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Standard-Essential Patents and Antitrust: Of Fighting Ships and Frankenstein Monsters

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"The time has come," the Walrus said, "To talk of many things: Of shoes—and ships—and sealing-wax—Of cabbages—and kings—And why the sea is boiling hot—And whether pigs have wings."[2]

I. INTRODUCTION

Standard-essential patents ("SEPs") have been at the heart of a debate about the reach of U.S. antitrust law. In recent years, the focus has been on whether breach of a good faith commitment to license on reasonable and non-discriminatory ("RAND") terms can be the basis for a monopolization claim.[3] The question is whether, in the absence of any fraud or deception at the time of the RAND commitment,[4] an antitrust violation occurs when a holder of a RAND-encumbered patent either refuses to grant a license on RAND terms or seeks injunctive relief.

In consent decrees, the Federal Trade Commission ("FTC") has stated that such conduct may violate Section 5 of the FTC Act as an unfair method of competition.[5] But no court has ruled on such a theory. And the Commission has been careful to distinguish between Section 5, which only the FTC can enforce, and Section 2 of the Sherman Act, which the Department of Justice and private litigants may enforce.[6]

Whether a breach of a RAND commitment may be a violation of Section 2 thus remains open to debate. But recent patent law developments may undermine any Section 2 theory. And breach of a RAND commitment as a Section 2 violation may face a difficult legal path in any event.

The time may have thus come to talk of *other* things, such as outsourcing patent enforcement by operating companies to patent assertion entities. Some have complained that such arrangements may violate the antitrust laws. If the theory gains any traction, such outsourcing may become like the fighting ships of shipping conference lore or the Frankenstein monsters of raising rivals' costs theory.

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[2] LEWIS CARROLL, THROUGH THE LOOKING GLASS (1871).

[3] *See, e.g.*, Renata B. Hesse, Dep't Ass't Att'y Gen., U.S. Dep't of Justice Antitrust Div., *IP, Antitrust and Looking Back on the Last Four Years*, at 19 (Feb. 8, 2013) (recounting debate), *available at* http://www.justice.gov/atr/public/speeches/292573.pdf.

[4] *See, e.g.*, Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297, 308 (3d Cir. 2007) (holding that enforcement of a patent over technology included in a standard due to a fraudulent RAND-commitment may violate Section 2).

[5] *See, e.g.*, *Motorola Mobility LLC*, 2013 FTC LEXIS 97, at *9-10 (FTC Jan. 3, 2013) (complaint); *Robert Bosch GmbH*, 2012 FTC LEXIS 186, at *15 (FTC Nov. 30, 2012) (analysis to aid public comment); *Negotiated Data Solutions LLC*, 2008 FTC LEXIS 7, at *9-14 (FTC Jan. 22, 2008) (complaint).

[6] *See, e.g.*, Statement of the Fed. Trade Comm'n, *Negotiated Data Solutions LLC*, *available at* http://www.ftc.gov/os/caselist/0510094/080122statement.pdf.

II. BARRIERS TO BREACH OF A RAND COMMITMENT AS A SECTION 2 VIOLATION

Both the U.S. Department of Justice ("DOJ") and private litigants remain keenly interested in the question of whether a breach of a RAND commitment may be a basis for a Section 2 violation. If it cannot, the DOJ will likely be unable to police such conduct, and private litigants will be consigned to less attractive causes of action, such as breach of contract. Some have thus urged that breach of a RAND commitment be considered a violation. But both patent law and antirust doctrine remain potential barriers to a Section 2 theory.

Recent developments in patent law tend to undermine the Section 2 theory. Central to the theory is the premise that a breach of a RAND commitment allows the patent holder to engage in hold-up. The potential for hold-up arises because after implementers have taken steps to produce standard-compliant products, patent holders may take advantage of specific investments and switching costs to demand royalties higher than could have been obtained before the adoption of the particular technology and the implementation of the standard.[7] The linchpin of hold-up is the threat of injunctive relief.[8] RAND commitments are intended to mitigate patent hold-up by requiring the patent holder to license on reasonable terms and have been characterized as "important safeguards against monopoly power."[9] A breach of a RAND commitment, it is argued, circumvents this safeguard.

But recent patent law cases may remove the linchpin of the RAND-breach patent hold-up theory. Following the equitable test dictated by *eBay v. MercExchange*,[10] several courts have held that a RAND commitment precludes injunctive relief.[11] And injunctive relief may become unavailable to RAND-encumbered patent holders even in the International Trade Commission, which is not bound by *eBay*.[12]

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[7] *See* U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* 37-38 (2007) (explaining that an implementer of standards may face high switching costs due to the need for the development of an alternative standard and network effects).

