



DEPARTMENT OF JUSTICE

ANTITRUST ENFORCEMENT AND STANDARD SETTING: THE VITA AND IEEE LETTERS AND THE “IP2” REPORT

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I. Introduction

In October 2006, the Department of Justice (DOJ) issued a business review letter to the VMEbus International Trade Association (VITA), a standards development organization (SDO) that develops standards for certain computer bus architecture.¹ On April 17, 2007, DOJ and the Federal Trade Commission (FTC) issued a joint report known as the “IP2” Report,² covering six topics at the intersection of intellectual property law and antitrust, one of which is standard setting. And on April 30, 2007, DOJ issued a business review letter to the Institute of Electrical and Electronics Engineers, Inc. (IEEE),³ which develops a wide range of technology standards. Today’s panel, therefore, is a timely one.

I will spend some time discussing each of these documents. My more important message, however, is a general one concerning the broader policy that underlies the letters, the report, and recent statements by officials in the Antitrust Division and the FTC. The message is that United States enforcers see antitrust and intellectual property as complementary forces, not forces in tension, and we support a high degree of licensing freedom. DOJ and the FTC are not in the business of endorsing particular approaches to intellectual property licensing; instead, in standard setting as in any other area, we leave the marketplace to pick winners and losers, and

¹Letter from Thomas O. Barnett, Assistant Att’y Gen., U.S. Dep’t of Justice, to Robert A. Skitol (Oct. 30, 2006) (hereinafter VITA Business Review Letter), <http://www.usdoj.gov/atr/public/busreview/219380.pdf>.

²U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, ANTITRUST ENFORCEMENT & INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION (April 17, 2007), <http://www.usdoj.gov/atr/public/hearings/ip/222655.pdf> (hereinafter “IP2 REPORT”). The shorthand title “IP2” is used to distinguish this from an earlier report issued by the FTC. *See* FED. TRADE COMM’N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY (Oct. 2003), <http://www.ftc.gov/os/2003/10/innovationrpt.pdf>.

³Letter from Thomas O. Barnett, Assistant Att’y Gen., U.S. Dep’t of Justice, to Michael A. Lindsay (April 30, 2007) (hereinafter IEEE Business Review Letter), <http://www.usdoj.gov/atr/public/busreview/222978.pdf>.

we intervene only where a practice imposes a restraint on competition *and* is likely to harm long-term efficiency and the competitive process itself. Businesses should be confident that antitrust enforcement will not stand in the way of competition related to intellectual property. Businesses also should know that if they are on the losing end of competition, a petition to the U.S. antitrust authorities will not save them.

II. The VITA and IEEE Business Review Letters

A. Background

Turning now to the two business review letters, it is necessary first to understand the DOJ business review process.⁴ The business review process begins when a firm submits a formal written request.⁵ DOJ opens an investigation and may research market conditions, conduct party interviews, and perform interviews of customers and competitors. Typically, however, DOJ relies heavily on the factual representations of the firm requesting the review, for three reasons: (1) conducting a full investigation is costly; (2) DOJ reviews only proposed conduct (not conduct that has already occurred),⁶ so many facts will be largely within the control of the requesting firm; and (3) any guidance issued will be valid only for the facts explained in the letter, so there is little incentive to withhold information – doing so could render the letter worthless. The process concludes when DOJ issues a letter stating that it has no intention to challenge the proposed conduct, that it does have an intention to challenge, or that it cannot make a decision

⁴ See generally U.S. Dep’t of Justice, Business Review Letters, <http://www.usdoj.gov/atr/public/busreview/letters.htm>.

⁵ See U.S. Dep’t of Justice, Business Review Procedure, <http://www.usdoj.gov/atr/public/busreview/procedure.htm>.

⁶ 28 C.F.R. § 50.6.

based on the facts in the request or the conditions of the market. Information about DOJ's enforcement intentions is useful on its own merits and can also have value in persuading private litigants not to sue, or courts to be skeptical of claims, under the Sherman Act. Note, however, that due to the narrow format of the request and answer, this is not vehicle for DOJ to endorse a particular practice as the best or only solution for an industry.

For purposes of antitrust analysis in standard setting, it is also helpful to understand patent hold up. Patent hold up can be defined to involve a situation where all the following conditions exist:

- after the standard is set, the holder of a patent essential to that standard identifies a patent, or attempts to impose licensing terms, that SDO members could not reasonably have anticipated;
- it is not a commercially reasonable option to abandon the standard and attempt to create an alternative, due to the cost of the standard setting process itself or the cost of developing products incorporating the alternative standard;
- and – most importantly – if the other SDO members *had* anticipated the patent holder's demands, those SDO members could have chosen a different technology that avoided this patent.

