GLOBAL COMPETITION REVIEW

Comment: *Rambus v FTC*

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“It's Not Over Until It's Over”.
David Balto and Richard Wolfram, independent practitioners based in Washington, DC and New York City respectively, examine the recent DC Circuit Court of Appeals decision in *Rambus Inc v Federal Trade Commission*.

Last month, the DC Circuit Court of Appeals, in *Rambus Inc v Federal Trade Commission*, unanimously reversed the FTC's August 2006 decision that Rambus had violated section 5 of the Federal Trade Commission Act by failing to disclose intellectual property rights to a standard setting organization (SSO). The decision might be seen as the closing chapter in the long saga of Rambus's antitrust battles. But such a view may be mistaken, because the DC Circuit committed significant legal errors that raise the potential for reversal by the en banc DC Circuit or the Supreme Court. As Yogi Berra famously put it, "it's not over until it's over."

The background of the case is familiar. Rambus belonged to the Joint Electron Device Engineering Council (JEDEC), an SSO that had a policy requiring disclosure of certain intellectual property rights. The FTC found that Rambus violated the FTC Act by failing to disclose patents under development and patent applications to the SSO. Once JEDEC adopted a standard that practised on the undisclosed patent rights, Rambus sought royalties from the companies practising the technology.

In June 2002, the FTC filed a complaint alleging that in failing to disclose IP rights relevant to the JEDEC standard, Rambus violated section 5 by unlawfully monopolising the technology markets in which its patented technologies compete. An FTC administrative law judge found for Rambus, but the full Commission reversed the decision. The FTC found that Rambus wilfully and intentionally engaged in misrepresentations, omissions, and other practices that misled JEDEC members about intellectual property information "highly material" to the standard-setting process.

There were two crucial elements to the DC Circuit's reversal of the FTC's decision. First, was the standard of causation: the court held that when the FTC pursues an antitrust claim based on misrepresentations or omissions to an SSO, it must show that the SSO would not have adopted the standard in question *but for* the misrepresentation or omission. The FTC had suggested that if Rambus had not engaged in deception but instead had made the necessary disclosure, either JEDEC would have chosen another technology or it would have required RAND licensing. However, significantly, the FTC did not specify which one of the two alternatives JEDEC would have chosen.

Second, the panel suggested that "deceit merely enabling a monopolist to charge higher prices than it otherwise could have charged - would not in itself constitute monopolization." The court reasoned that "an otherwise lawful monopolist's use of

deception simply to obtain higher prices normally has no particular tendency to exclude rivals and thus to diminish competition."

We believe that the DC Circuit made three serious, fundamental legal errors that are inconsistent with the law and sound antitrust policy, as follows.

The court applied the wrong standard of causation. The DC Circuit erred in adopting a standard of causation that is inconsistent with the law - indeed, with DC Circuit law: namely, that "an antitrust plaintiff must establish that the standard-setting organization would not have adopted the standard in question *but for* the misrepresentation or omission." The court erred in applying this standard because it sets the bar too high, given the difficulty of establishing with complete certainty the chain of causation in monopolisation - and this rationale applies with even more reason to an injunctive action by the government based on a monopolisation claim. As the DC Circuit itself said about the standard of proof for causation in its en banc decision in *Microsoft* in 2001:

> [W]ith respect to actions seeking *injunctive relief*, the authors of that treatise [Areeda and Hovenkamp] also recognize the need for courts to infer 'causation' from the fact that a defendant has engaged in anticompetitive conduct that "reasonably appears capable of making a significant contribution to . . . maintaining monopoly power." [...] To require that section 2 liability turn on a plaintiff's ability or inability to reconstruct the hypothetical marketplace absent a defendant's anticompetitive conduct would only encourage monopolists to take more and earlier anticompetitive action [... N]either plaintiffs nor the court can confidently reconstruct a product's hypothetical technological development in a world absent defendant's exclusionary conduct. To some degree, the "defendant is made to suffer the uncertain consequences of its own undesirable conduct." [Areeda.]

The DC Circuit's "significantly contributed to" standard in *Microsoft* is of course a lower burden of proof than the "but for" standard adopted in *Rambus*.

