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One Financial Center
Boston, Massachusetts 02111
617 542 6000
617 542 2241 fax

701 Pennsylvania Avenue, N.W.
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202 434 7300
202 434 7400 fax

666 Third Avenue
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212 935 3000
212 983 3115 fax

707 Summer Street
Stamford, Connecticut 06901
203 658 1700

Third Circuit Rules Deception in Standard-Setting Can Violate Antitrust Laws

On September 4, 2007, the U.S. Court of Appeals for the Third Circuit held that deceiving a standards-determining organization (SDO) by falsely promising to license an included patent on fair, reasonable and non-discriminatory (FRAND) terms may give rise to antitrust liability.[1] The Court specifically held that:

> (1) in a consensus-oriented private standard-setting environment, (2) a patent holder's intentionally false promise to license essential proprietary technology on FRAND terms, (3) coupled with an SDO's reliance on that promise when including the technology in a standard, and (4) the patent holder's subsequent breach of that promise, is actionable anticompetitive conduct.

This is the first such holding by an appellate court and an important decision in the field of intellectual property and antitrust. Companies that depend upon, or are involved in, standard-setting activities should pay close attention to the decision.

The Facts

Broadcom Corporation ("Broadcom") alleged in a lawsuit that Qualcomm, Inc. ("Qualcomm") unlawfully monopolized certain markets for cellular telephone technology and components. Cell phones use computer "chipsets" to transmit and receive information via radio to base stations and telephone and computer networks, all of which must be able to communicate with one another. Industry-wide standards are therefore necessary to ensure interoperability. Private standards-determining organizations are critical to these efforts.

Broadcom alleged that Qualcomm induced the relevant SDOs to include its proprietary technology in the current "3G" GSM standard by falsely

203 658 1701 fax

2029 Century Park East
Los Angeles, California 90067
310 586 3200
310 586 3202 fax

1400 Page Mill Road
Palo Alto, California 94304
650 251 7700
650 251 7739 fax

9255 Towne Centre Drive
San Diego, California 92121
858 320 3000
858 320 3001 fax

The Rectory
9 Ironmonger Lane
London EC2V 8EY England
+44 (0) 20 7726 4000
+44 (0) 20 7726 0055 fax

agreeing to abide by the SDOs' policies on intellectual property rights, then breaching those agreements by licensing its technology on non-FRAND terms and demanding discriminatory royalties from competitors and customers using chipsets not manufactured by Qualcomm. According to the complaint, Qualcomm has a 90% share in the CDMA chipset market, and by withholding favorable pricing in that market, it coerced cellular telephone manufacturers to purchase only Qualcomm-manufactured 3G GSM chipsets.

The district court found that Qualcomm enjoyed a legally sanctioned monopoly in its patented technology and that this monopoly conferred the right to exclude competition and set the terms by which that technology was distributed. The court reasoned that the inclusion of Qualcomm's technology in the 3G standard could not harm competition because an absence of competition was the inevitable result of any standard-setting process. Whether the inclusion of the technology was the product of deception did not matter under the antitrust laws, the district court believed, because the adoption of a standard was going to eliminate competition regardless. The Third Circuit rejected this analysis.

Standard-Setting Can Be Pro-Competitive but Must Be Fairly Implemented

The Third Circuit went to some lengths to explain the pro-competitive aspects of standard-setting organizations. There is no doubt that private standard-setting "can be rife with opportunities for anticompetitive activity."[2] But the court noted that private standard-setting still advances the primary goal of antitrust law, "which is to maximize consumer welfare by promoting competition among firms."

Standard-setting maximizes consumer welfare by facilitating information sharing among producers to ensure the interoperability of products, thereby enhancing the utility of all products and enlarging the overall consumer market. This permits firms to spread the costs of research and development across a greater number of consumers, resulting in lower per-unit prices. Industry standards may also lower the cost to consumers of switching between competing products and services, thereby enhancing competition among suppliers. Finally, standards enhance competition in upstream markets by, for example, facilitating objective comparison between competing technologies, patent positions and licensing terms before an industry becomes locked into a standard. Standards may also reduce the risk to producers and consumers of investing scarce resources in a technology that ultimately may not gain widespread acceptance.

