

# Client Alert

Latham & Watkins Litigation Department

## The D.C. Circuit Overturns the FTC's *Rambus* Decision

One of the most important and closely watched cases concerning antitrust and standard-setting has been the Federal Trade Commission (FTC) action against the computer memory products company Rambus. In July 2006, the FTC found Rambus guilty of monopolization, because it had failed to disclose relevant patents to a standard-setting body, and, after adoption of the standard, sued manufacturers for infringement of the undisclosed patents.<sup>1</sup> The FTC relied on two alternative theories of anticompetitive harm flowing from Rambus' alleged deception: (a) disclosure would either have given the standard-setting body a chance to exclude Rambus' patents from the standard completely, or (b) disclosure would have at least allowed the standard-setting body to ensure that any post-adoption license fees charged by Rambus would have to be reasonable and non-discriminatory (RAND). The FTC declined to find whether there were practical alternatives to Rambus' technology, reasoning that the loss of the opportunity to demand RAND assurances was sufficient. On April 22, 2008, the D.C. Circuit overturned the FTC's decision.<sup>2</sup> It held that the loss of an opportunity to negotiate RAND royalties does not constitute harm to competition, even if such loss was the result of deception. Accordingly, the entire judgment had to be set aside.

The D.C. Circuit's decision is significant on a number of levels. First, it addresses an important question of antitrust liability for a particular form of deceptive unilateral conduct in the context of a standard-setting process. A number of recent decisions and government prosecutions have expanded that liability. The *Rambus* decision is now imposing some limits. Second, the decision raises the more fundamental question of whether antitrust should get involved in deceptive conduct by firms with market power if the deception does not add to their market power. In this *Client Alert*, we first discuss the *Rambus* decision in the context of the broader issue of deception as an antitrust violation. We then turn to the policy questions raised by *Rambus*.

### ***Rambus* in Context: Deception as an antitrust violation**

The courts and the agencies have long been concerned with deception in the context of standard-setting and have found firms liable for:

- "Packing" standard-setting meetings to rig voting on a particular standard for the sole purpose of excluding a competing technology.<sup>3</sup>
- Deliberately misleading a standards setting organization (SSO) regarding

"The loss of an opportunity to seek favorable licensing terms as a result of deception is not as such an antitrust harm."

the existence of patents, thus depriving the SSO of the opportunity to exclude the patents from the standard, followed by patent infringement suits against firms practicing the standard after its adoption.<sup>4</sup>

- Making intentionally false license royalty commitments to the SSO, and pursuing discriminatory licenses after the adoption of the standard.<sup>5</sup>
- Reneging on a good faith license royalty commitment (by a predecessor in interest) to the SSO after the adoption of the standard.<sup>6</sup>

The antitrust concern with the subversion of the standard-setting process is rooted in a view of standard adoption as a *market power generating event*, which in turn is a result of seeing the standard-setting process as a two-stage competitive event. In the first stage, alternative technologies compete for inclusion in the standard. After the adoption of one of the contenders, competition *for the standard* ceases and is replaced by competition *for the implementation* of the standard. Each stage usually involves a different set of competitors. Within that paradigm, the decision to adopt a particular technology as part of a standard eliminates alternative technologies and, in doing so, confers significant market power upon the firms whose technologies and patents get included in the standard. If the inclusion is the result of deception, then such deception, it has been alleged, is an exclusionary acquisition of market power. Deception is clearly not competition on the merits, so if one accepts that deception in standard-setting is exclusionary, it will nearly always be unlawful if monopoly power, typically in a licensing market, results. This view is reflected in the two most significant precursors to the *Rambus* decision, the consent order in *Dell*, and the recent decision by the Third Circuit in *Broadcom v. Qualcomm*.

In *Dell*, the Video Electronics Standard Association (VESA) set a standard for

the VL-bus, a mechanism to transfer data from one computer component to another. VESA was strongly adverse to including any proprietary technology in its standards and thus required disclosure of any applicable intellectual property. In addition, at a later stage, VESA asked its members to certify expressly that they had no patents covering the VL-bus standard. Dell certified that it had no such patents. After VESA adopted the standard, which quickly became ubiquitous, Dell sought to enforce its patents against firms planning to ship standard-compliant products. The FTC challenged Dell's deception under Section 5 of the FTC Act (Section 5) as an unfair method of competition, but not as a monopolization offense under Section 2 of the Sherman Act (Section 2), leading to a consent decree, in which a royalty-free license to all firms using the VL-bus standard was ordered as a remedy.

