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FTC Invokes Novel Theories in Standard-Setting Case

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On January 23, 2008, the Federal Trade Commission announced it had entered into a consent decree with Negotiated Data Solutions LLC ("N-Data") to settle a complaint against the company for repudiating a prior commitment to license users of its computer communications technology. The commitment had been made to induce a standard-setting organization to adopt the technology in its standard. Issues involving intellectual property in the standard-setting process are an area the agency has monitored very carefully; this action is another example of that scrutiny.

The FTC's complaint alleges two separate violations of Section 5 of the FTC Act: (1) that N-Data engaged in unfair methods of competition and (2) that N-Data engaged in unfair acts and practices The complaint, which the FTC approved by a 3-2 vote with Chairman Deborah Platt Majoras and Commissioner William Kovacic dissenting, is a rare use of the FTC's Section 5 authority to challenge conduct that does not rise to the level of an antitrust violation. Further, the complaint is a novel use of the FTC's consumer protection authority in what is otherwise a competition case, and where the "consumers" protected are technology firms. Simultaneously with the complaint, the FTC entered into a consent decree with N-Data under which N-Data must offer prospective future licensees of the patents terms substantially identical to those of the original commitment. If the consent decree is ultimately approved following a 30-day public comment period, it may represent a substantial expansion of the FTC's use of its statutory power.

Background

The Institute of Electrical and Electronics Engineers ("IEEE") is a standard-setting organization for computer and other technologies. The IEEE's 802.3 standard, first published in 1983 and commonly referred to as "Ethernet," applies to local area networks built on copper, and more recently, fiber optic cables. In updating the standard in 1994, the IEEE decided to make Ethernet equipment compatible, to the extent possible, with existing LAN equipment and with future generations of equipment. The IEEE determined that a technology variously known as "autodetection" and "autonegotiation" would permit such compatibility.

National Semiconductor Corporation ("National") participated actively in the 802.3 Working Group and proposed its own autonegotiation technology, known as "NWay," for the 802.3 standard. National disclosed to the 802.3 Working Group during its deliberations that National had filed for patent protection for NWay, but stated, both orally and in writing, that if the Working Group adopted NWay as the standard, National would offer to license the technology to any requesting party on a nondiscriminatory basis for a one-time royalty fee of $1000. The IEEE subsequently adopted NWay as the autonegotiation standard. The technology became the primary autonegotiation standard used in the computer industry. The technology was incorporated into hundreds of millions of devices such as personal computers, switches, routers, DSL and cable modems, wireless LAN access points, IP phones, and other equipment. As a result, according to the FTC, the industry is now "locked in" to using the N-Way technology in their products.

In 1998, National assigned several of its patents, including the patents on autonegotiation technology, to Vertical Networks, a firm formed by former employees of National, "subject to any

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existing licenses that [National] may have granted." National also provided Vertical with National's 1994 letter to the IEEE describing its offer to license the technology on nondiscriminatory terms to potential users for $1000 each.

In 2001, Vertical sent a "superseding" letter to the IEEE repudiating the terms of the 1994 letter. Vertical promised instead to make the patents available "on a non-discriminatory basis and on reasonable terms and conditions including its then current royalty rates." According to the complaint, Vertical later proceeded to enforce the patents against companies it determined were infringing, ultimately entering into several licensing agreements with fees larger than $1000 per company.

In 2003, Vertical assigned the autonegotiation patents to N-Data, owned by Vertical's former patent attorney. N-Data knew about the 1994 letter from National to the IEEE, but rejected requests from other companies to abide by its terms. Instead, N-Data continued to demand royalties in excess of $1000 per company from potential licensees.

FTC Complaint

The FTC brought a complaint against N-Data both under its anticompetitive conduct enforcement authority and under its consumer protection authority. Under its competition authority, the agency appeared to concede that N-Data's conduct did not violate the antitrust laws, but nevertheless found that it was an "unfair method of competition" because it met the lesser legal standard of being "coercive" or "oppressive" and having some adverse effect on competition. The Commission alleged that N-Data had coerced potential licensees into accepting its higher royalty rates, and that N-Data's conduct had the potential to undermine the standard-setting process, which in turn could undermine competition in an entire industry.

Under its consumer protection authority, the FTC found that N-Data's conduct was an unfair act or practice because it victimized businesses as consumers of autonegotiation technology. The Commission alleged that the "course of conduct has caused and is likely to continue to cause substantial injury to consumers of NWay technology that could not reasonably be avoided and is not outweighed by countervailing benefits to consumers or competition."

Chairman's Dissent

Noting in her dissent that the FTC rarely invokes its power to regulate unfair methods of competition where the conduct at issue does not also violate the Sherman or Clayton Act, Chairman Majoras argued that the agency should undertake such exercises only under clear limiting principles, which she maintained the majority did not provide here. Without limiting principles, she argued, the agency is on a slippery slope toward unstructured intervention in business decisions without rules that can provide predictability to the business community.

Chairman Majoras's dissent also argued that the case is an inappropriate use of the FTC's consumer protection enforcement power. A finding of an unlawful act or practice that injures consumers in this case requires the FTC to treat large, established computer manufacturers as "consumers." Chairman Majoras argued that the FTC's consumer protection mission should be limited to protecting individuals, small businesses, churches, nonprofits, and other organizations who frequently lack the ability to defend themselves against fraud.

Kovacic Dissent

The FTC majority's decision notes that because the complaint is not based on liability under the Sherman or Clayton Act, it will not provide private plaintiffs an opportunity to bring treble damage antitrust claims in federal court since such claims are not available under Section 5 of the FTC Act. Commissioner William Kovacic, however, pointed out in his dissent that the Commission's decision overlooks how the proposed settlement could affect the application of state statutes modeled on the FTC Act, commonly known as "baby FTC Acts." State courts, he noted, frequently cite federal actions as authority for state decisions, and in those states that allow private rights of action for damages or other relief, the decision may prompt litigation under the theories adopted by the majority.

Conclusion

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By law, the Decision and Order is not final and will remain open for public comment for 30 days.

The FTC has offered little guidance regarding how it will determine what types of conduct short of antitrust violations will attract its future review under its unfair methods of competition power. Further, because the FTC has never used its consumer protection power in what is otherwise a competition case, it is not clear whether and under what circumstances the FTC will invoke that power in such cases in the future. It is also unclear what the impact of these developments might be in states that have baby FTC Acts. These developments are of particular significance to firms engaged in standard-setting activities.

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