

## Notes

# Why the Enforcement Agencies' Recent Efforts Will Not Encourage Ex Ante Licensing Negotiations in Standard-Setting Organizations\*

### I. Introduction

Fairtrade-certified coffee,<sup>1</sup> an elevator's alarm button,<sup>2</sup> a teddy bear's button nose,<sup>3</sup> the supersonic Concorde<sup>4</sup>—all of these products incorporate standards: “set[s] of characteristics or quantities that describe[] features of a product, process, service, interface, or material.”<sup>5</sup> Standards are “absolutely everywhere” and have been for some time.<sup>6</sup> For example, Intertek, a company that ensures products meet relevant standards,<sup>7</sup> is almost 100 years old, as it was once part of Thomas Edison's laboratory.<sup>8</sup> While standards arise through different mechanisms, private industry groups known as standard-setting organizations (SSOs) frequently develop those most important to intellectual property (IP)-intensive, high-technology industries.<sup>9</sup> Oftentimes, these standards incorporate technology covered by a patent; when this occurs, corporations that manufacture products that include the standard—

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1. See FAIRTRADE LABELLING ORGS. INT'L, FAIRTRADE STANDARDS FOR COFFEE FOR SMALL PRODUCERS' ORGANIZATIONS 4–5 (2009), available at [http://www.fairtrade.net/fileadmin/user\\_upload/content/02-09\\_Coffee\\_SPO\\_EN.pdf](http://www.fairtrade.net/fileadmin/user_upload/content/02-09_Coffee_SPO_EN.pdf) (defining standards that cover the purchase and sale of Arabica and Robusta green coffee).

2. See *In Business: Who Sets Our Standards?*, BBC RADIO 4, at 2:21–2:50 (Apr. 4, 2010), available at <http://www.bbc.co.uk/programmes/b00rp1wj> (discussing with Professor of Industrial Economics Peter Swann the standards incorporated into an elevator, including those surrounding public information signs, e.g., the buttons used to sound the alarm).

3. See *id.* at 7:00–7:51 (interviewing Philip Bullock, Technical Manager, Intertek, as he tests whether a teddy bear's nose meets a standard requiring it to withstand ninety newtons of force for ten seconds—and hopefully withstand a child's prying fingers).

4. See *id.* at 17:38–18:02 (eliciting from Howard Mason, Information Standards Manager, BAE Systems, why his company became involved in standards during the development of the Concorde).

5. NAT'L RESEARCH COUNCIL, STANDARDS, CONFORMITY ASSESSMENT, AND TRADE: INTO THE 21ST CENTURY 9 (1995).

6. *In Business: Who Sets Our Standards?*, *supra* note 2, at 2:00–2:08.

7. *About Us*, INTERTEK, <http://www.intertek.com/about/>.

8. *In Business: Who Sets Our Standards?*, *supra* note 2, at 7:52–8:08.

9. See Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEXAS L. REV. 783, 837 (2007) (asserting that SSOs are typical of firms interested in implementing heavily patented technologies).

such as Apple, Dell, Hewlett Packard, and Sony, who manufacture computers that virtually all incorporate Intel's x86 microprocessor architecture<sup>10</sup>—must license the patented technology from the patent holder.

Typically, the patent holder and many potential licensees are SSO members, and ostensibly they could determine licensing terms when considering whether to incorporate the patented technology into the standard. Historically, however, the agencies tasked with enforcing U.S. antitrust laws—the Department of Justice (DOJ) and the Federal Trade Commission (FTC)—have discouraged SSOs from engaging in such ex ante licensing negotiations; because SSO members frequently are competitors, these negotiations could facilitate collusion in violation of the Sherman Act's Section 1.

Recently, however, the enforcement agencies have indicated that ex ante licensing negotiations have procompetitive benefits that may outweigh any anticompetitive effects. As such, the enforcement agencies have begun to encourage SSOs to engage in such negotiations through a series of speeches and documents. In this Note, I abstain from commenting on whether it is wise for the enforcement agencies to promote such conduct. I do, however, argue that given this policy, SSOs will continue to *not* engage in ex ante licensing negotiations without further agency action. The statements made by the DOJ and the FTC to date do not provide SSOs with sufficiently clear guidance. As such, SSOs continue to fear antitrust liability, and without more, the agencies' recently announced policy will not be implemented. This is problematic both because it undermines the agencies' credibility and because it will remain unclear whether ex ante licensing negotiations are in fact desirable.

Before moving forward, it is important to clarify that although the government and the marketplace also develop standards, this Note will focus only upon SSOs—because they are the focus of the enforcement agencies' recently announced policy. Hundreds of SSOs, which vary in formality as well as size and scope, exist worldwide.<sup>11</sup> On one end of the spectrum are formal SSOs, such as the American National Standards Institute, an umbrella organization for more than 200 standard-developing organizations<sup>12</sup> that requires due process and open participation.<sup>13</sup> On the other end are informal consortia, such as the World Wide Web consortium,<sup>14</sup> which generally have

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10. See Benj Edwards, *Birth of a Standard: The Intel 8086 Microprocessor*, PCWORLD (June 17, 2008), [http://www.pcworld.com/article/146957/birth\\_of\\_a\\_standard\\_the\\_intel\\_8086\\_microprocessor.html](http://www.pcworld.com/article/146957/birth_of_a_standard_the_intel_8086_microprocessor.html) (explaining that the “DNA” of Intel’s 8086 microprocessor “is likely at the center of whatever computer—Windows, Mac, or Linux—you’re using to read this”).

11. MICHAEL A. CARRIER, *INNOVATION FOR THE 21ST CENTURY: HARNESSING THE POWER OF INTELLECTUAL PROPERTY AND ANTITRUST LAW* 326 (2009).

12. *Standards Activities Overview*, AM. NAT’L STANDARDS INST., [http://ansi.org/standards\\_activities/overview/overview.aspx?menuid=3](http://ansi.org/standards_activities/overview/overview.aspx?menuid=3).

13. CARRIER, *supra* note 11, at 326.

14. *Id.*

fewer procedural protections and limited membership but greater control and faster implementation.<sup>15</sup>

The standards developed by SSOs are frequently those most important to IP-intensive, high-technology industries and are known as interoperability or compatibility standards.<sup>16</sup> These standards “specify properties that a product must have in order to work . . . with complementary products within a product . . . system.”<sup>17</sup> Because of them, consumers can purchase a printer made by one manufacturer and a personal computer made by another, knowing they will be able to communicate.<sup>18</sup> Oftentimes, interoperability standards also foster network externalities,<sup>19</sup> which occur when a product becomes more valuable to a user as more users adopt the same or compatible products.<sup>20</sup> The benefits to consumers from network externalities occur both directly and indirectly. A direct benefit results when more users adopt the same product: for example, a telephone user directly benefits when others join the same telephone network.<sup>21</sup> An indirect benefit occurs when the adoption by many users of Product A leads suppliers to produce complementary Products B, C, and D.<sup>22</sup> For example, as more users adopt a computer operating system, more applications will be written on it; similarly, as more people purchase a certain car brand, more dealerships will service it.<sup>23</sup>

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15. ABA SECTION OF ANTITRUST LAW, HANDBOOK ON THE ANTITRUST ASPECTS OF STANDARDS SETTING 5 (2004) [hereinafter HANDBOOK].

16. *Id.* at 10; see also James J. Anton & Dennis A. Yao, *Standard-Setting Consortia, Antitrust, and High-Technology Industries*, 64 ANTITRUST L.J. 247, 247 (1995) (stating that interface standards “are of primary interest in telecommunications and information technology industries”). For examples, see David A. DeMarco, Note, *Understanding Consumer Information Privacy in the Realm of Internet Commerce: Personhood and Pragmatism, Pop-Tarts and Six-Packs*, 84 TEXAS L. REV. 1013, 1047 n.178 (2006) (describing the World Wide Web consortium as a promoter of web interoperability), and Kevin Werbach, *Supercommons: Toward a Unified Theory of Wireless Communication*, 82 TEXAS L. REV. 863, 944–45 (2004) (explaining that the WiFi Alliance tests WiFi devices if the devices are to use the WiFi trademark).

17. Gregory Tasse, *Standardization in Technology-Based Markets*, 29 RES. POL’Y 587, 590 (2000). Complementary goods are “two products, for which an increase (or fall) in DEMAND for one leads to an increase (fall) in demand for the other.” *Economics A–Z*, ECONOMIST, <http://www.economist.com/research/economics/alphabetic.cfm?term=complementarygoods#complementarygoods>.

18. See HANDBOOK, *supra* note 15, at 10 (“[I]nteroperability standards also allow communication between devices. Facsimile machines are able to transmit faxes because of an interoperability standard.”).

19. See Patrick D. Curran, Comment, *Standard-Setting Organizations: Patents, Price Fixing, and Per Se Legality*, 70 U. CHI. L. REV. 983, 986–87 (2003) (describing the way in which interoperability creates demand-side economies of scale).

20. JEAN TIROLE, *THE THEORY OF INDUSTRIAL ORGANIZATION* 405 (1988).

21. *Id.*

22. *Id.*

23. *Id.*; see also Robert P. Merges, *Software and Patent Scope: A Report from the Middle Innings*, 85 TEXAS L. REV. 1627, 1661–62 (2007) (describing Adobe’s marketing technique of providing free software in order to make PDF compatible software more valuable).

In Part II, I indicate that in an effort to mitigate holdup, many SSOs require members to license any patented technology incorporated into a standard on certain terms. However, because SSOs fear antitrust liability, the terms are not determined through ex ante licensing negotiations and are vague, arguably undercutting their usefulness. In Part III, I argue that the approach of the enforcement agencies matters. I also offer a refresher on the Sherman Act before taking a more in-depth look at naked restraints of trade and the exercise of group buying power, two violations potentially posed by ex ante licensing negotiations. In Part IV, I analyze the statements recently made by the DOJ and the FTC. I argue that while the agencies needed to provide clear legal guidance to SSOs to catalyze their engagement in such negotiations, they failed to do so for several reasons. Although I concede that the agencies' lack of experience with ex ante licensing negotiations may have been a factor, I encourage the agencies to provide additional guidance. And, assuming that the agencies' approach changes over time as their experience increases and as economic thinking evolves, I offer two suggestions to reduce the likelihood that SSOs that engage in ex ante licensing negotiations today will be ensnared in liability tomorrow. Finally, in Part V, I provide concluding remarks.

## II. Antitrust Liability Concerns Constrain SSOs' Use of Licensing Policies to Deter Holdup

When SSOs adopt a standard that incorporates patented technology, they confer substantial market power upon the patent holder.<sup>24</sup> Oftentimes, the patent holder uses this market power to engage in “holdup”—a phenomenon discussed in more detail below—of SSO members who wish to license the technology and use the standard. In an attempt to deter holdup, many SSOs implement licensing policies that require patent-holding members to license on a “reasonable and nondiscriminatory” (RAND) basis.<sup>25</sup> However, because SSOs fear antitrust liability arising under Section 1 of the Sherman Act—which prohibits collective conduct that unreasonably restrains competition—the terms of the licensing policies generally are vague and, arguably, less effective at mitigating holdup.

