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State Council Legislative Affairs Office
No. 33 Ping'anli Xidajie
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The People's Republic of China

Re Comments on the Revised Draft Amendments to the Patent Law

Ladies and Gentlemen:

The State Council Legislative Affairs Office of the People's Republic of China (LAO) has invited public comments on the Revised Draft of the Patent Law Amendments. I respectfully submit my comments and suggestions to the Revised Draft.

My name is J. Gregory Sidak. I am the founder and chairman of Criterion Economics, L.L.C. in Washington, D.C. I am also a founding co-editor of the *Journal of Competition Law & Economics*, published quarterly by the Oxford University Press since 2005. For more than three decades, I have worked at the intersection of law and economics in academia, government, and private practice. As an expert economic consultant, I have served clients in the Americas, Europe, and the Pacific. I have done extensive work in the area of standard-essential patents (SEPs): I have testified as an economic expert on issues regarding fair, reasonable, and nondiscriminatory (FRAND) licensing in various legal proceedings, I have published academic articles, and I have presented my research at international conferences on FRAND matters and related topics. I have also served as Judge Richard Posner's court-appointed neutral economic expert on patent damages in the U.S. District Court for the Northern District of Illinois. With respect to this submission, I do not represent any party, and I have no economic interest in the adoption of the Intellectual Property Enforcement Guidelines.

I attach four articles that I have written in recent years that add depth to the ideas expressed in my comments submitted herein. The first article, *Bargaining Power and Patent Damages*, presents the basic economic principles that guide the calculation of patent damages.[1] The second article, *The Meaning of FRAND, Part I: Royalties*, analyzes the economic methodology to determine a FRAND royalty for SEPs.[2] The third article, *Apportionment, FRAND Royalties, and Comparable Licenses After Ericsson v. D-Link*, explains how U.S. courts' decisions can assist courts in other

1. J. Gregory Sidak, *Bargaining Power and Patent Damages*, 19 STAN. TECH. L. REV. 1 (2015), https://www.criterioneconomics.com/bargaining-power-and-patent-damages.html.

2. J. Gregory Sidak, *The Meaning of FRAND, Part I: Royalties*, 9 J. COMPETITION L. & ECON. 931 (2013), https://www.criterioneconomics.com/meaning-of-frand-royalties-for-standard-essential-patents.html.

jurisdictions in determining a FRAND royalty.[3] The fourth article, *Evading Portfolio Royalties for Standard-Essential Patents Through Validity Challenges*, examines, among other things, the risk of opportunistic litigation by implementers of SEPs.[4]

I. Article 14 Risks Introducing Legal Uncertainty that Would Harm Consumers and Innovation

Article 14 of the Revised Draft provides that "[t]hose who apply for [a] patent and exercise [a] patent right shall follow the good faith principle rather than abuse the patent right to damage public interests or unreasonably exclude or restrict competition."[5] The provision seems to introduce into the Patent Law the concept of an "abuse of a dominant position" already embodied in Chinese competition law. I believe that introducing such a provision in the Patent Law could increase prices, reduce innovation, and thus harm consumers.

I understand that Chinese Antimonopoly law contains a provision that prohibits dominant companies from "abus[ing] a dominant market position to eliminate or restrict competition,"[6] and that the Rules on Stopping the Abuse of Intellectual Property to Eliminate or Restrict Competitive Conduct clarify the circumstances in which the exercise of patent rights could amount to such an abuse.[7] I also understand that Chinese authorities are in the process of adopting guidelines that will clarify how the Antimonopoly Law applies to intellectual property rights. Because the existing legal provisions already prohibit a dominant company, such as a dominant patent holder, from abusing its position, there is no need to include a similar prohibition in the Revised Draft.

