APPLYING SECTION 2 TO FRAND VIOLATIONS: "IT'S ELEMENTARY, MY DEAR WATSON"

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Applying Section 2 to Frand Violations: "It's Elementary, My Dear Watson"

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Many well-reasoned cases have concluded that a holder of standard-essential patents ("SEPs") subject to a commitment to license on fair, reasonable, and nondiscriminatory ("FRAND") terms may violate section 2 of the Sherman Act by breaching that FRAND commitment. However, a small but vocal minority has increasingly questioned that view, relying on *Rambus*, where the D.C. Circuit overturned an FTC order finding that *Rambus* engaged in unlawful monopolization due to its failure to disclose its patents to a standard-setting organization. For this point, *Rambus* relied almost entirely on the Supreme Court's 1998 *NYNEX* decision, which involved a legal monopoly, not standard-setting activities. This article will (1) explain why *Rambus* was incorrectly decided, including its misinterpretation of *NYNEX*, and (2) describe the circumstances under which a unilateral breach of FRAND is a cognizable Section 2 violation.

I. INTRODUCTION

Commitments by holders of standards-essential patents ("SEPs") to license their patented technology on fair, reasonable, and nondiscriminatory ("FRAND") terms serve as "important safeguards against monopoly power."[2] So when companies that make FRAND commitments do not follow through on them, they bypass these important safeguards. Thus, it is elementary that a SEP-holder's violation of a prior FRAND commitment can be exclusionary conduct that distorts competition. Accordingly, various well-reasoned cases have concluded that a SEP-holder's breach of its FRAND commitment may constitute a violation of Section 2.[3]

Nonetheless, in recent years, a small but vocal minority has increasingly questioned the appropriateness of applying Section 2 to violations of the FRAND obligation. The strongest voice in this contingent came from the prior administration's Justice Department, which went on an aggressive campaign to promote this misguided view.[4] That administration's DOJ and other proponents of this position often rely on the D.C. Circuit's 2008 decision in *Rambus v. Federal Trade Commission*. In that case, the court overturned an FTC order finding that Rambus engaged in unlawful monopolization due to its failure to disclose its patents to a standard-setting organization ("SSO"). *Rambus* held that a "lawful monopolist's use of deception simply to obtain higher prices normally has no particular tendency to exclude rivals and thus to diminish competition."[5] For this point, *Rambus* repeatedly misapplied the Supreme Court's 1998 *NYNEX Corp. v. Discon, Inc.*[6] decision.

Contrary to this characterization in the *Rambus* decision, *NYNEX* does not support the conclusion that a SEP-holder's breach of its FRAND commitments is outside the scope of Section 2. This is because *NYNEX* is inapplicable to voluntary standard-setting activities where market power arises not from a natural, legal monopoly — as was the situation in *NYNEX* — but rather from the act of standardization. This article will (1) explain why *Rambus* was incorrectly decided, including its misinterpretation of *NYNEX*, and (2) describe the circumstances under which a unilateral breach of FRAND is a cognizable Section 2 violation under traditional application of antitrust law.

II. *RAMBUS'S* CONCLUSION STEMMED FROM FLAWED LEGAL REASONING

The FTC in *Rambus* alleged that Rambus engaged in patent ambush before the Joint Electron Device Engineering Council ("JEDEC") by failing to disclose relevant patents during the standardization process. After an administrative law judge dismissed the FTC's complaint, the Commission ruled that Rambus had violated Section 2 through this deceptive behavior. The FTC relied on two alternative theories of competitive harm, without determining which one was more likely: (1) that disclosure would either have given JEDEC a chance to exclude Rambus' patents from the standard entirely, or (2) disclosure would have allowed JEDEC to ensure that Rambus commit to FRAND licensing.[7]

The D.C. Circuit set aside the FTC's decision because the FTC's "either/or" counterfactual failed to demonstrate that Rambus harmed competition by foreclosing alternative technologies.[8] The court held that "JEDEC lost only an opportunity to secure a [F]RAND commitment from Rambus," which "is not a harm to competition from alternative technologies."[9] This conclusion was premised on the principle that "an otherwise lawful monopolist's end-run around price constraints, even when deceptive or fraudulent, does not alone present a harm to competition in the

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2 *Broadcom Corp. v. Qualcomm, Inc.*, 501 F.3d 297, 314 (3d Cir. 2007); see also *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872, 876 (9th Cir. 2012) ("[O]nce a standard has gained such widespread acceptance that compliance is effectively required to compete in a particular market, anyone holding a standard-essential patent could extract unreasonably high royalties from suppliers of standard-compliant products and services.").