In subpart A, I describe how the adoption of standards can facilitate holdup. In subpart B, I explain that while most SSOs do implement licensing policies in an attempt to mitigate holdup, the terms of such policies are consciously vague because SSOs fear that more precise language would result in antitrust liability arising under Section 1 of the Sherman Act.

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24. See Stacey L. Dogan & Mark A. Lemley, *Antitrust Law and Regulatory Gaming*, 87 TEXAS L. REV. 685, 719 (2009) (explaining that when companies make misrepresentations to SSOs in attempting to adopt a standard, such misrepresentations can facilitate monopolization of an industry if the standard is patented).

25. Daniel A. Crane, *Intellectual Liability*, 88 TEXAS L. REV. 253, 268 (2009).

### A. *Standards Adoption Facilitates Holdup*

When SSO members select a proprietary technology to incorporate into a standard, they confer substantial market power, “the ability profitably to maintain prices above, or output below, competitive levels for a significant period of time,”<sup>26</sup> upon the technology’s owner—which he or she can use to hold up potential licenses.<sup>27</sup> In the SSO context, holdup occurs because (1) potential patent licensees incur sunk costs, and (2) the adoption of one proprietary technology over another reduces the number of competing technologies. First, potential patent licensees incur sunk costs—costs that have been sustained and cannot be recovered<sup>28</sup>—when they make expenditures that are specific to the adopted IP and that cannot be redeployed to alternative IP.<sup>29</sup> Second, before a proprietary technology is selected, there may be other technologies vying for inclusion; however, after the SSO selects one technology, alternative technologies likely will be nonexistent in the market, even if viable in principle, precisely because the SSO did not choose them.<sup>30</sup> The lack of alternatives, coupled with sunk costs incurred by potential patent licensees, places the owner of the selected technology “in a very strong bargaining position to extract royalties . . . from people who want to comply with the standard.”<sup>31</sup>

### B. *While Most SSOs Implement Licensing Policies, the Terms Are Vague—SSOs Fear Antitrust Liability*

To reduce the possibility of holdup, most SSOs impose upon their members licensing policies,<sup>32</sup> which require patent-holding members to

26. U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY 4 (1995) [hereinafter IP GUIDELINES], available at <http://www.justice.gov/atr/public/guidelines/0558.pdf>.

27. See Curran, *supra* note 19, at 991 (“When an SSO adopts a proprietary technology as an industry standard, the owner of that technology obtains considerable market power, . . . [the] grant of [which] can (and often does) result in monopoly pricing for patent licenses . . .”).

28. *Economics A–Z*, ECONOMIST, <http://www.economist.com/research/economics/alphabetic.cfm?letter=s#sunkcosts>.

29. U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 35 n.11 (2007) [hereinafter IP2 REPORT], available at <http://www.usdoj.gov/atr/public/hearings/ip/222655.pdf>.

30. *Id.* at 35–36; see also Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEXAS L. REV. 1991, 2016 (2007) (describing the difficulties in designing around standards set by SSOs).

31. Federal Trade Commission and Department of Justice Antitrust Division Roundtables: Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy 15 (Nov. 6, 2002) (remarks of Carl Shapiro, Transamerica Professor of Bus. Strategy, Haas Sch. of Bus., Univ. of Cal., Berkeley) [hereinafter Roundtable Discussion], available at <http://www.ftc.gov/opp/intellect/021106ftctrans.pdf>.

32. See *id.* (explaining that companies with essential patents are in a “very strong bargaining position” for obtaining licenses).

license implicated IP on certain terms.<sup>33</sup> The majority of these policies require members to license their patents on a RAND basis.<sup>34</sup> Generally, however, the terms *reasonable* and *nondiscriminatory* are not defined and are instead left vague, arguably because SSOs themselves<sup>35</sup> and their members fear that more precise terms would result in antitrust liability under Section 1 of the Sherman Act.<sup>36</sup> To date, courts also have failed to define RAND.<sup>37</sup> As a result, a license's specific terms are determined in bilateral negotiations that take place outside the SSO.<sup>38</sup>

Specifically, members must negotiate individually with the patent holder, either before or after the adoption of the standard.<sup>39</sup> According to Damien Geradin and Miguel Rato, bilateral ex ante licensing negotiations conducted outside of the SSO occur frequently.<sup>40</sup> Given that the terms reached during such negotiations are rarely disclosed, however, members who have not yet engaged with the patent holder are no more informed as to what RAND means practically than are others.<sup>41</sup> Because of this uncertainty and because most SSOs do not provide procedures for resolving disputes,<sup>42</sup> patent owners and SSO members who cannot come to a bilateral agreement have been forced to either litigate the definition of RAND<sup>43</sup> or mount costly challenges, such as “developing evidence of prior art that would invalidate the patent claims.”<sup>44</sup>

33. See *id.* at 42 (remarks of Carolyn Galbreath, U.S. Dep't of Justice, Antitrust Div.) (acknowledging the potential for licensing holdups).

34. See *supra* note 27 and accompanying text.

35. See John J. Kelly & Daniel I. Prywes, *A Safety Zone for the Ex Ante Communication of Licensing Terms at Standard-Setting Organizations*, ANTITRUST SOURCE, Mar. 2006, at 5 (“[T]he Supreme Court has held that SSOs themselves are subject to liability for anticompetitive activity conducted under their auspices.”).

36. See Michael G. Cowie & Joseph P. Lavelle, *Patents Covering Industry Standards: The Risks to Enforceability Due to Conduct Before Standard-Setting Organizations*, 30 AIPLA Q.J. 95, 102 (2002) (“SSOs have been reluctant to specify or become involved in setting royalty rates for patented technology for fear that they will be accused of price fixing or another violation of the antitrust laws.”).

37. See Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 CALIF. L. REV. 1889, 1954 n.272 (2002) (asserting that “there has not been much in the way of judicial explanation” of RAND).

38. See Damien Geradin & Miguel Rato, *Can Standard-Setting Lead to Exploitative Abuse? A Dissonant View on Patent Hold-Up, Royalty Stacking and the Meaning of FRAND* 27 (April 2006) (unpublished manuscript), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=946792](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=946792) (stating that parties can license outside of the SSO if they so choose).

39. Curran, *supra* note 19, at 992.

40. Geradin & Rato, *supra* note 38 (manuscript at 27).

41. See Lemley, *supra* note 37, at 1965 (claiming that “reasonable and nondiscriminatory” may be “too amorphous” for some).

42. *Id.* at 1906.

43. See Curran, *supra* note 19, at 983 (explaining that the ambiguity of RAND has led to high-risk litigation for those seeking licenses).

44. Letter from Thomas O. Barnett, Assistant Att’y Gen., U.S. Dep’t of Justice, to Robert A. Skitol, Esq., Drinker, Biddle & Reath LLP 3 (Oct. 30, 2006) [hereinafter VITA Business Review Letter], available at <http://www.usdoj.gov/atr/public/busreview/219380.pdf>.

### III. The Enforcement Agencies' Traditional Approach Toward Section 1 Violations, Including Those Presented by Ex Ante Licensing Negotiations

For fear of violating Section 1 of the Sherman Act, some SSOs do not engage in ex ante licensing negotiations. While Section 1 may be enforced by state attorneys general<sup>45</sup> and private parties, it is also enforced by the DOJ and the FTC.<sup>46</sup> In subpart A, I explain why the DOJ and the FTC approach in particular is relevant. In subpart B, I describe the two Section 1 violations that the agencies believe ex ante licensing negotiations might present: naked restraints of trade and the exercise of group buying power. Lastly, in subpart C, I explain how the enforcement agencies have traditionally addressed Section 1 violations in the context of licensing agreements.

#### A. *The Enforcement Agencies' Approach Toward Section 1 Violations Is Relevant*

SSOs fear that ex ante licensing negotiations will be prosecuted under Section 1 of the Sherman Act,<sup>47</sup> which provides that “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”<sup>48</sup> While most antitrust actions are *not* brought by the DOJ and the FTC, and while “the ultimate responsibility for interpretation of the Sherman Act lies not with the DOJ or the FTC but with the federal courts,”<sup>49</sup> the enforcement approach of the DOJ and the FTC is relevant.

The agencies' enforcement approach, particularly with respect to ex ante licensing negotiations, is relevant because little on-point case law exists,<sup>50</sup> courts often follow the agencies' approach,<sup>51</sup> and, likely as a result of these two factors, lawyers of SSO members rely upon the agencies'

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45. 15 U.S.C. § 15c(a)(1) (2006).

46. See U.S. DEP'T OF JUSTICE, ANTITRUST ENFORCEMENT AND THE CONSUMER, available at [http://www.usdoj.gov/atr/public/div\\_stats/211491.pdf](http://www.usdoj.gov/atr/public/div_stats/211491.pdf) (explaining that the federal antitrust laws are enforced through “criminal and civil enforcement actions brought by the Antitrust Division of the Department of Justice, civil enforcement actions brought by the Federal Trade Commission and lawsuits brought by private parties asserting damage claims”).

47. See HANDBOOK, *supra* note 15, at 23 (“Cooperative standard-setting activities are most often challenged under Section 1 of the Sherman Act . . .”).

48. 15 U.S.C. § 1 (2006).

49. Margaret H. Lemos, *The Other Delegate: Judicially Administered Standards and the Nondelegation Doctrine*, 81 S. CAL. L. REV. 405, 462 (2008).

50. See Scott D. Russell, *Analytical Framework for Antitrust Counseling on Intellectual Property Licensing*, in PATENTS, COPYRIGHTS, TRADEMARKS, AND LITERARY PROPERTY 2009, at 575, 577 (2009) (“[T]here is some case law from lower courts that involves the appropriate antitrust principles to be applied in the context of IP licensing.”).

51. See *Roundtable Discussion: Revisions to the Horizontal Merger Guidelines*, ANTITRUST, Fall 2009, at 8, 9 (“And at this point, the [Horizontal Merger] Guidelines are so ubiquitous—[FTC] Chairman Leibowitz referred to them as one of the most cited documents in modern antitrust—the courts do rely on them.”).

approach when providing guidance.<sup>52</sup> Generally, the approach is expressed in reports, “business review” letters, and speeches.<sup>53</sup> While the reports—and the business review letters and speeches—are not binding upon the courts,<sup>54</sup> they do “reflect the enforcement position and governing analytical framework of the federal antitrust authorities” and “are based primarily on existing case law and current economic thinking, making them persuasive authority and an informed source for counselors.”<sup>55</sup>

Additionally, SSO members may either request a business review letter from the DOJ with respect to a proposed patent policy or look to existing letters responding to other parties’ proposed policies, which are publicly available.<sup>56</sup> A business review letter is the DOJ’s response to a private party who has requested that the DOJ state its enforcement intentions relative to the party’s proposed conduct.<sup>57</sup> Bear in mind, however, that the DOJ may refuse a request,<sup>58</sup> and if it opts to respond, which likely will take months,<sup>59</sup> it will only address proposed conduct<sup>60</sup> and will not be barred from bringing “whatever action or proceeding it subsequently comes to believe is required by the public interest,” even if it indicates it currently has no such intention.<sup>61</sup> Nonetheless, to date, the DOJ “has never exercised its right to bring a criminal action [against a party to whom it has stated a present intention not to bring an action] where there has been full and true disclosure at the time of presenting the request.”<sup>62</sup> And again, while business review letters are not binding, the Supreme Court recently relied favorably on a business review letter in the context of a joint venture.<sup>63</sup>

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52. See Russell, *supra* note 50, at 577 n.2 (“The 1995 *Intellectual Property Guidelines* . . . form the primary basis for advising clients on the antitrust boundaries of technology licensing.”).

