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National Development and Reform Commission
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Re Comments on the Anti-Monopoly Guidelines on the Abuse of Intellectual Property Rights

Ladies and Gentlemen:

The National Development and Reform Commission (NDRC) has invited public comments on its Anti-Monopoly Guidelines on the Abuse of Intellectual Property Rights (Guidelines). I respectfully submit my comments and suggestions concerning the Draft Guidelines.

My name is J. Gregory Sidak. I am the chairman of Criterion Economics, LLC 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 35 years, 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 worked extensively in the area of antitrust and patents: I have testified as an economic expert on issues regarding fair, reasonable, and nondiscriminatory (FRAND) licensing of standard-essential patents (SEPs) in various legal proceedings, I have published numerous academic articles on these topics, and I have presented my research at major universities and international conferences. 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 Anti-Monopoly Guidelines.

I attach five articles that I have written in recent years that add depth to the ideas expressed in this letter. The first article, *Bargaining Power and Patent Damages*, explains the economic principles that guide the calculation of patent damages.[1] The second article, *The Meaning of FRAND, Part I: Royalties*, examines economic methodologies 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 in cases concerning SEPs can assist courts in other jurisdictions to determine a FRAND royalty.[3] The fourth article, *Evading Portfolio Royalties for Standard-Essential Patents Through Validity Challenges*, examines the marginal benefits and costs that challenges to patents' validity have for consumers.[4] The fifth article, *The Meaning of FRAND, Part II: Injunctions*, analyzes the SEP holder's right to request an injunction from the perspectives of antitrust, contract, and patent law.[5]

I. Unfairly High Royalties

Section III.1 of the Guidelines emphasizes that a holder of intellectual property rights (IPRs) should be able to receive a reasonable return for the use of its IPRs, so that it can recoup its investment in research and development (R&D) and thus have an incentive to invest in future innovation. The Guidelines clarify that the Anti-Monopoly Law typically does not regulate the royalties for IPRs. However, Section III.1 provides that a dominant IPR holder could face antitrust liability if it compels the payment of an unfairly high royalty. That provision raises significant concerns.

Economists (including distinguished scholars who have served as chief economists to antitrust enforcement authorities) have, for a long time, advised against antitrust intervention in cases of excessive prices.[6] A high price, even an unfairly high price, does not, by itself, restrict or eliminate market competition. High prices typically impel other firms to enter the market to exploit the supracompetitive profits. In that respect, high prices tend to *increase*, rather than decrease, market competition. That increased competition should, in turn, drive prices down to competitive levels. The Supreme Court of the United States has also emphasized that a firm's ability to charge monopoly prices and reap monopoly profits, at least for a short amount of time, induces risk-taking that spurs innovation and economic growth.[7] Consequently, U.S. courts have long recognized that U.S. antitrust law does not prohibit the mere imposition of high prices.

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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.
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 for Standard-Essential Patents Through Validity Challenges*, 39 WORLD COMPETITION (forthcoming 2016), https://www.criterioneconomics.com/docs/evading-portfolio-royalties-for-seps.pdf.
5. J. Gregory Sidak, *The Meaning of FRAND, Part II: Injunctions*, 11 J. COMPETITION L. & ECON. 201 (2015), https://www.criterioneconomics.com/meaning-of-frand-injunctions-for-standard-essential-patents.html.
6. *See, e.g.*, MASSIMO MOTTA, COMPETITION POLICY: THEORY AND PRACTICE 89 (Cambridge Univ. Press 2004) ("[T]he prospect of having some market power (i.e., some profit) represents a most powerful incentive for firms to innovate and invest. Competition laws and their enforcement should therefore ensure that firms will be able to enjoy the rewards for their investments."); *see also* DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 679 (Pearson-Addison Wesley 4th ed. 2005).
7. Verizon Commc'ns Inc. v. Trinko, LLP, 540 U.S. 398, 407 (2004).