3 *Broadcom*, 501 F.3d at 318-19; *Lenovo v. InterDigital Tech. Co.*, 2021 WL 1123101, at *8 (D. Del. Mar. 24, 2021); *Wi-LAN Inc. v. LG Elecs.*, Inc., 382 F. Supp. 3d 1012, 1022-1023 (S.D. Cal. 2019); *u-blox AG v. InterDigital, Inc.*, 2019 WL 1574322, at *4 (S.D. Cal. Apr. 11, 2019); *Funai Elec. Co. v. LSI Corp.*, 2017 WL 1133513, at *5 (N.D. Cal. Mar. 27, 2017); *Microsoft Mobile Inc. v. Interdigital, Inc.*, 2016 WL 1464545, at *2 (D. Del. Apr. 13, 2016); *Actividentity Corp. v. Intercede Grp. PLC*, 2009 WL 8674284, at *3 (N.D. Cal. Sep. 11, 2009); *Research In Motion, Ltd. v. Motorola, Inc.*, 644 F. Supp. 2d 788, 796 (N.D. Tex. 2008).

4 See, e.g. John "Jay" Jurata, Jr. & Emily Luken, *Out of Sync?: DOJ's Policy Reversal Towards SEPs Lacks Legal Support*, Global Competition Review (June 6, 2018), available at https://s3.amazonaws.com/cdn.orrick.com/files/GCROrrickArticle.pdf.

5 522 F.3d 456, 464 (D.C. Cir. 2008).

6 525 U.S. 128 (1998).

7 552 F.3d at 643.

8 On the first alternative, the D.C. Circuit assumed that this "was indeed anticompetitive," but noted that the Commission made clear in its remedial opinion that there was insufficient evidence that JEDEC would have standardized other technologies had it known the full scope of Rambus's intellectual property." *Id.* at 463-64.

9 *Id.* at 466.

monopolized market,"[10] which the court derived from *NYNEX*.

NYNEX, however, has no bearing on the question presented in *Rambus. NYNEX* involved a provider of local telephone services, which had a lawful monopoly subject to government pricing oversight. Plaintiff Discon alleged that the provider switched its purchase of removal services of obsolete equipment from Discon to one of its higher priced competitors (AT&T) "as part of an attempt to defraud local telephone service customers by hoodwinking regulators."[11] Under the alleged scheme, the local telephone provider paid AT&T more than Discon would have charged for similar removal services so "it could pass the higher prices on to New York Telephone [the provider], which in turn could pass those prices on to telephone consumers in the form of higher regulatory-agency-approved telephone service charges."[12] The local provider would then receive a "special rebate" from AT&T at the end of the year, but consumers were still charged the higher rate.[13] Discon alleged that it was driven out of business because it refused to participate in this fraudulent scheme.

The Supreme Court ruled that these allegations did not support a claim for conspiracy to monopolize the market for removal services[14] because even though both Discon and consumers were harmed, there were insufficient allegations of harm to competition itself. The Court observed that "consumer injury naturally flowed not so much from a less competitive market for removal services, as from the exercise of market power that is *lawfully* in the hands of a monopolist, namely, New York Telephone, combined with a deception worked upon the regulatory agency that prevented the agency from controlling New York Telephone's exercise of its monopoly power."[15] In other words, *NYNEX* hinged on the fact that the defendant *already* possessed a legal monopoly *prior* to engaging in the deceptive behavior.[16]

Rambus and *NYNEX* therefore encompass two fundamentally different scenarios: Rambus's market power arose from the act of standardization, whereas New York Telephone's market power was preexisting. New York Telephone did not obtain its monopoly through deception in *NYNEX*, but Rambus was alleged to have done so. This distinction is significant for at least two reasons.