Rambus is a government injunctive enforcement action and the *Microsoft* causation standard therefore should apply. From a policy perspective, the standard of proof for causation in private treble damage actions is not appropriate for an FTC enforcement action. As Professors Areeda and Hovenkamp further explain: "because monopoly will almost certainly be grounded in part on factors other than a particular exclusionary act, no government seriously concerned about the evil of monopoly would condition its intervention solely on a clear and genuine chain of causation from an exclusionary act to the presence of monopoly. And so it is sometimes said that doubts should be resolved against the person whose behavior created the problem." This teaching is especially appropriate in a case such as *Rambus*, where the opportunistic conduct at issue is not the sort one should be concerned about overdeterring. Accordingly, the DC Circuit erred in reversing the Commission on this basis. The Commission in *Rambus* applied the correct legal standard: "In an equitable enforcement action, it is sufficient that the exclusionary conduct reasonably appears capable of making a significant contribution to creating or maintaining monopoly power."

It should also be noted that the DC Circuit cited Hovenkamp et al as the sole authority for its reliance on the "but for" standard, but we doubt that the authors

would agree with this interpretation or the result in this case. The IP and Antitrust treatise explicitly endorses the Commission's decision in *Rambus* as a matter of law. The treatise approves - with the proviso that the FTC's findings of fact are correct - the finding of causation, quoting the Commission's conclusion in its decision that "Rambus's conduct significantly contributed to JEDEC's choice of Rambus's technologies for incorporation in the JEDEC DRAM standards and to JEDEC's failure to secure assurances regarding future royalty rates - which, in turn, significantly contributed to Rambus's acquisition of monopoly power."

The court's reliance on NYNEX is misplaced. In view of the Commission's alleged inability to show that "but for" Rambus's failure to make the necessary disclosure, JEDEC would have selected alternative technology, the court said that the FTC could sustain its burden only if it could then show that Rambus's evasion of the RAND obligation necessarily produced an anti-competitive result - that is, by raising prices. The court then reasoned that raising prices alone does not violate section 2 (or section 5) and relied for this proposition principally on the Supreme Court's 1998 decision in *NYNEX Corp v Discon, Inc*. But *NYNEX* is inapt to a claim of abuse of standard setting such as this, and the DC Circuit's reliance on it in these circumstances weakens section 2 jurisprudence.

Relying on *NYNEX*, the DC Circuit broadly stated that "deceit merely enabling a monopolist to charge higher prices than it otherwise could have charged . . . would not in itself constitute monopolization." And, the court added, "to the extent that [the Commission's ruling in *Rambus*] may have rested on a supposition that there is a cognizable violation of the Sherman Act when a lawful monopolist's deceit has the effect of raising prices (without an effect on competitive structure), it conflicts with *NYNEX*."

The DC Circuit panel's reliance on *NYNEX* is misplaced and the reason is clear: NYNEX was a lawful monopolist and the court's reliance on the case hinges on that fact (as the panel explained, "an otherwise lawful monopolist's use of deception simply to obtain higher prices normally has no particular tendency to exclude rivals and thus to diminish competition"); but Rambus, in contrast, was not a lawful monopolist. The panel's conclusion of law, based on *NYNEX*, that the *exercise* of monopoly power by a lawful monopolist in raising prices through deception is not exclusionary, cannot apply to the entirely distinct factual circumstances of *Rambus*, in which Rambus *acquired* its monopoly power through deception.

The illogic of the panel's rationale as applied to Rambus is revealed by asking whether the panel would countenance the acquisition of monopoly power through deception as not violative of section 2 in circumstances where the monopolist then raises price. (This is after all precisely what Rambus did in avoiding giving a RAND obligation through its non-disclosure.) To answer this question in the affirmative of course would turn section 2 entirely on its head. A lawful monopolist does not violate section 2 merely by raising prices, but an entity that has acquired monopoly power through exclusionary conduct and then exercises that unlawfully acquired power by raising prices does violate section 2.

More particularly, the Supreme Court in *NYNEX* held that the fraudulent scheme to increase prices did not violate the antitrust laws because the consumer harm stemmed, not from a "less competitive market," but from market power that was "lawfully in the hands of the monopolist." NYNEX had a lawfully secured monopoly with attendant monopoly power, which was then subjected to a regulatory regime

intended to limit what NYNEX could charge for certain services. NYNEX's wrongful conduct thus had no nexus to its initial acquisition of monopoly power. In contrast, Rambus obtained monopoly power by deceptively inducing the SSO participants into believing that its non-disclosure obviated the need to demand a RAND commitment from it, as a means to prevent the creation of monopoly power. Thus, only through its deceptive failure to disclose was Rambus able to acquire monopoly power. Rambus did not have monopoly power prior to the inclusion of its technology in the standard, and this distinction from *NYNEX* is crucial.

