

**FTC REQUIRES PATENTEE TO FULFILL LICENSING COMMITMENTS  
TO A STANDARD-SETTING ORGANIZATION  
TO PREVENT CONSUMER HARM**

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-Data”), regarding patents related to the ubiquitous “Ethernet” computer networking standard.<sup>1</sup> With this decision, the Commission has undertaken to enforce licensing commitments made by a patentee to a standard-setting organization (an “SSO”) without requiring proof that the patentee has market power.

The Commission found that N-Data’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 result in substantial consumer harm. Under the proposed order, N-Data is required to offer paid-up, royalty-free licenses to the relevant patents for a one-time fee of \$1,000. The proposed order is subject to public comment until February 22, 2008.

**Background**

In 1994, National Semiconductor Corporation (“National”) participated in standard-setting activities with the Institute of Electrical and Electronics Engineers (the “IEEE”) for developing a faster Ethernet standard. National disclosed its pending patent application relating to its “NWay” autonegotiation technology to the IEEE and submitted a letter of assurance that it would license its technology to any requesting party for a one-time fee of \$1,000. The IEEE incorporated NWay technology into the Ethernet standard published in 1995. No party took advantage of National’s offer to license its NWay patents.

In 1998, National assigned to Vertical Networks (“Vertical”) two U.S. patents that had issued from the NWay patent application. Vertical and its outside patent counsel were aware that the assigned patents might be “encumbered” under the IEEE standard. Nevertheless, in 2002, Vertical announced to the IEEE and its members that a new offer to license the patents on reasonable and non-discriminatory terms and rates would supersede the prior licensing offer by National. From 2002 through 2003, Vertical filed suit against a number of companies practicing the standard, and entered into licensing agreements with fees in excess of the \$1,000 flat fee set by National.

In late 2003, Vertical assigned the patents to N-Data, a patent licensing company owned and operated by Vertical’s outside patent counsel. Although N-Data was also aware of National’s licensing assurance, N-Data refused to license the patents for \$1,000 and sued companies that refused to pay royalties in excess of that amount.

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<sup>1</sup> *In the Matter of Negotiated Data Solutions LLC*, File No. 0510094, Complaint, Decision and Order, and other documents available at <http://www.ftc.gov/os/caselist/0510094/index.shtm>.

## Analysis

The Commission found that N-Data'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). Chairman Majoras and Commissioner Kovacic dissented from the decision.

The fundamental disagreement between the majority and the dissenters is whether the conduct at issue injured consumers. The majority argued that, because standard-setting mechanisms themselves eliminate competition, any conduct that undermines the integrity of the standard-setting process may also harm consumers. In addition, the Commission emphasized that industry standards are one of the engines that drive the modern economy. Allowing standard-setting participants to renege on their licensing commitments would have a chilling effect on standard-setting activities and "threaten to stall that engine to the detriment of all consumers."<sup>2</sup> The Commission explained, however, that not all breaches of commitments made to SSOs will violate Section 5. For example, no violation would exist if the commitment was immaterial to adoption of the standard, or if those practicing the standard could take countermeasures to avoid injury from the breach.

The dissenters argued that one can never assume consumer injury but must prove it through market power or direct evidence. Chairman Majoras acknowledged that, given the high switching costs and lack of effective substitutes that may exist once a standard has been adopted, the owner of a patent that covers a standard could have market power and the ability to harm consumers. To avoid such patent "hold up" behavior and its resulting consumer harm, most SSOs take measures to protect their members by imposing patent disclosure rules or securing agreement on licensing terms.<sup>3</sup> In this case, however, the Chairman disagreed that the facts showed that there was any market-wide injury because National had not deceived the SSO, the SSO accepted Vertical's revised letter of assurance without objection, and other SSO participants had changed their letters of assurance.

Chairman Majoras also questioned whether N-Data has market power. She noted that (1) the NWay technology is an optional technique under the standard, (2) no company sought to accept National's \$1,000 offer, and (3) even after Vertical and N-Data's enforcement efforts only one company paid materially more than \$1,000 to license the technology. The Chairman expressed the view that Section 5 liability should generally be reserved for activities that would violate the Sherman Act if fully consummated, such as invitations to collude. She also argued that Section 5 liability should be reserved for protecting end consumers or "mom and pop" businesses, not large sophisticated corporations.

Commissioner Kovacic expressed concern that the Commission's decision would invite plaintiffs to bring private claims for treble damages. He noted that, although Section 5 does not support private rights of action, many states have unfair competition laws modeled after Section 5 that do allow private suits. He also criticized the majority for failing to distinguish clearly between the unfair method of competition and unfair acts or practices theories of liability.

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<sup>2</sup> Statement of the Federal Trade Commission at 3.

<sup>3</sup> Dissenting Statement of Chairman Majoras at 1.

## Implications

The N-Data case highlights the Commission's increasing efforts to regulate the exploitation of intellectual property rights that cover industry standards and a willingness to prosecute unfair competition in the standard-setting context to prevent consumer harm. The Commission has previously imposed compulsory licensing remedies on companies that failed to disclose intellectual property rights to an SSO.<sup>4</sup> The N-Data case shows that the Commission will also take action if a patent holder attempts to renege on licensing assurances made to an SSO by it or its predecessors in interest if those licensing assurances were material to adoption of the standard and licensees are effectively locked in to using the 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 should 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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<sup>4</sup> See, e.g., *In the Matter of Rambus*, No. 93-02, <http://www.ftc.gov/os/adjpro/d9302/index.shtm>; Willkie Farr & Gallagher LLP, *FTC Orders Compulsory Licensing And Sets Maximum Royalty Rate For Patent Concealed From Standard-Setting Organization* (March 1, 2007), available at [http://www.willkie.com/files/tbl\\_s29Publications/FileUpload5686/2399/FTC\\_Orders\\_Compulsory\\_Licensing.pdf](http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/2399/FTC_Orders_Compulsory_Licensing.pdf).