In *Broadcom v. Qualcomm*, Qualcomm was alleged to have made an intentionally false promise to the SSO to license its patents for a particular cell phone technology on FRAND terms, that is, terms that are fair, reasonable and non-discriminatory. The SSO relied on that promise in adopting the standard. Subsequently, Qualcomm sought, among other non-FRAND concessions, discriminatory prices from licensees, *i.e.*, different royalties depending on who the licensee was. Here, the deception was not the fraudulent concealment of existing patents, as was the case in *Dell*, but the affirmative misrepresentation of terms under which disclosed patents would be licensed post-adoption. The Third Circuit held that "[d]eceptive FRAND commitments, no less than deceptive nondisclosure of IPRs, may result in such [anticompetitive] harm,"<sup>7</sup> and let a claim for monopolization proceed.

The FTC's decision in *Rambus* presented similar facts to *Dell*, but based liability on a monopolization theory under Section 2.<sup>8</sup>

In the 1990s, the Joint Electronic Device Engineering Council (JEDEC), a cooperative standard-setting organization, was engaged in developing standards for a new generation of computer memory. JEDEC required of its members at a minimum the disclosure of patents and patent applications and RAND licensing commitments. Rambus participated in the JEDEC standard-setting process. In that context, it allegedly concealed the existence of patents and patent applications and, after gaining information about where the standard was headed, amended its patent applications to ensure that subsequently issued patents would cover the ultimate standard. After the adoption of the standard, Rambus launched an aggressive licensing campaign against the manufacturers of standards compliant memory chips.<sup>9</sup>

The FTC found that Rambus had violated Section 2, relying on a novel theory as to how the company's alleged deceptive conduct constituted monopolization. Monopolization, as a general matter, requires (i) a monopoly position and (ii) exclusionary conduct, which conduct must have either created or reinforced the monopolist's market power. The required causal connection between the exclusionary conduct and monopoly power serves to ensure that liability for monopolization attaches only if the exclusionary conduct *also* harms the competitive process. Harm to a competitor without more is not enough.

As to the monopoly power element, the FTC held that, after the adoption of the standards, "Rambus held over 90 percent of the market share in the relevant markets."<sup>10</sup> There was little dispute about that; the real action was whether the creation of those post-adoption monopolies were attributable to Rambus' pre-adoption conduct, namely the deceptive omissions and misrepresentations relating to Rambus' patents and patent applications. The Commission answered that question in the affirmative:

[B]ut for Rambus's deceptive course of conduct, JEDEC either would have excluded Rambus's patented technologies from the JEDEC DRAM standards, or would have demanded RAND assurances, with an opportunity for *ex ante* licensing negotiations.<sup>11</sup>

The D.C. Circuit, on appeal, found the FTC's reasoning unpersuasive. The first alternative, that JEDEC would have excluded Rambus' patented technologies from the JEDEC standards altogether was undermined by "insufficient evidence that JEDEC would have standardized other technologies had it known the full scope of Rambus' intellectual property."<sup>12</sup> In other words, even if Rambus had fully disclosed its pending patent applications, JEDEC may well have included Rambus' technology in the standard.<sup>13</sup> The attention thus shifted from the first to the second candidate for exclusionary conduct, namely that but for Rambus' deception, JEDEC would have demanded RAND assurances, with an opportunity for *ex ante* licensing negotiations. It is here that the D.C. Circuit makes new law. The court held that:

Rambus's alleged deception cannot be said to have an effect on competition in violation of the antitrust laws; *JEDEC's loss of an opportunity to seek favorable licensing terms is not as such an antitrust harm.*<sup>14</sup>

In other words, if all that results from the deception is the inability of the SSO to seek *ex ante* license royalty commitments, then such deception is not exclusionary under Section 2. Because the FTC had not made an ironclad independent finding that but for Rambus' deceptive course of conduct, JEDEC would have excluded Rambus patented technologies from the DRAM standards, the D.C. Circuit's rejection of the lost licensing opportunity theory gutted the monopolization case as a whole.

## The Meaning of *Rambus*

The obvious question about the D.C. Circuit's *Rambus* decision is how far it goes in disapproving the deception theories that have become increasingly common since *Dell*. Undoubtedly the case will be cited as broadly rejecting efforts to convert frauds and misrepresentations, typically the stuff of contract and tort law, into antitrust cases. There will also be efforts to limit the case to its facts, perhaps so that it applies only where an SSO would have adopted the relevant technology irrespective of the alleged deception – the *Rambus* contention that the D.C. Circuit found that the FTC skirted.

