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CLIENT ADVISORY

NOVEMBER 2006

DOJ Issues Advisory Opinion Stating It Will Not Oppose Standard-Setting Organization Proposal

On October 30, the Antitrust Division of the U.S. Department of Justice (DOJ) issued a Business Review Letter (BRL) indicating that it had no present intention to challenge proposed rules of a standard-setting organization that would require[1] not only the disclosure of essential patents and patent applications and a commitment to license on fair, reasonable, and non-discriminatory terms, but also a declaration of the highest license fee and most restrictive licensing terms that the patent holder will require.[1] This client advisory provides a brief background on the antitrust treatment of standard setting, describes the IP disclosure policy reviewed by DOJ, and discusses the practical implications of the BRL.

BACKGROUND

For many years, courts and the federal enforcers emphasized the potential for anticompetitive conduct in standard setting in cases like *Allied Tube & Conduit Corp. v. Indian Head, Inc.*[2] (group boycott in context of private standard-setting activity not protected by Noerr immunity); *FTC v. Indiana Federation of Dentists*[3] (challenge to association rule barring submission of x-rays to insurers); *American Society of Mechanical Engineers v. Hydrolevel Corp.*[4] (antitrust challenge to application of safety standard to foreclose competitor); *National Society of Professional Engineers v. United States*[5] (challenge to ethical standard barring competitive bidding); and *National Macaroni Manufacturer's Association v. FTC*[6] (standard for wheat content in past is per se unlawful attempt to affect prices of inputs). *Cf. California Dental Ass'n v. FTC*[7] (rejecting FTC application

1 Business Review Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice to Robert A. Skitol (October 30, 2006), available at http://www.usdoj.gov/atr/public/busreview/219380.htm.

2 486 U.S. 492 (1988).

3 476 U.S. 447 (1986).

4 456 U.S. 556 (1982).

5 435 U.S. 679 (1978).

6 345 F.2d 421 (7th Cir. 1965).

7 526 U.S. 756 (1999).

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of "quick look" doctrine to advertising standard for dentists). More recently, the federal antitrust enforcers have recognized that standard setting is essential to the operation of a modern technological economy. Nevertheless, the operations of standard-setting organizations have remained hampered by a concern that their every action will be treated as that of a "walking conspiracy," with its accompanying risk of per se liability for price fixing or a group boycott.

As a result of this antitrust risk, well-counseled SSOs have focused on the technological merit of proposed standards, relying on rules requiring disclosure of IP rights that read on the proposed standard and commitments from IP holders that they will license on "reasonable and non-discriminatory" (RAND) terms. The ambiguity in the RAND standard has left SSOs and their members facing some risk of "patent holdups" by IP owners whose technology is adopted as part of the standard, but there has been little SSOs could do when faced with cases like *Addamax v. Open Software Foundation.*[8]

Open Software Foundation (OSF), a joint venture that was creating a new operating system, proposed a maximum price it would pay for the right to incorporate Addamax's security technology in its software, implying that if Addamax refused to accept that price, it would purchase another system. Addamax sued when OSF purchased alternative security, claiming that OSF was a consortium of competitors that had unlawfully agreed on the price they would pay to purchase security software. Although the court rejected Addamax's claim that OSF's conduct constituted a per se illegal price-fixing agreement, it held OSF's conduct might be unlawful under the rule of reason and denied summary judgment. On appeal after a verdict for OSF (based upon a finding that Addamax had not been injured), the First Circuit affirmed the district court's rejection of per se liability but noted in *dicta* that OSF's conduct was not "per se legal" and that the issue was whether the "concentration of purchasing power" created a risk of monopsony pricing, and whether the risk of such pricing "outweighed any benefit from the venture or, more plausibly, that the venture could achieve those benefits in a less restrictive fashion, i.e. without creating a substantial threat of monopsony pricing."[9] Given this precedent, SSO participants have been justifiably concerned that *ex ante* price negotiations could subject them to claims of unlawful price fixing that could survive a motion for summary judgment.

In a September 2005 speech, however, FTC Chairman Deborah Majoras indicated openness to *ex ante* negotiations by SSOs or their members, that is, determining the price of a license to IP before a standard embodying that IP is selected for use in the standard. While recognizing that the antitrust concerns of SSO participants were "understandable" and agreeing with *Addamax* that joint *ex ante* negotiations should be analyzed under the rule of reason rather than the per se rule, Chairman Majoras also indicated her view that while anticompetitive effects through subcompetitive prices that reduced innovation were "theoretically possible, this risk is unlikely to be a frequent practical concern."[10] In its recent *Rambus* decision, the full Commission gave further support for *ex ante* negotiation of royalties by condemning Rambus's conduct because it had the effect of preventing such negotiations and citing Chairman Majoras for the proposition that "under certain

8 888 F. Supp. 274 (D. Mass. 1995), *aff'd* 152 F.3d 48 (1st Cir. 1998).

9 *Addamax Corp. v. Open Software Foundation, Inc.*, 152 F.3d 48, 52 (1st Cir. 1998).

10 Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, Remarks Prepared for Standardization and the Law: Developing the Golden Mean for Global Trade: Recognizing the Procompetitive Potential of Royalty Discussions in Standard Setting (Sept. 23, 2005).

circumstances, members of an SSO may even collectively negotiate these types of *ex ante* licenses, without necessarily running afoul of the antitrust laws."[11]

While the Majoras speech and the *Rambus* decision demonstrated the FTC's general openness to *ex ante* royalty negotiation, the Department of Justice's recent business review letter to the VMEbus International Trade Association ("VITA") lays out a specific path for *ex ante* negotiation of royalty rates.

