THE INTERNATIONAL JOURNAL OF COMPETITION POLICY AND REGULATION www.globalcompetitionreview.com VOL 12 | ISSUE 7 | JULY 2009

GCR
GLOBAL COMPETITION REVIEW

SECTION 2 ROUND TABLE

Enforcement under a new administration

COUNTRY SURVEY: DENMARK • *RAMBUS* • DAMAGES ACTIONS • GLOBAL BRIEFING

Down the rabbit hole with *Rambus*

Independent practitioner **Richard Wolfram**, co-author of an amicus brief supporting the US Federal Trade Commission's unsuccessful petition for review by the Supreme Court in *FTC v Rambus*, revisits the upside-down "but for" world of the Court of Appeals' decision, which reversed the FTC decision

An incorrectly reasoned antitrust decision by a leading US federal court of appeals can cast a wide shadow, with unfortunate consequences for competition. If steps are not taken to correct the error, or to limit its effects, then it might be repeated and the costs to society can multiply. Such is the case, in my view, with *Rambus v FTC*, the April 2008 decision by the District of Columbia Circuit Court of Appeals regarding alleged patent hold-up in standard setting (522 F.3d 456 (DC Cir 2008)), and with more reason now, following the Supreme Court's rejection in February of the FTC's petition to review the decision.

The Supreme Court's denial of the FTC's request is not a decision on the merits, *Rambus* is not binding outside the DC Circuit, and there has been considerable disagreement with the decision and its rationale, including in a number of amicus briefs. Before the dust settles any further, this is an opportune time to take stock of the decision – the better to guard against its potential consequences, particularly for the substantial percentage of standard-setting organisations (SSOs) with licensing requirements similar to those at issue in *Rambus*.

The FTC decision

In July 2006, the FTC unanimously ruled that Rambus, a developer of dynamic random access memory (DRAM) technology, had engaged in unlawful monopolisation of relevant DRAM markets through patent hold-up. The commission found that Rambus, as a participant in the Joint Electron Device Engineering Council (JEDEC), a standard-setting group, had deceptively avoided a JEDEC obligation to license technology essential to standards that Rambus helped select and which covered its technology. JEDEC required that participants disclose any intellectual property relevant to a standard and then, upon demand by the SSO, commit to license that IP on reasonable and non-discriminatory (RAND) terms. (The other typical licensing requirement imposed by SSOs is an up-front, blanket commitment by participants to license on RAND terms – that is, without the disclosure trigger – any IP relevant or essential to the standard.) JEDEC further prohibited the selection of any standard covering the IP of a member who refused to make a RAND commitment upon demand.

The commission found that Rambus deceptively avoided giving the required disclosure, which would have triggered a demand for a RAND commitment, and then, following industry lock-in, charged supracompetitive, non-RAND royalties for the licensing of its technology, in violation of section 2 of the Sherman Act and section 5 of the FTC Act. In a subsequent ruling on remedies, over the partial dissents of two commissioners, the commission declined to impose royalty-free licensing, on the grounds that without the deception by Rambus, the SSO might have chosen Rambus's technology for the standard anyway, provided Rambus gave a RAND commitment. Consequently, the commission instead capped Rambus's royalties at RAND rates.

The Court of Appeals reverses the decision

In April 2008, the Court of Appeals ruled that the FTC failed to show that Rambus had monopolised the relevant DRAM technology markets because it could not establish that Rambus's deception necessarily caused JEDEC to choose its technology for the standard.

The core reasoning of the Court of Appeals is elusive and cryptic. Even after several close readings, the interested observer could be forgiven for feeling like a dog chasing its tail. In my estimation, the court's rationale is hoisted by its failure to credit the RAND licensing obligation in standard setting with the power to condition and constrain the acquisition of monopoly power that the technology owner would otherwise acquire in the absence of that obligation.

RAND licensing principles

Organised standard-setting is a widespread, efficiency-enhancing activity, and a critical driver of the economy, in which companies compete primarily on the basis of quality and price to have their technology included in a standard. The typical price term is RAND licensing. Selection of a standard hinges on both the giving and the subsequent fulfilment of a RAND commitment by the owner of the technology selected for the standard.