Thus, one of two results likely would have occurred if the SDO members had known of the patent and the patent holder's demands: the SDO (1) actually would have chosen the alternative technology, or (2) the patent holder might seek to induce SDO members to adopt its patented technology by offering a license with a competitive royalty rate. This definition is important because it makes clear that hold up involves the loss of the opportunity to pursue a meaningful competitive alternative. Hold up involves market power that is created by a standard itself, *not* market power that would have existed regardless of the standard. Hold up, as I use the term, does not exist merely because a group of licensors is upset that a patentee holds the key to an

essential technology. Hold up certainly does not exist merely by the fact that a patentee charges a particular rate for its royalty when licensees would prefer to pay a lower rate.

B. The VITA Letter

VITA described its proposed policy as an effort to avoid hold up as I have defined it.

The VITA policy contains a number of provisions, including these five:

- *Disclosure.* Each member of a standards working group must disclose all patents or patent applications that it knows about and that it believes may become essential to implementation of the future standard. Members must do this on three occasions: before a working group is formed to create a standard; within sixty days after the working group is formed; and within fifteen days after the draft standard is published. In addition, any member must disclose any previously undisclosed essential patents at any meeting, and must follow that disclosure with a formal declaration within thirty days.
- *Maximum terms.* Members must disclose maximum royalty rates, whether in terms of dollars or as a percentage of a device sale price, and also the most restrictive non-royalty terms they will demand for essential rights. The commitments are irrevocable; however, patent holders are free to submit subsequent declarations with lower rates and less restrictive terms.
- *Limited application.* These commitments apply to implementation of the VITA standard being developed, and any revisions to that standard, but they do not apply to any other uses of the technology.
- *No horizontal negotiations.* Working group members may consider the various declared licensing terms when deciding which technology to support for the standard, but cannot negotiate or discuss specific licensing terms among working group members or with third parties.
- *Arbitration and consequences.* The policy creates an arbitration procedure to resolve any disputes over members' compliance. There are a number of specified consequences for non-compliance, including that failure to disclose an essential patent will lead to that patent being licensed on a royalty-free basis within the standard.

In its response to the request from VITA, the Department of Justice concluded that this policy was not likely to harm competition. DOJ found that the policy should not lead to

depression of the price for licenses through joint, anticompetitive actions because it prohibits any joint negotiation of licensing terms. Working group members do not set actual licensing terms: the patent holders propose their terms, balancing their interest in higher royalties against the possibility that too high a “price” ex ante would prevent their technology from being chosen for the standard because of competitive alternatives. Before or after the standard is set, the patent holder and each prospective licensee will negotiate separately, subject only to the maximum terms set forth in the patent holder’s original, unilateral declaration. Any attempt to use this process as a sham to cover horizontal price fixing likely would result in antitrust liability,⁷ as an illegal agreement under Section 1 of the Sherman Act,⁸ but the restrictions put in place by VITA appear to promote efficiency if they are followed and enforced.

C. The IEEE Letter

The IEEE request differs from VITA’s policy chiefly in that it gives patent holders more options. Under the IEEE proposal, if the chair of an IEEE standards working group believes that a patent holder has a patent that potentially will be essential to the proposed standard, the chair may ask the patent holder to disclose relevant patent rights and to provide IEEE a letter of assurance (LOA) about licensing terms. The patent holder then has five options:

- provide no assurance;
- state that it does not hold essential patents;
- commit not to assert its patents against implementers of the standard;
- commit to license on RAND terms; or

⁷VITA Business Review Letter, *supra* note 1, at 9-10.

⁸15 U.S.C. § 1.

- commit to maximum price terms or most restrictive non-price terms.

The IEEE will then post the licensing assurances, or lack thereof, on its website. If a patent holder chooses the fifth option, the IEEE working groups may then use this information to assess the relative costs of alternative technologies. The explicit consideration of relative costs makes IEEE's policy somewhat different from VITA's. In addition, unlike VITA, IEEE has not created a consequences provision that could impose arbitration and royalty-free licenses. If a patent holder were to choose IEEE's fifth option and then fail to adhere to its assurances, any party that claims injury would be left to seek redress in a civil court action. IEEE has no obligation to become directly involved in enforcing the policy.

DOJ concluded that IEEE's policy offered potential benefits comparable to VITA's, and did not merit an enforcement challenge. DOJ stated:

the proposed IEEE policy . . . could generate similar benefits as patent holders may compete to offer the most attractive combination of technology and licensing terms . . . members may make better informed decisions by considering potential licensing fees when weighing the relative costs of technological alternatives in addition to their technological merits.”⁹

DOJ did not object to IEEE's desire to permit its members to consider the relative costs of alternative technologies. This strikes me as not particularly controversial. Former AAG Hew Pate said as early as 2005 that “[i]t would be a strange result if antitrust policy [were] used to prevent price competition,”¹⁰ which perfectly encapsulates the issue. FTC Chairman Deborah

⁹IEEE Business Review Letter, *supra* note 3, at 10.