53. See *id.* (relating that in addition to reports and business review letters, “the various mechanisms used to provide industry guidance, such as: speeches from the top ranking officials, studies from agencies’ leading economists; policy statements regarding the negotiation and settlement of claims that fall short of litigation; and joint reports generated from investigative hearings into particular practices and hearings,” are relevant to understanding the agencies’ position).

54. See Geraldine M. Alexis, Troy P. Sauro & Mamta Ahluwalia, *The Department of Justice’s Report on Single Firm Conduct: What Influence Will It Have?*, ANTITRUST, Fall 2008, at 51, 51 (indicating that the “antitrust guidelines . . . do not constitute substantive regulations under the [Administrative Procedures Act]” and “do not therefore have the weight of law”).

55. Russell, *supra* note 50, at 577 n.2; see also *id.* (making such remarks about the IP Guidelines).

56. 28 C.F.R. § 50.6(10) (2009).

57. *Id.* § 50.6.

58. *Id.* § 50.6(3).

59. See Joyce Mazero & Suzie Loonam, *Purchasing Cooperatives: Leveraging a Supply Chain for Competitive Advantage*, 29 FRANCHISE L.J. 148, 158 (2010) (noting that “[m]ost requests take months”).

60. 28 C.F.R. § 50.6(2).

61. *Id.* § 50.6(9).

62. *Id.*

63. See *Texaco, Inc. v. Dagher*, 547 U.S. 1, 3–4 (2006) (referring to the FTC’s approval of a joint venture in evaluating whether the venture violated Section 1 of the Sherman Act).

*B. Ex Ante Licensing Negotiations Present Two Potential Section 1 Violations*

As previously mentioned, Section 1 prohibits “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations.”<sup>64</sup> In the context of ex ante licensing negotiations, the enforcement agencies fear that SSO members will exercise market power—“the ability profitably to maintain prices above, or output below, competitive levels for a significant period of time”<sup>65</sup>—to unreasonably restrain trade in one of two ways: (1) to reach naked restraints of trade, or (2) to exercise group buying power.<sup>66</sup>

*1. The First Potential Section 1 Violation: Naked Restraints of Trade.*—Naked restraints of trade “only function . . . to create, allocate, exploit or police economic or market power,”<sup>67</sup> and therefore constitute conduct that always or almost always tends to raise price or to reduce output. In the context of ex ante licensing negotiations, restraints may arise in two ways. First, “[s]ham multilateral licensing negotiations . . . may offer an opportunity for SSO members to reach naked price-fixing agreements that lack plausible and cognizable justifications, restraints that the Agencies and courts summarily condemn” under Section 1.<sup>68</sup> Because SSO membership generally includes manufacturers of standardized products, manufacturers may “use the cover of multilateral licensing negotiations to reach naked agreements on the prices of the products they sell downstream.”<sup>69</sup> According to Professor Robert Skitol, however, such collusion in the context of ex ante licensing negotiations is unlikely. To trigger this concern, the license must represent at least 20% of the total cost of the downstream product, yet “[r]oyalties on patents incorporated in a standard are not likely ever to approach that percentage.”<sup>70</sup>

Second, because SSO membership also includes companies that possess IP vying for inclusion in a standard, such patent holders may “reach naked agreements on the licensing terms they will propose . . . , thus, in effect, rigging their selling bids.”<sup>71</sup> Bid rigging raises prices for purchasers

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64. 15 U.S.C. § 1 (2006).

65. IP GUIDELINES, *supra* note 26, at 4.

66. IP2 REPORT, *supra* note 29, at 50.

67. Peter C. Carstensen & Bette Roth, *The Per Se Legality of Some Naked Restraints: A [Re]conceptualization of the Antitrust Analysis of Cartelistic Organizations*, 45 ANTITRUST BULL. 349, 355 (2000) (emphasis added).

68. IP2 REPORT, *supra* note 29, at 51.

69. *Id.*

70. Robert A. Skitol, *Concerted Buying Power: Its Potential for Addressing the Patent Holdup Problem in Standard Setting*, 72 ANTITRUST L.J. 727, 741 (2005).

71. IP2 REPORT, *supra* note 29, at 51–52.

(licensees) and occurs when competitors (patent holders) agree in advance who will submit the winning bid (the least restrictive licensing terms).<sup>72</sup>

2. *The Second Potential Section 1 Violation: The Exercise of Group Buying Power.*—Alternatively, ex ante licensing negotiations might lead to members exercising group buying power.<sup>73</sup> Particularly when no alternatives to a patent holder’s technology exist and the patent holder’s market power is not enhanced by the standard,<sup>74</sup> potential licensees can “say to the patent holder, ‘We will collectively reject a standard that incorporates your patented technology unless you agree to license it to us at pre-specified rates that we collectively find acceptable.’”<sup>75</sup> Effectively, competition between potential licensees is eliminated,<sup>76</sup> and together licensees can require the patent holder to license at subcompetitive prices.<sup>77</sup> The enforcement agencies prohibit the exercise of group buying power, not because prices increase, as in the case of naked restraints of trade, but because innovation incentives for patent holders may be reduced.<sup>78</sup> While a patent holder may also license other technology incorporated into standards—and *save* money by paying subcompetitive prices on these technologies—he or she will *lose* money when paid subcompetitive prices for his or her technology: if the patent holder’s losses exceed his or her gains, he or she has fewer innovation incentives.<sup>79</sup>

### C. *The Enforcement Agencies’ Traditional Approach Toward Section 1 Violations in the Context of Licensing Agreements*

Depending upon the alleged restraint of trade, the DOJ and the FTC will examine potential Section 1 violations under either a “rule of reason” or per

72. See U.S. DEP’T OF JUSTICE, PRICE FIXING, BID RIGGING, AND MARKET ALLOCATION SCHEMES: WHAT THEY ARE AND WHAT TO LOOK FOR 2, available at <http://www.justice.gov/atr/public/guidelines/211578.pdf> (“Bid rigging is the way that conspiring compet[i]tors effectively raise prices where purchasers . . . acquire goods or services by soliciting competing bids. Essentially, competitors agree in advance who will submit the winning bid on a contract being let through the competitive bidding process.”).

73. For a more detailed discussion of this phenomenon, known as monopsony, see generally Alan Devlin, *Questioning the Per Se Standard in Cases of Concerted Monopsony*, 3 HASTINGS BUS. L.J. 223 (2007).

74. See *infra* text accompanying note 145.

75. David J. Teece & Edward F. Sherry, *Standards Setting and Antitrust*, 87 MINN. L. REV. 1913, 1955 (2003).

76. See *id.* (explaining that requiring potential licensees to announce the terms for a patent license in advance may result in “collusive, oligopolistic ‘price-fixing’” in advance).

77. CARRIER, *supra* note 11, at 337.

78. See *id.* (explaining that if SSO members have the power to reduce license prices below competitive levels, dynamic efficiency may be affected, reducing innovation).

79. While I cannot comment on whether the average licensee will likely save or lose money, some suggest that “many firms take on the roles of both IP owners and users in the standard-setting process.” Michael A. Carrier, *Why Antitrust Should Defer to the Intellectual Property Rules of Standard-Setting Organizations: A Commentary on Teece & Sherry*, 87 MINN. L. REV. 2019, 2030 (2003).

se approach. While the rule of reason is more commonly applied,<sup>80</sup> the per se approach is appropriate for conduct “that always or almost always tends to raise price or to reduce output”<sup>81</sup>—naked restraints of trade.<sup>82</sup> With a per se restraint of trade, commission of the conduct is in and of itself a Section 1 violation.<sup>83</sup> However, if the conduct is not per se illegal, the agencies apply the rule of reason to determine whether the restraint of trade is reasonable.<sup>84</sup> In the context of licensing agreements, the rule of reason considers “whether the restraint is likely to have anticompetitive effects and, if so, whether the restraint is reasonably necessary to achieve procompetitive benefits that outweigh those anticompetitive effects.”<sup>85</sup>

*1. Ex Ante Licensing Negotiations Affect Both Goods and Technology Markets.*—To demonstrate that the agreement is anticompetitive, the plaintiff must show either that (1) the restraint has caused actual harm to competition through increased prices or decreased output, or (2) “the restraint is likely to impair competition by creating, enhancing, or facilitating the use of market power.”<sup>86</sup> Most rule of reason analyses proceed under the second theory,<sup>87</sup> and to determine whether market power exists, the agencies begin by defining the relevant market or markets affected by the challenged practice.<sup>88</sup> While licensing arrangements in general affect three types of markets—(1) goods markets, (2) technology markets, or (3) innovation markets<sup>89</sup>—only the first two are directly affected by the naked restraints to trade and exercise of group buying power that the agencies fear could result from ex ante licensing negotiations.

The first type of market—a goods market—consists of markets for intermediate or final goods made using the IP (downstream goods markets) or markets for goods used, in combination with the IP, as inputs to the

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80. David A. Balto & Andrew M. Wolman, *Intellectual Property and Antitrust: General Principles*, 43 IDEA 395, 400 (2003); see also Frank B. Cross, *What Do Judges Want?*, 87 TEXAS L. REV. 183, 221 (2008) (book review) (noting that antitrust law increasingly employs a rule of reason analysis).

81. U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS 3 (2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>.

82. See Chiawen C. Kiew, Comment, *Contracts, Combinations, Conspiracies, and Conservation: Antitrust in Oil Unitization and the Intertemporal Problem*, 99 NW. U. L. REV. 931, 951 (2005) (explaining that naked agreements are “formed with the objectively intended purpose or likely effect of increasing price or decreasing output”).

83. Balto & Wolman, *supra* note 80, at 400.

84. *Id.*

85. IP GUIDELINES, *supra* note 26, at 16.

86. HANDBOOK, *supra* note 15, at 44.

87. See *id.* at 44–45 (“A number of courts and commentators take the position that a showing of market power is a requirement for a rule of reason claim.”).

88. *Id.*

89. IP GUIDELINES, *supra* note 26, at 7–8.

production of other goods (upstream goods markets).<sup>90</sup> The downstream goods market for standardized products will be affected if ex ante licensing negotiations allow SSO members who manufacture standardized products to reach naked agreements on the products' prices. The second type of market—a technology market—consists of the IP that is licensed and its close substitutes—the technologies or goods that significantly “constrain the exercise of market power with respect to the intellectual property that is licensed.”<sup>91</sup> Technology markets will be affected if ex ante licensing negotiations either allow SSO members who are patent holders to reach naked agreements on the licensing terms they will propose—bid rigging—or lead to members exercising group buying power.