[8] *See* Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies With Competition* 114 (2011) ("Where a patentee asserts a patent seeking an ex post licensing agreement, and the infringer has sunk costs in product design and production using the patented technology, switching to an alternative technology may be very costly. In that case, the patentee can use the threat of an injunction to obtain royalties covering not only the value of its invention compared to alternatives, but also a portion of the costs that the infringer would incur if it were enjoined and had to switch. This higher royalty based on switching costs is called the 'hold-up' value of the patent.").

[9] *Broadcom*, 501 F.3d at 314.

[10] 547 U.S. 388 (2006).

[11] *See, e.g.*, *Microsoft v. Motorola*, 696 F.3d 872 (9th Cir. 2012) (upholding preliminary injunction preventing enforcement of German injunction—injunctive relief inconsistent with contractual RAND obligation); *Apple v. Motorola*, 869 F. Supp. 2d 901 (N.D. Ill. 2012) (Posner, J.) ("A FRAND royalty would provide all the relief to which Motorola would be entitled if it proved infringement of the '898 patent, and thus it is not entitled to an injunction"); *Microsoft v. Motorola*, 2012 WL 5993202 (W.D. Wash. Nov. 30, 2012) (Microsoft agreed to pay RAND royalty; no irreparable harm and damages—RAND royalty—was adequate remedy).

[12] *See* Letter from Hon. Michael B.G. Froman, U.S. Trade Representative, to Hon. Irving A. Williamson, Chairman, U.S. International Trade Commission (Aug. 3, 2013) (disapproving ITC determination in *In re Certain Electronic Devices*, Inv. No. 337-TA-794, because exclusion order was based on the enforcement of RAND-encumbered patents).

Whether patent law will ultimately preclude RAND-encumbered patent holders from seeking injunctive relief remains to be seen. The question of the availability of such relief in U.S. district courts is currently pending before the Federal Circuit. And how the ITC will deal with RAND-encumbered patents is still developing.

But assuming that developments in patent law do not moot the debate, the Section 2 theory must still overcome certain antitrust law hurdles. First, there is some precedent that breach of a RAND commitment—though it may raise prices—cannot violate Section 2 because it does not harm the competition. In *Rambus Inc. v. FTC*,[13] for instance, the FTC found that Rambus unlawfully monopolized certain markets by engaging in deceptive conduct in a standard-setting organization, allowing Rambus to avoid committing to license patented technology incorporated into an industry standard on RAND terms. Vacating the Commission's decision, the D.C. Circuit held that the standard-setting organization "lost only an opportunity to secure a RAND commitment from Rambus. But loss of such a commitment is not a harm to competition.…"[14] According to the court, an "end-run around price constraints … does not alone present a harm to competition."[15]

In reaching this conclusion, the *Rambus* court relied on *NYNEX Corp. v. Discon, Inc.*,[16] in which the Supreme Court addressed claims that a firm with monopoly power violated Sections 1 and 2 of the Sherman Act by engaging in conduct to avoid regulatory price constraints. Recognizing the plaintiff's allegation that the "behavior hurt consumers by raising … rates," the Court nonetheless held that the plaintiff failed to state a claim because the avoidance of price constraints by a firm that had gained a lawful monopoly does not harm competition.[17]

In addition to *Rambus*, the Section 2 theory must overcome Supreme Court precedent regarding refusals to deal. The breach of a RAND commitment is, after all, a refusal to grant access to the patent holder's property. And the Court has extensively dealt with the question of when a breach of a duty to grant access to a firm's assets may violate Section 2.

In *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*,[18] government regulations mandated that the defendant provide rivals access to its assets.[19] The plaintiff alleged that defendant refused to do so, thereby monopolizing the relevant market.[20] The Court rejected plaintiff's antitrust claim, explaining the fact that Congress imposed duties on the defendant to deal with its rivals "does not automatically lead to the conclusion that they can be enforced by means of an antitrust claim."[21] Rather, a refusal to grant access to a monopolist's assets only violates the antitrust laws in narrow circumstances: where a monopolist terminates a voluntary course of dealings, forsaking short-term profits to achieve an anticompetitive end.[22] In other

[13] 522 F.3d 456 (D.C. Cir. 2008).
[14] *Id.* at 466.
[15] *Id.*
[16] 525 U.S. 128 (1998).
[17] *Id.* at 135-36, 138 (alleged conduct did not "harm to the competitive process").
[18] 540 U.S. 398 (2004).
[19] *Id.* at 403.
[20] *Id.* at 403-04.
[21] *Id.* at 406.
[22] *Id.* at 408-09.

words, evading federal regulations that require dealing with rivals is not enough to bring the antitrust laws into play; there must be an *antitrust duty* to deal.

