# MONETIZING INTELLECTUAL PROPERTY

## STANDARD SETTING: IS YOUR IP AT RISK? THE FTC "CLARIFIES" THE LAW

*By Sean P. Gates**

High-tech companies are increasingly finding themselves at the cross-roads of two important industry trends: standardization and the monetizing of intellectual property. These companies need to participate in industry standard-setting efforts. But participation may have a substantial impact on the ability to monetize their intellectual property. This is especially true in light of recent actions by the Federal Trade Commission. Knowing the issues is crucial to making intelligent and informed decisions. Ignorance can cost millions.

Standards are becoming increasingly important in high-tech industries. Computer memory chips from different manufacturers need to work with microprocessors from other companies. Various generations of computers need to communicate through local area networks. Audio files need to be read by all sorts of electronic devices. Industry standards allow this to happen; standards ensure compatibility.

Not surprisingly, high-tech companies routinely participate in dozens if not hundreds of industry standard setting committees. Participation is an economic necessity. It allows companies to gain crucial lead time to prepare to manufacture standard-compliant products.

These same companies typically possess large portfolios of intellectual property – hundreds if not thousands of patents. For years many high-tech companies only used their patent portfolios defensively. But many now see their patents as a potential revenue source.

This potential revenue source, however, may be substantially impacted by participation in standard setting activities. Many (if not most) standard setting organizations have developed intellectual property policies. These policies often require participating firms to agree to license their IP under certain conditions. The idea is to get an up-front commit-

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ment from the IP holder, limiting the ability to raise rates after the industry starts producing the products. For instance, some require all participants to grant a royalty-free license for all relevant IP. Others require companies to disclose IP that may be relevant to a developing standard and agree to license "essential" IP on fair, reasonable and non-discriminatory terms (FRAND).

Participation in standard setting and the company's licensing efforts may therefore conflict. This is especially the case when—as is often typical—the company's standard setting efforts are not coordinated with its licensing activities. The individuals participating in standard setting committees are typically engineers who are not under the jurisdiction of the IP licensing department. Yet too often these engineers are the ones committing the company's IP simply by participating in the standard setting organization.

This can lead to disaster. One very large California-based computer manufacturer wrote off $40 million in potential licensing fees because of an engineer's attendance at a standard setting meeting. One engineer; one meeting; a $40 million loss.

Managing the impact of participating in standard setting organizations on the company's IP portfolio is fraught with difficulty. Under recent case law, failure to make appropriate disclosure may bar a company from seeking licensing fees from those practicing the standard. The concern is that a company may intentionally mislead a standard setting organization into adopting the company's IP. Yet the IP policies of the hundreds of standard setting organizations vary tremendously. For instance, some require only the disclosure of issued patents. Others require patent applications as well. Some even require companies to disclose their *intentions* to seek patents. The IP policies also vary regarding the trigger for a disclosure obligation. Some require that companies to disclose only "essential" IP, i.e., patents that must be used to practice the standard. Others require disclosure of patents that participants "believe" may be infringed by practicing the standard. Still others have procedures to follow after disclosure but do not specify what triggers a duty to disclose. Compounding the situation, the policies typically require these disclosures even while the standard is developing and changing. And even after a company discloses its IP and commits to license it on FRAND terms, parties (not surprisingly) disagree as to what constitutes fair and reasonable royalties.

To make things more complicated, recent FTC cases demonstrate that knowing the letter of the standard setting organization policy is not enough. In a recent action, the FTC charged a technology company with monopolization for failing to disclose its IP while involved in a standard setting organization. The FTC held the company liable despite finding that the organization's disclosure rules were "not the model of clarity" – in fact a federal appellate court had found that these same rules had a "staggering lack of defining details." This lack of clarity led a federal district court to throw out a claim that the technology company had breached a contract to disclose its IP; the court held that the policies were so unclear that they could not form the basis of a duty to disclose. The FTC nonetheless found that the organization's members "expected disclosure of both patent and patent applications that might be applicable to the work" of the organization and used these "expectations" as a basis to find that the technology company's conduct was deceptive. Based on this finding, the FTC imposed a cap on the royalties that the company could demand.

Not only may the organization policies be an insufficient guide, companies cannot depend on normal rules of contract when dealing with licensing obligations in standard setting organizations. In another recent FTC action, a technology company participating in a standard setting organization made a commitment to license its IP to any company practicing the standard for a royalty of $1000. Eight years later, though the standard was widely adopted, not a single company took the offer. During that time, other participants in the organization changed the terms of their licensing offers. The technology company also announced that it was changing its offer, requiring licensees to pay reasonable royalties. Under normal contract principles, this change may have been perfectly all right.

The FTC, however, charged the technology company with violating federal law. According to the FTC, the repudiation of a prior licensing commitment made in the standard setting context may be an "unfair method of competition." Because the technology company had changed its licensing offer only after firms were "locked into a standard," the change was unlawful because it was "coercive" and "oppressive" and would result in higher prices for the licensed technology.

As a dissenting Commissioner pointed out, the FTC normally reserves this type of charge for conduct that violates the antitrust laws. Those laws prohibit single-firm conduct that is "exclusionary" and allows the firm to acquire or maintain "monopoly power." The courts have carefully applied these requirements to ensure that the antitrust laws do not chill rough and tumble competition. In this case, the FTC found liability even though the conduct was arguably not "exclusionary" and there was a substantial question—according to the FTC Chairman—as to whether the technology company had "monopoly power." According to the dissenting Chairman, this puts FTC law on a "slippery slope" – is any "evasion of a contractual price constraint" a violation of federal law?

Going farther, the FTC reached into its consumer protection powers and charged that the technology company engaged in an "unfair practice." Prior to this case, the FTC's power to prohibit "unfair practices" had been used to protect individual consumers or small business owners. The standard for what is an unfair practice has developed accordingly. For instance, in a statement to Congress, the FTC stated that an unfair practice requires a "substantial injury," which included monetary loss but not purely emotional injury. Here, over the dissent of two Commissioners, the FTC used this power to protect large computer manufacturers, who are presumably sophisticated enough to understand that companies may not hold an offer to license open and unchanged indefinitely.

These FTC cases demonstrate that "knowing the rules" takes more than simply perusing the standards setting organization's policies. To ensure that their company's IP is not at risk, savvy IP managers need more. They need to understand the rules of the game and how the FTC may be changing those rules.