2. *The Enforcement Agencies Are Familiar with Goods—but Not Technology—Markets.*—If the competitive effects of the licensing agreement can be adequately assessed within the goods market, the agencies define and analyze only that market<sup>92</sup>—arguably because the agencies know how to define it and analyze it, unlike technology and innovation markets. Because goods markets involving IP are analogous to goods markets not involving IP,<sup>93</sup> the agencies define the relevant market and measure market share—perhaps the most important factor considered when determining whether market power exists<sup>94</sup>—according to principles used for non-IP goods markets.<sup>95</sup>

However, while the agencies claim to provide a means by which to delineate the relevant technology market that “is conceptually analogous to the analytical approach to goods markets,”<sup>96</sup> to date neither they nor the courts have substantively specified the process for defining technology markets.<sup>97</sup> The agencies' guidance as to how to determine whether market power exists is equally vague. If market-share data are available—which would require the technology market to be defined<sup>98</sup>—and such data

90. *Id.* at 8.

91. *Id.*

92. *Id.* at 7–8.

93. *See id.* at 2 (“[F]or the purpose of antitrust analysis, the Agencies regard intellectual property as being essentially comparable to any other form of property . . .”).

94. *See* Russell, *supra* note 50, at 589 (relating three points regarding the importance of market share: (1) that “[m]arket shares are a starting point for determining whether a party has ‘market power’ in a relevant market,” (2) that when analyzing technology markets, “the [IP Guidelines] instruct that one first look to objective evidence of market share,” and (3) that, in the context of innovation markets, the IP Guidelines indicate how to compute market shares).

95. *See* IP GUIDELINES, *supra* note 26, at 8 (“[T]he Agencies will approach the delineation of relevant market and the measurement of market share in the intellectual property area as in section 1 of the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines.”).

96. *Id.* at 9 & n.20.

97. *See* Russell, *supra* note 50, at 587 (“To date, the courts have not yet specified the process for defining technology markets.”).

98. *See* U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES 13–14 (rev. 1997), available at <http://www.justice.gov/atr/public/guidelines/hmg.pdf> (“[T]he

“accurately reflect the competitive significance of market participants,” the agencies will consider the data; however, the agencies “also will seek evidence of buyers’ and market participants’ assessments of the competitive significance of technology market participants.”<sup>99</sup> Barring the availability of market-share data or “other indicia of market power,” the agencies will assign each technology the same market share if “it appears that competing technologies are comparably efficient.”<sup>100</sup> The agencies decline to indicate how they will determine whether the data “accurately reflect the competitive significance of market participants,” or what constitutes “evidence of buyers’ and market participants’ assessments of the competitive significance of technology market participants” or “comparably efficient” competing technologies.<sup>101</sup>

#### IV. Analysis of the Enforcement Agencies’ Recent Approach Toward Ex Ante Licensing Agreements

Between 2006 and 2007, the enforcement agencies offered guidance to SSOs on ex ante licensing negotiations. In subpart A, I review the details of this guidance: while most of the discussion is devoted to the three documents that provide the most substantive statements, I do mention speeches by top officials as these, more than the other documents, clearly indicate that the agencies wish to foster the use of and experimentation with ex ante licensing negotiations. In subpart B, I argue that while the enforcement agencies issued guidance in 2006 and 2007 with an eye toward encouraging ex ante licensing negotiations, their efforts did not go far enough. In particular, while five reasons mandated that the agencies provide clear legal guidance, they failed to do so sufficiently. Both what constitutes permissible conduct in joint ex ante licensing negotiations occurring within the SSO and, assuming the rule of reason is applied to such joint negotiations, how the agencies will conduct their analysis when technology markets are implicated are unclear. In subpart C, I argue that the agencies can provide clear legal guidance, primarily through reports and commentaries. While the agencies’ approach will likely change, potentially imposing liability upon SSOs that relied upon previous statements to engage in ex ante licensing negotiations, the agencies and courts can act—and historically have acted—to minimize such risks.

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Agency normally will calculate market shares . . . based on the total sales or capacity currently devoted to *the relevant market* together with that which likely would be devoted to *the relevant market* in response to a ‘small but significant and nontransitory’ price increase.” (emphasis added).

99. IP GUIDELINES, *supra* note 26, at 10.

100. *Id.*

101. *Id.* at 11.

A. *The Details of the Enforcement Agencies' Recent Approach Toward Ex Ante Licensing Negotiations*

In a series of speeches and documents issued in 2006 and 2007, the FTC and the DOJ indicated they would take a more lenient approach toward ex ante IP licensing negotiations that occur within SSOs. While the agencies had previously indicated that such negotiations would generally be examined under the rule of reason, they had provided no guidance as to which types of negotiations, such as those held jointly and within SSOs, would be permissible.<sup>102</sup> Beginning in 2006, the agencies made more specific statements in seven documents: (1) DOJ Business Review Letter to VMEbus International Trade Association (VITA), October 30, 2006;<sup>103</sup> (2) then-Deputy Assistant Attorney General's January 18, 2007 Speech;<sup>104</sup> (3) Chapter 2, DOJ and FTC IP2 Report of April 17, 2007;<sup>105</sup> (4) DOJ Business Review Letter to the Institute of Electrical and Electronics Engineers, Inc. (IEEE), April 30, 2007;<sup>106</sup> (5) then-Deputy Assistant Attorney General's May 10, 2007 Speech;<sup>107</sup> (6) then-Deputy Assistant Attorney General's October 11, 2007 Speech;<sup>108</sup> and (7) then-Counsel to the Assistant Attorney General's March 29, 2007 Speech.<sup>109</sup>

Most of the agencies' substantive guidance occurs in the two business review letters and the report, which the speeches summarize for various audiences. As such, I devote most of this subpart to a discussion of these documents. However, the speeches are noteworthy because they contain general but very encouraging statements by some of the enforcement

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102. 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 (Sept. 23, 2005), *available at* <http://www.ftc.gov/speeches/majoras/050923stanford.pdf>.

103. VITA Business Review Letter, *supra* note 44.

104. Gerald F. Masoudi, Deputy Assistant Att'y Gen., U.S. Dep't of Justice, Efficiency in Analysis of Antitrust, Standard Setting, and Intellectual Property, Remarks at the High-Level Workshop on Standardization, IP Licensing, and Antitrust (Jan. 18, 2007) [hereinafter Masoudi, Jan. 18 Speech], *available at* <http://www.usdoj.gov/atr/public/speeches/220972.pdf>.

105. IP2 REPORT, *supra* note 29, at 33–53.

106. Letter from Thomas O. Barnett, Assistant Att'y Gen., U.S. Dep't of Justice, to Michael A. Lindsay, Esq., Dorsey & Whitney LLP (Apr. 30, 2007) [hereinafter IEEE Business Review Letter], *available at* <http://www.usdoj.gov/atr/public/busreview/222978.pdf>.

107. Gerald F. Masoudi, Deputy Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Enforcement and Standard Setting: The VITA and IEEE Letters and the "IP2" Report, Remarks Before the American Intellectual Property Law Association (May 10, 2007), *available at* <http://www.usdoj.gov/atr/public/speeches/223363.pdf>.

108. Gerald F. Masoudi, Deputy Assistant Att'y Gen., U.S. Dep't of Justice, Objective Standards and the Antitrust Analysis of SDO and Patent Pool Conduct, Address at the Annual Comprehensive Conference on Standards Bodies and Patent Pools (Oct. 11, 2007) [hereinafter Masoudi, Oct. 11 Speech], *available at* <http://www.usdoj.gov/atr/public/speeches/227137.pdf>.

109. Hill B. Wellford, Counsel to the Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Issues In Standard Setting, Remarks at the 2d Annual Seminar on IT Standardization and Intellectual Property (Mar. 29, 2007), *available at* <http://www.usdoj.gov/atr/public/speeches/222236.pdf>.

agencies' top officials. For example, in his January 18, 2007 speech, then-Deputy Assistant Attorney General Masoudi encouraged approaches different from those addressed in business review letters<sup>110</sup>—in part because “experimentation and competition between S[S]Os . . . is a good thing.”<sup>111</sup> Moreover, he indicated that the agencies should exercise “great caution,” acknowledging that the agencies could hinder “dynamic efficiency and long-term consumer welfare.”<sup>112</sup> In his March 29, 2007 speech, then-Counsel to the Assistant Attorney General Wellford echoed these sentiments when stating that “we should not overreact to the inevitable short-term missteps—or perceived missteps—that S[S]Os and businesses will make.”<sup>113</sup> Although lacking in substantive guidance, these statements signal an agency that wishes to foster the use of and experimentation with ex ante licensing negotiations.

Below, I discuss the following documents, in the following order: the DOJ Business Review Letter to VITA, the DOJ Business Review Letter to IEEE, and Chapter 2 of the IP2 Report. While the IP2 Report was issued before the IEEE letter (April 17 versus April 30), I have chosen to address them in reverse chronological order because the IP2 Report not only incorporates analysis from the VITA letter,<sup>114</sup> delivered nearly six months earlier, but also from the IEEE letter.<sup>115</sup> Because only a matter of days separated the issuance of the IP2 Report and the IEEE letter and because the letters ought to be discussed in tandem—in the sense that their analyses concern only specific, proposed patent policies, unlike the IP2 Report, which provided more generally applicable guidance—I think this approach sensible.

In summary, the DOJ indicated in the letters that because ex ante licensing negotiations had procompetitive effects, they would generally be examined under the rule of reason; however, because such negotiations did raise anticompetitive concerns, they would be condemned as per se illegal under certain circumstances. While these comments sanctioned some forms of ex ante licensing negotiations, the agencies were not required to offer guidance on *joint* licensing negotiations *within* the SSO because neither policy permitted them. To clarify their position, the DOJ and the FTC

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110. Masoudi, Jan. 18 Speech, *supra* note 104, at 14–16.

111. *Id.* at 15.

112. *Id.* at 16.

113. Wellford, *supra* note 109, at 18.

114. *See, e.g.*, IP2 REPORT, *supra* note 29, at 54–55 (discussing the VITA Business Review Letter).

115. For example, in the IEEE letter, the DOJ indicated that it currently would not take enforcement action against IEEE's proposed patent policy, which gave patent holders the option to disclose their most restrictive licensing terms, including their maximum royalty rate. IEEE Business Review Letter, *supra* note 106, at 4, 12. In the IP2 Report, the agencies approved of “voluntary and unilateral disclosure[s] of . . . licensing terms, including . . . royalty rate[s].” IP2 REPORT, *supra* note 29, at 54.

released the IP2 Report in April 2007, which provided their most comprehensive statements yet on ex ante licensing negotiations.<sup>116</sup>

1. *VITA DOJ Business Review Letter of October 30, 2006.*—In October 2006, the DOJ issued a business review letter to VITA, in which it stated that it “ha[d] no present intention to take antitrust enforcement action”<sup>117</sup>—the agency’s “most favorable possible response”<sup>118</sup>—against VITA’s proposed patent policy. VITA proposed to supplant its RAND licensing policy with one in which all members “must declare the maximum royalty rates and most restrictive non-royalty terms that the . . . member . . . will request for any such patent claims that are essential to implement the eventual standard.”<sup>119</sup> Although the members could consider the licensing terms when determining which technology to adopt for the proposed standard, the proposed policy forbade “any negotiation or discussion of specific licensing terms among working group members or with third parties at all [VITA] and working group meetings.”<sup>120</sup> Thus, while the proposed policy *would* require members to unilaterally disclose the maximum rate at which they would seek to license their IP and *would* allow members to consider those terms when selecting a technology, it *would not* allow members to engage in ex ante negotiations of specific licensing terms, either bilaterally or jointly, within the SSO—members would still have to negotiate such terms bilaterally with the patent holder outside the SSO.

