LATHAM & WATKINS

Number 578 March 12, 2007

Client Alert

Latham & Watkins
Litigation Department

Lessons from *Rambus* – Play by the Rules in Standards Setting Organizations

The recent Federal Trade Commission opinion concerning Rambus, Inc.[1] provides important lessons for companies that participate in standards setting organizations (SSOs). The FTC found that Rambus' misconduct in concealing its pending patent applications from an SSO had harmed competition. To remedy this harm, the FTC imposed mandatory patent licensing terms on Rambus, with royalty rates dropping to zero after three years. Two dissenting commissioners expressed their opinions that Rambus should have been forced to license its patents for free.

This *Client Alert* discusses SSOs, reviews the FTC's opinion, and presents high-level guidance for companies participating – or contemplating participating – in SSOs.

> "The *Rambus* decision provides a clear warning that manipulation of standards setting processes can result in close antitrust scrutiny. Potential remedies...include compulsory royalty-free [patent] licensing."

Standards Setting Organizations – A Primer

Many industries have created SSOs to promulgate technical standards, the objective generally being to ensure that a company's products can interface with products from other suppliers. Standards facilitate and thereby promote compatibility and interoperability among products offered by different suppliers and/or competitors. Standards setting activities can have procompetitive effects if they increase the number of suppliers in the market and/or assure potential customers that standardized products will be generally available and supported in the future. While competitors collaborate to achieve greater compatibility and interoperability, they continue to compete on implementation and other differentiating features of product and service offerings.

Companies that develop products in compliance with a standard can confront patent infringement claims from holders of patents that may be *essential* to or *necessary to practice* the standard. Most SSOs have adopted policies to create IPR (intellectual property rights) safe harbors and reduce the risk of patent hold-ups. Although the terms of SSO IPR policies vary significantly, a common goal of such policies is to prevent an SSO member from concealing its patents or pending patent applications relating to a proposed standard under consideration, only to assert the patents later – after the standard has been adopted and the market "locked in."

Manipulation of standards setting activities may harm competition and chill standards setting efforts. In contrast, accurate and timely patent disclosures along with *ex ante* license disclosure obligations promote informed decision-making by SSO members concerning the benefits of the patented technology and non-patented alternatives. This can be an important factor in selecting among competing standard proposals. Most SSO IPR policies require that members agree to license essential patents on at least reasonable and non-discriminatory (RAND) terms.[2]

Rambus and JEDEC

The Joint Electron Device Engineering Council (JEDEC) is an SSO focused on standardizing technologies for the solid state industry. JEDEC has a patent policy that requires participants and/or members to disclose whether they have any issued (or pending) patents that may relate to, or cover, the technology under consideration for adoption.[3] For example, Section 8.3 of the JEDEC Manual 21-L, now states "The chairperson of any JEDEC committee must call to the attention of all those present the requirements contained in JEDEC Legal Guides and the obligation of all participants to inform the meeting of any knowledge they may have of any patents, or pending patents, that might be involved in the work they are undertaking."[4] JEDEC's patent policy also requires that the patent owner indicate its willingness to grant licenses on RAND or FRAND (free, reasonable and non-discriminatory, also referred to as royalty free, RF) terms.

JEDEC's written patent policy has been revised over time to clarify that patent applications as well as issued patents must be disclosed. Both the FTC and the Court of Appeals for the Federal Circuit have addressed the various revisions and have reached diametrically opposed conclusions as to the guidance they provided to JEDEC participants. The FTC stated that although the applicable JEDEC policy was "not a model of clarity, a duty of good faith underlies the standard-setting process" and noted that Rambus and other JEDEC members understood that patent applications needed to be disclosed.[5] Conversely, the Federal Circuit opined that Rambus had no duty to disclose its intention to amend pending claims to cover the proposed standards under consideration.[6]

Rambus was a member of the JEDEC subcommittee addressing standards for dynamic random access memory (DRAM) chips[7] from February 1992 until June 1996. During this time period, Rambus had pending patent applications with disclosures broad enough to cover technologies for the standards under consideration. Using information from the JEDEC meetings, Rambus repeatedly 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 patent activity to JEDEC.[8]

