FTC ORDERS COMPULSORY LICENSING AND SETS MAXIMUM ROYALTY RATE FOR PATENTS CONCEALED FROM STANDARD-SETTING ORGANIZATION

On February 5, 2007, the Federal Trade Commission (the "Commission") issued its remedial opinion and final order in legal proceedings it brought against Rambus Inc., for Rambus's failure to disclose its intellectual property rights relating to a standard for computer-memory technology. The Commission found that, by concealing a patent and pending patent applications during its participation in a standard-setting organization, Rambus violated not only that organization's disclosure policy but also Section 2 of the Sherman Act and Section 5 of the Federal Trade Commission Act. The Commission's order is significant because it compels Rambus to license its patents relating to the standard and sets the maximum royalty rates that Rambus can collect for the licenses, which become royalty-free after three years.

Background

In 2002, the Commission charged Rambus with antitrust violations relating to its concealment of a patent and pending patent applications related to dynamic random access memory ("DRAM") from the Joint Electron Device Engineering Council ("JEDEC") standard-setting organization.[1] DRAM chips are used in a variety of electronic devices, including personal computers, servers, printers, and cameras. JEDEC required its members to disclose their patents and pending applications, and to provide assurances that all patents covering a standard would be licensed on reasonable and nondiscriminatory ("RAND") terms. Rambus participated in JEDEC's DRAM standard-setting activities for over four years without disclosing that it had a patent that covered, and was actively pursuing additional patent applications that would cover, the proposed standards for two types of DRAM (SDRAM and DDR SDRAM). Rambus officially ceased participating in JEDEC approximately two years before the two standards were adopted, but continued to stay abreast of developments within the organization.

In February 2004 after an administrative trial, the administrative law judge dismissed the complaint against Rambus finding, in part, that Rambus did not violate JEDEC's disclosure policy or have any undisclosed patents or patent applications that it would have been required to disclose even if the policy had been mandatory.

In July 2006, however, the Commission found that Rambus violated JEDEC's disclosure policy by concealing its patent and pending patent applications until JEDEC had adopted the SDRAM and DDR SDRAM standards. The Commission also found that Rambus abused its position after the standards were adopted by suing firms that practiced the standards for patent infringement. The Commission concluded that: (1) Rambus engaged in a course of conduct that was materially deceptive under the totality of circumstances in which the standard-setting occurred; (2) Rambus's deceptive acts constituted exclusionary conduct under Section 2 of the Sherman Act; and

[1] For more information on the Commission's liability decision, *see* Willkie Farr & Gallagher LLP, *FTC Addresses Application of Antitrust Laws to Standard-Setting Process* (Aug. 9, 2006), *available at* http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/2320/FTC_Addresses_Application_of_Antitrust_Laws.pdf.

(3) Rambus unlawfully monopolized the markets for four technologies incorporated into JEDEC's DRAM standards in violation of Section 5 of the Federal Trade Commission Act.

The Imposed Remedy

The remedy imposed by the Commission goes well beyond a "cease-and-desist" order prohibiting Rambus from deceiving standard-setting organizations in the future. The Commission emphasized that it has broad remedial authority to restore the competitive conditions that would have existed "but for" Rambus's unlawful conduct, including the authority to order compulsory licensing on either reasonable or royalty-free terms. While two of the Commissioners would have required royalty-free compulsory licenses, the majority of the Commission members decided that, in the "but-for" world, Rambus would have agreed to license on RAND terms rather than forgoing royalties altogether. Therefore, the Commission ordered worldwide, nonexclusive compulsory licensing and set the maximum royalty rates that Rambus can charge those practicing the SDRAM and DDR SDRAM standards.

In determining the maximum royalty rates, the Commission started with the rates Rambus charges for its proprietary DRAM technology ("RDRAM"). The Commission started at 1%, the lower end of the RDRAM licensing range, and discounted that rate based on several factors, including that the RDRAM licenses covered more technologies, provided discounts for high volumes, and declined over time (for example, the rates Rambus charged to Samsung declined to zero five years after shipment of the 500,000th unit, provided that more than 10 million units had been shipped). Using this methodology, the Commission determined that a maximum royalty rate of .5% for DDR SDRAM was reasonable and appropriate. The Commission halved that rate to .25% for SDRAM, based on Rambus's own cost estimates and because the SDRAM standard utilizes only two of the four relevant Rambus technologies. The Commission found that these rates reflect the *ex ante* negotiating positions of the parties and prevent Rambus from benefiting from its unlawful actions. Both rates are required to drop to zero (royalty-free) three years from the date of the Commission's order. The Commission noted that the reduction after three years follows from Rambus's RDRAM license agreement with Samsung, lends temporal certainty to the remedy, and requires that the royalty rates drop to zero before the patents expire in 2010.