The Supreme Court later extended this reasoning, holding that a firm's pricing of access to its assets to rivals—even where that pricing is contrary to regulations mandating access—does not violate the antitrust laws absent an antitrust duty to deal. In *Pacific Bell Telephone Co. v. linkLine Communications, Inc.*,[23] the defendants were obligated by federal regulations to provide access to their telephone network facilities to rival digital subscriber line ("DSL") service providers at certain wholesale rates.[24] The plaintiffs alleged that the defendants employed a price squeeze to monopolize the DSL retail market, raising wholesale prices for interconnection services while lowering retail prices for defendants' competing DSL service.[25] The plaintiffs claimed that the antitrust laws mandate that defendants' pricing give them a "fair" margin.[26] The Court, however, held that *Trinko* foreclosed any challenge to the defendant's pricing for access to its assets:

> [F]or antitrust purposes, there is no reason to distinguish between price and nonprice components of a transaction. The nub of the complaint in both *Trinko* and this case is identical—the plaintiffs alleged that the defendants (upstream monopolists) abused their power in the wholesale market to prevent rival firms from competing effectively in the retail market. *Trinko* holds that such claims are not cognizable under the Sherman Act in the absence of an antitrust duty to deal.[27]

Courts may view the actions of a patent holder refusing to honor a RAND commitment to be analogous to the defendants' actions in *Trinko* and *linkLine*. A RAND commitment is arguably nothing more than a promise to grant access to intellectual property essential to a standard on reasonable and non-discriminatory terms. If the breach of a duty imposed by federal regulation to grant access at certain rates does not harm competition—even where that breach excludes rivals and leads to monopoly power—the refusal to honor a private commitment to a standard-setting organization may receive a similar reception from the courts. But that remains to be seen.

III. OF FIGHTING SHIPS AND FRANKENSTEIN MONSTERS

Regardless of the outcome of the debate, another issue regarding standard-essential patents is coming to the fore. Some have recently argued that outsourcing of patent enforcement by operating companies may violate antitrust laws. Last year, for instance, Google filed a complaint with the European Commission, asserting that Microsoft and Nokia violated EU competition laws by transferring patents related to mobile telephone technology to a patent assertion entity, MOSAID Technologies Inc. In April 2013, Google, BlackBerry, EarthLink, and

[23] 555 U.S. 438 (2009).
[24] *Id.* at 443.
[25] *Id.*
[26] *Id.* at 449.
[27] *Id.* at 450.

Red Hat submitted comments to the FTC and DOJ, arguing that such outsourcing of standard-essential patents (which they call "privateering") potentially violates U.S. antitrust law.[28]

It is argued that operating companies could outsource patent enforcement as a means to raise rivals' costs. Unlike an operating company, a patent assertion entity cannot be deterred by the threat of retaliatory patent litigation. By outsourcing, an operating company may raise rivals' costs through proxy patent enforcement and licensing while avoiding a patent war, perhaps undermining certain RAND obligations.

Under this theory, outsourcing creates "fighting ships" that impair rivals. In the early 1900s, liner conferences comprised of competing shipping companies deployed ships offering predatory prices on routes identical to those of rivals. The Supreme Court found such "employment of 'fighting ships' to kill off competing vessels" to violate the Sherman Act.[29] Depending on the particular facts, the use of assertion entities by collaborating operating companies may be analogous.

Alternatively, the argument could be made that outsourcing creates "Frankenstein monsters." Under the raising rivals' cost theory, a firm may use exclusive contracts to "create[] and turn[] loose upon its rivals an industry structure likely to generate a price increase."[30] By locking up all but one retailer with exclusive contracts, for instance, a firm may create a situation in which the one retailer "can then monopolize trade with the manufacturer's rivals."[31] The retailer becomes a Frankenstein monster, which terrorizes rivals and raises their costs. By assigning standard-essential patents to an assertion entity, while retaining a license to the patents, an operating company may be able create an analogous situation by turning the assertion entity loose on its rivals.

Neither of these arguments has been accepted by the agencies or the courts. And the viability of either would be dependent on the particular facts. But both offer intriguing, and colorful, theories that may become the next focus of antitrust and standard-essential patents. Outsourcing may be the next big issue for standard-essential patents and antitrust.

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[28] Comments of Google, BlackBerry, EarthLink and Red Hat to the Federal Trade Commission and U.S. Department of Justice on Patent Assertion Entities (Apr. 5, 2013), *available at* http://www.ftc.gov/os/comments/pae/pae-0047.pdf.

[29] *See Thomsen v. Cayser*, 243 U.S. 66, 87 (1917).

[30] Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209, 240-41 (1986).

[31] *Id.*