U.S. antitrust authorities have recognized that this profound economic principle also applies in the context of IPRs. For example, William Baer, Assistant Attorney General for the Antitrust Division of the U.S. Department of Justice, reiterated in September 2015 that the Antitrust Division does not "use antitrust enforcement to regulate royalties. That notion of price controls interferes with free market competition and blunts incentives to innovate. For this reason, U.S. antitrust law does not bar 'excessive pricing' in and of itself."[8]

Even in jurisdictions that prohibit dominant companies from engaging in exploitative practices (such as imposing unfair prices), antitrust authorities have typically focused their intervention on exclusionary conduct, rather than exploitative conduct. For example, Professor Massimo Motta, the current Chief Competition Economist at the Directorate General for Competition at the European Commission, has previously emphasized that intervention against excessive prices should be limited to exceptional circumstances.[9] He said that "the conditions for antitrust intervention [against excessive prices] should be very strict."[10] According to the Organisation for Economic Co-operation and Development (OECD), the European Commission suggested that its "enforcement against excessive prices is generally only contemplated in markets . . . where entry and expansion of competitors can not be expected to ensure effective competition in the foreseeable future."[11] Conversely, in a market with low barriers to entry and rapid technological advancement, antitrust intervention against high prices, including unfairly high royalties, is unwarranted.

Furthermore, even in markets with barriers to entry, antitrust intervention might be superfluous if other bodies of law, such as contract law or patent law, provide adequate tools to address concerns about the royalty level. For example, antitrust intervention against unfair royalties might be unnecessary in the context of FRAND-committed SEPs, where an implementer of an industry standard might ask the court to determine a FRAND royalty. When an SEP holder agrees to contribute its patented technology to an industry standard, it typically agrees to license that technology to the implementers of the standard on FRAND terms. Courts in the United States and the European Union treat the SEP holder's FRAND commitment as a binding contract with the SSO, and implementers of industry standards—as intended third-party beneficiaries of that contract—typically may enforce that contract in court.[12] If the SEP holder offers license terms that exceed the FRAND range, the implementer may enforce the SEP holder's FRAND commitment in court. The European Commission has noted that, in such

8. Bill Baer, Assistant Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Remarks as Prepared for Delivery at the 19th Annual International Bar Association Competition Conference, Reflections on the Role of Competition Agencies When Patents Become Essential 5 (Sept. 11, 2015), http://www.justice.gov/opa/file/782356/download [hereinafter Baer 2015 Speech].

9. Massimo Motta & Alexandre de Streel, *Excessive Pricing in Competition Law: Never Say Never?*, *in* SWEDISH COMPETITION AUTHORITY, THE PROS AND CONS OF HIGH PRICES 14, 15 (2007), http://www.konkurrensverket.se/globalassets/english/research/the-pros-and-cons-of-high-prices-14mb.pdf.

10. *Id.*

11. OCED, 2011 POLICY ROUNDTABLES: EXCESSIVE PRICES 321 (Feb. 7, 2012), http://www.oecd.org/competition/abuse/49604207.pdf (emphasis added).

12. *See* J. Gregory Sidak, *A FRAND Contract's Intended Third-Party Beneficiary* (Criterion Economics Working Paper, Jan. 5, 2016), https://www.criterioneconomics.com/a-frand-contracts-intended-third-party-beneficiary.html.

circumstances, national courts or arbitrators are generally "well equipped" to determine a FRAND royalty.[13] Consequently, antitrust intervention would be superfluous.

The NDRC should consider excluding the prohibition on unfairly high royalties from its Guidelines. Alternatively, the NDRC might opt to limit its antitrust intervention to exceptional cases. For example, the Guidelines could clarify that competition authorities will not address high royalties in markets with low barriers to entry and rapid technological advancement, or in cases where other bodies of law, such as contract law or patent law, already adequately address concerns about the royalty level.[14]

II. Unreasonable Trading Conditions: Expired Patents

Section II.4(4) of the Guidelines provides that a dominant IPR holder might restrict or eliminate competition, and thus abuse its dominant position, by requesting payment for invalid or expired patents. The prohibition presumably relies on the notion that a dominant IPR holder should not use its market position to force the licensee to pay for invalid patents. However, the prohibition in section II.4(4) risks exposing a patent holder to antitrust liability even if the patent holder does not impose any illegitimate costs on licensees or consumers.

During a negotiation to determine licensing terms for a patent portfolio, the parties lack perfect information about the value of the portfolio. Given enough time and resources, the parties could try to determine the validity and the value of every patent (and every patent claim) before executing a license. However, when parties negotiate a royalty for a large patent portfolio, as is often the case in the context of SEPs, it would be time-consuming and prohibitively costly for the parties to obtain perfect information about the validity and value of each of the hundreds or thousands of patents included in a single portfolio. To avoid these exorbitant transactions costs, the parties knowingly negotiate licensing terms with incomplete information.