The DOJ examined VITA’s proposed patent policy under the rule of reason and chose to not take action because “the proposed policy should preserve, not restrict, competition among patent holders.”<sup>121</sup> Specifically, the DOJ believed that by requiring members to disclose their maximum royalty rates, competition between technologies would increase—because technology would be evaluated on technical merit *and* licensing terms—and holdup would be mitigated—because members would not be subject to “unreasonable patent licensing terms that might threaten the success of future standards.”<sup>122</sup> Additionally, given the licensing terms, members might make more informed decisions<sup>123</sup> and avoid disputes over licensing terms,<sup>124</sup> which can be costly if litigation results or the standard’s adoption and

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116. Frances E. Marshall, *U.S. Department of Justice Guidance Regarding Ex Ante Patent Licensing Policies of Standard-Setting Organizations*, in 2 PATENT LAW INSTITUTE 211, 217 (2008).

117. VITA Business Review Letter, *supra* note 44, at 10.

118. Ed Levy et al., *Patent Pools and Genomics: Navigating a Course to Open Science?*, 16 B.U. J. SCI. & TECH. L. 75, 85 (2010).

119. VITA Business Review Letter, *supra* note 44, at 4.

120. *Id.* at 5.

121. *Id.* at 8, 10.

122. *Id.* at 9–10.

123. *Id.* at 9.

124. *Id.* at 10.

implementation are delayed. Because the policy forbade members from discussing licensing terms, the DOJ found the exercise of group buying power unlikely.<sup>125</sup> However, the DOJ did caution that any attempt to use the declaration process as a cover for price-fixing of downstream goods or to rig bids among patent holders would be a per se violation of Section 1 of the Sherman Act.<sup>126</sup>

2. *IEEE DOJ Business Review Letter of April 30, 2007.*<sup>127</sup>—In April 2007, the DOJ issued a business review letter to IEEE, declaring that it would not presently take antitrust enforcement action against IEEE’s proposed patent policy.<sup>128</sup> Under the proposed policy, patent-holding members could, but would not be required to, “publicly disclose and commit to the most restrictive licensing terms (which may include the maximum royalty rate) they would offer for patent claims that are found to be essential to the standard.”<sup>129</sup> Although members may “discuss the relative costs of licensing . . . the essential patent claims needed to implement the technologies under consideration,” they would not be allowed to confer about specific licensing terms.<sup>130</sup>

As with its review of VITA’s proposed patent policy, the DOJ examined IEEE’s policy under the rule of reason and decided not to take action, finding that IEEE’s policy “could generate similar benefits” as those provided by VITA’s policy.<sup>131</sup> Similar to its statements in VITA’s business review letter, the DOJ emphasized the increased competition between technologies and the ability of members to make more informed decisions, as well as the avoidance of holdup and litigated disputes over licensing terms; however, it also based part of its decision upon the “increased predictability of licensing terms,” which “could lead to faster *development*, implementation, and adoption of a standard.”<sup>132</sup> In addition to expressing frustration with holdup and litigation, IEEE complained that its existing policy, which requested members to agree either to not enforce their IP rights or to license on RAND terms, “impede[d] the ability of . . . members to make decisions on a consensus basis,” as required by IEEE procedures.<sup>133</sup> Thus, it appears that when evaluating SSOs’ licensing policies under the rule of reason, the DOJ is

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125. *Id.* at 9.

126. *Id.* at 9–10.

127. As of Fall 2009 and two years after IEEE enacted the policy, only three members had provided licensing terms. Anne Layne-Farrar et al., *Preventing Patent Hold Up: An Economic Assessment of Ex Ante Licensing Negotiations in Standard Setting*, 37 AIPLA Q.J. 445, 452 (2009).

128. IEEE Business Review Letter, *supra* note 106, at 12.

129. *Id.* at 4.

130. *Id.* at 8.

131. *Id.* at 9–10, 12.

132. *Id.* at 10 (emphasis added).

133. *Id.* at 3–4.

increasingly willing to identify more expected competitive benefits as its experience with such policies increases and/or as the circumstances present themselves.

While noting that IEEE's policy prohibited joint negotiation of licensing terms within meetings, the DOJ did indicate that permitted discussions of costs related to a proposed standard "could, in certain circumstances, rise to the level of joint negotiation of licensing terms."<sup>134</sup> With regard to such negotiations, the DOJ declined to provide its "views on joint negotiations that might take place inside or outside such standards development meetings or IEEE sponsored meetings."<sup>135</sup> It did, however, reiterate the DOJ's willingness to challenge any attempt to fix prices of standard-dependent products or to rig bids among patent holders.<sup>136</sup>

3. *Chapter 2, DOJ and FTC IP2 Report of April 17, 2007.*— Recognizing the procompetitive effects of SSOs, the DOJ and the FTC indicated in their IP2 Report that they would generally adopt a rule of reason approach toward ex ante licensing negotiations, including those negotiations that occur jointly and inside an SSO and those that involve disclosure of maximum or model licensing terms.<sup>137</sup> Specifically, the enforcement agencies identified the two primary procompetitive benefits as ex ante competition between technologies and mitigation of holdup, both of which might also foster additional, downstream benefits.<sup>138</sup>

First, because "[p]atent holders choosing to participate in the standard-setting process would compete against other patent holders, as well as against public domain technologies, on the basis of technical merit and on price and other licensing terms in order to have their technology included in the standard," ex ante competition between technologies would increase.<sup>139</sup> Because such negotiations would "increas[e] the [ex ante] knowledge of SSO decision-makers about licensing terms," ex ante competition might also "improve the quality of their decisions, enabling them to make tradeoffs between price and technical merit that are not possible unless the price of patented technological inputs is known before the standard is set."<sup>140</sup> Second, ex ante licensing negotiations would mitigate holdup because they would "place an upper bound on a patent holder's RAND commitment and . . . lower[] the risk that users of a standard [would] face," demanding "more restrictive licensing terms after the standard is set than SSO members expected when they chose to include the patented technology in the

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134. *Id.* at 11.

135. *Id.*

136. *Id.*

137. IP2 REPORT, *supra* note 29, at 37.

138. *Id.* at 52–53.

139. *Id.* at 52.

140. *Id.* at 52–53.

standard.”<sup>141</sup> A downstream benefit of this reduced risk might be faster adoption of the standard in the marketplace.<sup>142</sup>

Nonetheless, the DOJ and the FTC acknowledged that ex ante licensing negotiations raise two antitrust concerns: naked agreements to restrain trade by patent holders or SSO members and the exercise of group buying power by potential licensees.<sup>143</sup> Naked agreements to restrain trade—“such as bid rigging by members who otherwise would compete in licensing technologies for adoption by the SSO or naked price fixing on downstream products by members who otherwise would compete in selling downstream products compliant with the standard”—would be condemned as per se illegal.<sup>144</sup> Similarly, joint negotiations might also be unreasonable if “there were no viable alternatives to a particular patented technology that is incorporated into a standard, the IP holder’s market power was not enhanced by the standard, and all potential licensees refuse to license that particular patented technology except on agreed-upon licensing terms” because potential licensees could exercise group buying power.<sup>145</sup>

Emphasizing that it would examine joint ex ante licensing negotiations under the rule of reason, the DOJ and the FTC provided specific guidance in three situations.<sup>146</sup> First, voluntary, unilateral disclosure of licensing terms by a patent holder—like the conduct permitted by IEEE’s proposed policy<sup>147</sup>—is not a violation of Section 1 of the Sherman Act.<sup>148</sup> Second, bilateral ex ante licensing negotiations that occur outside SSOs—like the conduct that already occurs under most SSO policies<sup>149</sup>—generally do not require antitrust review.<sup>150</sup> Third, joint ex ante licensing negotiations that occur inside SSOs and require unilateral disclosures of licensing terms—like the conduct mandated by VITA’s proposed policy<sup>151</sup>—are not per se illegal—unless they constitute naked restraints of trade or exercises of group buying power and instead will be examined under the rule of reason.<sup>152</sup>

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141. *Id.* at 53.

142. *Id.*

143. *Id.* at 50.

144. *Id.* at 37.

145. *Id.* at 53.

146. *Id.* at 54–55.

147. *See supra* note 129 and accompanying text.

148. *See* IP2 REPORT, *supra* note 29, at 54 (“[A]n IP holder’s voluntary and unilateral disclosure of its licensing terms, including its royalty rate, is not a collective act subject to review under section 1 of the Sherman Act.”).

149. *See supra* note 40 and accompanying text.

150. *See* IP2 REPORT, *supra* note 29, at 54 (“[B]ilateral [ex ante] negotiations about licensing terms that take place between an individual SSO member and an individual intellectual property holder (without more) outside the auspices of the SSO also are unlikely to require any special antitrust scrutiny.”).

151. *See supra* note 119 and accompanying text.

152. *See* IP2 REPORT, *supra* note 29, at 54 (explaining that per se “condemnation is not warranted for joint SSO activities,” which include joint ex ante licensing negotiations or an SSO

*B. The Flaws of the Enforcement Agencies' Recent Approach Toward Ex Ante Licensing Negotiations*

By issuing a series of speeches and documents in 2006 and 2007, the enforcement agencies intended to encourage those SSOs that wished to engage in ex ante licensing negotiations to do so. While statements made by top officials in several speeches *generally* reassured SSOs that they would not face antitrust liability if they experimented with ex ante licensing negotiations, two business review letters and a 2007 report provided more *specific* guidance. However, these documents were largely insufficient to inform SSOs as to what conduct would and would not result in antitrust liability. This is particularly ironic as the agencies themselves identified several of the reasons why “clear legal guidance” was necessary.<sup>153</sup>

*1. The Enforcement Agencies Must Provide Clear Legal Guidance for Five Reasons.*—The enforcement agencies must provide clear legal guidance to SSOs for five reasons: (1) antitrust claims are expensive to defend, even if the SSO prevails; (2) engineers who possess minimal legal knowledge would be the participants in any ex ante licensing negotiations; (3) little guidance on what constitutes legal ex ante licensing negotiations currently exists, with the enforcement agencies' statements serving as the primary source; (4) since the 2006 and 2007 statements on ex ante licensing negotiations were issued, the administration has changed, potentially affecting the agencies' approach; and (5) the existing safe harbors generally will not be available.

*a. Antitrust Claims Are Expensive to Defend.*—Given that ex ante licensing negotiations may reduce holdup and given the enforcement agencies' recent, encouraging statements, the SSOs' trepidation would appear foolish if the costs of “get[ting] the selection process ‘wrong’” were not so high.<sup>154</sup> However, the costs associated with antitrust litigation, whether or not the SSO loses, can be enormous.<sup>155</sup> First, an action brought by the enforcement agencies themselves may engender additional private claims, “intensif[y]ing the penalty.”<sup>156</sup> Second, an action brought by state attorneys

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rule requiring IP holders to announce their intended (or maximum) licensing terms for technologies under consideration).

153. See Masoudi, Jan. 18 Speech, *supra* note 104, at 10 (insisting that standard-setting participants “crave clear legal guidance”).