First, the FRAND commitment is designed to cap the market power that SEP-holders enjoy *after* standardization. A patent alone does not confer market power for purposes of antitrust law.[17] But because a "standard, by definition, eliminates alternative technologies,"[18] SEP-holder's market power many times stems from the fact of standardization. After standardization and subsequent widespread adoption, SEP-holders can wield this power to extract excessive royalties from potential licensees that inappropriately reflect the value of standardization, as opposed to the underlying technology, a tactic known as "hold up."[19]

It is precisely for this reason that SSOs require FRAND commitments as a condition of accepting offers from patent holders to include their technology in standards.[20] Even *Rambus* recognized that standardization alters the competitive landscape: "Before an SSO adopts a standard, there is often vigorous competition among different technologies for incorporation into that standard. After standardization, however, the dynamic typically shifts, as industry members begin adhering to the standard and the standardized features start to dominate."[21] The FRAND commitment is one way to preserve the benefits of this ex ante competition between technologies, one of the hallmarks of collaborative standard setting.

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10 *Id.*

11 525 U.S. at 132.

12 *Id.*

13 *Id.*

14 The Court also held that the allegations did not state a *per se* claim under Section 1 of the Sherman Act. *Id.* at 137.

15 *Id.* at 136 (emphasis in original).

16 See, e.g. George S. Cary, Paul S. Hayes, & Larry C. Work-Dembowski, *Antitrust Implications of Abuse of Standard-Setting*, 15 Geo. Mason L. Rev. 1241, 1252-53 (2009).

17 *Il. Tool Works Inc. v. Indep. Ink.*, 547 U.S. 28, 38 (2006).

18 *Broadcom*, 501 F.3d at 313; see also *Ericsson, Inc. v. D-Link Systems, Inc.*, 773 F.3d 1201, 1233 (D.C. Cir. 2014) ("When a technology is incorporated into a standard, it is typically chosen from among different options. Once incorporated and widely adopted, that technology is not always used because it is the best or the only option; it is *used because its use is necessary to comply with the standard.*") (emphasis added).

19 See, e.g. *Microsoft Corp. v. Motorola, Inc.*, 795 F.3d 1024, 1031 (9th Cir. 2015).

20 *Id.*

21 *Rambus*, 552 F.3d at 459.

But the court in *Rambus* failed to apply this lesson to its logical conclusion and, thus, did not recognize the market-shifting consequences of standardization. *Rambus's* analogy to *NYNEX*, where the telephone company had a preexisting legal monopoly, is inapposite because the patent holder in *Rambus* did not possess market power before the JEDEC standard was set.

Second, through the FRAND commitment, the SEP-holder voluntarily agrees *not* to seek monopoly pricing in exchange for inclusion of its patents in the standard. In the absence of a FRAND commitment, a patent holder has the right to charge whatever the market will bear — including monopoly pricing — because a patent confers the right to exclude.[22] But a FRAND commitment voluntarily relinquishes the rights to exclude and seek monopoly-level royalties in exchange for the benefit of inclusion in the standard. "Because of [the] [F]RAND commitment," a SEP-holder "cannot have . . . [a] policy for maintaining a patent monopoly."[23] This is why courts determining patent damages for FRAND-encumbered SEPs do not consider certain of the traditional *Georgia-Pacific* factors applicable to patent damages, including the patent-holder's established policy to "maintain [a] patent monopoly."[24] Properly framing the FRAND commitment in this context, *Rambus's* conclusion that JEDEC's "lost opportunity" to obtain a FRAND commitment is not a harm to competition is wrong.[25] Had Rambus made a FRAND commitment to JEDEC, Rambus would not have been free to seek monopoly pricing.

Rambus relied almost exclusively on *NYNEX* in its analysis concerning the lack of harm to competition.[26] The opinion acknowledged the Third Circuit's decision in *Broadcom v. Qualcomm* — which expressly held that an intentionally false FRAND commitment can constitute a Section 2 violation[27] — but summarily dismissed *Broadcom* as "conflict[ing] with *NYNEX*."[28] But again, *NYNEX* is irrelevant in the standard-setting context, which is likely why the *Broadcom* court did not discuss *NYNEX*. Absent *NYNEX*, as incorrectly interpreted through *Rambus*, there is no basis for holding that reneging on a FRAND commitment is outside the scope of Section 2.

As mentioned above, numerous decisions have recognized that the type of conduct at issue in *Rambus* (or similar allegations of deception in connection with the standard-setting process) comes within the purview of Section 2.[29] Of these cases, only one discussed *NYNEX* and appropriately observed that, contrary to the *Rambus* court's view, *Broadcom* does not conflict with *NYNEX*.[30]

22 See, e.g. *Brulotte v. Thys Co.*, 379 U.S. 29, 30 (1964).

23 *Ericsson*, 773 F.3d at 1230.