A close reading of the decision suggests that it does not undermine either *Dell*, *Broadcom v. Qualcomm* or deception theories generally, but instead demands much greater attention to the causal relationship between deception and market power than has been evident in the cases to date. The key to the D.C. Circuit's *Rambus* decision is the familiar idea that not all patents are created equal with respect to the market power that they confer.<sup>15</sup> Some patents can easily be engineered around and do not therefore, at least on their own, confer any significant market power. Others are so fundamental that they must be included in any standard covering the field. As to the weak patents, it is appropriate to think of the SSO's decision to include them in the standard as a market power generating event. As to the strong patents, however, it does not. For those patents, the market power generating event is the patent grant. Whatever happens after that does not necessarily increase the monopoly power of the patent holder, deception or not. As Richard Rapp, one of *Rambus*' economic experts, has written:

Standard setting has the potential for increasing the value of a technology when a technology with close substitutes wins a formal standard-setting competition.

Standard setting can create market power by making otherwise close substitutes inferior, and thereby increasing the royalty rate (price) a technology can command. By contrast, when the invention would dominate the alternatives in a technology market on its own inherent merits, ratification of the market outcome by formal standard setting is an afterthought; it changes nothing.<sup>16</sup>

Under this view, if the invention would dominate the alternatives in any event, deception in the context of an SSO may be a breach of contract, fraud, or a business tort, but it is not an antitrust violation, *because the market power predates and is causally independent of the deceptive conduct*. That is the essence of the argument, which the D.C. Circuit puts forward in a somewhat cryptic fashion by extensively discussing the 1998 Supreme Court decision in *NYNEX v. Discon*.<sup>17</sup>

In that case, NYNEX had a lawful monopoly for the local telephone market in New York.<sup>18</sup> The rates that NYNEX could charge to the end user were capped by regulation. Discon and AT&T Technologies (AT&T) bid for a contract with NYNEX to remove old telephone switches. NYNEX chose AT&T over Discon, even though Discon's bid was lower. NYNEX used the higher AT&T charges to justify an increase on the cap for its phone service price to the end user by the regulator, and, in addition, received a kickback from AT&T at the end of the year. After having lost the contract to AT&T, Discon's fortunes declined and it brought suit, arguing that NYNEX and AT&T were engaged in an illegal group boycott to drive it out of business. The US Supreme Court, in a passage cited by the D. C. Circuit in *Rambus*, rejected that theory.

[W]e concede Discon's claim that the [defendants'] behavior hurt consumers by raising telephone service rates. But that consumer

injury flowed not so much from a less competitive market for removal services, as from the exercise of market power that is *lawfully* in the hands of a monopolist ... combined with a deception worked upon the regulatory agency.<sup>19</sup>

The D.C. Circuit analogizes the *Rambus* situation to that in *NYNEX*. In light of the FTC's failure to find conclusively that JEDEC could have avoided Rambus' patents, the D.C. Circuit assumed that Rambus earned its monopoly power lawfully at the time of the patent grant. Everything else, including the deception of the SSO, happened later. Thus "as in *NYNEX*, an otherwise lawful monopolist's end-run around price constraints, even when deceptive or fraudulent, does not alone present a harm to competition in the monopolized market."<sup>20</sup>

This arguably limits the significance of the D.C. Circuit's view that the "loss of an opportunity to seek favorable licensing terms is not as such an antitrust harm," because the position holds only for patents that confer significant, if not absolute, monopoly power upon issuance. These high-quality, strong patents arguably would have to be included in any standard covering the field, no matter what, so that subsequent SSO deception by the patent holder may well have no incremental market power effect.<sup>21</sup> But for weak patents, there will be at least some additional market power from the inclusion in a standard. For such patents, the "loss of an opportunity to seek favorable licensing terms" may well constitute an antitrust harm, at least in the short run.<sup>22</sup> In other words, the stronger the underlying patents, the weaker the claim that deceiving the SSO has an anticompetitive effect. Conversely, the weaker the patents and the more market power conferring the inclusion into the standard, the more plausible the claim that the deception caused anticompetitive harm.

