Standard Setting under Section 5 of the FTC Act

Alden F. Abbott
Associate Director
Bureau of Competition
U.S. Federal Trade Commission

University of Oxford Centre for Competition Law and Policy
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Introduction

- The views set forth below are solely attributable to me and do not necessarily represent the views of the U.S. FTC or any U.S. FTC Commissioner
- I will discuss the application of Section 5 of the FTC act to potentially anticompetitive activity in the standard setting context
- In particular, I will assess the extent to which Section 5 may be used to reach practices that are beyond the reach of the Sherman Act

The Scope of Section 5

- Section 5 condemns “unfair methods of competition” and “unfair acts or practices” in or affecting interstate commerce
- I will be primarily concerned with the “unfair methods of competition” phrase (“unfair acts or practices” primarily has been used in consumer protection cases)
- However, no judicial precedent re whether “unfair acts or practices” language may be applied in competition cases

Section 5's Scope, cont.

- The U.S. Supreme Court has held that Section 5 reaches "not only practices that violate the Sherman Act and other antitrust laws, but also practices that the Commission determines are against public policy for other reasons." (*FTC v. Indiana Federation of Dentists* (1986))
- But courts have established limits to FTC's discretion in applying Section 5

Judicial Limits on Section 5

- Three 1980s appeals court cases limited the FTC's Section 5 discretion in competition area
- *Boise Cascade* (1980) (lack of substantial evidence basing point pricing anticompetitive)
- *Ethyl* (1984) ("indicia of oppressiveness" such as "anticompetitive intent or purpose" *or* no legitimate business reason needed for liability)
- *Official Airline Guides* (*OAG*) (1980) (can't reach monopolist's behavior affecting unrelated industry absent pernicious or coercive intent)

How Broad is Section 5?

- Unclear what specific limiting principles flow from 1980s Section 5 competition holdings
- Former Chairman Muris, others, argued Section 5 "unfair methods of competition" clause should be applied in a manner consistent with Sherman Act's reach
- But FTC majority has pushed Section 5 competition doctrine beyond Sherman Act in various consent decrees, both prior and subsequent to Timothy Muris' tenure as Chairman (2001-2004)

Section 5 Competition Consents

- Invitations to Collude – e.g., *Stone Container* (1998), *Vallasis* (2006) ("gap filling" cases, no Sherman Act agreement)
- Anticompetitive deception shielded by independent immunity – *Unocal* (2005) (FTC argued monopolizing conduct here)
- Failure to disclose patents in standard setting restricted competition – *Dell* (1996)
- *N-Data* (2008) (post-contractual opportunism, discussed later)

Section 5 Antitrust Litigation – Frontier Cases?

- Former Commissioner Leary argued that "pure" Section 5 claims might be asserted in "frontier cases" involving new types of claims, such as standard-setting "holdups" and "reverse payments" by patentee brand drug makers to allegedly infringing generic producers
- FTC in recent litigation has argued that Sherman Act principles had been violated in these cases, but without success (*Schering*, *Rambus*)
- Would applying a "pure" Section 5 theory have been a winning alternative?

Antitrust and Standard Setting – Background

- Focus now on standard setting
- Sherman Antitrust Act has long been held applicable to collusion among competitors and joint action to exclude competition (*e.g.*, *Allied Tube* (Supreme Court, 1988)) in the standard setting context
- But until recently Sherman Act had not been applied to deceptive pattern of single firm conduct in standard setting, allegedly aimed at obtaining market power
- What should standard setting organizations (SSOs) do?

Rambus Case

- In *Rambus*, FTC alleged that the Rambus company had engaged in a pattern of anticompetitive conduct that enabled it to obtain monopoly power in SDRAM technology market
- Anticompetitive behavior centered around Rambus's failure to disclose relevant patents and pending patent applications while participating in JEDEC SSO, allegedly violating JEDEC rules and undermining JEDEC goals
- Rambus' alleged aim was to "hold up" firms by demanding high royalties ex post for licenses to Rambus patents that read on JEDEC standards

Rambus Case, cont.