In June 1996, several months after learning of an FTC consent order involving Dell Computer's failure to disclose a patent to an SSO,[9] Rambus notified JEDEC 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." Even after terminating its JEDEC membership, Rambus actively sought information as to features of devices being proposed for standardization. Rambus continued to use this type of information in filing and amending its patent applications. Internal Rambus communications advised the company not to assert its patents "until ramp reached a point of no return." The FTC determined that "after leaving JEDEC, Rambus strategically maintained its silence, thereby prolonging the misimpression created by its prior conduct."[10]

Rambus subsequently launched an aggressive patent licensing campaign against the manufacturers of industry-standard DRAM chips, backed by several lawsuits. This campaign resulted in helping the company increase its annual revenue to nearly $200 million in 2006, most of this being patent licensing revenue.[11]

The FTC Gets Involved

Rambus' conduct, documented in various counterclaims brought by DRAM suppliers it had sued for patent infringement, attracted the FTC's attention.[12] In June 2002, FTC Complaint Counsel accused Rambus of engaging in a pattern of anticompetitive acts and alleged that such behavior caused or threatened to cause harm to competition and consumers in violation of Section 5 of the FTC Act (prohibiting unfair or deceptive methods of competition)[13] and Section 2 of the Sherman Act (prohibiting monopolization).[14] On February 17, 2004, however, the ALJ overseeing the proceeding entered an initial decision in favor of Rambus.[15]

Complaint Counsel successfully appealed the ALJ's decision to the Commission, which overturned it in August 2006.[16] In its opinion, the 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 anticompetitive 'hold up' of the computer memory industry."[17] The Commission opined that "when a firm engages in exclusionary conduct that subverts the standard-setting process and leads to the acquisition of monopoly power, the procompetitive benefits of standard setting cannot be fully realized."[18] The Commission concluded that "Rambus engaged in exclusionary conduct that significantly contributed to its acquisition of monopoly power in four related [DRAM] markets."[19]

It is significant that the FTC found a Section 2 violation on these facts, reasoning that deception qualified as an exclusionary practice and therefore established the conduct element of a monopolization claim.[20] This is generally regarded as an aggressive antitrust theory, because in ordinary circumstances companies are free to keep their unpublished pending patents secret. (Indeed, the law of trade secrets proceeds from an assumption that competition is fostered by maintaining the confidentiality of certain technology assets.) Nevertheless, the FTC very clearly sided with full disclosure, opining that in an SSO setting, the prospect that nondisclosure could lead to an illegitimate increase in patent-based monopoly power was the paramount concern.[21] Rambus' own documents provided significant evidence of "deceptive conduct,"[22] which set up the comparatively easy argument that there is no social value in deceit.

The FTC Sets Compulsory (Including Royalty-Free) Licensing Terms

Following its August 2006 liability decision, the Commission ordered additional briefing and hearings as to the appropriate remedy. Rambus contended that the FTC did not have the authority to impose compulsory licensing terms or to order Rambus to license its disputed patent portfolio on royalty-free licensing terms. In a February 5, 2007 decision, however, the Commission disagreed, finding such remedies well within its authority to balance competition and prevent consumer harm.[23]

The Commission found that compulsory licensing terms were justified, both to remedy the effects of the unlawful monopoly Rambus obtained and "to inspire confidence in the standard-setting process."[24] 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) nonetheless alternatives were 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. After reviewing the evidence, the Commission concluded that if Rambus had properly disclosed its pending patents, it likely would have resulted in *ex ante* licensing negotiations for the next generation SDRAM and DDR SDRAM technologies.[25]

The Commission determined the appropriate royalty rates by reviewing and extrapolating from Rambus' actual RDRAM license agreements and applying a *Georgia Pacific* analysis.[26] Using this approach, the Commission ordered that Rambus could charge maximum royalty rates of 0.5 percent for DDR SDRAM and 0.25 percent for SDRAM for three years. After the three-year royalty period, Rambus is precluded from seeking further patent license royalties with respect to those technologies.[27] Two commissioners dissented, stating that the remedies did not go far enough and that Rambus should have been forced to license its patents without receiving any royalty.

The Commission also prohibited Rambus from misrepresenting its patents or patent applications to any SSO or its members. It ordered Rambus to comply with SSO requirements or policies to make complete, accurate and timely disclosures of its patents and patent applications. To ensure and oversee such compliance, the order requires Rambus to employ a Commission-approved compliance officer to ensure disclosure of patent rights and to verify the accuracy of Rambus' periodic audit reports to the Commission.[28]

Rambus has filed a motion to stay this remedy pending appeal.[29]

Guidance for Companies Participating in Standards Setting Activities

The *Rambus* decision provides a clear warning that manipulation of standards setting processes can result in close antitrust scrutiny. Potential remedies for such behavior include compulsory royalty-free licensing that can encumber patents covering next generation technologies.