Negotiating a royalty on the basis of incomplete information does not imply that the licensee will pay a royalty that exceeds an unbiased, market-disciplined estimate of the value of the licensed portfolio. During negotiation, the parties perform due diligence on the strength, scope, and enforceability of the entire portfolio. Instead of auditing the value and validity of each individual patent in the portfolio, the parties estimate the portfolio's aggregate value. The parties rationally expect that some of the patents included in the portfolio will turn out to be invalid, and they account for that possibility when determining the portfolio royalty. In other words, the portfolio royalty upon which the parties agree reflects the possibility that some of the patents included in the portfolio will be invalid. In such circumstances, it would be incorrect to claim that the patent holder is charging for invalid patents, even if the licensed portfolio ultimately includes some invalid patents.

Invalid patents are even less likely to impose any cost on potential licensees in the case of SEPs. An SEP holder typically does not license a portfolio with a fixed stock of SEPs, but rather with a

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13. Press Release, European Commission, Antitrust: Commission Sends Statement of Objections to Motorola Mobility on Potential Misuse of Mobile Phone Standard-Essential Patents—Questions and Answers (May 6, 2013), http://europa.eu/rapid/press-release_MEMO-13-403_en.htm.

14. For an in-depth analysis of the economic methodologies to calculate a FRAND royalty, see Sidak, *Apportionment, FRAND Royalties, and Comparable Licenses After* Ericsson v. D-Link, *supra* note 3; Sidak, *Bargaining Power and Patent Damages*, *supra* note 1; Sidak, *The Meaning of FRAND, Part I*, *supra* note 2.

flow of SEPs. The actual SEPs contained in a licensed portfolio can change over the license term. For example, as the standard evolves, additional patents become essential. Consequently, an SEP holder might add new patents to the licensed portfolio. The SEP holder might also remove old SEPs that are no longer valid or essential to practicing the standard. The SEP holder's practice of "rebalancing," or grooming, its patent portfolio further reduces the risk that the presence of invalid or expired SEPs imposes any significant cost on the licensee and therefore consumers.

The NDRC should account for the parties' rational expectations in negotiating a portfolio royalty when it examines the conduct of a dominant IPR holder. In particular, the Guidelines should recognize that the mere presence of invalid patents does not necessarily indicate that the patent holder is "charging" the implementer for invalid patents.[15]

III. Unreasonable Trading Conditions: No-Challenge Clauses

The Guidelines recognize that no-challenge clauses "can generally avoid lawsuit abuse and enhance transaction efficiency."[16] However, section 4.2 of the Guidelines provides that a dominant IPR holder would abuse its dominant position if it prohibits the licensee from challenging the validity or infringement of its IPRs. The provision would presumably prohibit a dominant IPR holder from including in a license agreement a no-challenge clause, or any other comparable contractual limitation on the licensee's ability to challenge the validity of the licensed IPRs after executing a license agreement. Nonetheless, economic theory suggests that, in some circumstances, the use of no-challenge clauses would benefit consumers, and there is consequently no valid economic justification to discourage dominant IPR holders from using such clauses.

As I explained above in Part II, the royalty upon which the parties have agreed typically accounts for the possibility that some licensed patents are invalid. The discovery that several SEPs in a licensed portfolio of hundreds are invalid would neither surprise the parties nor justify reducing the portfolio royalty. Thus, challenging the validity of licensed patents *after* executing a license agreement would likely generate few benefits for the licensee, and, consequently, consumers.

Conversely, allowing the licensee to continue challenging the validity of the licensed patents after executing a license agreement would undermine the finality of that agreement. Basic legal principles recognize the need to balance the interest in resolving a dispute in a fair and correct manner and the public interest in finality—that is, that disputes achieve an incontrovertible resolution. For example, the doctrine of *res judicata* extinguishes a cause of action after the court issues the final judgment deciding a dispute, such that the parties cannot further litigate the dispute on the basis of the same cause of action.

15. For an in-depth analysis of whether invalid patents increase licensing costs, see Sidak, *Evading Portfolio Royalties for Standard-Essential Patents Through Validity Challenges*, *supra* note 4.