- FTC (2006) held that Sherman Act Section 2 applied here, finding substantial anticompetitive harm would likely result from Rambus' conduct, which FTC deemed deceptive and exclusionary
- FTC further noted deceptive conduct might be found in absence of express obligation to disclose (might be inferred by examining how rules were interpreted by SSO members)
- FTC found that by distorting JEDEC's choice of technologies and undermining SSO's protections against patent hold-up, Rambus' deceptive conduct gave it monopoly power and harmed competition

Rambus, cont.

- In addition to establishing exclusionary conduct and possession of monopoly power, Section 2 required that Rambus' deception was causally linked to Rambus' monopoly power
- In addressing causation, FTC inferred that, but for Rambus' deception, JEDEC either would have (1) excluded Rambus' patented technology from the SDRAM standards; or (2) demanded RAND assurances with an opportunity for ex ante licensing negotiations

Rambus, cont.

- Lastly, in a separate remedial opinion and final order (1987), FTC found evidence supporting the proposition that JEDEC *might* have still incorporated Rambus' patented technology even if it had fully known of Rambus' IP interests
- Rather than requiring royalty free licensing, FTC's remedial opinion required Rambus to license its technology at "reasonable rates" based on a hypothetical negotiation undertaken before JEDEC set the standards

Rambus Appeal

- On appeal, D.C. Circuit held that FTC failed to sustain its monopolization claim
- Court stressed that preventing JEDEC from obtaining a RAND assurance (1 of 2 alternatives posited by FTC) was protected by the Supreme Court's *Discon* decision (a lawful monopolist's deceptive or fraudulent practices leading to price rise does not violate Section 2)

Rambus Appeal, cont.

- D.C. Circuit also had "serious" reservations regarding the strength of the FTC record to support a "standalone" Section 5 action suggested by FTC Commissioner Leibowitz's concurrence
- Court called FTC's findings "murky" re what disclosures JEDEC required and what Rambus failed to disclose
- Court also criticized FTC's conclusion that Rambus engaged in deception re 2 technologies adopted over 2 years after Rambus last participated in JEDEC meetings. *Cert denied*.

Implications of Rambus

- One should not "overread" D.C. Circuit's legal opinion as precluding future Section 2 "standards deception" cases
- Had FTC found that in the "but for" world JEDEC would not have adopted Rambus' technologies, Court *presumably* (?) would have upheld Sherman 2 violation finding – *Discon* defense would not have existed
- Also, case law (e.g., *Microsoft*) and scholarly support for proposition that defendant, not plaintiff, should bear the risk of any uncertainty about alternative "but for" worlds
- Also, FTC's 2006 *Rambus* opinion discussed favorably by Third Circuit in 2007 *Broadcom v. Qualcomm* case (patentee deception before standard setting body stated a Section 2 claim)

Rambus and Section 5

- Would *Discon* problems have been avoided by bring *Rambus* as a "pure" Section 5 case "beyond" Sherman Act?
- Argument would be that when (1) conduct lacking in efficiency justifications allows (2) greater market power to be exercised than otherwise, Section 5 should bar conduct, even if it escapes Sherman Act condemnation for "technical reasons" peculiar to Sherman Act case law
- Not clear what courts would hold
- (Note, FTC position in *Rambus* was that Discon should not have been invoked because Rambus obtained its monopoly through bad conduct, rather than through competition on the merits)

Are "Rambus-Type" Hold-Ups no Longer a Serious Problem?