It is critically important that companies participating in SSOs understand the applicable patent policy and comply with it. The FTC and European regulators, *e.g.*, DG Competition of the European Commission, emphasize the importance of an SSO's written patent disclosure policy as a means to minimize the risk of the "patent ambush" perpetrated by Rambus.[30] Thus, the logical first step is to review the written IPR policy. The *Rambus* case, however, demonstrates that further investigation may be necessary. If the written policy does not provide clear guidance on what, when, how and to whom members must disclose essential IPR, courts and investigating agencies may look to the practices and understandings of fellow SSO members to ascertain what disclosures are required. In the litigation context, such members may have financial motivations to support a finding that the patent policy was violated. Accordingly, an SSO participant may decide to proceed proactively and seek clarification of the patent policy.

Companies with pending or issued patents that may cover certain technologies being considered for inclusion in standards should implement an internal company process to ensure timely and accurate disclosures pursuant to the 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 may need to be given during the patent prosecution process to the effect of contemplated claim amendments.

For companies with substantial patent portfolios, compliance with patent disclosure obligations can be a daunting and difficult task. As a result, a common debate concerning SSO patent disclosure policies is whether or not a participant company should have a *duty to search* its entire patent portfolio for potentially applicable patents and pending patents.[31] Proponents of such a duty note that the anticompetitive impact of a failure to disclose can be the same whether the failure was knowing or inadvertent. Furthermore, excusing "inadvertent" failures can lead to situations where a company's SSO representative is deliberately kept uninformed as to patents and pending applications. Opponents of such a duty cite to the chilling effect on participation that may result from a "strict liability" policy. Knowledge of the applicable disclosure policy in this regard is fundamental.

Certain SSOs have adopted IPR/patent policies that include more specific *ex ante* license disclosure obligations. For example, VITA (an international trade association) recently changed its IPR/patent licensing obligation to include more specific *ex ante* licensing disclosure of maximum royalty rates for any non-RF licensing commitments for disclosed patents.[32] However, while *ex ante* licensing commitments and discussions are appealing for the potential increased certainty of license terms compared with the ambiguous F/RAND terms, such licensing raises antitrust and competition considerations of its own. Unlike patent pools, most SSOs are not set up to oversee the establishment of common and capped royalty rates for essential patents (*e.g.*, most SSO IPR policies forbid discussions of pricing, distribution, marketing, suppliers, and patent licensing royalty rates among SSO members, who are often competitors).[33] Furthermore, agreements to manipulate the adoption/rejection of a particular standard can themselves give rise to antitrust scrutiny.[34]

The complexities and strategic implications of the issues discussed above are meant to provide guidelines for practitioners, and to also highlight when specialized advice from IPR/patent and antitrust experts would be appropriate.

Endnotes

1 *In the Matter of Rambus, Inc.*, FTC Docket No. 9302 (February 5, 2007). The FTC's opinion and order are available at http://www.ftc.gov/os/adjpro/d9302/index.htm.

2 The RAND terms required by most SSO IPR policies are generally broadly worded and do not specify the actual license terms. Moreover, RAND obligations do not necessarily require that all licensees receive identical license terms. A RAND license obligation, however, at least provides reasonable assurances that a potential patent holder will not be able to hold up the standard by refusing to license the patent or only offering a license on unreasonable terms.

3 *See* JEDEC's website, available at http://www.jedec.org/. JEDEC's current patent policy is available at http://www.jedec.org/home/patent_related/.

4 JEDEC Manual 21-L, available at http://www.jedec.org/Home/manuals/JM21L.pdf.

5 *In the Matter of Rambus, Inc.*, FTC Docket 9302, Opinion of the Commission (August 2, 2006), at 52-56. This opinion is available at http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf.

[6] *Rambus, Inc. v. Infineon Tech. AG,* 318 F.3d 1081, 1102 (Fed. Cir. 2003) ("[i]n this case there is a staggering lack of defining details in the EIA/JEDEC patent policy. When direct competitors participate in an open standards committee, their work necessitates a written patent policy with clear guidance on the committee's intellectual property position. A policy that does not define clearly what, when, how, and to whom the members must disclose does not provide a firm basis for the disclosure duty necessary for a fraud verdict. Without a clear policy, members form vaguely defined expectations as to what they believe the policy requires – whether the policy in fact so requires or not.").