154. See Kelly & Prywes, *supra* note 35, at 5 (“If an SSO and its participants get the selection process ‘wrong’ under the antitrust laws, and lose an antitrust case in litigation, the cost can be enormous.”).

155. *Id.*; see also Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEXAS L. REV. 1, 12–13 (1984) (arguing that the use of the rule of reason in antitrust analysis is a strong example of litigation costs borne of “vague rules with high stakes”).

156. John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215, 223 (1983); see also *id.* at 222–23 (explaining that private parties “simply piggyback[] on the efforts of public agencies—such as the

general or private parties may result in treble damages, payment of plaintiff's attorneys' fees, and injunctions that impede future standard-setting activity.<sup>157</sup> Even if no liability is imposed upon the SSO, the cumulative litigation expense, both in terms of dollars spent and time diverted, can be considerable: for example, in *Sony Electronics, Inc. v. Soundview Technologies, Inc.*,<sup>158</sup> two SSOs and several of their member companies spent over ten million dollars and two years to defend against antitrust counterclaims that were eventually mooted.<sup>159</sup>

*b. Engineers, Not Lawyers, Participate in Ex Ante Licensing Negotiations.*—Because engineers—and not economists or lawyers—ordinarily determine which technology to incorporate into a standard,<sup>160</sup> clear legal guidance is required if the agencies wish to convince SSOs that ex ante licensing negotiations will not necessarily result in costly antitrust liability. The enforcement agencies recognized this. For example, in his January 18, 2007 speech, Masoudi indicated that SSO members erroneously pointed to *Soundview* as the source of their group-buying-power liability fears precisely because the members were not lawyers:<sup>161</sup> while “[i]t may seem strange to you that a case like *Soundview* could have such a great impact on standard setting participants[] when a careful reading by an antitrust lawyer shows that it should have little impact,” SSO members “generally are not antitrust lawyers or lawyers at all, and do not wish to delve into legal complexities. . . . They crave clear legal guidance.”<sup>162</sup>

*c. The Enforcement Agencies' Statements Are the Primary Source of Guidance.*—Little guidance on what constitutes legal ex ante licensing negotiations currently exists, with the enforcement agencies' statements the primary source.<sup>163</sup> Because courts are less likely to misinterpret and to rule adversely to the agencies' approach if that approach is apparent, the agencies must provide clear legal guidance.

Courts are less likely to misinterpret the agencies' approach if that approach is clear. Because the agencies' approaches are motivated by

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SEC, the FTC, and the Antitrust Division of the Department of Justice—in order to reap the gains from the investigative work undertaken by these agencies”).

157. Kelly & Prywes, *supra* note 35, at 5.

158. 157 F. Supp. 2d 180 (D. Conn. 2001).

159. *Id.* at 5–6.

160. *Id.* at 4–5.

161. See Masoudi, Jan. 18 Speech, *supra* note 104, at 9–10 (indicating that SSOs usually point to *Soundview*, as well as one other district court case, “as the source of their buy-side antitrust liability fears”).

162. *Id.* at 10.

163. See *supra* notes 50–52 and accompanying text.

economics<sup>164</sup> and because courts, unlike the agencies, do not have staffs of Ph.D. economists,<sup>165</sup> the courts may honestly misinterpret the agencies' approaches—particularly if they are unclear. The courts' initial misinterpretation of the DOJ's more nuanced challenges to mergers on grounds of ease of entry provides a good example. In the 1990 appellate decisions *Baker Hughes*<sup>166</sup> and *Syufy*,<sup>167</sup> the DOJ attempted to enjoin mergers based on new economic learning about entry that was not reflected in the 1984 Merger Guidelines<sup>168</sup> then in force.<sup>169</sup> Both courts, however, misunderstood the DOJ's arguments,<sup>170</sup> and after "sharply criticiz[ing] the Justice Department's entry arguments and the Department's seeming lack of fidelity to the 1984 Merger Guidelines," they refused to enjoin the mergers.<sup>171</sup> As a result, the enforcement agencies drafted the 1992 Merger Guidelines, in which they successfully articulated the new economic learning and why it mattered.<sup>172</sup> Subsequently, they not only stopped habitually losing merger challenges on grounds of ease of entry<sup>173</sup> but also saw the new economic learning, as embodied in the 1992 Merger Guidelines, invoked by the courts.<sup>174</sup>

Courts also are less likely to rule adversely to the agencies' approach if that approach is clear. Much of this has to do with reliance: if, in the absence of case law, parties, such as SSOs and their lawyers, rely upon agency statements in good faith to engage in, for example, ex ante licensing

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164. See Jonathan B. Baker, *Responding to Developments in Economics and the Courts: Entry in the Merger Guidelines*, 71 ANTITRUST L.J. 189, 189–90 (2003) (remarking, "only partly facetious[ly]," that any redrafting of the 1992 Merger Guidelines should "encapsulate every major article on industrial organization economics published in the *American Economic Review*"); *supra* note 55 and accompanying text.

165. *Roundtable Discussion*, *supra* note 51, at 9.

166. *United States v. Baker Hughes Inc.*, 908 F.2d 981 (D.C. Cir. 1990).

167. *United States v. Syufy Enters.*, 903 F.2d 659 (9th Cir. 1990).

168. U.S. DEP'T OF JUSTICE, 1984 MERGER GUIDELINES, available at <http://www.justice.gov/atr/hmerger/11249.pdf>.

169. See Baker, *supra* note 164, at 196 n.39 (indicating that while the 1984 Merger Guidelines incorporated a distinction that "was a predecessor to the distinction made in the 1992 Merger Guidelines between uncommitted and committed entry, . . . it was rooted more in Bainian entry barrier thinking").

170. See *id.* at 197 (stating that the courts' exasperation with the government arose from their misunderstanding of the government's arguments about committed entry).

171. *Id.* at 190–91.

172. See *id.* at 191 ("The drafters of the 1992 Merger Guidelines understood the need to respond to these decisions by setting forth a[n] . . . analysis that would harmonize the Division's internal analytic approach to entry with the judiciary's concerns."); *id.* at 201–02 (stating that the 1992 Merger Guidelines successfully articulated "the distinction between committed and uncommitted entry and explain[ed] why the difference matters").

173. *Id.* at 201.

174. See *id.* at 202 (indicating that the district courts in *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997), and in *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34 (D.D.C. 1998), followed the 1992 Merger Guidelines).

negotiations, courts arguably will not impose liability.<sup>175</sup> However, courts also will not rule conversely to the agencies' approach—and will even overturn precedent—if the agencies convince them that current economic thinking so requires. A paramount example is *Illinois Tool Works, Inc. v. Independent Ink, Inc.*,<sup>176</sup> in which the Supreme Court abrogated *International Salt Co. v. United States*<sup>177</sup> to hold that possession of IP in a tying product is not per se illegal because it does not necessarily confer market power upon the owner.<sup>178</sup> In so doing, the Court relied upon the IP Guidelines, which it believed reflected “the virtual consensus among economists” that a patent does not necessarily confer market power upon its owner.<sup>179</sup>

*d. The Administration Has Changed Since the Statements Were Made.*—Because the DOJ and the FTC are led by political appointees,<sup>180</sup> many believe that the amount<sup>181</sup> and the type of action taken by the enforcement agencies change with the administrations.<sup>182</sup> If this is true, the agencies' approach toward ex ante licensing negotiations expressed in 2006 and 2007 may no longer be accurate: in 2009, Democrat Barack Obama replaced Republican George W. Bush as President.<sup>183</sup> The agencies must thus signal to SSOs whether it is safe to rely upon their previously issued statements.

Since the change in administration, the DOJ and the FTC have not issued any new statements on ex ante licensing negotiations; they have,

175. Cf. Brian D. Shannon, *Administrative Law*, 21 TEX. TECH L. REV. 1, 9 (1990) (indicating that in *NLRB v. Bell Aerospace Co.*, 416 U.S. 267 (1974), the Supreme Court identified several possible exceptions in which an agency's discretion might be limited, including (1) “in a case in which the affected parties have placed substantial reliance on the agency's past decisions that invoked a contrary policy to the one being established;” and (2) “in a case in which the agency has imposed some new liability on individuals for past actions that were taken in good-faith reliance on prior agency pronouncements”).

176. 547 U.S. 28 (2006). In *Staples*, the district court chose to harmonize, rather than abrogate, the entry analysis of *Baker Hughes*, which controls in the D.C. Circuit, with the 1992 Merger Guidelines. Baker, *supra* note 164, at 202.

177. 332 U.S. 392 (1947).

178. *Ill. Tool Works*, 547 U.S. at 45–46.

179. *Id.* at 45.

180. The FTC consists of five commissioners appointed by the President, whereas the DOJ's Antitrust Division is led by “an assistant attorney general who is appointed by, and serves at the pleasure of, the president.” William J. Baer & David A. Balto, *The Politics of Federal Antitrust Enforcement*, 23 HARV. J.L. & PUB. POL'Y 113, 113 n.2 (1999).

181. See Steven T. Taylor, *Antitrust Practices Bustling with International, M&A and Class-Action Matters*, OF COUNSEL, Aug. 2006, at 1, 2 (relating that “with most Republican administrations, antitrust investigations . . . wane”).

182. See Daniel A. Crane, *Obama's Antitrust Agenda*, REG., Fall 2009, at 16, 18 (remarking that the kind of case that the agencies brought changed from administration to administration).

183. Andrew Clark, *Obama Inauguration: George Bush—The Man Who Was No Longer President*, GUARDIAN.CO.UK, Jan. 20, 2009, <http://www.guardian.co.uk/world/2009/jan/20/obama-inauguration-george-bush>.

however, signaled a more aggressive stance toward antitrust enforcement<sup>184</sup> and a willingness to jettison approaches of the Bush-era agencies.<sup>185</sup> Nonetheless, these actions may not portend a DOJ and FTC that are less encouraging of ex ante licensing negotiations for two reasons. First, while the agencies under the Bush Administration largely ignored monopolization cases<sup>186</sup> and merger reviews,<sup>187</sup> they aggressively fought price-fixing cartels<sup>188</sup>—one of the two types of Section 1 violations the agencies feared ex ante licensing negotiations would facilitate.<sup>189</sup> Yet, at the same time they were fighting price-fixing cartels, the agencies *also* issued statements that encouraged ex ante licensing negotiations.<sup>190</sup> Even if the Obama-era enforcement agencies are as aggressive at fighting price-fixing cartels, which appears not to be the case,<sup>191</sup> it does not necessarily follow that they will take a less encouraging approach toward ex ante licensing negotiations.

Second, President Obama appointed Commissioner Jon Leibowitz, who joined the majority in *N-Data*,<sup>192</sup> to chair the FTC.<sup>193</sup> In *N-Data*, N-Data allegedly “repudiated a prior licensing commitment made to a standard-setting organization, demanding royalties higher than the original offer made when the organization was deciding whether to adopt the patented technology.”<sup>194</sup> While the case was decided under Section 5 of the FTC Act,<sup>195</sup> it is relevant in the context of Section 1 of the Sherman Act both because of its pro-SSO statements and its broad interpretation of the FTC’s enforcement powers. Specifically, the majority reasoned that “[c]onduct like N-Data’s—which undermines standard-setting—threatens to stall [one of

184. See Crane, *supra* note 182, at 18 (“There is no doubt that the Obama administration is trying to up the tempo of antitrust enforcement.”).