From a policy point of view, the D.C. Circuit shines a spotlight on some assumptions underlying the often unquestioned embrace of SSOs by the agencies and the courts. Without question, SSOs solve hold-up problems, created mostly by an overbroad patent system, bypass costly standards wars, reduce transaction costs and make investment decisions more predictable, all of which are welfare-enhancing. But in many ways, this is fighting fire with fire, because SSOs often pick winners by a negotiated consensus among constituencies whose collective action is generally feared by antitrust policy, *e.g.*, competitors and buyers. SSO decisions are not always merit-driven, and some standard-setting sessions devolve into thinly veiled collective bargaining sessions, where holders of meritorious patents are forced to accept royalty rates that might be lower than a true competitive benchmark. Despite these arguable competitive problems with SSO decision-making, decisions such as *Dell*, *Broadcom* and the FTC's opinion in *Rambus* come down strongly in favor of SSO collective action, to the point that they affirmatively attach antitrust liability to *unilateral conduct interfering with such coordination*. Antitrust law has thus moved from providing a shield to coordination in the standard setting context—a view generally regarded as appropriate and procompetitive—to lending a sword to those who want to prevent interference with collective royalty setting.

## Words of Caution

The D.C. Circuit cautioned the FTC to proceed simply on a broader Section 5 theory on remand, voicing "serious concerns about [the] strength of the evidence relied on to support some of the Commission's crucial findings regarding the scope of JEDEC's patent disclosure policies and Rambus's alleged violations of those policies."<sup>23</sup>

One of the cornerstones of the FTC's decision, the D.C. Circuit remarks, is that Rambus was required not only to disclose its patents and its patent applications, but also unfiled work in progress on potential amendments to patent applications. This is because the patents ultimately included in the standard and enforced by Rambus post-adoption were unfiled work in progress at the time when Rambus left JEDEC. While there is clear evidence for an obligation to disclose patents and patent applications, there is only scant support for a duty to disclose unfiled work in progress. A related problem with the disclosure obligations discussed by the D.C. Circuit is their inherent vagueness. Citing *Rambus v. Infineon*, the court points out that SSO policies requiring the sharing of highly sensitive information among competitors must "define clearly what, when, how, and to whom the members must disclose."<sup>24</sup> As a result, "the more vague and muddled a particular expectation of disclosure, the more difficult it should be for the Commission to ascribe competitive harm to its breach."<sup>25</sup>

## Conclusion

For participants in SSOs, nothing much changes. Deceptive concealment of patents and patent applications with subsequent hold-ups expose the patent holder to antitrust liability under *Dell*. Similarly, reneging on express RAND commitments remains actionable under *Broadcom v. Qualcomm*. That said, now is a good time for SSO participants to review the disclosure policies of the SSOs in which they participate, and to make sure that those "define clearly what, when, how, and to whom the members must disclose." If there is an immediate lesson from the D.C. Circuit's decision, it is that ambiguity exposes patent holders to significant antitrust litigation risk. Clarity, in contrast, is everyone's friend.

The D.C. Circuit's *Rambus* decision will not be the end of the quest for workable antitrust standards in the standard-setting process. Chances are that it will not even end the *Rambus* litigation anytime soon. The decision did not address whether a monopolization claim could be based on a showing that but for the deception JEDEC would have excluded Rambus' patented technologies from the standards. Moreover, the decision leaves open whether liability under Section 5 extends beyond that of Section 2. Lastly, the scope of the D.C. Circuit's rejection of the "loss of opportunity to negotiate RAND commitments" theory may well be limited to patents for which there is no realistic alternative, as discussed in this *Alert*. The main impact of *Rambus*, in our view, will be to reinvigorate the discussion of the relationship of antitrust to the treatment of SSOs and its participants. *Rambus* sends a cautionary signal to those who propose greater regulatory involvement in the evolutionary process of standards development.

## Endnotes

<sup>1</sup> *In the Matter of Rambus, Inc.*, FTC Docket No. 9032 (July 31, 2006). <http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf> ("Liability Opinion"); *In the Matter of Rambus, Inc.*, FTC Docket No. 9032 (February 5, 2007). <http://www.ftc.gov/os/adjpro/d9302/070205opinion.pdf> (Remedy Opinion)

<sup>2</sup> *Rambus Inc. v. Federal Trade Commission*, --- F.3d ---, 2008 WL 1795594, C.A.D.C., April 22, 2008 (NO. 07-1086). <http://pacer.cadc.uscourts.gov/common/opinions/200804/07-1086-1112217.pdf> (Slip Opinion).

