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Playing by The Rules

Focus Column

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Reprinted from

Daily Journal

May 21, 2007

The recent Federal Trade Commission opinion concerning Rambus Inc. provides important lessons for companies that participate in standards setting organizations.

The FTC found that Rambus' failure to disclose its normally secret pending patent applications to such an organization had harmed competition. As a remedy, the FTC imposed mandatory patent licensing terms on Rambus, cutting the company's royalties on its patents to zero after only three years.

This case is a reminder to companies participating in SSOs to be vigilant about the requirements, and potential risks, of their participation.

Rambus and JEDEC

The Joint Electron Device Engineering Council is an SSO focused on standardizing technologies for the solid state industry. The council's written patent policy has been revised over time to clarify that patent applications, as well as issued patents, must be disclosed.

From February 1992 until June 1996, Rambus was a member of the engineering council's subcommittee addressing standards for dynamic random access memory chips. During that period, Rambus had pending patent applications with disclosures broad enough to cover technologies for the standards under consideration.

Using information from the subcommittee meetings, Rambus amended pending patent claims and filed a series of divisional applications in order to build a patent portfolio that would cover the standards. Rambus did not disclose this pending patent activity to the council.

In June 1996, Rambus notified the council that it was withdrawing from the organization. Rambus' notification letter included a list of Rambus patents. The list, however, did not include "the only then-issued patent that Rambus believed covered technology under consideration by JEDEC." Internal Rambus communications advised the company not to assert its patents "until ramp reached a point of no return."

After a number of manufacturers began large-scale production of DRAMs complying with the council's standards, Rambus launched an aggressive patent-licensing campaign, backed by several lawsuits. This campaign helped Rambus increase its annual revenue to $200 million in 2006, mostly in patent licensing revenue.

FTC Involvement

Rambus' conduct, documented in various counterclaims brought by DRAM manufacturers it had sued for patent infringement, attracted the FTC's attention. In June 2002, FTC complaint counsel accused Rambus of engaging in a pattern of anti-competitive acts and said that such behavior caused or threatened to cause harm to competition and consumers in violation of Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive methods of competition, and Section 2 of the Sherman Antitrust Act, prohibiting monopolization.

On appeal from an administrative law judge's decision, the full commission found that Rambus violated the JEDEC patent policy through its deliberate decision not to disclose its patent rights. The commission found that "Rambus was able to distort the standard-setting process and engage in anti-competitive 'hold up' of the computer memory industry."

The commission said that, "when a firm engages in exclusionary conduct that subverts the standard-setting process and leads to the acquisition of monopoly power, the pro-competitive benefits of standard setting cannot be fully realized."

The commission concluded that "Rambus engaged in exclusionary conduct that significantly contributed to its acquisition of monopoly power in four related [DRAM] markets."

It is significant that the FTC found a Section 2 violation. The commission reasoned that deception qualifies as an exclusionary practice and therefore establishes the conduct element of a monopolization claim.

This is an aggressive antitrust theory because, in ordinary circumstances, companies are free to keep their unpublished pending patents secret. Indeed, the law of trade secrets assumes that competition is fostered by maintaining the confidentiality of certain technology assets, absent contractual or overriding competition obligations.

Nevertheless, the FTC sided with full disclosure. It concluded that, in an SSO setting, nondisclosure risks an illegitimate increase in patent-based monopoly power. Rambus' own documents provided significant evidence of "deceptive conduct," which set up the comparatively easy argument that deceit has no social value.

Compulsory Licensing Terms

In a Feb. 5, 2007, decision, the commission found that compulsory licensing terms were justified, both to remedy the effects of the unlawful monopoly Rambus had obtained and "to inspire confidence in the standard-setting process." It concluded that, to determine the appropriate royalty rate, it would have to consider the "but for" world - in other words, what would have happened if Rambus had properly disclosed its pending patent applications.

The commission reviewed the evidence establishing that (1) Rambus' technologies were superior to alternatives, (2) alternatives were nonetheless available, (3) JEDEC had a stated preference for open, patent-free standards, (4) JEDEC's members were highly cost-sensitive and (5) Rambus had had a strong economic incentive to do what was necessary to ensure that its technology was incorporated into JEDEC's standards.

The commission imposed compulsory royalty rates lower than those Rambus had obtained in licensing negotiations. Furthermore, the compulsory rates drop to zero after three years. Rambus has obtained a stay of this order pending appeal.

Guidance for SSO Participants

The *Rambus* decision provides a clear warning that participation in standards-setting processes can result in antitrust scrutiny. Potential remedies for such behavior include compulsory royalty-free licensing that can encumber patents covering next-generation technologies. European regulators, including DG Competition of the European Commission, have given similar warnings.

Companies participating in an SSO review must understand the applicable patent policy and then, of course, follow it. The logical first step is to review the written policy and its associated patent-disclosure obligations.

The *Rambus* case, however, demonstrates that further investigation may be necessary. If the written policy does not provide adequate guidance on what, when, how and to whom members must disclose, courts and investigating agencies may look to the practices and understandings of fellow SSO members to clarify the policies and requirements.

Companies with pending or issued patents that may cover or even relate to technologies being considered for inclusion in standards should implement an internal process to ensure timely and accurate disclosures under the SSO's policy. Given the potential penalties for failing to disclose, as evidenced by *Rambus*, companies may choose to err on the side of caution and disclose potentially essential issued patents and pending applications. Special consideration should be given during the patent prosecution process to the effect of contemplated claim amendments.

For companies with substantial patent portfolios of several hundred patents and applications, compliance with patent disclosure obligations can be a daunting and difficult task. Thus, those companies, especially, must define an internal policy and process to ensure appropriate compliance. Depending on the SSO policy, and other strategic considerations, that may not involve searching the company's own patent portfolio. However, some SSOs' disclosure policies specifically state that a participant is not obligated to search for potentially applicable patents or applications.

Antitrust Issues

If an SSO member's undisclosed patent is incorporated into a final standard, the patent holder's bargaining power in future licensing negotiations may be enhanced unfairly by the standard itself rather than the value of the patented technology.

One potential solution to this problem is for the SSO to impose ex ante patent license-disclosure requirements. In other words, the organization may require its members to agree beforehand that they will license all of their patents necessary to practice the standard at a specified rate. For example, VITA (an international trade association) recently changed its intellectual property/patent licensing obligation to include more specific ex ante licensing disclosure of maximum royalty rates.

Although such ex ante licensing commitments and discussions are appealing because of the potential increased certainty of license terms, such activities can raise antitrust and competition considerations of their own. Unlike patent pools, most SSOs are not set up to oversee the establishment of common and capped royalty rates for essential patents. (For example, most SSOs forbid discussions of pricing, distribution, marketing, suppliers and patent licensing royalty rates among members, who are often competitors.)

Accordingly, members of an SSO with such ex ante licensing obligations need to educate their participants carefully both to comply with the SSO's disclosure obligations and to avoid other antitrust and competition problems, while furthering the entity's licensing strategy.

In other words, given the vagueness and variation in SSO patent-disclosure requirements, each company's situation needs to be assessed individually.

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