ALSTON+BIRD LLP

ANTITRUST AND INTELLECTUAL PROPERTY ADVISORY

February 26, 2008

FTC Adopts Broad Unfairness Standard Governing Patent Holders in Standard-Setting Context

Summary

On January 23, 2008, a divided Federal Trade Commission ("FTC") issued an opinion that expanded the legal duties and risks of patent holders participating in standard-setting organizations ("SSOs").[1] In a 3-2 opinion, the FTC found that Negotiated Data Solutions LLC ("N-Data"), which acquired a patent from a previous holder, engaged in unfair methods of competition and unfair acts or practices in violation of Section 5 of the FTC Act. The principal charge was that N-Data refused to honor the terms of an agreement between the original patent holder and the Institute of Electrical and Electronics Engineers ("IEEE"), an SSO governing the standards utilized in Ethernet connections. Notably, contrary to its usual approach, the FTC chose not to pursue Section 5 liability based on N-Data's conduct being an antitrust violation, but rather on the conduct being unfair. This could foreshadow additional FTC enforcement actions against unfair conduct that does not rise to the level of Sherman Act violations.

Background

The original patent holder, National Semiconductor Corporation ("National"), was an active participant in IEEE. In 1993, National convinced IEEE to adopt its autonegotiation technology, referred to as "NWay," into the Fast Ethernet standard. In order to persuade IEEE to adopt the technology, National publicly announced that if NWay technology were chosen, National would license NWay to any requesting party for a one-time fee of $1,000. As a result, National's technology was incorporated into the Fast Ethernet standard.

In 2003, N-Data was assigned the patent for NWay technology; at the time, N-Data was aware of National's prior commitment to IEEE. However, a direct relationship between N-Data and IEEE did not exist. N-Data thereafter rejected requests from companies to license NWay technology for the one-time fee. Instead, N-Data threatened to initiate legal action against companies that refused to pay its royalty demands, which were far in excess of the one-time fee.

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[1] *In re Negotiated Data Services LLC*, FTC File No. 051 0094 at 2 (Jan. 23, 2008), *available* at http://www.ftc.gov/opa/2008/01/ethernet.shtm.

On January 23, 2008, the FTC issued a complaint against N-Data, claiming that N-Data used unfair acts or practices and unfair methods of competition in attempting to break the licensing agreement entered into by National. Simultaneously, the FTC voted to adopt the proposed consent agreement settling the matter, which ordered N-Data to cease and desist litigation, enforcement, or licensing relating to the relevant patents without first making an offer compliant with National's prior licensing agreement with IEEE. The order further forbade N-Data from selling or assigning the patents without executing an agreement binding the successor to the terms of the order as well.[2]

This case represents a step further than the FTC's recent standard-setting decision in the *Rambus* case.[3] In *Rambus*, the FTC found that Rambus had violated Section 5 by deceiving an SSO through concealing its patent portfolio, knowing the organization was developing standards that incorporated Rambus's patented technology.[4] That opinion was significant because it emphasized the FTC's willingness, even in a case based on antitrust theories of liability like *Rambus*, to incorporate consumer protection standards to actions directly connected to the initial standard-setting process. In the N-Data case, though, the FTC applied Section 5 where the alleged violating party was not directly involved with the standard-setting process. Additionally, and perhaps more significantly, the FTC departed from its previous SSO enforcement actions by finding a Section 5 violation not based on any underlying Sherman Act violation.

The FTC Opinion

The majority opinion held that N-Data's conduct constituted unfair methods of competition and unfair acts and practices under Section 5. Crucial to the FTC's decision was the fact that this conduct took place within the context of an SSO, noting that the "process of establishing a standard displaces competition; therefore, bad faith or deceptive behavior that undermines the process may also undermine competition in an entire industry, raise prices to consumers, and reduce choices."[5]

With regard to N-Data's conduct constituting an unfair method of competition, the FTC first noted that the Supreme Court has endorsed an expansive reading of the "unfair method of competition" provision of Section 5.[6] To support a finding of an unfair method of competition, the FTC determined that N-Data acted coercively and oppressively, due to its efforts to

2 *In re Negotiated Data Services LLC*, FTC File No. 051 0094, Decision and Order at 5-10 (Jan. 23, 2008), *available* at http://www.ftc.gov/os/caselist/0510094/080122do.pdf.

3 *In re Rambus*, FTC File No. 982 3563 (July 31, 2006), *available at* http://www.ftc.gov/opa/2006/08/rambus.shtm, *appeal pending*, Docket Nos. 07-1086, 07-1124 (D.C. Cir. 2007).

4 An Alston & Bird advisory summarizing the opinion and its implications is available at: http://www.alston.com/antitrust_rambus_2006.

5 *In re Negotiated Data Services LLC*, FTC File No. 051 0094 at 2.

6 The FTC cited authority stating that the FTC is empowered to "define and proscribe an unfair competitive practice, even though the practice does not infringe either the letter or spirit of the antitrust laws" and to "proscribe practices as unfair … in their effect on competition." *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 239 (1972).

exploit its power over those practicing the Fast Ethernet standard and lacking any practical alternatives. The FTC further stated that this form of patent enforcement is inherently "coercive" and "oppressive" with respect to the firms locked into this standard. Second, the FTC found that N-Data's conduct had an adverse effect on competition, through an adverse impact on prices for autonegotiation technology and the threat that such conduct poses to standard-setting at IEEE and elsewhere.