24 *Id.*

25 *Rambus*, 552 F.3d at 466.

26 The opinion also cited a leading treatise for the proposition that "an antitrust plaintiff must establish that the [SSO] would not have adopted the standard in question but for the misrepresentation or omission." See *Rambus*, 552 F.3d at 466 (quoting 2 Hovenkamp et al., IP and Antitrust: An Analysis of Antitrust Principles Applied to Intellectual Property Law § 35.5). But whether the SSO would have adopted the technology but for the deception is a separate issue from the question of whether the loss of a FRAND commitment harms competition.

27 501 F.3d at 314.

28 *Rambus*, 552 F.3d at 466.

29 See *supra* note 3.

30 *Microsoft*, 2016 WL 1464545, at *2 n.1 ("I do not read *Broadcom* to be inconsistent with *NYNEX*.").

III. UNILATERAL BREACH OF FRAND IS A COGNIZABLE SECTION 2 CLAIM UNDER CERTAIN CIRCUMSTANCES

Without the strictures of *Rambus's* flawed analogy to *NYNEX*, it is appropriate to treat a SEP-holder's unilateral breach of the FRAND commitment as a Section 2 violation under at least two circumstances: when unilateral exclusionary conduct (1) forecloses alternative technologies, and/or (2) decreases output of the technology or the downstream products incorporating that technology.[31]

Because the standardization process "creates an opportunity for companies to engage in anti-competitive behavior,"[32] FRAND commitments are designed, in part, to address potential collusion concerns. SSO members collectively make the decision what technologies to, and not to, include in a formal industry standard. Once finalized, that ends competition for other technologies within that standard.[33] Antitrust law generally permits this artificial decrease in competition because of the resulting efficiencies that arise from standard setting — including moving the opportunity for competition between technologies from ex post competition between standards in the market place to ex ante competition during the standard-setting process — as well as the fact that SSOs generally require those designing the standard to pledge to make their underlying technology incorporated into the standard available for licensing on FRAND terms as a condition of inclusion.[34]

But when SSO members fail to follow through on that pledge while still reaping the benefits of standardization — such as a much larger market for patent licenses — it brings into question (1) whether the underlying technology would have been included in the standard in the first place, or (2) if there is decreased output in downstream markets due to a FRAND breach. The first and simpler example is where the exclusionary conduct, the failure to disclose patents or the false promise to license on FRAND terms, forecloses the adoption of an alternative technology. This is the type of behavior that *Broadcom* and other decisions have recognized as actionable Section 2 violations.[35] In *Broadcom*, the failure to disclose was intentional, but such intentionality is not necessary for a Section 2 violation if the market impact is otherwise the same.

Increased prices also can harm competition when those increased prices reduce output of either the technology itself or downstream products. Such situations primarily arise when the increased prices result from the exercise of market power conveyed by the SSO process (as opposed to the pre-existing market power of the patent prior to standardization) and are passed on to consumers of those downstream products.[36] Outside of the standardization context, there is a long history in antitrust law of analyzing whether excess costs are passed through, thus decreasing downstream output.[37] Decreased output of downstream products can also occur in situations where higher prices are not passed on to consumers, but result in the decreased quality of those products.

Real world evidence shows that this harm occurred with the 4G/Long Term Evolution ("LTE") wireless standard. In 2008, there was substantial concern that the aggregate royalty stack for the standard was threatening its development and adoption given the potential competitive alternative of WIMAX to 4G/LTE.[38] This concern prompted numerous participants in the SSO process, including prominent SEP-holders such as Ericsson, Nokia, and Qualcomm, to publicly declare the maximum royalty stack for handsets would be in the single digit range.[39] Following those assurances, the 4G/LTE standard was adopted and became highly successful. That success, in turn, conferred additional market power on most, if not all patents reading on 4G/LTE. But subsequent decisions by 4G/LTE SEP-holders to breach FRAND commitments and seek aggregate royalties in excess of single digits of a handset price threatens to decrease consumer demand for downstream handsets.

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31 Assuming that the other requisite elements for a Section 2 violation as satisfied (as described later in this section).

32 *Microsoft*, 795 F.3d at 1030-31.