[7] DRAM chips are used in a range of computing, consumer electronics and communications applications. System level products that utilize this technology include personal computers, computer servers, printers, video projectors, video game consoles, digital TVs, set-top boxes, routers and switches.

[8] *In the Matter of Rambus, Inc.*, FTC Docket 9302, Opinion of the Commission (August 2, 2006), at 37-46.

[9] *In re Dell Computer Corp.*, 121 FTC 616 (1995). In *Dell*, the FTC brought suit under Section 5 of the FTC Act when Dell failed to disclose that it owned the patent for VL Bus design incorporated into a Video Electronics Standards Association (VESA) standard. Although Dell had represented to VESA that the standard did not infringe its patent, it then attempted to enforce patent rights after the standard was adopted. As part of the settlement, Dell agreed not to enforce its patent. *Cf. Wang Labs., Inc. v. Mitsubishi Elecs. Am., Inc.*, 103 F.3d 1571 (Fed. Cir. 1997) (Mitsubishi accused Wang of misleading JEDEC by concealing a *pending* patent application that related to the Single In-Line Memory Modules (SIMM) standard; doctrine of equitable estoppel did not apply but Mitsubishi received an implied license to use such patented technology due to technical exchanges between the companies during joint development activities; Wang was free to enforce the patent against other companies).

[10] *In the Matter of Rambus, Inc.*, FTC Docket 9302, Opinion of the Commission (August 2, 2006), at 44-48.

[11] Rambus' 10-Q filed on May 9, 2006 suggests that more than 80 percent of its annual revenue is generated from patent licensing royalties.

[12] Rambus had brought several lawsuits against DRAM manufacturers, including Infineon, Hynix and Micron.

[13] 15 U.S.C. § 45. The FTC has the authority to issue an administrative complaint by approval of the Commission. If an administrative complaint is issued, then a formal proceeding that is much like a court trial begins before an administrative law judge (ALJ). If a violation is found, a cease and desist order or other appropriate relief may be issued. Initial decisions of the ALJ may be appealed to the full Commission, which consists of five Commissioners. Final decisions issued by the Commission may be appealed to any of the US Court of Appeals (except the Court of Appeals for the Federal Circuit), and ultimately, to the US Supreme Court.

[14] 15 U.S.C. § 2.

[15] A timeline of the FTC investigation and the docket are available at http://www.ftc.gov/os/adjpro/d9302/index.htm.

[16] *In the Matter of Rambus, Inc.*, FTC Docket 9302, Opinion of the Commission (August 2, 2006).

[17] *Id.* at 3.

[18] *Id.*

[19] *Id.* at 118.

[20] *Id.* at 28-36.

[21] *Id.* at 33-35.

[22] *Id.* at 36-37.

[23] *In the Matter of Rambus, Inc.*, FTC Docket 9302, Opinion of the Commission (February 5, 2007).

[24] *Id.* at 11.

[25] *Id.* at 18.

[26] *Id.* at 19. *See Georgia Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116, 1120-21 (S.D.N.Y. 1970).

[27] *Id.* at 22-23. The order also prohibits Rambus from enforcing any current license agreements that would allow it to collect royalties greater than these capped royalty rates.

[28] *Id.* at 4-5.

[29] *In the Matter of Rambus, Inc.*, FTC Docket 9302, Motion of Respondent Rambus Inc. for Stay of Order Pending Appeal (February 7, 2007), available at http://www.ftc.gov/os/adjpro/d9302/070216rammostayordpendappeal.pdf.

[30] *See Antitrust Guidelines for Collaboration Among Competitors*, issued by the FTC and DOJ, Section 2.2 (April 2000), available at http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf. DG Competition of the European Commission has also considered competition implications of IPR policies of SSOs and is currently investigating complaints against Qualcomm from Nokia, Ericsson, Broadcom, Panasonic, Texas Instruments and NEC on the basis that its WCDMA technology licensing policy violates European competition law.