With regard to N-Data's conduct being an unfair act or practice, the FTC commented that the efforts of N-Data to unilaterally increase the price for the relevant technology by knowingly reneging on National's commitment met the relevant statutory criteria under Section 5.[7] The FTC further called N-Data's activity a form of "patent hold-up," in that it exploited companies that had been locked into the IEEE standard. Lastly, the FTC noted that N-Data's conduct was also considered an unfair act or practice under Section 5(n) because such conduct victimized consumer businesses.

The FTC noted that, in finding a Section 5 violation without a corresponding Sherman Act violation, it was adopting a broader interpretation of Section 5, stating that "[w]e recognize that some may criticize the Commission for broadly (but appropriately) applying our unfairness authority…But the cost of ignoring this particularly pernicious problem is too high."[8]

It is significant that the opinion only received the votes of three of the FTC's five commissioners. Chairman Majoras issued a dissenting opinion arguing that this case is distinguishable from other standard-setting "patent hold-up" challenges the FTC has considered such as *Unocal*,[9] *Dell*,[10] and *Rambus*,[11] in that there is no allegation that National engaged in improper or exclusionary conduct to induce IEEE to adopt its technology as the Fast Ethernet standard.[12] In addition, Chairman Majoras took issue with the majority's willingness to expand the zone of activity covered by Section 5 but not by the Sherman Act, citing "a scholarly consensus that finds the Sherman and Clayton Acts, as currently interpreted, to be sufficiently encompassing to address nearly all matters that properly warrant competition policy enforcement."[13] The chairman also argued that coercion and oppression on the part of N-Data were impossible

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7 These criteria include: (1) the conduct must cause substantial consumer injury; (2) the injury must not be outweighed by any countervailing benefits to consumers or competition that the practice produces; and (3) the injury must be one that consumers themselves could not reasonably have avoided.

8 *In re Negotiated Data Services LLC*, FTC File No. 051 0094 at 3.

9 *In re Union Oil Co. of Ca.*, FTC File No. 011 0214 (July 7, 2004), *available* at http://www.ftc.gov/os/adjpro/d9305/040706commissionopinion.pdf.

10 *In re Dell Computer Corp.*, 121 F.T.C. 616 (1996).

11 *In re Rambus*, FTC File No. 982 3563 (July 31, 2006), *available at* http://www.ftc.gov/opa/2006/08/rambus.shtm, *appeal pending*, Docket Nos. 07-1086, 07-1124 (D.C. Cir. 2007).

12 *In re Negotiated Data Services LLC*, FTC File No. 051 0094, Dissenting Statement of Chairman Majoras at 2.

13 *Id*. at 3 (*citing E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984)) (holding that "unfair" conduct under Section 5 not rising to the level of an antitrust violation must exhibit some indicia of oppressiveness, such as evidence of anticompetitive intent or lack of independent legitimate business reasoning).

to find based on the evidence before the FTC, and commented that to find substantial consumer injury in this case, the majority had to treat large, sophisticated computer manufacturers as "consumers," a characterization with which she disagreed.[14] Commissioner Kovacic issued a separate dissent, commenting that although Section 5 grants no private cause of action and parties will be unable to rely solely upon the FTC's finding to bring treble damages claims in federal antitrust suits, finding liability as the FTC did here may lead to suits under state laws based on the FTC Act.[15]

Implications

The N-Data opinion sends the technology industry and SSO participants a strong message in the context of patent licensing: any action taken by the holder of a patent may affect later licensing of that patent. As a result, individuals and businesses should consider the long-term effects of making representations regarding their IP, particularly where other actors rely upon these representations while locking themselves into long-term agreements, as in the standard-setting context. Further, any individual or business that is acquiring IP rights should investigate whether the IP to be acquired may be encumbered by a prior owner's involvement with an SSO.

In addition, individuals and businesses must consider whether it is in their best interest to be involved in SSOs in light of their IP portfolio. If the decision is made to be involved in such an organization, it is important for the individual or business to review and understand that organization's IP policies and duly disclose any relevant IP according to those polices. It is also important to track and document any type of representations made by other members of the organization pertaining to their IP, to avoid allowing other members to abuse their IP rights.

Future FTC opinions should shed light on what forms of conduct, including non-royalty terms, will be considered pernicious enough to merit Section 5 enforcement without Sherman Act violations, but IP rights holders should keep in mind that the FTC appears poised to stop uses of these rights that threaten to harm consumers, particularly where those consumers are vulnerable to exploitation, such as where they have bound themselves to long-term industry standards through SSOs.

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[14] *Id.* at 4-5. In the past, reselling businesses have been considered consumers under Section 5 of the FTC Act. *See, e.g. FTC v. Websource Media, LLC*, No. H-06-1980 (S.D. Tex. filed June 12, 2006) (holding that the "cramming" of unauthorized charges onto businesses' telephone bills violated Section 5). Chairman Majoras distinguished these holdings based on the level of sophistication of the businesses protected by the prior opinions.

[15] *In re Negotiated Data Services LLC*, FTC File No. 051 0094, Dissenting Statement of Commissioner Kovacic at 2.

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