THE BUSINESS REVIEW LETTER

VITA is a non-profit organization that develops interoperability standards for computer systems based on VMEbus computer architecture. VMEbus systems are used in a wide range of technologies, including ultrasound and magnetic resonance imaging machines, radar systems, certain types of manufacturing and industrial equipment and space exploration and weapons systems.

VITA requested a BRL from DOJ to gauge its enforcement intentions concerning two aspects of VITA's proposed patent policy. First, VITA's proposed policy would require patent holders participating in VITA standard setting to disclose patents and patent applications that might be necessary for the implementation of VITA standards, once adopted. Second, the proposed policy would require patent holders to state the maximum royalty rate and most restrictive non-price licensing terms they would require from entities that would need a patent license in order to implement the VITA standard. The required declarations would be irrevocable, but patent holders would have the option of submitting later declarations containing less restrictive terms.

On October 30, the DOJ issued a BRL indicating that it has no present intention of challenging VITA's proposed patent policy. The BRL notes VITA's claim that its current policy of requiring patent owners to commit to licensing on "reasonable and non-discriminatory terms" has resulted in uncertainty and confusion regarding the meaning of those terms and disagreements related to royalties that have resulted in lengthy controversies that significantly delayed the adoption of standards.[12]

The letter observed that requiring patent holders to disclose their most restrictive licensing terms could foster competition between technologies during the standard-setting process and prevent the difficulties involved in substituting technologies in the future, once licensees are "locked in" to a standard. The disclosure of such terms would allow working group members to more efficiently evaluate competing technologies on the basis of both technical merit and cost. Such evaluation is likely to create incentives for patent holders to more actively compete with one another to have their particular technology chosen.[13]

The DOJ noted that under the VITA proposal prospective licensees would not be able to depress the price of technology licenses through joint action because the proposed policy prohibits working group members from engaging in joint negotiation or discussion of licensing terms. Instead, the patent holder and each licensee would negotiate separately subject to the patent holder's declaration of its most restrictive terms.[14] Interestingly, however, the DOJ stated that "if the proposed policy did allow such negotiations and discussions, the Division likely would evaluate any antitrust concerns about them under the rule of reason because such actions could be procompetitive."[15]

11 *In the Matter of Rambus, Inc.*, Docket No. 9302, Opinion of the Commission (August 2, 2006), http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf, at 35-36, 77.

12 Business Review Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't of Justice to Robert A. Skitol (October 30, 2006), at 3-4.

13 *Id.* at 7.

14 *Id.* at 8.

15 *Id.* at 9 n.27.

DISCUSSION

The DOJ letter may be viewed as a significant step forward for SSOs that wish to select intellectual property for use in standards based on an accurate comparison of *both* technical merit *and* royalty costs (if any) associated with each technology. In the past, standard-setting organizations have been reluctant to require anything more than "RAND" assurances, due to concern that any attempt to establish *ex ante* rates would be viewed as an unlawful group boycott or price-fixing agreement. In contrast with the negotiation of licensing terms after the relevant standard has been adopted, the *ex ante* disclosure of maximum terms approved in the BRL would appear to have the potential to reduce future controversy regarding what terms are "fair" and "reasonable" for a particular technology under a given set of circumstances. In particular, it may prevent licensors from demanding royalties that reflect not only the intrinsic merit of the licensed technology, but also a measure of switching costs associated with licensees being committed to employ technologies embodied in a standard (a.k.a. "the lock-in effect").

Nevertheless, the practical benefit of *ex ante* disclosure of licensing terms may be modest in cases where the eventual contours of a standard are unclear. Where IP owners are uncertain about how much of their intellectual property will ultimately be included in the standard, they may have an incentive to overstate their maximum royalty demand. If this is the case, it is possible that the most important aspect of the VITA process and procedures approved by DOJ will be the ability of intellectual property owners to stake out their position on non-monetary terms (such as defensive suspension—the right to terminate a license if the licensee sues the licensor). *Ex ante* disclosure policies also carry the risk that the added burden of disclosure will create disincentives for IP owners to participate in SSOs.

The impact of the VITA policy may also be limited because it forbids any "discussion of specific licensing terms among working group members or with third parties at all VSO and working group meetings."[16] It is thus far from clear what SSO members can practically do with the information disclosed by IP owners. For example, the VITA policy would appear to bar collective discussion of the price-performance tradeoffs of various proposed technologies, for doing so would involve the discussion of licensing terms. The policy addressed by the BRL may therefore be of marginal benefit to SSOs that operate using a consensus process in which the merits of alternative technologies are discussed and debated.

Because the VITA policy does not permit collective discussion or negotiations of royalty terms, the BRL does not address full-fledged *ex ante* collective negotiation of royalty terms. The BRL does note, however, the procompetitive potential for such collective negotiations and thus rejects per se condemnation. In so doing, DOJ joins the FTC in appearing to recognize that there is greater risk of harm to consumers from patent hold-ups of SSO members than there is from an SSO member "boycott" of higher-priced technologies. Proposed SSO policies permitting collective discussion and negotiation of royalty terms are thus likely be the subject of future business reviews.

CONCLUSIONS

There is a still a great deal that remains unaddressed regarding standard-setting organizations and disclosure requirements for patent holders. DOJ's apparent interest in providing the advisory opinion was to promote policies enabling such organizations as VITA to make better informed decisions and thus implement standards that ultimately benefit consumers. However, the full ramifications and real-world implications of the new procedures remain to be seen.

16 *Id.* at 5.

We hope you find this summary helpful. If you would like more information about antitrust issues in standard setting, please feel free to contact your Arnold & Porter attorney or

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