FTC Requires Patentee To Fulfill Licensing Commitments To A Standard-Setting Organization To Prevent Consumer Harm

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On January 23, 2008, the Federal Trade Commission (the “FTC” or the “Commission”) announced a complaint and a proposed consent order with a patent licensing company, Negotiated Data Solutions LLC (“N-Da”). The Commission alleged that N-Da’s refusal to license its patented technology on reasonable terms and conditions undermined standard-setting processes and the integrity of a standard-setting organization (“SSO”) without requiring proof that the patentee has market power. The proposed consent order, if approved, would require N-Da to license its patented technology, and would impose a one-time fee of $1,000.

The Commission emphasized that conduct that undermines standard-setting processes can undermine competition in an entire industry and may not serve consumer harm. Under the proposed order, N-Da is required to offer paid-up, royalty-free licenses to the relevant patents for a one-time fee of $1,000.

The N-Data case highlights the Commission’s efforts to address the exploitation of intellectual property rights by large companies, and a willingness to prosecute unfair competition in the standard-setting context to prevent consumer harm. This case shows that the Commission may take action if a patent holder attempts to renege on licensing commitments to manipulate market conditions, and it may be willing to impose a one-time fee for the use of patented technology.

The value of the technology exceeds its value.

The Presence of Network Effects. Network effects arise when one consumer’s enjoyment or value of a product increases with the number of other users of that product. For example, a video phone is of no value unless at least one other person has one, and it becomes more valuable as more people have them. A standardized technology is one whose market subjected to network effects will experience greater value because standardization can enhance adoption of the technology by ensuring compatibility across users.

Switching Costs. A technology whose network effects are embedded in a standard will not be able to extract supracompetitive royalty payments for its technology if the costs of switching practically to a viable, compatible alternative are low. Switching costs may include the costs of coordinating with other market participants if coordinated switching is a requirement of change.

Frequency of Change. “Hold-up” by one technology owner will be more diffuse (and less likely) if the industry is subject to rapid technological change and participants meet regularly to adapt the standard to such change. A technology owner that attempts to extract high switching profits risks being excluded from future generations of the standard.

Economies Of Standardization And Market Power

The majority seems to conclude that adopting the NWay technology as part of the Ethernet standard automatically conferred market power that the technology would not have attained under competitive conditions. That conclusion, however, may have benefited from further assessment.

Standard setting confers market power on a chosen technology if incorporation into a standard elevates the chosen technology above previously interchangeable alternatives or raises barriers to entry to other technologies. Certain market conditions contribute to the likelihood that standard setting will confer market power for the chosen technology, but not all of those conditions necessarily will be met in any particular market.

The Need for Standardization. Standardization ensures that parts work together. The greater the need for interoperability, the greater the value to consumers of common parts. If interoperability is part of the license terms, then the standard may not enjoy market power, and thus neither the patentees incorporated into the standard nor the practicing firms that are alternatitives to these technologies in the other standards.

The N-Data case highlights the Commission’s increasing efforts to regulate the exploitation of intellectual property rights in ways that promote consumer welfare and a willingness to prosecute unfair competition in the standard-setting context to prevent consumer harm. This case shows that the Commission may take action if a patent holder attempts to renege on licensing commitments to enhance market conditions, and it may be willing to impose a one-time fee for the use of patented technology. Companies that participate in standard-setting activities should give careful consideration before making open-ended commitments to offer set license terms to encourage adoption of their technology. Similarly, companies that acquire patent portfolios that conduct due diligence to determine whether any of the patents they are acquiring is encumbered by licensing commitments previously made to an SSO.

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On January 23, 2008, the Federal Trade Commission (the “FTC” or the “Commission”) announced a complaint and a proposed consent order with a patent licensing company, Negotiated Data Solutions LLC (“N-Da”), regarding patents related to the ubiquitous Ethernet computer networking standard. With this decision, the Commission has enforced licensing commitments made by a patentee to a standard-setting organization (an “SSO”) without requiring proof that the patentee has market power. The public comment period for the decision closed recently, on April 24, 2008, with eight comments submitted.

The Commission found that N-Da’s refusal to honor assurances made by the previous patent owner to an SSO violated Section 5 of the FTC Act even if the refusal did not amount to an antitrust violation under the Sherman Act. The Commission emphasized that conduct that undermines standard-setting processes can undermine competition in an entire industry and may not serve consumer harm. Under the proposed order, N-Da is required to offer paid-up, royalty-free licenses to the relevant patents for a one-time fee of $1,000.

Analysis

The Commission found that N-Da’s conduct violated Section 5 of the FTC Act, which prohibits “[1] unfair methods of competition in or affecting commerce [and] [2] unfair or deceptive acts or practices in or affecting commerce.” 15 U.S.C. § 45(a)(1). Former Chairman Majoras and Commissioner Kovacic (who is now Chairman) dissented from the decision.

The fundamental disagreement between the majority and the dissenters was whether the conduct at issue injured consumers. The majority explained that, because “the process of establishing a standard displaces competition,” any conduct that undermines the integrity of the standard-setting process may not serve consumer harm. Under the proposed order, N-Da is required to offer paid-up, royalty-free licenses to the relevant patents for a one-time fee of $1,000.

In 1994, National Semiconductor Corporation (“National”) participated in a standard-setting activity with the Institute of Electrical and Electronics Engineers (“IEEE”). The IEEE incorporated N-Way technology into the Ethernet standard published in 1995. The technology was an optional feature of the standard, and no party took advantage of National’s offer to license its N-Way patents.

In 1998, National assigned its N-Way patents to a licensing company, Negotiated Data Solutions LLC (“N-Data”). National’s licensing assurance was that the patents would be available to the relevant parties on reasonable terms.

In late 2003, Verti-Mark announced to the IEEE and N-Data that it had issued from the N-Way patent family a patent that Verti-Mark had assigned to the IEEE (“vertical N-Way”). N-Data refused to license the patent to Verti-Mark.

According to the dissent, Verti-Mark’s patented technology undermined the standard-setting process by encoding the patented technology into the Ethernet standard automatically conferring market power to the patentee.

The dissenters argued that one consumer’s enjoyment or value of a product increases with the number of other users of that product. For example, a video phone is of no value unless at least one other person has one, and it becomes more valuable as more people have them. A standardized technology is one whose market subjected to network effects will experience greater value because standardization can enhance adoption of the technology by ensuring compatibility across users.

The dissenters questioned whether N-Da had market power, given that (1) the N-Way technology is an optional feature under the standard, (2) no company sought to accept National’s licensing assurance, N-Data refused to license the patent for $1,000 and sued companies that refused to pay royalties in excess of that amount.

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The majority seems to conclude that adopting the N-Way technology as part of the Ethernet standard automatically conferred market power that the technology would not have attained under competitive conditions. That conclusion, however, may have benefited from further assessment.

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