185. See *id.* at 16 (discussing “the dramatic decision of Christine Varney—the Obama administration’s new Antitrust Division head—to jettison the entire report on monopolization offenses released by the Bush Justice Department just eight months earlier”).

186. Sean Gates, *Obama’s Antitrust Enforcers: What Can We Expect?*, ANTITRUST SOURCE, Apr. 2009, at 1, 2 (“[T]he Bush administration DOJ did not bring a single monopolization case.”).

187. See *id.* at 6 (remarking that President Obama “cited statistics showing that [during the Bush Administration], the antitrust agencies challenged mergers at less than half the rate of the prior four years under the Clinton administration”).

188. See Crane, *supra* note 182, at 18 (“In recent decades, Republican administrations have prioritized fighting price-fixing cartels.”).

189. See *supra* notes 67–72 and accompanying text.

190. See *supra* notes 102–52 and accompanying text.

191. See Crane, *supra* note 182, at 18 (indicating that agencies in recent Republican administrations have brought price-fixing cartel cases, rather than monopolization cases or merger reviews); Gates, *supra* note 186, at 1 (arguing that actions taken by the Obama agencies “will likely lead [to] a resurgence of antitrust enforcement in both the [single-firm] conduct and merger areas,” while making no mention of any change in the agencies’ position toward price-fixing cartels).

192. In the Matter of Negotiated Data Solutions LLC, Statement of the Fed. Trade Comm’n (2008) [hereinafter N-Data Statement], available at <http://www.ftc.gov/os/caselist/0510094/0810122statement.pdf>.

193. Gates, *supra* note 186, at 1.

194. *Id.* at 4.

195. N-Data Statement, *supra* note 192, at 1.

the] engine[s driving the modern economy] to the detriment of all consumers.”<sup>196</sup> And, in finding N-Data’s alleged conduct to be a Section 5 violation, the majority condemned N-Data’s conduct arguably without finding a concurrent Sherman Act violation<sup>197</sup>—extending the FTC’s powers beyond those popularly viewed permissible<sup>198</sup>—and “alleged that the conduct was an ‘unfair practice’ . . . , an allegation normally reserved for consumer protection matters, not competition matters involving major corporations.”<sup>199</sup> As Chairman, Leibowitz may also be willing to use the FTC’s enforcement powers broadly to address conduct, such as barriers to ex ante licensing negotiations, that “undermines standard-setting.”<sup>200</sup>

*e. Existing Safe Harbors Offer Little Protection.*—The two existing safe harbors for which SSOs may qualify are either largely unavailable or offer little protection. First, in the IP Guidelines, the DOJ and the FTC established safety zones for restraints in IP-licensing arrangements that affect competition in both goods and technology markets, provided that the restraints are not facially anticompetitive.<sup>201</sup> The agencies will not challenge a restraint if the licensor and its licensees collectively account for no more than 20% of the goods market significantly affected by the restraint.<sup>202</sup> This, however, may not be the case in many SSOs. As long as the analysis of the goods market alone adequately addresses the effects of the licensing arrangement on competition among technologies, the agencies will assess the restraint by reference only to the goods market.<sup>203</sup> If analysis of the goods market alone is insufficient, however, and “if market share data are unavailable or do not accurately represent competitive significance,” a safety zone exists for a restraint “that may affect competition in a technology market if . . . there are four or more independently controlled technologies in addition to the technologies controlled by the parties to the licensing arrangement that may be substitutable for the licensed technology at a comparable cost to the user.”<sup>204</sup> However, because in complex industries

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196. *Id.* at 3.

197. *See* Gates, *supra* note 186, at 4 (indicating that the “conduct arguably did not violate Section 2” of the Sherman Act).

198. *See id.* at 3 (relating that Chairman Leibowitz’s view—“that the FTC has powers that reach beyond the bounds of Section 2 [of the Sherman Act], allowing the FTC to condemn conduct that neither the DOJ nor private antitrust litigants may challenge”—is not the prevailing position).

199. *Id.* at 4.

200. N-Data Statement, *supra* note 192, at 3.

201. IP GUIDELINES, *supra* note 26, at 22–23. “‘Facially anticompetitive’ refers to restraints that normally warrant per se treatment, as well as other restraints of a kind that would always or almost always tend to reduce output or increase prices.” *Id.* at 22 n.30.

202. *Id.* at 22.

203. *Id.*

204. *Id.* at 23.

there often are no substitutable technologies,<sup>205</sup> this safe harbor often may be unavailable.

Second, under the Standards Development Organization Advancement Act (SDOAA),<sup>206</sup> enacted by Congress in 2004, “SSOs that engage in a defined range of ‘standards development activity’ will be subject to antitrust challenge only under the rule of reason standard”<sup>207</sup> and subject to only actual—not treble—damages.<sup>208</sup> However, this safe harbor does not apply to individual firms participating in an SSO’s standards development process.<sup>209</sup> Nor does it extend to the “[e]xchang[e of] information among competitors relating to cost, sales, profitability, prices, marketing, or distribution of any product, process, or service that is not reasonably required for the purpose of developing or promulgating a voluntary consensus standard, or using such standard in conformity assessment activities,”<sup>210</sup> which may include ex ante licensing negotiations—the SDOAA is unclear.<sup>211</sup> Because SSO members “remain at risk of claims alleging that their [ex ante] royalty communications are illegal per se”<sup>212</sup> and of treble damages and because ex ante licensing negotiations may themselves constitute per se illegal activity, the SDOAA offers little protection to SSOs that wish to pursue such negotiations.

Several commentators have advocated providing a safe harbor to SSOs specifically for ex ante licensing negotiations.<sup>213</sup> Such a safe harbor would constitute clear legal guidance<sup>214</sup> and would encourage SSOs to engage in

205. Damien Geradin, *Pricing Abuses by Essential Patent Holders in a Standard-Setting Context: A View from Europe* 12 (Tilburg Law & Econ. Ctr., Working Paper No. 1174922, 2008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1174922](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1174922) (“In many instances of standard development, . . . no sufficiently attractive alternative technology exists.”).

206. Standards Development Organization Advancement Act of 2004, 15 U.S.C. §§ 4301–4306 (2006).

207. Kelly & Prywes, *supra* note 35, at 6.

208. See Masoudi, Jan. 18 Speech, *supra* note 104, at 11 (explaining that the Act grants limited immunity from treble damages if the SSOs file notification of their activities with the agencies).

209. 15 U.S.C. § 4301(a)(8).

210. *Id.* § 4301(c)(1).

211. See Greg R. Vetter, *Open Source Licensing and Scattering Opportunism in Software Standards*, 48 B.C. L. REV. 225, 237–38 (2007) (“Discussing licensing in the S[SO], however, creates a potential dilemma: are licensing terms an intellectual property policy, or does such discussion constitute . . . prohibited exchange of information . . . ? The Act gives little guidance on how to resolve this tension.”).

212. Kelly & Prywes, *supra* note 35, at 6.

213. See, e.g., Alan Devlin, *Standard-Setting and the Failure of Price Competition*, 65 N.Y.U. ANN. SURV. AM. L. 217, 223 (2009) (“[T]here should be an explicit safe harbor provision for SSOs that require prospective licensors to declare their most restrictive licensing terms, including the highest royalty rate, ex ante.”).

214. See Kelly & Prywes, *supra* note 35, at 11 (asserting that “[t]he time has arrived to bring greater certainty into the area of ex ante royalty communications” and that “[t]he federal antitrust agencies, and Congress, should seriously consider adopting such safety zones in the near future”).

such negotiations.<sup>215</sup> However, the agencies may be cautious to offer blanket protection to such conduct because they know so little about its anticompetitive effects:<sup>216</sup> in other contexts, the agencies have offered safe harbors only after building up institutional knowledge.<sup>217</sup> Here, I take no position: a safe harbor may “jumpstart” ex ante licensing negotiations, but so too may additional, clear legal guidance. Regardless, it is important to note that a safe harbor defined by the agencies, such as those in the IP Guidelines, would not be binding upon private antitrust suits, although it may be influential upon the courts.<sup>218</sup> A safe harbor defined by new legislation, such as that in the SDOAA, would be binding.<sup>219</sup>

2. *The Enforcement Agencies Fail to Provide Clear Legal Guidance for Two Reasons.*—The enforcement agencies’ statements on ex ante licensing negotiations did not provide sufficiently clear legal guidance for two reasons: (1) what constitutes permissible conduct in joint ex ante licensing negotiations occurring within the SSO is unclear, and (2) assuming the rule of reason is applied to such joint negotiations, how the agencies will conduct their analysis is unclear when technology markets are implicated.

In the two business review letters and the IP2 Report, the enforcement agencies indicated that both voluntary and required unilateral disclosures of licensing terms occurring within the SSO and voluntary, bilateral negotiations occurring outside the SSO are permissible.<sup>220</sup> What is less clear, however, is what type of voluntary or required joint negotiation is per se illegal and what type will be analyzed under the rule of reason. To this end, the agencies made three relevant statements: (1) per se “condemnation is not warranted for joint SSO activities that mitigate hold up and that take place before deciding which technology to include in a standard;”<sup>221</sup> (2) however, any attempt “to use the declaration process as a cover for price-fixing of downstream goods or to rig bids among patent holders” would be a per se violation of Section 1;<sup>222</sup> and (3) joint negotiations in which “there were no viable alternatives to a particular patented technology that is incorporated

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215. *Cf. id.* at 6 (“SSOs and their respective industries would greatly benefit from the development of ‘safety zone’ guidelines which, if followed by SSOs, would ensure that antitrust action will not be taken by the federal antitrust agencies absent extraordinary circumstances.”).

216. *See infra* text accompanying note 230.

217. *See, e.g.,* Neil B. Cohen & Charles A. Sullivan, *The Herfindahl-Hirschman Index and the New Antitrust Merger Guidelines: Concentrating on Concentration*, 62 TEXAS L. REV. 453, 461 n.45 (1983) (“One can . . . identify examples, especially in the safe harbor area, in which the 1982 [Merger] Guidelines will immunize a merger that would have been challenged under the 1968 version.”).

218. Kelly & Prywes, *supra* note 35, at 6.

219. *Id.*

220. *See supra* notes 146–52 and accompanying text.

221. IP2 REPORT, *supra* note 29, at 54.

222. *See supra* note 126 and accompanying text.

into a standard, the IP holder's market power was not enhanced by the standard, and all potential licensees refuse to license that particular patented technology except on agreed upon licensing terms" might also be per se illegal.<sup>223</sup>

These statements raise several questions: (1) To what extent is a showing that the joint ex ante negotiation mitigated hold up relevant? (2) What circumstantial evidence will be considered proof of the use of the negotiations as a cover for price-fixing or bid-rigging? (3) What circumstantial evidence will be considered proof that all potential licensees refused to license except on agreed upon licensing terms? Questions (2) and (3) are particularly pertinent because in civil prosecutions, the SSO's intent need not be shown.<sup>224</sup> Question (3) may arise more often than anticipated because one of the conditions identified as encouraging the exercise of group buying power—no viable alternatives to a particular patented technology—may be quite common.<sup>225</sup>

Additionally, assuming the rule of reason is applied, the framework used by the agencies—and possibly mimicked by the courts<sup>226</sup>—to analyze the conduct is unclear when technology markets are implicated. For example, the agencies will analyze only the goods market when "[t]he competitive effects of licensing arrangements . . . can be adequately assessed within the relevant markets for the goods affected by the arrangements"<sup>227</sup> but "may rely on technology markets" when rights to IP are marketed separately from the products in which they are used,<sup>228</sup> as will often be the case in ex ante licensing negotiations.<sup>229</sup> What constitutes competitive effects that "can be adequately assessed" within the goods market and the point at which technology markets "may" be analyzed is unclear, particularly as relevant case law is absent.