Prohibiting the same conduct in multiple legal acts could lead to an inconsistent interpretation of the prohibition and, in turn, result in legal uncertainty. Economists and legal scholars have widely acknowledged the negative effects that legal uncertainty has for consumers.[8] In economic terms, legal uncertainty would increase transactions costs and, consequently, prices for consumers. Legal uncertainty would also reduce innovation, if the increased transaction costs decrease the patent holder's investment in research and development. Legal uncertainty

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3. J. Gregory Sidak, *Apportionment, FRAND Royalties, and Comparable Licenses After Ericsson v. D-Link*, 2016 U. ILL. L. REV. (forthcoming 2016), https://www.criterioneconomics.com/apportionment-frand-royalties-comparable-licenses-ericsson-dlink.html.

4. J. Gregory Sidak, *Evading Portfolio Royalties Through Standard-Essential Patents Through Validity Challenges*, 39 WORLD COMPETITION (forthcoming 2016), https://www.criterioneconomics.com/docs/evading-portfolio-royalties-for-seps.pdf.

5. Draft Amendment to the Patent Law of the People's Republic of China (draft for review) (promulgated by the Legis. Aff. Off. St. Council, Dec. 2, 2015), LEGIS. AFF. OFF. ST. COUNCIL 1, 5 art. 14 (China), http://images.chinalaw.gov.cn/www/201512/20151202075620423.doc [hereinafter Draft] (unofficial English translation available at https://chinaipr2.files.wordpress.com/2015/12/comparison-table-of-patent-law-amendments.doc).

6. The Antimonopoly Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008) 2007 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. 517, art. 55 (China), http://www.gov.cn/flfg/2007-08/30/content_732591.htm.

7. Prohibition of the Abuse of Intellectual Property Rights to Eliminate or Restrict Competition Behavior (promulgated by the State Admin. of Indus. and Commerce, Apr. 7, 2015, effective Aug. 1, 2015), Order No. 74 (China), http://www.saic.gov.cn/zwgk/zyfb/zjl/fld/201504/t20150413_155103.html.

8. Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J.L. ECON. & ORG. 279, 298–99 (1986); Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175, 1178–83 (1989); Kathleen M. Sullivan, *The Supreme Court, 1991 Term—Foreword: The Justices of Rules and Standards*, 106 HARV. L. REV. 22, 62–64 (1992); Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953, 957 (1995); Helmut Wagner, *Economic Analysis of Cross-Border Legal Uncertainty, in* THE NEED FOR A EUROPEAN CONTRACT LAW: EMPIRICAL AND LEGAL PERSPECTIVES 25, 44 (Jan Smits ed., Europa Law Publishing 2005).

could also deter procompetitive practices, if a patent holder, fearing liability under Article 14, would avoid activities that benefit consumers.[9]

In addition, legal uncertainty regarding the scope of Article 14 could increase opportunistic litigation—that is, litigation in which a party seeks some collateral gain from a dispute that is unrelated to the decision on the merits.[10] Consider the example of an unwilling licensee that is negotiating a royalty for the use of SEPs. Assume that the patent holder has offered to license its SEP portfolio to Company *A* for 10 Yuan and assume further that such a royalty is FRAND. During the negotiation process, Company *A* could try to gain bargaining power over the SEP holder by threatening to initiate a legal action under Article 14. The uncertainty about the exact scope of Article 14 could stimulate the patent holder to accept a lower royalty, perhaps even below a FRAND rate, to avoid the risk of an unjust condemnation. Article 14's prohibition could thus undermine the very purpose of the amendments—that is, to "[i]ntensify patent protection to safeguard the legitimate rights and interests of right holders."[11]

LAO could address those concerns by deleting Article 14. Alternatively, LAO could revise Article 14 to clarify that competition law does not differentiate patent rights from other forms of property. In the United States, for example, competition authorities have recognized that, "for the purpose of antitrust analysis, . . . intellectual property [is] essentially comparable to any other form of property."[12] Although the exercise of a patent right does typically not raise anticompetitive concerns, a patent holder (as a holder of any other tangible property) is not exempt from the prohibitions of competition law. Article 14 could thus clarify that the patent holder's conduct should comply with the relevant provisions in the Antimonopoly Law and its implementing provisions.