¹⁰R. Hewitt Pate, Assistant Att’y Gen., U.S. Dep’t of Justice, Competition and Intellectual Property in the U.S.: Licensing Freedom and the Limits of Antitrust, Address at the 2005 EU Competition Workshop 9 (Florence, Italy, June 3, 2005), <http://www.usdoj.gov/atr/public/speeches/209359.pdf>.

Majoras has made similar statements.¹¹ But note that, in essence, the IEEE policy permits its members to consider such costs only in generalized or non-collaborative ways. The policy “prohibits discussion of specific licensing terms within . . . standards development meetings” and, based on statements by IEEE’s counsel, DOJ understood that “this prohibition extends to joint negotiations of licensing terms within standards development meetings.”¹² IEEE did not request, and DOJ did not provide, “views on joint negotiations that might take place inside or outside such standards development meetings or IEEE sponsored meetings,”¹³ but DOJ noted in a footnote that it would “typically apply a rule-of-reason analysis to joint negotiations of licensing terms in the standard setting context.”¹⁴

III. The IP2 Report and Standard Setting

The IP2 Report consists of six chapters devoted to particular IP-related practices, and states conclusions for each chapter. Briefly, those conclusions are:¹⁵

- *Chapter 1:* Antitrust liability for mere unilateral, unconditional refusals to license patents will not play a meaningful part in the interface between patent rights and antitrust protections. Conditional refusals to license, however, can be subject to antitrust liability if they cause competitive harm.

¹¹See Deborah Platt Majoras, Chairman, Fed. Trade Comm’n, Recognizing the Procompetitive Potential of Royalty Discussions in Standard Setting, Address at Standardization and the Law: Developing the Golden Mean for Global Trade 7 (Stanford University, Sept. 23, 2005) (“[T]ransparency on price can increase competition among rival technologies striving for incorporation into the standard at issue.”), <http://www.ftc.gov/speeches/majoras/050923stanford.pdf>.

¹²IEEE Business Review Letter, *supra* note 3, at 11.

¹³*Id.*

¹⁴*Id.* at 11 n.47.

¹⁵The following is a summary. It is not meant to alter the conclusions of the IP2 REPORT.

- *Chapter 2:* Ex ante consideration of licensing terms by SDO participants is likely to be procompetitive. Such joint action might pose problems in some contexts but is most likely to be reasonable where adoption of a standard would create or enhance market power in a patent holder. Such joint negotiations, therefore, are likely to be analyzed under the rule of reason, not considered as per se violations (buyer price fixing) under the Sherman Act.
- *Chapter 3:* Combining complementary patents in cross licenses or patent pools is generally procompetitive. Combining substitute patents in a pool can raise concerns but is not presumptively anticompetitive. Cross licenses and patent pools, whatever their design, typically will be analyzed on a rule-of-reason basis, and the Agencies generally will not inquire into the reasonableness of royalties set as a result.
- *Chapter 4:* The flexible rule of reason approach set forth in the Agencies' 1995 *Antitrust-IP Guidelines*¹⁶ is fundamentally sound. The Agencies will continue to use it to assess the competitive effects of a range of licensing restraints, including non-assertion clauses, grantbacks, and reach-through royalty agreements.
- *Chapter 5:* Regarding IP-related bundling and tying, the *Antitrust-IP Guidelines* will continue to govern the Agencies' analysis, meaning that the Agencies will focus on seller market power, competitive effects in the tied product market, and efficiency justifications proffered in favor of the bundle or tie.
- *Chapter 6:* When licensing practices are alleged to extend a patent beyond its statutory term, the Agencies will apply standard antitrust analysis, including consideration of whether the patent confers market power, which generally will lead to analysis under the rule of reason. In particular, the Agencies recognize that it may be efficient to collect royalties – or perhaps more accurately, to collect payments related to use of the formerly-patented invention – beyond the patent's term.

