ANALYSIS OF PROPOSED CONSENT ORDER TO AID PUBLIC COMMENT

***In the Matter of Negotiated Data Solutions LLC,* File No. 051 0094**

The Federal Trade Commission ("Commission") has accepted, subject to final approval, an Agreement Containing Consent Order ("Agreement") with Negotiated Data Solutions LLC ("N-Data"), a limited liability company whose sole activity is to collect royalties in connection with a number of patents. The Agreement settles allegations that N-Data has violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, by engaging in unfair methods of competition and unfair acts or practices relating to the Ethernet standard for local area networks. Pursuant to the Agreement, N-Data has agreed to be bound by a proposed consent order ("Proposed Consent Order").

The Proposed Consent Order has been placed on the public record for thirty (30) days for comments by interested persons. Comments received during this period will become part of the public record. After thirty (30) days, the Commission will again review the Agreement and the comments received and will decide whether it should withdraw from the Agreement or make final the Agreement's Proposed Consent Order.

The purpose of this analysis is to facilitate comment on the Proposed Consent Order. This analysis does not constitute an official interpretation of the Proposed Consent Order, and does not modify its terms in any way. The Agreement has been entered into for settlement purposes only, and does not constitute an admission by N-Data that the law has been violated as alleged or that the facts alleged, other than jurisdictional facts, are true.

Background

The Institute of Electrical and Electronics Engineers ("IEEE") is a standard-setting organization active in a number of different industries. IEEE standards often enhance the interoperability of communications products. One important example, which is at issue here, is the 802 series of networking standards. Many of the standards in the 802 series allow users to reliably access and share information over communications systems by interconnecting many compatible products manufactured by different producers.

The IEEE 802.3 standard, first published in 1983, and commonly referred to as "Ethernet," applies to local area networks ("LANs") built on copper, and more recently fiber optic, cables. That standard initially accommodated a maximum data transmission rate of 10 megabits per second (10 Mbps) between networked devices. By 1994, the 802.3 Working Group was developing a new 802.3 standard for "Fast Ethernet," which would transmit data across a copper wire at 100 Mbps. The Working Group determined that it would be desirable for Fast Ethernet equipment to be compatible, to the extent possible, with existing LAN equipment and with future generations of equipment. A technology, variously known as "autodetection" and "autonegotiation," was developed that would permit such compatibility.

equipment already installed on existing LANs, increasing the demand for Fast Ethernet products by those with existing systems.

In 1997, the United States Patent and Trademark Office issued U.S. Patent Nos. 5,617,418 and 5,687,174 (the'418 and '174 Patents) to National. Both patents arose from the patent application that National disclosed to the IEEE in 1994. National later received equivalent patents in other countries.

In 1998, National assigned a number of patents, including the '418 and the '174 Patents, to Vertical Networks ("Vertical"), a telecommunications start-up company founded by former National employees. Before the assignment, National gave Vertical a copy of the June 7, 1994 letter to the 802.3 Working Group. Vertical's outside patent counsel, Mr. Alan Loudermilk, acknowledged in writing that National had informed him "that several of the patents may be 'encumbered'" by actions National had taken with respect to the IEEE standards. The final agreement between Vertical and National stated that the assignment was "subject to any existing licenses that [National] may have granted." It further provided, "Existing licenses shall include

In late 2003, Vertical assigned some of its patent portfolio, including the '174 and '418 patents, to N-Data, a company owned and operated by Mr. Loudermilk.[1] N-Data was aware of National's June 7, 1994 letter of assurance to the IEEE when Vertical assigned those patents to N-Data. Yet it rejected requests from companies to license NWay technology for a one-time fee of $1,000. Instead, N-Data threatened to initiate, and in some cases prosecuted, legal actions against companies refusing to pay its royalty demands, which are far in excess of that amount.

The Proposed Co plaint

Vertical and N-Data sought to exploit the fact that NWay had been incorporated into the 802.3 standard, and had been adopted by the industry for a number of years, by reneging on a known commitment made by their predecessor in interest. Even if their actions do not constitute a violation of the Sherman Act, they threatened to raise prices for an entire industry and to subvert the IEEE decisional process in a manner that could cast doubt on the viability of developing standards at the IEEE and elsewhere. The threatened or actual effects of N-Data's conduct have been to increase the cost of practicing the IEEE standards, and potentially to reduce output of products incorporating the standards.[2] N-Data's conduct also threatens to reduce the

[1] Vertical subsequently sold its remaining business assets and ceased operations.

[2] The conduct by Vertical and N-Data has led to, or threatened to lead to, increased prices in the markets for autonegotiation technology (1) used in 802.3 compliant products and (2) used in products that implement an IEEE standard enabling autonegotiation with 802.3 compliant products.

with patentees and with the mixed incentives generated when members may be positioned to pass on royalties that raise costs market-wide contract remedies may prove ineffective, and Section 5 intervention may serve an unusually important role.

N-Data's conduct, if allowed, would reduce the value of standard-setting by raising the possibility of opportunistic lawsuits or threats arising from the incorporation of patented technologies into the standard after a commitment by the patent holder. As a result, firms may be less likely to rely on standards, even standards that already exist. In the creation of new standards, standard-setting organizations may seek to avoid intellectual property entirely, potentially reducing the technical merit of those standards as well as their ultimate value to consumers.