Standard-setting may create opportunities for anti-competitive abuse because the participants in the process usually are economically interested in the outcome and because it pre-empts market choice (see, for example, the Supreme Court cases *Hydrolevel* (1982) and *Allied Tube & Conduit* (1988)). Thus, distortion of competition for the standard can affect the competitive structure of the market and antitrust principles may apply. One form of such distortion is patent hold-up: after industry "lock-in" of the technology chosen for the standard, the technology owner might opportunistically obtain control of a standard by deceptively evading or otherwise repudiating its RAND commitment.

A RAND commitment normally constrains the acquisition of monopoly power by the owner of technology chosen for a standard: by giving the commitment, the patent holder "negotiates away" the market (or, in *Rambus*, as in most instances, the monopoly) power it otherwise would obtain through the selection of its IP for the standard. Unless repudiated, the RAND commitment therefore protects the other SSO participants, and indeed the rest of industry and consumers, from the patent holder's acquisition of an otherwise unfettered right under patent law to charge whatever royalties it chooses, for in that latter event it could hold the market hostage to its dependence on the standardised technology (hence the term "patent hold-up").

Repudiation

Where control over a standard confers monopoly power, the acquisition of such power through deception or other opportunistic conduct (see *Kodak v Image Technical Servs*, Supreme Court, 1992, regarding installed-based opportunism) based on a repudiation of the RAND commitment is not the acquisition of monopoly power on the merits. To the extent a participating firm, but for its RAND commitment, would otherwise acquire market or monopoly power from the selection of its IP for the standard, its repudiation of the commitment "reaches back" and vitiates the competition for the standard and, thus, the lawfulness of its acquisition of such power. Repudiation undermines the reliance triggered by the RAND commitment and is exclusionary because it distorts SSO participants' evaluation of the relative merits of alternative technologies competing for the standard, of which the cost of licensing is a material element.

SSO participants' evasion of RAND obligations, through deception or other repudiation, has been the subject of other agency enforcement and private actions, such as *FTC v Dell* (1996); *FTC v Unocal* (2005); *FTC v N-Data* (2008); and the Third Circuit's decision in *Broadcom v Qualcomm* (2007) (holding that Qualcomm's repudiation of an up-front, blanket FRAND commitment that it did not intend to honour could support a section 2 claim, and citing the FTC's *Rambus* decision in support).

Rambus: why the court reversed

For the court in *Rambus*, the fatal flaw in the FTC's case was the adequacy of the alleged causal link between the deceptive conduct and Rambus's acquisition of monopoly power. The FTC found that Rambus had failed to make the required disclosure to JEDEC and that this deception prevented JEDEC either from adopting an alternative technology or from demanding, and presumably extracting, a RAND commitment from Rambus, with an opportunity for ex ante negotiations before its technology was standardised. But the FTC could not state with certainty which of these two paths JEDEC would have chosen absent Rambus's deception.

The FTC thus could not show whether JEDEC's selection of Rambus's technology over alternative technologies necessarily resulted from Rambus's deception or whether, had JEDEC known of Rambus's relevant IP rights, it would have selected that technology for the standard anyway, assuming Rambus gave a RAND commitment. The court was satisfied that the first alternative would support a monopolisation claim but it held – erroneously, I believe – that the second would not. There was in fact nothing remarkable about this second alternative, though: the FTC framed its patent hold-up complaint against Unocal in similar alternative terms. In each case, the clear implication was that with the RAND constraint preventing the acquisition of monopoly power through standardisation of a given technology, the SSO might have chosen that technology for the standard, secure in the knowledge – or at the very least with a reasonable expectation – that the technology would be licensed on RAND terms.

To satisfy the court's causation standard, the FTC thus had to show that "but for" Rambus's deceptive avoidance of a RAND commitment, Rambus could not have lawfully acquired monopoly power. As the FTC and various amici contended, this imposed a higher causation standard for government monopolisation claims than that applied by six courts of appeal, including the DC Circuit itself in *US v Microsoft*; under the lower bar, the FTC would have had to show only that Rambus's conduct "reasonably appeared capable of making a significant contribution" to the alleged anti-competitive effects. The court's higher causation standard is accepted here, however, for the sake of argument only, in order to focus on the court's RAND and related causation analysis.