The court misapprehends the use of deceptive conduct to acquire monopoly power in standard setting. Finally, on a related point, the DC Circuit failed to recognize the crucial role of deception (or other bad faith conduct) in harming competition in standard setting.

The court held that the only certain effect of an alleged deceptive failure to disclose pending patents - in the absence of evidence that JEDEC would have chosen an alternative technology but for its failure to disclose - is that JEDEC was unable to "extract" a RAND assurance from Rambus and so it was able to charge higher royalty rates than if it had made the proper disclosure and given the RAND assurance. Thus, the panel said, first, the failure to disclose did not with certainty cause JEDEC to choose Rambus's technology for the standard; and, second, the only other possible result from the failure to disclose - the higher royalties charged by Rambus, because it was unconstrained by a RAND assurance - did not harm competition in the monopolised market. This reasoning allowed the court then to assume that, given the FTC's failure to find conclusively that JEDEC could have avoided Rambus's IP rights, Rambus must have earned its monopoly power lawfully at the time of the patent grant.

But 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 that it otherwise would receive by virtue of its technology being selected for the standard. In other words, it acquired monopoly power by virtue of its deceptive non-disclosure; had it made the necessary disclosure, it would have been asked to provide a RAND assurance, and by providing that assurance, it would have negotiated away the monopoly power that was otherwise conferred on it.

It should be noted that Professor Hovenkamp in his *IP and Antitrust* treatise agrees that the higher prices in these circumstances can constitute competitive harm, contrary to the position of the DC Circuit. He observes that if nondisclosure to an SSO enables a participant to obtain higher royalties than otherwise would have been the case, the "overcharge can properly constitute competitive harm attributable to the nondisclosure", as the overcharge "will distort competition in the downstream market". Whereas the court acknowledges this statement by Hovenkamp in the *Rambus* decision but dismisses it as inconsistent with *NYNEX*, we contend that the court here has erroneously applied *NYNEX* to circumstances where it does not apply, and that Hovenkamp's view is the correct one.

To understand this dynamic better, it may be useful to contrast the timing of a RAND commitment under the JEDEC rules as applied in *Rambus* with the more usual circumstances in which a RAND obligation is given. SSO members are customarily required to commit at the *outset* of their participation to license any technology that is "essential" (or "relevant", as the case may be) to the standard either royalty-free

or on RAND terms. If a participant then fails to offer a licence to technology included in the standard on such terms, that failure can constitute exclusionary conduct, provided there were alternative technologies that the SSO would have chosen (or very likely would have chosen - to apply a slightly less exacting standard than that required by the DC Circuit in *Rambus*) but for the deceptive or bad-faith RAND commitment. Under the JEDEC rules, however, as generally understood, a participant's duty to state whether it would license the technology in question either royalty-free or on reasonable and non-discriminatory terms arose *not* at the outset of the standard-setting process but only later, when technology covered by the participant's patents or pending patents was proposed for inclusion in a JEDEC standard.

Thus, whereas in *Rambus* the FTC could not say whether, in the absence of Rambus's deception, JEDEC would have chosen another technology or required a RAND commitment, in the more usual scenario there could be no uncertainty about whether, in the absence of the participant's deception, the SSO would have chosen an alternative technology or required a RAND commitment - because the commitment was already given and therefore binding on the participant. In other words, in that scenario, the issue of an alleged inability to determine whether the SSO would have selected an alternative technology or required a RAND commitment cannot, logically, even arise: there is a binding RAND commitment regardless of any failure to disclose.

But there is less legal consequence to the difference between these two factually contrasting scenarios than might first appear to be the case. The FTC's 'uncertainty', such as it was, arose only because JEDEC did not require a *prior* RAND commitment. And when examined against the backdrop of the JEDEC rules as they were intended to work, the alternative paths - selecting a different technology or demanding a RAND commitment - as to which the FTC was unable to allege which of the two JEDEC would have chosen in the absence of Rambus's deception, collapse into just one, single path. In this respect the *Rambus* scenario is no different from the usual one (such as, for instance, in the *Broadcom v Qualcomm* standard-setting case), where the complainant faces no such alleged either-or syllogism, which the DC Circuit said dooms the FTC's case in *Rambus*. The alleged either-or syllogism facing the FTC simply reflects the structure of the JEDEC rules, as they were intended to apply, assuming no deception on the part of the SSO participants.