A mere departure from a previous licensing commitment is unlikely to constitute an unfair method of competition under Section 5. The commitment here was in the context of standard-setting. The Supreme Court repeatedly has recognized the procompetitive potential of standard-setting activities. However, because a standard may displace the normal give and take of competition, the Court has not hesitated to impose antitrust liability on conduct that threatens to undermine the standard-setting process or to render it anticompetitive.[7] The conduct of N-Data (and Vertical) at issue here clearly has that potential.[8]

2. Unfair Act or Practice

N-Data's efforts to unilaterally change the terms of the licensing commitment also constitute unfair acts or practices under Section 5 of the FTC Act. The FTC Act states that "unfair or deceptive acts or practices in or affecting commerce[] are . . . unlawful." An unfairness claim under this part of Section 5 must meet the following statutory criteria:

> The Commission shall have no authority . . . to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably

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[7] , , , 226 U.S. 20, 41 (1912); *A* & , 486 U.S. 492, 500 (1989); *A* ., 456 U.S. 556, 571 (1982).

[8] It is worth noting that, because the proposed complaint alleges stand-alone violations of Section 5 rather than violations of Section 5 that are premised on violations of the Sherman Act, this action is not likely to lead to well-founded treble damage antitrust claims in federal court. , Herbert Hovenkamp, Federal Antitrust Policy at 588 (2d ed. 1999).

avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.[9]

[9] 15 U.S.C. § 45(n) (1992).

[10] .

[11] , 849 F.2d 1354, 1364 (11th Cir. 1988).

[12] See Letter from Federal Trade Commission to Senators Ford and Danforth (Dec. 17, 1980), reprinted in H.R. Rep. No. 156, Pt. 1, 98th Cong., 1st Sess. 33-40 (1983) http://www.ftc.gov/bcp/policystmt/ad-unfair.htm, appended to the Commission's decision in , 104 F.T.C. at 949, 1061 (1984), and subsequently codified by Congress at 15 U.S.C. § 45(n).

[13] The IEEE designed its rules to avoid just such a result. IEEE's stated purpose for requesting letters of assurance was to avoid giving "undue preferred status to a company" and to ensure that the adoption of a technology would not be "prohibitively costly or noncompetitive to a substantial part of the industry." 1994 §6.3.

[14] The Commission has a "longstanding position that the statutory prohibition against 'unfair or deceptive acts or practices' includes practices that victimize businesspersons as well as those

the industry could not have reasonably anticipated before the market wide adoption of the standard and which consumers had no chance of avoiding due to network effects and lock-in.

Clearly, merely breaching a prior commitment is not enough to constitute an unfair act or practice under Section 5. The standard-setting context in which National made its commitment is critical to the legal analysis. As described above, the lock-in effect resulting from adoption of the NWay patent in the standard and its widespread use are important factors in this case. In addition, the established public policy of supporting efficient standard-setting activities is an important consideration in this case.[18] Similarly, it must be stressed that not all breaches of commitments made by owners of intellectual property during a standard-setting process will constitute an unfair act or practice under Section 5. For example, if the commitment were immaterial to the adoption of the standard or if those practicing the standard could exercise countermeasures to avoid injury from the breach, the statutory requirements most likely would not be met. Finally, it needs to be emphasized that not all departures from those commitments will be treated as a breach. The , court suggested that there might be a distinction between an open-ended commitment and a contract having a fixed duration.[19] That distinction does not apply here because the context of the commitment made it plain that it was for the duration of National's patents. However, most such commitments, including the one here, are simply to offer the terms specified. Indeed, those principles are reflected in the remedy set forth in the consent decree.

The Proposed Consent Order

The Proposed Consent Order prohibits N-Data from enforcing the Relevant Patents, defined in the order, unless it has first offered to license them on terms specified by the order. The terms of that license follow from those promised by National Semiconductor in its letter of June 7, 1994, to the IEEE. Specifically, N-Data must offer a paid-up, royalty-free license to the Relevant Patents in the Licensed Field of Use in exchange for a one-time fee of $1,000. The form of this license is attached as Appendix C to the order. The Licensed Field of Use is defined in the license as the "use of NWay Technology to implement an IEEE Standard," and this includes

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[18] , , A , & o , . , , ., 486 U.S. 492, 500-01 (1998) (regarding the potential procompetitive advantages of private associations promulgating safety standards).

[19] , , 849 F.2d at 1361.

days, the Proposed Consent Order allows N-Data to sue to enforce the Relevant Patents. At the time N-Data files suit, however, it must make a second offer. This second offer provides a prospective licensee with an opportunity to accept the patent license specified by the order in return for a payment of thirty-five thousand dollars ($35,000). The requirement that the second offer be delivered in the context of litigation gives N-Data an incentive to pursue patent enforcement only against companies over which it has a reasonable likelihood of prevailing in court. It will also ensure that the second offer will receive the full attention of knowledgeable counsel for the offeree. A $35,000 license fee will offset some of N-Data's costs of litigation, and it will discourage recipients of an initial offer from simply waiting to be sued, and then