### C. *How the Enforcement Agencies Should Provide Clear Legal Guidance*

The enforcement agencies' failure to provide sufficiently clear guidance on ex ante licensing negotiations is unsurprising: because "S[S]O practices

223. See *supra* note 145 and accompanying text.

224. While specific intent must be proved in a criminal prosecution, in a civil prosecution, the plaintiff need only establish an unlawful intent or an anticompetitive effect. THOMAS V. VAKERICS, ANTITRUST BASICS § 1.05 (2009).

225. See *supra* note 209.

226. See *Roundtable Discussion, supra* note 51, at 9 (stating in the context of the proposed redrafting of the Horizontal Merger Guidelines, "[t]he agencies might as well concede that the courts are going to rely on them and draft them accordingly").

227. IP GUIDELINES, *supra* note 26, at 7–8.

228. *Id.* at 8.

229. See Damien Geradin, *What's Wrong with Royalties in High Technology Industries?* 3 (Tilburg Law & Econ. Ctr., Working Paper No. DP 2009-043, 2008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1104315](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1104315) (indicating that licensing agreements include pure upstream firms that "conduct research and development activities and patent their innovations, but . . . do not engage in manufacturing").

are evolving and it is not yet clear what the specific practices and their effects are likely to be” and because “[s]ound antitrust analysis is fact-specific and, at least outside the realm of [per se] violations, is effects-based,” the agencies have chosen to “reserv[e] judgment on the many S[S]O practices that have not come before them.”<sup>230</sup> Similarly, when issuing guidelines on horizontal mergers, the agencies’ first attempts at guidance were vague and difficult to apply; it was not until later revisions that the framework became clearly defined.<sup>231</sup> Nonetheless, without clear legal guidance, SSOs’ fears of antitrust liability likely will not be allayed sufficiently to encourage them to engage in ex ante licensing negotiations. Going forward, if the agencies do wish to provide additional guidance, they should do so primarily in reports and commentaries, the latter of which have been used by the agencies to provide example analyses in other contexts.<sup>232</sup> Based upon the agencies’ experience in other contexts, the agencies should use reports to provide more guidance on the framework that they and the courts should use to analyze ex ante licensing negotiations<sup>233</sup> and the commentaries to provide examples of analyses<sup>234</sup> applied to joint negotiations conducted within the SSO, for example. While the economic thinking that informs the agencies’ approach will and does change, experience has shown that the enforcement agencies can and do update the reports to reflect these changes and that the courts can and do alter their analyses accordingly.

The agencies’ approach toward ex ante licensing negotiations will likely change over time, both as the agencies gain more institutional knowledge about such negotiations as more SSOs engage in them<sup>235</sup> and as economic

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230. Masoudi, Jan. 18 Speech, *supra* note 104, at 1.

231. See Gina M. Killian, Note, *Bank Mergers and the Department of Justice’s Horizontal Merger Guidelines: A Critique and Proposal*, 69 NOTRE DAME L. REV. 857, 880–81 (1994) (explaining that while the 1984 Merger Guidelines’ vague analysis was hard to apply, the 1992 Merger Guidelines’ three-part analysis “should enable regulators to more clearly identify a committed entrant”).

232. *E.g.*, U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES (2006), *available at* <http://www.justice.gov/atr/public/guidelines/215247.htm>. All of this is not to say that the agencies should stop issuing speeches and business review letters. Instead, I argue that the bulk of the agencies’ guidance should be disseminated through reports and commentaries.

233. See *Roundtable Discussion*, *supra* note 51, at 9 (soliciting from Paul Denis, one of the principal drafters of the 1992 Merger Guidelines, that “[t]he Guidelines ought to provide th[e] framework and literally become the outline the staff uses to organize information necessary to support their recommendations” and that the 1992 Merger Guidelines, and any update to them, “can also guide the courts”).

234. See *id.* (“The Guidelines cannot be a detailed description of how the facts in each case will be analyzed because the appropriate analysis will vary depending on the very different circumstances of each case. A commentary . . . , describing examples of analyses that have been used in the past, could be useful.”).

235. See Masoudi, Jan. 18 Speech, *supra* note 104, at 1 (“The application of antitrust law to . . . the use of [ex ante] licensing regimes by S[S]Os . . . is unsettled. . . . [T]he U.S. antitrust agencies are reserving judgment on the many S[S]O practices that have not come before them.”).

thinking evolves.<sup>236</sup> In other contexts, the agencies have accommodated these changes by updating their reports, effectively providing notice to firms, lawyers, and courts.<sup>237</sup> Notice, however, does not mean that SSOs that relied upon the agencies' previous statements to engage in ex ante licensing negotiations may not subsequently find themselves liable. To allay such fears, the agencies have stated that "businesses, when applying guidance put forth by the enforcement agencies, should have every confidence that past guidance will be adapted to new developments in a flexible and efficient way."<sup>238</sup> Moreover, even when administrations change, the agencies rarely reject a recently announced approach wholesale.<sup>239</sup> However, such liability in fact may arise if either (1) the agencies apply the rule of reason to conduct previously considered per se illegal but the courts fail to follow, or (2) the agencies find previously permissible conduct unreasonable.

While the agencies have indicated that the rule of reason generally should apply to ex ante licensing negotiations, the courts may fail to follow, at least immediately, and find SSOs liable for conduct taken in reliance upon the agencies' current statements. Historically, this has occurred in other contexts; for example, the Supreme Court's eleven-year delay in holding that the possession of IP in a tying product is not per se illegal.<sup>240</sup> While the

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236. See Press Release, Fed. Trade Comm'n, Federal Trade Commission and Department of Justice to Hold Workshops Concerning Horizontal Merger Guidelines (Sept. 22, 2009), available at <http://www.ftc.gov/opa/2009/09/mgr.shtm> (indicating that the FTC and the DOJ are considering updating the 1992 Merger Guidelines in part "to take into account legal and economic developments that have occurred"). The agencies' approach toward tying provides a good example: in 1972, the Deputy Assistant Attorney General for Antitrust stated that tying the sale of patented goods to unpatented materials was prohibited; however, in the IP Guidelines, the agencies reversed course by presuming that a patent did not necessarily confer market power upon its owner. Michael G. Egge & Nathan D. Grow, *An Introduction to the Interface Between Antitrust and Intellectual Property*, in UNDERSTANDING THE INTELLECTUAL PROPERTY LICENSE 2005, at 613, 616–17, 620 (2005).

237. See Press Release, *supra* note 236 ("Merger Guidelines were first adopted in 1968 by DOJ. They were substantially revised in 1982 and again in 1992, when they became the Horizontal Merger Guidelines, jointly issued by the FTC and DOJ. The section on efficiencies was revised in 1997.").

238. Masoudi, Jan. 18 Speech, *supra* note 104, at 16.

239. I have found only two examples of a subsequent administration explicitly rejecting a former administration's antitrust guidelines: (1) Assistant Attorney General Anne Bingaman's 1993 rescission of the Reagan-era 1985 Vertical Restraint Guidelines, see Alexis, Sauro & Ahluwalia, *supra* note 54, at 55, and (2) Assistant Attorney General Christine Varney's 2009 rescission of the Bush-era Section 2 Report, see Russell, *supra* note 50, at 640. In both instances, however, it is unlikely that many firms were adversely affected. For example, when the 1985 Vertical Restraint Guidelines were rescinded, the announcement was displayed in the Antitrust Division's Manual on its website, providing firms notice. Alexis, Sauro & Ahluwalia, *supra* note 54, at 55. The Section 2 Report was rejected only eight months after it was adopted, limiting the number of firms that had relied upon it. See *supra* note 185. Moreover, the circumstances surrounding its adoption also likely limited reliance: while the FTC and the DOJ had conducted joint hearings in anticipation of the report, the FTC refused to endorse it and issued a critique joined by three of the four FTC commissioners. Chris Bernard, Note, *Shifting and Shrinking Common Ground: Recalibrating the Federal Trade Commission's and Department of Justice's Enforcement Powers of Single-Firm Monopoly Conduct*, 34 DEL. J. CORP. L. 581, 582, 586–87 (2009).

240. See *supra* notes 176–79 and accompanying text.

agencies cannot require the courts' compliance, they likely can expedite it by providing clear legal guidance, as discussed above.<sup>241</sup>

Second, if the agencies find previously permissible conduct unreasonable, SSOs that relied upon their previous statements may find themselves facing liability. As long as the agencies' change in approach is clear and as long as it is not retroactive, SSOs likely have little to fear. However, a real possibility exists that the modification will not be clear, given the criticisms of the agencies' current statements waged here and the agencies' inability to explain their new approach toward mergers in *Baker Hughes* and *Syufy*.<sup>242</sup> Here, the courts have a real role to play by not finding liability and forcing the agencies to better explain their revised analysis. In the aftermath of *Baker Hughes* and *Syufy*, the agencies drafted the 1992 Merger Guidelines, successfully articulated the change in their analysis, and stopped habitually losing merger challenges on grounds of ease of entry.<sup>243</sup>

## V. Conclusion

In stating that the rule of reason typically would be applied and sanctioning proposed patent policies such as those considered by VITA and IEEE, the DOJ and the FTC signaled a change in their approach toward ex ante licensing negotiations. To those SSOs that would like to engage in such negotiations to mitigate holdup, these statements are welcome. However, because SSOs historically have feared antitrust liability arising from such conduct—going so far as to outright forbid it—the agencies need to provide clear legal guidance as to which types of negotiations will and will not warrant their attention. In the statements issued in 2006 and 2007, however, the agencies failed to do so sufficiently. As a result and without more, it is unlikely that their policy will be implemented and that they, SSOs, and academics will know whether ex ante licensing negotiations are in fact desirable.

To remedy the situation, the agencies must clarify both what constitutes permissible conduct in joint ex ante licensing negotiations occurring within the SSO and, assuming the rule of reason is applied to such negotiations, how the agencies will conduct their analysis when technology markets are implicated. And while the approach of the agencies likely will evolve over time as they gain more experience and as economic thinking changes, historically, the agencies have proven capable of updating their guidance through reports and commentaries. Nonetheless, SSOs that engage in ex ante licensing negotiations today might find themselves liable tomorrow under the agencies' updated approach. To reduce the likelihood of this occurring, both

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241. See *supra* Part IV.

242. See *supra* notes 166–71 and accompanying text.

243. See *supra* notes 172–74 and accompanying text.

the agencies, by providing clear legal guidance to the courts, and the courts, by forcing the agencies to effectively articulate their modified approach, have a role to play.

—*Lauren E. Barrows*