The mere fact that JEDEC might have chosen Rambus's technology for the standard does not legitimise on antitrust grounds its acquisition of monopoly pricing power

If, as the FTC reasoned, the RAND commitment would safeguard competition by alternative technologies and protect industry from ex post patent hold-up, then deliberately avoiding such a commitment would free the patent holder to engage in patent hold-up, with anti-competitive consequences. But the court did not see it that way.

Under the court's reasoning, all that Rambus did under this second scenario was deceptively avoid the RAND constraint, and all JEDEC lost was an opportunity to extract a RAND commitment from a monopolist, namely, after Rambus had legitimately acquired monopoly power through JEDEC's choice of its technology.

Consequently, in the court's view, the FTC could not show that Rambus's supracompetitive royalty charges had any effect on the competitive structure of the relevant market, because the choice of Rambus's technology and the concomitant exclusion of rival technology were not the result of any deceptive conduct by Rambus itself but instead the result of JEDEC's prior, deliberate choice. Citing the Supreme Court case of *NYNEX v Discon* (1998), which involved fraudulent pricing by New York Telephone, a lawful monopoly provider of local telephone service, the court explained, with reference to *Rambus*, that "an otherwise legitimate monopolist's deception simply to obtain higher prices normally has no particular tendency to exclude rivals and thus to diminish competition".

Where the court's reasoning collapses

Putting aside the merits of the court's assessment of pricing by a legitimate monopolist, the predicate question is whether the monopolist acquired its power lawfully in the first place – and here, I believe, the court's reasoning collapses. The mere fact that JEDEC might have chosen Rambus's technology for the standard, assuming proper disclosure and a RAND commitment by Rambus, does not somehow legitimise on antitrust grounds Rambus's acquisition of monopoly pricing power through its failure to make that disclosure: however deliberate the selection of Rambus's technology for the standard in this hypothetical scenario, it comes with a condition – the RAND commitment – which prevents the acquisition of unfettered monopoly pricing power.

In concluding that the legitimate acquisition of monopoly power by Rambus was a plausible scenario in the FTC's framing of the case, the court appears to have ignored the competitive significance of a RAND commitment and the disclosure "trigger" under JEDEC's rules. Where JEDEC participants relied on disclosure as the quid pro quo for a participant's not having to give a RAND assurance, it is precisely the non-disclosure that spared Rambus from having to negotiate away the monopoly power – by

making a RAND commitment – which it otherwise would acquire by virtue of its technology being selected for the standard.

The DC Circuit does not adequately explain how Rambus's intentional avoidance of the disclosure trigger and resulting RAND commitment effectively removes Rambus's acquisition of monopoly power from antitrust scrutiny, or how this can be properly analogised to the regulatory conferral of (legitimate) monopoly status in local telephone service on New York Telephone in *NYNEX*, where the court held that such conferral removed its subsequent fraudulent price increases from antitrust scrutiny. The DC Circuit's rationale – that JEDEC's possible choice of Rambus's technology legitimises Rambus's acquisition of monopoly power – misapprehends the role of the RAND commitment as conditioning the selection of a technology for the standard.

Although the FTC explained that JEDEC rules required Rambus to make RAND assurances ex ante, in order to preserve the benefits of competition from alternative technologies and protect industry from patent hold-up, the court evidently did not fully grasp the importance of RAND assurances as a constraint on royalties that would condition the very selection of its technology for the standard. The RAND term is not a follow-on constraint tacked on to monopoly power after it has been acquired, as the court seems to suggest. Instead, in the hypothetical, acceptance of the RAND term by Rambus is a necessary and prior condition to JEDEC's selection of Rambus's technology, and fulfilment of the commitment is a further, "subsequent" condition to the legitimacy of the limited power thereby obtained, which in turn at most entitles the firm to RAND royalties, not supracompetitive royalties otherwise obtainable by a monopolist.

