive, and potentially controversial, use of enforcement authority under Section 5. The courts and the FTC have struggled over the decades to develop a workable standard for evaluating those unfair competition claims under FTC Act Section 5 that fall outside of the scope of the Sherman and Clayton Acts. The FTC can challenge as an unfair method of competition any conduct that violates the Sherman or Clayton Acts. But defining the contours of the murky area within Section 5 that extends beyond the boundaries of the Sherman and Clayton Acts has proven to be a challenge. Commentators over the last couple of decades have argued that the scope of the unfair competition prong of Section 5 should be limited to and no broader than the conduct proscribed by the Sherman and Clayton Acts. The few cases to address the issue over the last few decades have tried to impose some limitations on the reach of Section 5 in this area. The cases suggest that the FTC had not at those times (in the 1980s) developed or proposed reasonable limitations on its rather vaguely defined authority under the unfair competition prong, and that reasonable standards were needed to enable businesses to evaluate the legality of their conduct.

This case against N-Data in some respects resembles a throw-back to the days in which the FTC took a very expansive approach to its unfair competition powers. But it is consistent with the FTC's recent focus on preventing abuses by IP owners during the standard setting

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process, an area in which the FTC has brought at least three other high profile cases – the *Dell*, *Unocal*, and *Rambus* cases – in the last decade or so. The FTC majority also seemed to find relevant the fact that N-Data does not make or sell anything but rather is in the business solely of exploiting IP rights that others had developed.

Whether the FTC will continue to take an expansive approach to its unfair competition powers remains to be seen. In the *Rambus* case, Commissioner Leibowitz, in a concurring statement, foreshadowed this type of case when he took the position that a patent hold-up scheme in the standard setting context could represent a stand alone violation of FTC Act Section 5 separate and apart from any Sherman Act violation. In any event, it seems for the time being that at least three sitting FTC commissioners are willing to take an aggressive stance regarding the scope of their authority in areas of enforcement priorities for the FTC.