<sup>3</sup> *Allied Tube v. Indian Head*, 486 U.S. 492 (1988).

<sup>4</sup> *In the Matter of Dell Computer Corp.*, 121 F.T.C. 616 (1996); *Union Oil Co. of California (Unocal)*, Analysis of Proposed Consent Order to Aid Public Comment, FTC Docket No. 9305, June 10, 2005. <http://www.ftc.gov/os/adjpro/d9305/050610analysis9305.pdf>; *In the Matter of Rambus, Inc.*, FTC Docket No. 9032 (July 31, 2006).

- <sup>5</sup> *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297 (3rd Cir. 2007).
- <sup>6</sup> *In the Matter of Negotiated Data Solutions LLC*, File No. 051 0094, Analysis of Proposed Consent Order to Aid Public Comment, January 23, 2008. <http://www.ftc.gov/os/caselist/0510094/080122analysis.pdf>
- <sup>7</sup> *Broadcom*, 501 F.3d at 314.
- <sup>8</sup> *Rambus*, Liability Opinion, at 27.
- <sup>9</sup> For a detailed discussion of the factual background of the FTC's case against Rambus, see Dunlavey and Schallop, Lessons from Rambus, Latham & Watkins *Client Alert* 578, March 12, 2007.
- <sup>10</sup> *Rambus*, Liability Opinion, at 73.
- <sup>11</sup> *Rambus*, Liability Opinion, at 74.
- <sup>12</sup> The court cites to *Rambus*, Remedy Opinion 12, see *Rambus*, Slip Opinion, at 13. However, the remedy opinion does not really seem to make that concession. Rather, it states: "Our liability opinion identified two realistic possibilities for what would have occurred had Rambus not engaged in deception of JEDEC members. ... *There is evidence in the record to support both possibilities.*" (Emphasis added.) (*Id.*, at 12).
- <sup>13</sup> *But see In the Matter of Rambus, Inc.*, FTC Docket No. 9302, Statement of Commissioner J. Thomas Rosch, Concurring in Part and Dissenting in Part, February 5, 2007 (p.6). <http://www.ftc.gov/os/adjpro/d9302/070205roschstmt.pdf> ("In short, the record seems to me strongly to support the conclusion that in the 'but for world' JEDEC and its principal stakeholders (the DRAM manufacturers), if fully informed about Rambus's patents and pending patents, would not have incorporated Rambus's technologies in the SDRAM and DDR SDRAM standards. In a world with alternative technologies, which was the real world here, Rambus would not be in a position to collect royalties from those practicing those standards.").
- <sup>14</sup> *Rambus*, Slip. Op, at 19. (Emphasis added).
- <sup>15</sup> *Illinois Tool Works v. Independent Ink, Inc.*, 547 U.S. 28 (2006).
- <sup>16</sup> Richard T. Rapp and Lauren J. Stiroh, Standard Setting and Market Power, Joint Hearings of the U.S. Department of Justice and the FTC, Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy, April 18, 2002, available at <http://www.nera.com/image/5156.pdf>.
- <sup>17</sup> *NYNEX Corp. v. Discon, Inc.*, 528 U.S. 128 (1998).
- <sup>18</sup> In the actual case, various subsidiaries carried out the conduct which we here, for simplicity's sake, summarily attribute to NYNEX itself.
- <sup>19</sup> NYNEX, 528 U.S. at 136.
- <sup>20</sup> *Rambus*, Slip Opinion, at 18.
- <sup>21</sup> This is not to say that such deception would not be actionable as a breach of contract, a business tort, fraud, etc. Moreover, SSO members may well have an affirmative defense of unclean hands against a patent holder who frustrated their justified expectations with its deception.
- <sup>22</sup> The court cautions that requiring *ex-ante* RAND commitments might result in a loss of dynamic efficiencies. "[H]ad JEDEC limited Rambus to reasonable royalties and required it to provide licenses on a nondiscriminatory basis, we would expect less competition from alternative technologies, not more; high prices and constrained output tend to attract competitors, not to repel them." *Rambus*, Slip Opinion, at 18.
- <sup>23</sup> *Rambus*, Slip Opinion, at 19.
- <sup>24</sup> *Rambus Inc. v. Infineon Technologies AG*, 318 F.3d 1081, 1102 (Fed. Cir. 2003).
- <sup>25</sup> *Rambus*, Slip Opinion, at 22.

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