33 See, e.g. *Ericsson,* 773 F.3d at 1233.

34 See, e.g. Christopher R. Leslie, *The DOJ's Defense of Deception; Antitrust Law's Role in Protecting the Standard-Setting Process*, 98 Or. L. Rev. 379, 392-95 (2020).

35 See, e.g. *Broadcom*, 501 F.3d at 314.

36 See, e.g. *Microsoft Corp. v. Motorola, Inc.*, 2013 WL 2111217, at *11 (W.D. Wash. Apr. 25, 2013) ("In addition to harming firms that are forced to pay higher royalties, hold-up also harms consumers to the extent that those excess costs are passed onto them.").

37 For example, in states that permit indirect purchaser actions (which are not permitted under federal antitrust law due to the Supreme Court's *Illinois Brick Co. v. Illinois* (431 U.S. 720 (1977)) decision), there is a defense that the alleged overcharge was not passed through to consumers, generating substantial expert testimony on this question.

38 See, e.g. Eric Stasik, *Royalty Rates and Licensing Strategies for Essential Patents on LTE (4G) Telecommunications Standards*, Les Nouvelles (September 2010).

39 See *id.* at 115-16.

In other words, as the price to license the SEP inputs increases, the output of downstream handsets will decrease, due to price-demand elasticity.[40] Because the increased prices are not the result of pre-SSO market power created by these patents, but rather resulted from the additional market power conferred on them via the fact of standardization, the decreased output of downstream products harms competition and the competitive process.

It is also worth emphasizing that continuing to apply Section 2 to certain unilateral FRAND breaches does not risk turning every breach of FRAND into a potential action for treble damages and attorneys' fees. Three additional conditions are necessary for Section 2 to apply:

- As with any Section 2 claim, the defendant, the SEP-holder, must have market power. There are at least two instances when this would not be true: (a) when there are competing standards to accomplish the same task — in which case an assessment of whether the alternative standard is an effective competition option is necessary; and (b) when the SEP reads upon an optional portion of the standard — in which case it is necessary to determine consumer demand for that option.

- The SEP-holder must be abusing additional market power conferred as the result of standardization, as opposed to pre-standardization market power arising from the underlying patented technology. If a patent was included in the standard because it was extremely valuable to begin with, that could be a situation where no additional market power is conferred as the result of standardization. In such circumstances, the underlying patented technology is included because it is, in fact, technologically superior to alternatives — and the additional market power conferred upon those patents via the fact of standardization may be marginal.

- There needs to a clear link between the exclusionary conduct and harm to competition in the form of foreclosed technologies or decreased output. Competition can be harmed (a) if commercially viable alternative technologies are excluded during standardization; (b) if the increased price for SEP licenses, made possible by the increased market power provided by inclusion in the standard, decreases demand for downstream products; and (c) if the increased royalties are not passed onto consumers, but nonetheless reduce the incentive of product manufacturers to innovate, thus decrease product quality.

When these circumstances are met, there is a role for antitrust to play. The fact that breach of FRAND may also be addressed by contract law does not mean that contract law is the exclusive remedy, similar to how antitrust law also applies when other legal theories are relevant. For example, if a monopolist repeals a customer contract for its monopoly product as retaliation for the customer also dealing with a potential competitor, the mere fact that the customer could pursue a contractual cause of action would not preclude a monopolization claim. Similarly, if a company burns down a rival's factory to monopolize a market, it would be absurd to suggest that antitrust should not apply just because the rival also possesses an action under tort.[41]

IV. CONCLUSION

It is only elementary that Section 2 be available to address a SEP-holder's breach of its FRAND obligation under certain circumstances, as many courts have concluded. The leading case cautioning against application of Section 2 to FRAND violations, *Rambus*, was incorrectly decided because the case failed to understand the interplay between standardization, the FRAND commitment, and the source of the SEP-holder's market power. A SEP-holder's unilateral beach of FRAND violates Section 2 when that conduct forecloses alternative technologies from being standardized and/or results in decreased output in downstream markets.

40 See, e.g. John "Jay" Jurata, Jr. & Emily Luken, Glory Days: *Do the Anticompetitive Risks of Standards-Essential Patent Pools Outweigh Their Procompetitive Benefits?*, 58 San Diego L. Rev. 417, 425 (2021).

41 To the extent that some may believe Section 2 liability might open the floodgates to class action litigation, addressing SEP abuse under Section 5 of the FTC Act would alleviate that concern.