Fundamentally, the adoption of a standard does not eliminate competition among producers. Instead, it shifts the focus of competition away from developing the chosen standard and towards implementing it.

For these reasons, private standard-setting – which might otherwise be viewed as a naked agreement among competitors not to manufacture, distribute, or purchase certain types of products – is not necessarily inconsistent with the goals of antitrust law.[3] However, judicial acceptance of private standard-setting is not without limits and is given "only on the understanding that it will be conducted in a nonpartisan manner offering pro-competitive benefits," and in the presence of "meaningful safeguards" that "prevent the standard-setting process from being biased by members with economic interests in stifling product competition."[4]

In the present case, the Third Circuit noted that inefficiency may be injected into the standard-setting process by what is known as "patent hold-up."[5] For example, after a standard is set participants may discover that technologies essential to implementing the standard are patented. When this occurs, the patent holder is in a position to "hold up" industry participants from implementing the standard. Industry participants who have invested significant resources developing products and technologies that conform to the standard will find it prohibitively expensive to abandon their investment and switch to another standard, thereby becoming "locked in" to the standard. In this unique position of bargaining power, the patent holder may be able to extract supra-competitive royalties from industry participants.[6]

The Third Circuit found that Broadcom properly stated a claim when it alleged that Qualcomm deceived relevant SDOs into adopting one standard by committing to license its technology on FRAND terms and then, after lock-in occurred, demanding non-FRAND royalties. Because a standard necessarily eliminates rivals, commitments to non-discriminatory terms in adopting a standard are important safeguards against monopoly power. Thus, inducing an SDO to include the patent holder's technology as an essential element of a standard by falsely promising to license its patents on FRAND terms, and then reneging on those promises after it succeeded in having its technology included in the standard, may form the basis of a lawsuit under Section 2 of the Sherman Act.[7]

Lessons and Implications

Deception in a consensus-driven private standard-setting environment harms the competitive process by obscuring the costs of including proprietary technology in a standard and increasing the likelihood that patent rights will confer monopoly power on the patent holder. Participants in—and beneficiaries of—standard-setting should consider this decision carefully. It serves as an important reminder that standard-setting, while integral to the competitive process, is subject to scrutiny under antitrust laws where competition to implement the standard is thwarted rather than promoted.

[1] *Broadcomm Corp. v. Qualcomm Inc.*, 3d Cir. No. 06-4292 (Sept. 4, 2007), *available at* http://www.ca3.uscourts.gov/opinarch/064292p.pdf.

[2] *Am. Soc. of Mech. Eng'rs, Inc. v. Hydrolevel Corp.*, 456 U.S. 556, 571 (1982).

[3] *See* United States Department of Justice and Federal Trade Commission, *Antitrust Enforcement and Intellectual Property Rights* (2007) at 33 ("Industry standards are widely acknowledged to be one of the engines driving the modern economy.") ("*DOJ-FTC Statement*").

[4] *Allied Tube and Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 501, 506–07 (1988).

[5] *See also DOJ-FTC Statement* at 37–40.

[6] *See also In the Matter of Rambus, Inc.*, No. 9302 (F.T.C. Aug. 2, 2006) at 4. There, the FTC held that deceptive conduct constituted "exclusionary conduct" under Section 2 of the Sherman Act, as well as unlawful monopolization under Section 5 of the FTC Act. *Rambus* is particularly noteworthy for its extensive discussion of deceptive conduct in the standard-setting context and the factors that make such conduct anticompetitive under Section 2 of the Sherman Act, which the FTC likened to the type of deceptive conduct that the D.C. Circuit found to violate Section 2 of the Sherman Act in *United States v. Microsoft Corp.*, 253 F.3d 34, 76–77 (D.C. Cir. 2001) (*en banc*). The *DOJ-FTC Statement* provides some additional general guidance for addressing potential hold-up problems without running afoul of the antitrust laws.

[7] 15 U.S.C. § 2.

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If you have any questions regarding this or any related issue, please contact

Fernando R. Laguarda
202.434.7347 | Laguarda@mintz.com

Bruce F. Metge
202.434.7343 | BMetge@mintz.com

Bruce D. Sokler
202.434.7303 | BDSokler@mintz.com

or the Mintz Levin attorney who ordinarily handles your legal affairs.