IP LITIGATION

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Federal Trade Commission Takes Jurisdiction of Intellectual Property Practices Without Charging Antitrust Violation

On January 23, 2008, the Federal Trade Commission announced a stipulated settlement with Negotiated Data Solutions LLC (N-Data) curtailing N-Data's efforts to license its patents relating to Ethernet, an almost universally used computer networking standard, on terms different than those that had been promised before the standard was adopted. The Commission, by a 3-to-2 majority, found that N-Data's efforts to obtain more favorable terms constituted an "unfair method of competition" and an "unfair or deceptive act or practice" in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, although no antitrust violation was charged. *In re Negotiated Data Solutions, LLC*, File No. 510094 (*Negotiated Data*). The Commission's actions may presage far greater Commission enforcement of intellectual property (IP) licensing assurances made by parties involved in standard-setting organizations than has been true in the past as well as a more active role for the Commission in IP issues generally.

The Commission's actions in *Negotiated Data* are particularly notable for several reasons. *First*, the Commission has in the past addressed IP issues sparingly under its Section 5 unfair competition authority; thus, its actions may signal an important new enforcement trend. Those that it has addressed have involved alleged misuse of the standard-setting process by failing to disclose patents relating to the standard. *In re Rambus Corp.*, Docket No. 9302 (2006), *appeal pending*, Docket Nos. 07-1086, 07-1124 (D.C. Cir. 2007); *In re Union Oil Co. of Cal.*, Docket No. 9305 (2005); *In re Dell Computer Corp.*, 121 F.T.C. 616 (1996). The Commission has scrutinized standard setting because it displaces competition and manipulation of the standard-setting process can adversely affect an entire industry.

Second, in contrast to *Negotiated Data*, the Commission's earlier cases focused on the antitrust issues inherent in a patent holder's subversion of the standard-setting process. But in *Negotiated Data*, the Commission found N-Data liable under Section 5 without any concurrent determination that N-Data's conduct had violated the Sherman Act or the Clayton Act. The majority recognized its own departure from the past, observing that "some may criticize the Commission for broadly (but appropriately) applying our unfairness authority to stop the conduct alleged in this complaint," but it concluded that "the cost of ignoring this particularly pernicious problem is too high."

The Commission's decision suggests that its enforcement policy will now target perceived abuses of IP rights that affect consumers — even sophisticated corporate consumers — in the absence of an antitrust violation. In refusing to defer to private enforcement of IP rights to protect competition and consumers, the Commission appears to be charting a course parallel to that taken by the U.S. Supreme Court in several recent decisions.

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FACTUAL BACKGROUND

The Commission's action is premised on the following allegations described in its complaint:

Adoption of a Standard

In 1993, the Institute of Electrical and Electronics Engineers (IEEE) formed a working group whose purpose was to update the standards that govern Ethernet connections between computers. Engineers from National Semiconductor Corporation (National Semiconductor) were part of this working group. In 1994, these engineers proposed that the IEEE adopt a particular technology, (NWay) for use as an optional part of the Fast Ethernet standard. National Semiconductor had filed a patent application for the NWay technology. At working group meetings, National Semiconductor stated that if NWay was chosen to be part of the standard, it would license the technology to any requesting party in return for a one-time payment of $1,000, and it repeated this offer in a letter to the chair of the Working Group.

Although the Working Group considered several alternatives to NWay, it eventually adopted a standard that incorporated NWay technology. As a result, NWay technology has been incorporated into literally hundreds of millions of computer devices. After the IEEE adopted the new standard, National Semiconductor received U.S. and foreign patents that claimed the NWay technology.

Patent Transactions

In 1998, National Semiconductor assigned two U.S. patents (and their foreign counterparts) that claimed the NWay technology to Vertical Networks, Inc. (Vertical). Before it acquired the patents, Vertical was informed that "the patents may be 'encumbered' by whatever actions [National Semiconductor] may have taken in the past with respect to the IEEE standards" and received a copy of National Semiconductor's letter to the chair of the Working Group. The assignment agreement specifically provided that the patents were assigned subject to any pre-existing licenses and other encumbrances.

By late 2001, Vertical sought to increase its revenue from patent licensing activities and attempted to back away from the commitment that National Semiconductor had made to the IEEE. Vertical identified 64 companies that were making equipment incorporating the NWay technology but that had not paid even the nominal license fee. Vertical then sent letters demanding that they pay substantially more than the nominal fee in return for a license and rejected subsequent efforts to obtain licenses by paying the promised original nominal fee.