In response to the further observation that Rambus in fact charged non-RAND royalties and thereby repudiated the hypothetical RAND commitment, comes the swift rejoinder that once Rambus gives a public binding RAND commitment, it would comply by charging RAND rates. And, indeed, the FTC itself lends support to this argument in its remedies decision, when it states that "[a]n unwillingness to comport with JEDEC policy while pursuing a hold-up strategy is not necessarily indicative of how Rambus would have acted after disclosure, when hold-up no longer was attainable".

We are thus invited to assume that Rambus would have given a RAND commitment and charged RAND rates. "This solves everything", one might conclude: "the 'but for' world includes even an alternative outcome. Rambus complies with its RAND commitment and the basis for the FTC's case against it disappears." But this proves too much: if the hypothetical assumption is stretched, as here, to the point of negating the FTC's finding that Rambus charged supracompetitive royalties, then it exhausts its usefulness as an analytical tool. We may approach this point from two angles.

First, the "but for" analytical exercise is intended to isolate the anti-competitive effects attributable – for purposes of showing antitrust causation and injury – only to the alleged anti-competitive conduct. It is within the normal parameters of the "but for" analysis to assume that Rambus would make the required disclosure and then, upon demand, would give the obligatory RAND commitment: this is hypothetical, counterfactual conduct. But it is another thing to freight the "but for" analysis with the further assumption that Rambus would comply with that commitment by charging RAND royalties; even if it might make sense for Rambus to do so, that also would assume out of existence the very outcome – the alleged anti-competitive effect, that is, the supracompetitive royalties – without which the FTC would have had no case at all.

> RAND was a necessary condition to the lawful selection of Rambus's technology, not a follow-on constraint tacked on to monopoly power after it has been acquired

This is a reductio ad absurdum, and more freight than the "but for" exercise logically can bear: it properly allows us to assume away certain allegedly anti-competitive conduct in order to determine whether, in the absence of that conduct, the same outcome would result, but it does not properly allow us, and it would serve no meaningful purpose, to assume away the factual outcome itself.

Second, the "but for" analysis was intended by the commission, and makes sense, only as a tool for calculating the royalties to which Rambus would have been entitled had it made the required disclosure – namely, on RAND rates. Assuming Rambus made and honoured a RAND commitment, then it would have been entitled to nothing more than RAND royalties; and that's all the remedies decision says. It of course does not negate the finding of supracompetitive royalties or mitigate the finding of liability. Having made such a public commitment, Rambus, without violating antitrust principles, could only have acquired the power to charge an amount commensurate with RAND royalties, and not, as the court seems to suggest (on its view of RAND as a mere follow-on pricing restraint), the right to charge royalties unconstrained by the RAND commitment.

The air gets a bit thin when contemplating such logical abstractions as these. More practically, although the court assumed the existence of a disclosure obligation and its violation by Rambus, the underlying driver of the decision may be the court's "serious concerns" (to which it devotes the latter quarter of the opinion, in dicta) about the strength of the evidence for the existence and scope of a disclosure obligation and whether Rambus violated that policy. But as the case is interpreted, and the fog left by the court's reservations about "murky" or "weak" evidence yields to the normal urge for judicial clarity, the following distillation is likely to emerge: if an SSO participant deceptively avoids a RAND obligation and, in the absence of the deception, the SSO might have selected its technology for a standard anyway, provided the participant gave a RAND commitment, then any non-RAND royalty charged by that company would be a "mere" price increase, not sanctionable under antitrust law.

It is wishful thinking at best to conclude that reliance in the future will not be placed on the court's incorrect rationale, at least in cases alleging patent hold-up involving JEDEC-type disclosure-and-then-RAND licensing rules, which are common among SSOs.

Only a few weeks ago, the European Commission announced a proposed settlement with Rambus over charges of patent hold-up based on the same conduct at issue in the FTC's case. Under DC Circuit law, it's a different story. Given the high stakes in standard setting, the only way properly to absorb the lessons from *Rambus* is to recognise and guard against the potential hold-up traps it creates – in structuring SSO rules and conduct, in advocacy and in judicial decision-making. ■