Now, the significance of the next JEDEC licensing rule cannot be overstated: if a member refused to license its technology either royalty-free or on RAND terms, then JEDEC (like most SSOs) *prohibited* incorporating it into the proposed standard (see JEDEC's Manual of Organization and Procedure.) The purpose of this rule is transparent: to prevent foreclosure of competition for the standard. Indeed, JEDEC itself explained in an amicus brief in earlier, related litigation, and the FTC emphasised in earlier briefs in *Rambus*, that the SSO's rules and procedures were intended to prohibit the incorporation of patented technology into a standard unless the patent owner is willing to grant a licence on reasonable terms. (They were also intended, JEDEC and the FTC make clear, to promote open standards, prevent a single entity from stifling competition, prevent unintentional standardisation of patent technology, and to require that JEDEC committee members make full disclosure as early in the standard development process as possible.) The clear purpose of this rule - to prevent foreclosure of competition for the standard - therefore undercuts the DC Circuit's reasoning that the failure to obtain a RAND commitment from Rambus because of its deception did not foreclose competition for

the standard but instead merely allowed Rambus to charge a higher royalty than if it had made the required disclosure.

Rambus used its deceptive failure to disclose its relevant technology as a mechanism to avoid giving a RAND commitment. The RAND commitment in turn was designed to prevent JEDEC participants from obtaining market or monopoly power - the ability to increase prices or reduce output - by virtue of the inclusion of their technology in the standard. By failing to make the required disclosure, Rambus therefore avoided the obligation to state whether it would license royalty-free or on RAND terms. And of course, if it had made that required statement in the negative, consistently with its subsequent non-RAND licensing demands, JEDEC would not have been permitted to include Rambus's technology in the standard.

In sum, each of the JEDEC rules and the interplay among them can be reasonably construed as intended to prevent deceptive conduct from unfairly foreclosing competition for the standard by other technologies, on the basis of technological superiority and pricing. It is therefore illogical, first, for the court to call Rambus's gaming of the system, through its failure to follow those rules, a matter of mere unconstrained pricing (and at most a breach of contract) by a "lawful monopolist", when the rules were designed to prevent participants from acquiring the market or monopoly power otherwise conferred through the selection of their technology for the standard in the absence of a RAND commitment. (In that respect, then, the court incorrectly likens Rambus's acquisition of monopoly power to NYNEX's lawful acquisition of monopoly power.)

Second, had Rambus not deceptively failed to disclose its IP interests, it would have triggered the JEDEC prohibition against incorporating a participant's technology in a standard where the participant refuses to make the required licensing commitment. The purpose of this prohibition was to prevent unfair foreclosure of competition for the standard. Rambus's deceptive avoidance of the prohibition can therefore be fairly understood as directly aimed at and having the effect of foreclosing competition from competing technologies. This should put paid to the view, embraced by the court, that Rambus's conduct did not cause harm to competition because it merely enabled Rambus to charge a higher royalty than if it had made the proper disclosure. Competition was indeed harmed because Rambus ensured through its deception that it would not trigger a prohibition on including its technology in the standard. And by deceptively preventing the prohibition from being triggered, Rambus prevented a competing technology from being chosen, based on the competitive criteria of superior technology and pricing.

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The chances of reversing a panel decision of the DC Circuit may appear daunting. But we should recognise what is at stake. By combining a mistaken view of causation with a misplaced rule of near per se legality for an SSO participant's use of deception to acquire monopoly power, the court encourages a new breed of anti-competitive conduct that can impose significant harm on consumers. No one can reasonably suggest that Rambus's conduct was somehow pro-competitive or efficient. Reversal is therefore necessary to protect the interests of consumers from this type of anticompetitive conduct. With due respect to the DC Circuit panel: to recall another (not so famous but no less profound) quotation from Yogi Berra - "You've got to be very careful if you don't know where you're going because you might not get there."

Footnotes are available on request to the authors.