In 2003, Vertical assigned the patents to N-Data and went out of business. N-Data, which had notice of National Semiconductor's representations to the Working Group, continued to pursue Vertical's aggressive licensing strategy, which included legal actions for patent infringement. The Commission alleged that this conduct constituted unfair methods of competition and unfair acts and practices under Section 5. The Commission's stipulated order requires N-Data to license the patents on the original term of a one-time payment of $1,000.

IP Licensing and Enforcement as Unfair Competition

Although the Commission often has taken the position that Section 5 is broader than the Sherman Act, it has not, in the past, acted to halt the exercise of IP rights without some nexus to an antitrust violation. The majority's conclusion in *Negotiated Data*, that N-Data's conduct violated Section 5 even in the absence of an antitrust violation, is unprecedented.

Proclaiming that "Congress created the Commission precisely to challenge just this sort of conduct," the Commission's Statement (joined in by Commissioners Harbour, Leibowitz, and Rosch) justifies the action as follows. *First*, the Statement concludes that the fact that N-Data and its predecessors reneged on a prior commitment to a standard-setting body was enormously harmful to the standard-setting process generally, which depends upon open disclosure of participating firms' IP claims. *Second*, the Statement reasons that deviations from promised licensing terms after the standard is accepted harms competition and consumers: "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." *Third*, the Statement finds that N-Data's conduct was an unfair act or practice that victimized businesses and consumers that were "locked in" to using the standard.

From the Commission majority's perspective, Section 5 readily covers conduct having "some indicia of oppressiveness" such as exploiting locked-in licensees and potential licensees, and does not require a predicate antitrust violation. To justify its expansive application of Section 5, the Commission quoted the Supreme Court's statement that the standard for "unfairness" under Section 5 is "by necessity an elusive one, encompassing not only practices that violate the Sherman Act . . . but also practices that the Commission determines are against public policy for other reasons" [internal citation omitted]. The two dissenting commissioners — Chairman Majoras and Commissioner Kovacic — disagreed strongly with this premise, arguing that Section 5 should not be applied to conduct outside the scope of the Sherman and Clayton Acts to protect sophisticated businesses that are presumptively able to protect themselves. Commissioner Kovacic warned also that the decision might be used as grounds for private actions under state unfair practices laws that incorporate FTC standards.

Patent Licensing and Due Diligence Issues Affecting Patent Holders

Recent years have seen an increasing emphasis on revenue generation from IP assets through licensing, including enforcement actions to generate license revenue. As the Commission's decision illustrates, actions taken before a patent issues can greatly affect the viability of these strategies. This matter should serve as an important reminder for those involved in licensing and standard-setting organizations:

- Participants in standard-setting processes need to be careful about representations that are made regarding their IP. An IP owner needs to consider whether participation in a standard-setting process is in its best interest, and to exercise extreme due diligence about disclosure representations. Other participants should carefully track and document promises made by IP owners during these processes, and set up monitoring procedures (e.g., tracking patent applications involving the technology at issue).

- As part of a potential IP transaction, due diligence should address the current IP owner's involvement in any standard-setting process.

- Before an IP owner undertakes a licensing campaign, the effects on the licenses and royalties of any past involvement in a standard-setting organization related to that IP should be considered carefully. Potential licensees should investigate the possibility that IP rights are encumbered due to the patentee's past involvement in a standard-setting organization.

- Given government enforcement in this area, companies involved in standard-setting processes should advise IP owners to comply fully with the organization's disclosure requirements.

- Companies should carefully consider the scope and meaning of standard-setting organizations' patent policies as well as the potential impact those policies might have on future IP rights. They also should review procedural requirements with participants required to demonstrate agreement with, and adherence to, the policies.

The Commission's decision could signal far more vigorous enforcement efforts in the IP area. Notably, the FTC's expansion in this case coincides with the recent Supreme Court's curtailment of the scope of antitrust enforcement in the past term and its corresponding emphasis on limiting the scope and/or breadth of enforcement of IP rights such as through further defining "obvious" patents, limiting entitlement to injunctive relief, and the like. *See, e.g., Bell Atl. Corp. v. Twombly*, 1275 S. Ct. 1955 (2007); *KSR Int'l Co. v. Teleflex Inc.*, 1275 S. Ct. 1727 (2007); *Credit Suisse Secs. (USA) LLC v. Billing*, 1275 S. Ct. 2883 (2007); *eBay Inc. v. MercExchange LLC*, 126 S. Ct. 1837 (2006). The Commission's actions, however, were based upon the facts of this case. Whether they will be replicated in other cases or extended beyond the specific kind of circumstance involved in this case is unpredictable.