- FTC and private litigation in U.S. (*Rambus* and *Qualcomm*), and investigations abroad (*Rambus* in EC), may lead SSOs to clarify disclosure/negotiation policies
- Also, recent Justice Department Business Review Letters and FTC-DOJ "IP II" Report (2007) clarify that ex ante price negotiations within SSO context will not be deemed per se illegal
- But SSO policies still differ, some SSO members may object to ex ante disclosure/price negotiations on grounds of business practicality

N-Data and Section 5

- In *In re Negotiated Data Solutions, LLC* (*N-Data*) (2008 consent), FTC alleged Section 5, not Sherman Act, violation
- In context of IEEE standard setting for "Fast Ethernet," National Semiconductor offered $1,000 paid up license for National's "NWay" patented technology
- IEEE adopted NWay, technology incorporated into digital devices
- National assigned NWay patents to Vertical, which demanded higher per unit license fees
- Vertical assigned patents to NData, which continued sending notice letters and asserting patents in litigation

N-Data, continued

- FTC 3-Commissioner majority (Rosch, Leibowitz, Harbour) found N-Data engaged in patent hold-up, seeking to extract valued created by opportunistic nature of its conduct, not value of patents
- Even though no Sherman Act violation because N-Data had not made any commitment itself (and National had not engaged in exclusionary conduct before IEEE), N-Data's conduct threatened to "subvert" IEEE standard setting process in a way that endangered viabililty of standard setting generally, according to FTC majority
- FTC proposed complaint alleged both an "unfair method of competition" and an "unfair act or practice" by N-Data

N-Data, cont.

- Re "unfair method of competition," FTC found patent hold-up here was "coercive" and "oppressive," as required by *OAG* and *Ethyl*
- Also harm to consumers, higher prices
- More generally, conduct threatened to reduce value of standard setting by raising the possibility of "opportunistic lawsuits"
- Also, new standards might be harmed because SSOs would "unreasonably" seek to avoid incorporating patent technologies for fear of N-Data-like hold-ups
- Case "particularly appropriate" for Section 5 because many injured third parties lacking privity with patentees and having mixed incentives to pass on royalties

N-Data, cont.

- FTC also found an "unfair act" here, relying on 3-pronged *Orkin* test: (1) substantial consumer injury, (2) not outweighed by countervailing benefits, and (3) not an injury consumers could have reasonably avoided themselves
- Consent order barred N-Data from enforcing its patents unless it first offered them on terms first offered by National or on a paid-up $1,000 license (free from additional royalties) basis

N-Data, cont.

- Then-Chairman Majoras and then-Commisioner Kovacic dissented
- Majoras warned that finding liability only under Section 5 is "not advisable as a matter of policy or prosecutorial discretion"
- Kovacic expressed concerns regarding the spillover effects in private, state, or federal litigation and the alternative bases for liability plead by the FTC

Critiques of N-Data

- A current majority at the FTC supports "post-contractual opportunism" cases analogous to *N-Data*
- Much criticism of *N-Data*, however, as unwisely going far beyond *Rambus*-type situations
- E.g., Wright and Kobayashi (2008):
  - *Trinko* (U.S., 2004) indicates mere monopoly pricing okay, thus shields N-Data type conduct
  - Also, use patent (equitable estoppel), state contract type remedies in *Rambus*-type cases, not antitrust

The Road Forward

- U.S. court prospects for pure Section 5 cases involving standard-setting hold-ups and opportunism cloudy at best
- Will Supreme Court soften or reinforce its skeptical attitude toward antitrust liability theories? (should *linkLine* be read narrowly?)
- How far will lower courts be willing to stretch Section 5 beyond the limits of the Sherman Act, given 1980s precedents and recent Supreme Court holdings that exhibit skepticism?
- Will *Rambus* (and even *N-Data*) type cases find a favorable reception in Europe? Quite possibly

Conclusions

- FTC has staked out an aggressive posture toward standard-setting hold-up cases, but initial judicial reception to such claims under the antitrust laws appears rather skeptical (but early stages, see, e.g., 3rd Circuit's *Qualcomm* case)
- Unanswered by the courts is the scope for Section 5 cases here if Sherman Act inadequate
- Will DOJ move closer to FTC position in this area? Will Obama Administration act to promote convergence of US, EU positions? Stay tuned for further developments. Thank you