[31] The issue is whether participants must have actual knowledge, which is often not the case for many large companies with significant patent portfolios, or whether knowledge is "imputed" to the corporation (thereby, in effect, require companies to perform patent searches to satisfy their patent disclosure obligations). Most SSOs have patent disclosure obligations that either do not specifically address this issue, or if so, the policies typically require only actual knowledge of the participants (or impose a "knew or should have known" standard on the participants/company). Some SSOs have even specified that a patent search is *not* required. *See, e.g.*, W3C Patent Policy, available at http://www.w3.org/Consortium/Patent-Policy-20030520.html (providing Section 6.1, which suggests that actual knowledge is the standard, and 6.7, which suggests that no patent search is required).

[32] See US Department of Justice Business Review Letter regarding VITA available at http://www.usdoj.gov/atr/public/busreview/219380.htm (responding to a request on behalf of VITA and its standards development subcommittee, VSO, for a business review letter from the Department of Justice pursuant to the DOJ's Business Review Procedure, 28 C.F.R. § 50.6). The DOJ generally reviews SSO activities and policies under the rule of reason standard, absent price fixing or bid rigging related activities.

[33] The DOJ has issued Business Review Letters for four patent pools, all of which were approved without any subsequent enforcement activities, available at http://www.usdoj.gov/atr/public/busreview/letters.htm: MPEG-2 on June 26, 1997; DVD 1 on December 16, 1998; DVD-2 on June 10, 1999; and 3G Patent Platform on November 12, 2002.

[34] *See Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 509-10 (1988) (holding that vote stacking by competing steel conduit companies to prevent the use of alternative plastic conduit in building standards setting violated the Sherman Act); *American Society of Mechanical Engineers v. Hydrolevel Corp.*, 456 U.S. 556, 571 (1982) (finding that a manipulation of a safety code for water boilers violated the Sherman Act).

Office locations:

Barcelona
Brussels
Chicago
Frankfurt
Hamburg
Hong Kong
London
Los Angeles
Madrid
Milan
Moscow
Munich
New Jersey
New York
Northern Virginia
Orange County
Paris
San Diego
San Francisco
Shanghai
Silicon Valley
Singapore
Tokyo
Washington, D.C.

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorneys listed below or the attorney whom you normally consult. A complete list of our *Client Alerts* can be found on our Web site at www.lw.com.

If you wish to update your contact details or customize the information you receive from Latham & Watkins, please visit www.lw.com/resource/globalcontacts to subscribe to our global client mailings program.

If you have any questions about this *Client Alert*, please contact Dean G. Dunlavey in our Orange County office or Michael J. Schallop in our Silicon Valley office or any of the following attorneys.

Barcelona
José Luis Blanco
+34-902-882-222

Brussels
Jean Paul Poitras
+32 (0)2 788 60 00

Chicago
David A. Nelson
+1-312-876-7700

Frankfurt
Bernd-Wilhelm Schmitz
+49-69-60 62 60 00

Hamburg
Ulrich Börger
+49-40-41 40 30

Hong Kong
Joseph A. Bevash
+852-2522-7886

London
John A. Hull
David L. Mulliken
+44-20-7710-1000

Los Angeles
Mark A. Flagel
Bob Steinberg
Belinda S. Lee
+1-213-485-1234

Madrid
José Luis Blanco
+34-902-882-222

Milan
David Miles
+39 02-3046-2000

Moscow
Anya Goldin
+7-495-785-1234

Munich
Jörg Kirchner
+49 89 20 80 3 8000

New Jersey
Alan E. Kraus
+1-973-639-1234

New York
James E. Brandt
Blair Connelly
Robert J. Gunther, Jr.
+1-212-906-1200

Northern Virginia
Eric L. Bernthal
+1-703-456-1000

Orange County
Dean G. Dunlavey
+1-714-540-1235

Paris
Christophe Clarenc
Patrick Dunaud
+33 (0)1 40 62 20 00

San Diego
Stephen P. Swinton
+1-619-236-1234

San Francisco
Daniel M. Wall
Christopher S. Yates
+1-415-391-0600

Shanghai
Rowland Cheng
+86 21 6101-6000

Silicon Valley
Michael J. Schallop
Matthew Rawlinson
Bob Steinberg
Mark A. Flagel
+1-650-328-4600

Singapore
Mark A. Nelson
+65-6536-1161

Tokyo
Bernard E. Nelson
+81-3-6212-7800

Washington, D.C.
Everett C. Johnson, Jr.
Abid R. Qureshi
+1-202-637-2200