II. Article 85 Risks Decreasing the Incentives to Participate in Standard-Setting Activities

Article 85 provides that, "[i]f a patentee participating in the formation of a national standard does not disclose the standard-essential patent in its possession during the formation thereof, it will be deemed as having permitted the implementer of the standard to use its patented technology."[13] Article 85 also provides that, in a case where a patent holder needs to license its SEPs, "[t]he two parties may consult about the royalties," and "[i]f no agreement can be reached, either party may request the patent administration department under the State Council to make a ruling."[14] In addition, a "party that is dissatisfied with the ruling may file a law suit with the people's court in 15 days after receipt of the notice."[15]

Presumably, Article 85 aims to address cases of "patent ambush," where a participant in the standardization process intentionally conceals the existence of patents that might be essential to

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9. *See, e.g.*, Louis Kaplow, *General Characteristics of Rules*, *in* ENCYCLOPEDIA OF LAW AND ECONOMICS, VOLUME I. THE HISTORY AND METHODOLOGY OF LAW AND ECONOMICS 502, 513 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000).

10. For a detailed discussion about the risk of opportunistic litigation, see Sidak, *Evading Portfolio Royalties for Standard-Essential Patents Through Validity Challenges*, *supra* note 4.

11. State Intellectual Property Office (SIPO), SIPO's Explanations about Draft Amendment to the Patent Law of the People's Republic of China § 3.1 (2015).

12. U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 2.0 (1995), http://www.justice.gov/atr/antitrust-guidelines-licensing-intellectual-property.

13. Draft, art. 85.

14. *Id.*

15. *Id.*

practice a standard, typically to avoid a commitment to license those patents on fair and reasonable terms. However, imposing compulsory licensing risks decreasing companies' incentives to participate in national standardization activities, and thus it harms consumers by lowering the standards' quality. Three points deserve consideration.

First, Article 85 seems to neglect that a nondisclosure of an essential patent might be unintentional. The requirement to identify every patent that is essential to practice a standard might be extremely onerous for companies that own thousands of patents and participate in multiple standard-setting organizations across the globe. Furthermore, the question of whether a patent is essential to practice a standard might be a question of patent interpretation. Some patents might be also granted after the standard has been adopted. Consequently, a failure to disclose an essential patent might be unintentional. Imposing a compulsory license because of a patent holder's oversight in declaring its patents during the standardization process is an unduly harsh remedy.

Second, imposing a compulsory license for undisclosed SEPs risks opening the door to manipulations of the standardization process. Assume, for example, that Company *A* owns a patented technology that it uses on an exclusive basis and has no intention of submitting for adoption into a standard. Assume further that Company *B*, a competitor, wants to obtain a license to Company *A*'s technology so that it could reduce Company *A*'s proprietary advantage in the market. Company *B*, in a collaboration with an SSO, could use the standardization process to extract an involuntary license from Company *A*. For example, Company *B* could persuade a national SSO to adopt a standard that reads on Company *A*'s patent and try to create conditions in which Company *A* would fail to disclose its patents. For example, the SSO could hold a standardization meeting without giving its participants reasonable advance notice. If Company *A* fails to participate in the SSO's meeting and consequently fails to disclose its patent, it would be forced to license that patent, even if it never intended to contribute that patent to an industry standard. Indeed, imposing on a patent holder a duty to license patents that it never intended to contribute to an SSO could severely undermine patent holders' incentives to participate in national standardization activities.

Third, one might ask whether the State Council is the appropriate body to determine the licensing terms for SEPs.[16] Courts are typically in a better position to determine royalties for SEPs, and China has highly specialized judges for competition and patent disputes. LOA should thus consider allowing the parties to file suit in court even before requesting a royalty determination from the State Council.

Respectfully submitted,

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Chairman

Attachments

16. For a general discussion on how to calculate FRAND royalties, see Sidak, *Bargaining Power and Patent Damages*, *supra* note 1; Sidak, *The Meaning of FRAND, Part I: Royalties*, *supra* note 2; Sidak, *Apportionment, FRAND Royalties, and Comparable Licenses After Ericsson v. D-Link*, *supra* note 3.