So from an SDO's perspective, the IP2 Report is an interesting addition to the VITA and IEEE business reviews. The report's Chapter 2 considers standard setting as a whole, rather than just the two specific VITA and IEEE proposals, and unlike those proposals it does consider the issue

¹⁶U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 4 (1995), <http://www.usdoj.gov/atr/public/guidelines/ipguide.pdf>.

of joint license negotiations in depth. And the report as a whole places standards setting questions within a much larger, and instructive, context of intellectual property and antitrust policy. That larger context shows that antitrust analysis of SDO practices properly focuses not on the effects to individual competitors – or on the individual participants in a standard setting process, regardless of whether they are in a horizontal or vertical relationship – but on competition as a whole. That means focusing on three items in particular: market power, competitive effects, and dynamic efficiencies. Rather than recapitulate Chapter 2, I advise you to read its 22 pages.¹⁷

IV. Observations About Antitrust and Standard Setting

I considered writing out a hypothetical regarding an SDO evaluating different approaches to a patent disclosure policy, so that I could walk you down the various branches of the decision tree and identify the antitrust inflection points. When I started to do this, however, I did not produce a tree – I produced a fractal. There are potentially infinite problems, solutions, and practical and legal questions facing SDOs. Sham or otherwise marginal cases aside, there is simply no way to make definitive statements about these issues without analyzing a specific SDO policy, on a case-by-case basis. But that is hardly a reason for despair. Case-by-case, effects-based analysis is familiar to all of us who practice U.S. antitrust law. In fact, the clearest message of the IP2 Report, like the *Antitrust-IP Guidelines* before it, is that intellectual property is not really a special antitrust case. Neither is standard setting.

Allow me to make some general observations. First, you will go a long way toward answering your antitrust questions if you focus on how a practice affects the exercise of market

¹⁷IP2 REPORT, *supra* note 2, at 33-56.

power, and in the SDO context it is particularly helpful to start by distinguishing market power created by a standard from market power, if any, that exists in the IP rights, independent of the standard. It might well be reasonable for SDO members, ex ante, to engage in joint licensing negotiations with the owners of several roughly equivalent patents, since no one invention would have market power ex ante and the SDO members may be attempting merely to prevent the creation of a patent blocking position that would not exist absent the SDO members' own standard-setting efforts. In contrast, if SDO members ex ante already know that a particular patent is essential, and their joint negotiations are just an attempt to drive down the price via a buyer-side agreement not to compete for this necessary input, we would need to ask more questions, such as whether the "buyers" have inappropriately created market power for use against the patent license "seller."

Second, harm to a particular faction does not necessarily equate to harm to competition. If a particular SDO's policy would reduce the royalties obtained by a particular patentee, that is not necessarily a violation of the antitrust laws. The antitrust laws may not be violated even if such an SDO policy reduces innovation incentives to that particular patentee; antitrust policy may ask broader questions, such as whether the combined innovation incentives of *all* patentees and SDO creators, or an economically significant number, will suffer. Similarly, harm to short-term efficiency does not necessarily equate to harm to competition. If a patentee and an SDO cannot agree about disclosure policies or royalty rates, and end up with competing standards backed by each camp, this may be costly to efficiency in the short run; however, if the credible threat to set up competing standards causes parties to bargain, innovate, or otherwise compete harder, long-term efficiency may benefit. There is always a temptation to focus on short-term,

party-specific harm, since that is the easiest to measure, but the proper focus is on the competitive process and the long-term efficiency of standard setting. Measuring long-term efficiency is difficult but we need to remind ourselves constantly that this is the goal.

Third, there are many problems that antitrust enforcement is not likely to solve. No standard-setting process is perfectly efficient. No patent system has perfect patent quality. No disclosure or licensing policy can perfectly anticipate every future need of patent holders and licensees. The best we can do is to bring enforcement actions when we develop reasonably solid evidence that a practice harms competition as a whole; otherwise, we trust market forces to eventually, if imperfectly, reach efficient results, and we engage in competition advocacy to improve case law, international practices, and the understanding of enforcers, private counsel, and business persons.

I previously stated,¹⁸ and it bears repeating, that antitrust enforcers need to act with caution in the standard setting area. Antitrust has a role to play, but we need to bear in mind that where an unsound rule is proposed by a government enforcer, there is often no way to contract around it, and worse, there may be no way to conduct a natural experiment without the rule that can prove it should be abandoned. The standard setting community should continue to bring us its concerns whenever it believes a practice harms competition, and should particularly come to us if our position as neutral entities could lend special force to competition advocacy. The standards community should remember, however, that the first solution to any competitive

¹⁸Gerald F. Masoudi, Deputy Assistant Att’y Gen., U.S. Dep’t of Justice, Efficiency in Analysis of Antitrust, Standard Setting, and Intellectual Property, address at the High-Level Workshop on Standardization, IT Licensing, and Antitrust 15-16 (Brussels, Belgium, Jan. 18, 2007), <http://www.usdoj.gov/atr/public/speeches/220972.pdf>.

problem is more and harder competition, and we will be reluctant to intervene against practices by either side to an SDO licensing discussion if those practices can be characterized merely as hard bargaining over terms and price.