In addition, the Commission ordered broad "fencing-in relief" to prevent future unlawful conduct by Rambus and to restore the competitive conditions that would have existed but for Rambus's deceptive conduct. For example, the order prohibits Rambus from making misrepresentations to standard-setting organizations relating to its patents or pending patent applications and requires Rambus to hire a Commission-approved compliance officer to ensure that it follows each organization's disclosure policies. The order covers all JEDEC-compliant technologies protected by any patents Rambus filed while a member of JEDEC, not just the four technologies that were at issue in the instant case. The maximum royalty rates apply to U.S. patents and to foreign patents with respect to imports into, or exports from, the United States. The order does not extend to the next generation of DRAM technology (DDR2 SDRAM), although one of the Commissioners would have ordered compulsory licensing for that technology as well. The order remains in effect for 20 years.

Implications Of The Decision

The Commission's order has significant implications for government enforcement of antitrust laws, for private parties engaged in patent infringement litigation involving patents that are part of an industry standard, and for companies that are considering whether to participate in standard-setting organizations.

First, the Commission's order highlights the continuing focus of competition authorities on the activities of standard-setting organizations and their members. Last year, the Antitrust Division of the Department of Justice endorsed the *ex ante* disclosure of maximum royalty rates and licensing terms to a standard-setting organization.[2] Now, the Commission's order illustrates its broad view of what type of disclosure of intellectual property rights is required in a standard-setting context. When a standard-setting organization requires disclosure of intellectual property rights, a party that fails to disclose its rights and then demands royalties from those practicing the standard after it has been adopted may be liable for deceptive conduct under Section 5 of the Federal Trade Commission Act. Even if a standard-setting organization does *not* require disclosure, the Commission stated that "members still are not free to lie or to make affirmatively misleading representations. In either case, whether the [standard-setting organization] requires disclosure should be judged not only by the letter of its rules, but also on how the rules are interpreted by its members, as evidenced by their behavior as well as by their statements of what they understand the rules to be."[3]

Second, the Commission's decision provides a rare example of a royalty rate being set by a competition authority. In its remedial opinion, the Commission cited several Supreme Court decisions to support the proposition that compulsory licensing on a reasonable-royalty basis is a well-recognized remedy.[4] However, those cases all involved coordinated conduct, patent pools, information exchanges, restrictive licensing provisions, and other activities that allowed competitors to allocate markets and maintain prices. The *Rambus* decision also stands in contrast to the remedy imposed by the Ninth Circuit Court of Appeals when Kodak was found liable for unilaterally using its monopoly in photocopier parts to monopolize the aftermarket for photocopier service.[5] In that case, the district court issued an injunction requiring Kodak to sell its parts to independent service organizations on RAND terms. The Ninth Circuit modified the injunction by dropping the reasonableness requirement, concluding that nondiscriminatory pricing (but not necessarily reasonable pricing) would be sufficient to end Kodak's service monopoly while protecting Kodak's intellectual property rights. The Ninth Circuit held that "Kodak should be permitted to charge all of its customers . . . any nondiscriminatory price that the market will bear."[6]

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[2] For more information, *see* Willkie Farr & Gallagher LLP, *Antitrust Division Endorses Ex Ante Disclosure Of Maximum Royalty Rate And Licensing Terms In Context Of Standard Setting* (Nov. 30, 2006), *available at* http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/2346/Antitrust%20Division%20Endorses%20Ex%20Ante%20Disclosure.pdf.

[3] *In the Matter of Rambus*, No. 93-02, Opinion of the Commission, at 35 (Aug. 2, 2006).

[4] *In the Matter of Rambus*, No. 93-02, Opinion of the Commission on Remedy, at 9 (Feb. 5, 2007) (citing *United States v. Glaxo Group*, 410 U.S. 52, 62 (1973); *Besser Mfg. Co. v. United States*, 343 U.S. 444, 448-49 (1952); *United States v. Nat'l Lead Co.*, 332 U.S. 319, 348-49 (1947); *Hartford-Empire Co. v. United States*, 323 U.S. 386, 418-19 (1945)).

[5] *Image Tech. Servs. v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1997).

[6] *Id.* at 1225-26.

Third, the Commission's order has implications for patent infringement litigation involving patents that are part of an industry standard. Parties accused of infringing patents that relate to a standard might raise a defense or counterclaim alleging patent misuse based on the patent holder's abuse of the standard-setting process.[7] The Commission's methodology for determining the reasonable royalty rate also might guide district courts as to the appropriate damages for infringement of patents that are part of an industry standard.

Finally, the Commission's order might have a chilling effect on the willingness of companies to participate in standard-setting activities. Part of the Commission's rationale in imposing liability on Rambus was that standard-setting processes should not be distorted because they can yield significant efficiencies that benefit both participants and consumers. Ironically, the Commission's decision might discourage companies from participating in efficient standard-setting activities and increase the type of patent "holdup" behavior in which the Commission found Rambus to have engaged. Companies might prefer not to participate in a standard-setting process until a standard is adopted and then seek to enforce their patents against practitioners of the standard, rather than participate in the process and face the penalty of compulsory licensing if they fail to disclose all of their existing and pending intellectual property rights.

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[7] *See, e.g.*, *Matsushita Elec. Indus. Co. Ltd. v. CMC Magnetics Corp.*, 2006 WL 3290413, *2 (N.D.Cal. 2006) (finding that activities related to participation in a standard-setting organization can form the basis of a patent misuse counterclaim).