Standard Setting under Section 5 of the FTC Act

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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

- 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 viability 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-Commissioner 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