United States Federal Trade Commission

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FTC Challenges Patent Holder's Refusal to Meet Commitment to License Patents Covering 'Ethernet' Standard Used in Virtually All Personal Computers in U.S.

The Federal Trade Commission today announced a complaint and settlement with Negotiated Data Solutions LLC (N-Data), which allegedly violated federal law by engaging in unfair methods of competition and unfair acts or practices regarding its enforcement of certain patents against makers of equipment employing Ethernet, a computer networking standard used in nearly every computer sold in the U.S. The settlement will protect consumers from higher prices and ensure competition by preventing the company from charging higher royalties for the technologies used in the standard. The Commission found N-Data liable for its conduct under Section 5 of the FTC Act, alone, without a concurrent determination that the conduct rose to the level of a Sherman Act violation. The vote was 3-2 with Commissioners Pamela Jones Harbour, Jon Leibowitz, and J. Thomas Rosch in the majority and Chairman Deborah Platt Majoras and Commissioner William E. Kovacic dissenting and issuing separate statements.

According to the majority, "We recognize that some may criticize the Commission for broadly (but appropriately) applying our unfairness authority to stop the conduct alleged in this Complaint." But the FTC's authority to stop anticompetitive conduct that does not rise to the level of a Sherman Act violation is unique among federal agencies – and "the cost of ignoring this particularly pernicious problem is too high. Using our statutory authority to its fullest extent is not only consistent with the Commission's obligations, but also essential to preserving a free and dynamic marketplace."

Chairman Majoras disagreed with the majority's determination of liability, stating that "[t]his case departs materially from the prior line [of FTC standard-setting 'hold-up' challenges], in that there is no allegation that [the patent holder] engaged in improper or exclusionary conduct to induce IEEE [Institute of Electrical and Electronics Engineers] to specify its NWay technology" into the relevant standard. "The majority has not identified a meaningful limiting principle that indicates when an action – taken in the standard-setting context or otherwise – will be considered an 'unfair method of competition,'" she said, adding also, "The novel use of our consumer protection authority to protect large corporate members of a standard-setting organization is insupportable."

N-Data, based in Chicago, is engaged in the business of licensing patents that it has acquired from inventors or other holders of patents. The patents involved in this matter were originally held by National Semiconductor Corporation (National). According to the FTC's complaint, in 1994 National made a commitment to an electronics industry standard setting organization, the IEEE, that if the IEEE adopted a standard based on National's patented NWay technology, National would offer to license the technology, for a one-time, paid-up royalty of $1,000 per licensee, to manufacturers and sellers of products that use the IEEE standard.

NWay technology enables two devices at opposite ends of a local area network (LAN) link to exchange information and automatically configure themselves to optimize their communication. This process is sometimes referred to as "autonegotiation." Standardizing on a single autonegotiation technology allowed devices made by different manufacturers to work with one another and with different generations of Ethernet equipment.

As alleged in the complaint, N-Data obtained the patents knowing about National's prior commitment and after the industry became committed to the standard, but N-Data has refused to comply with that commitment and instead has demanded royalties far in excess of that commitment. The complaint alleges that because N-Data began demanding royalties after it became expensive and difficult for the industry to switch to another standard, N-Data was able to demand higher royalties than the industry otherwise would have paid for the technologies. The complaint also alleges that consumers would be harmed because of N-Data's conduct for a number of reasons, including that firms would be less likely to assist in the development of industry standards, and that many firms would be unwilling to rely on such standards even if they were developed. In addition, the complaint alleges that consumers would be forced to pay higher prices because of N-Data's conduct.

N-Data has settled the charges and will be placed under an order prohibiting it from enforcing the patents unless it has first offered the patent license attached to the order, which is based on the terms offered in 1994, before the patented technology was incorporated into the Ethernet standard.

The Commission vote to issue the complaint and accept the consent order and to place a copy on the public record was 3-2, with Commissioners Harbour, Leibowitz, and Rosch voting yes and issuing a majority statement, and Chairman Majoras and

Commissioner Kovacic voting no and issuing separate dissenting statements. The order will be subject to public comment for 30 days, until February 22, 2008, after which the Commission will decide whether to make it final. Comments should be sent to: FTC, Office of the Secretary, 600 Pennsylvania Ave., N.W., Washington, DC 20580.

NOTE: The Commission issues a complaint when it has "reason to believe" that the law has been or is being violated, and it appears to the Commission that a proceeding is in the public interest. The complaint is not a finding or ruling that the defendant has actually violated the law. The stipulated order is for settlement purposes only and does not constitute an admission by the defendant of a law violation. A consent agreement is for settlement purposes only and does not constitute an admission of a law violation. When the Commission issues a consent order on
a final basis, it carries the force of law with respect to future actions. Each violation of such an order may result in a civil penalty of $11,000.

Copies of the complaint, consent agreement, and an analysis of the agreement to aid in public comment are available from the FTC's Web site at http://www.ftc.gov and also from the FTC's Consumer Response Center, Room 130, 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. The FTC's Bureau of Competition works with the Bureau of Economics to investigate alleged anticompetitive business practices and, when appropriate, recommends that the Commission take law enforcement action. To inform the Bureau about particular business practices, call 202-326-3300, send an e-mail to antitrust@ftc.gov, or write to the Office of Policy and Coordination, Room 394, Bureau of Competition, Federal Trade Commission, 600 Pennsylvania Ave, N.W., Washington, DC 20580. To learn more about the Bureau of Competition, read "Competition Counts" at http://www.ftc.gov/competitioncounts.

MEDIA CONTACT:

Frank Dorman
Office of Public Affairs
202-326-2674

STAFF CONTACT:

Kent E. Cox
Bureau of Competition
202-326-2058