16. Guanyu Lanyong Zhishi Chanquan de Fanlongduan Zhinan (关于滥用知识产权的反垄断指南) [Antitrust Guidelines Regarding the Abuse of Intellectual Property Rights], Guowuyuan Fanlongduan Weiyuanhui (国务院反垄断委员会) (Dec. 31, 2015) ST. COUNCIL ANTITRUST COMM. (China) (unofficial English translation provided by T&D Associates, http://uschinatradewar.com/files/2016/01/IPR-Guideline-draft-20151231-EN.pdf).

In other words, the law recognizes that, although further examination of evidence might lead to a more accurate judgment, it is in the public interest that a legal dispute reach a conclusive end. Ensuring the finality of patent-licensing agreements similarly serves the consumer's interest, particularly when those agreements conclude ongoing litigation.[17] Parties to a license agreement expend considerable resources during negotiation. Devoting additional resources thereafter to litigating the validity of the licensed SEPs distracts the parties from their core business—the research and development of new technologies and the manufacture of new products that practice those technologies. Put differently, it is in the interest of consumers that legal disputes between the patent holder and the licensee reach an end, even if some invalid patents will remain unchallenged. To encourage an indefinite number of examinations of the validity of the licensed SEPs would waste judicial resources and ultimately harm, rather than benefit, consumers.

A system that encourages unfettered validity challenges might also harm consumers by stimulating opportunistic litigation, through which a licensee seeks some collateral gain unrelated to a decision on the merits of the dispute. The licensee might have a strategic incentive to challenge the validity of individual patents so as to delay paying royalties for the entire portfolio until the court decides whether the few challenged patents are valid. A continuous and significant delay in portfolio royalty payments would decrease the patent holder's access to capital and thus impede its ability to invest in additional research and innovation. A strategy of prolonged and opportunistic litigation could coerce a patent holder urgently in need of capital to reduce its portfolio royalty simply to settle the dispute and obtain immediate (though lower) compensation from the licensee for its use of the patent portfolio. The patent holder's inability to monetize its patents adequately and expeditiously would destroy its incentive to innovate in the future. The resulting decline in the quality of innovation would harm consumer welfare.

It is worth noting that the public interest in ensuring the finality of a license agreement and avoiding opportunistic litigation does not imply that a potential licensee should not be able to challenge the patent's validity. The licensee had the opportunity to challenge the patent's validity from the time that the patent office granted the patent until the time that the licensee executed the agreement with the patent holder. A potential licensee could even challenge the validity of a licensed patent during the negotiation process, before the parties have reached an agreement. However, there is no valid justification for the licensee to wait to challenge the validity of the licensed patents until after the parties have concluded a license agreement and have perhaps settled an ongoing legal dispute. The marginal benefits of such validity challenges are unlikely to outweigh the marginal costs.

In sum, there is no valid economic justification for assuming that a system that discourages the use of no-challenge clauses or similar contractual provisions will generate net benefits for consumers.[18] A basic principle of welfare economics is that a regulator should not pursue a

17. In the United States, the U.S. Court of Appeals for the Federal Circuit has emphasized that the courts must balance the public interest "of ridding the public of invalid patents" against "the fundamental policy favoring the expedient and orderly settlement of disputes and the fostering of judicial economy." Hemstreet v. Spiegel, Inc., 851 F.2d 348, 351 (Fed. Cir. 1988) (internal quotation marks omitted).

18. For an in-depth analysis of the marginal costs and the marginal benefits of a system that discourages the use of no-challenge clauses, see Sidak, *Evading Portfolio Royalties for Standard-Essential Patents Through Validity Challenges*, *supra* note 4.

particular policy beyond the point at which that policy's marginal cost exceeds its marginal benefit.[19] I thus respectfully recommend that the NDRC reevaluate whether antitrust law should discourage dominant IPR holders from including such clauses in their license agreements.

IV. Injunctions

Section 6 of the Guidelines correctly emphasizes that injunctions provide an important safeguard for the protection of IPRs. The provision says, nonetheless, that, in specific circumstances, a dominant IPR holder's request for an injunction could have anticompetitive effects and therefore trigger antitrust liability. Section 6 suggests that a dominant IPR holder's request for an injunction would trigger antitrust liability if that request forced the licensee to accept unfairly high licensing fees or other unreasonable conditions. The Guidelines suggest that, in examining whether an IPR holder's request for an injunction would have anticompetitive effects, the competition authority should consider several criteria, including the parties' conduct during the negotiation process, the IPR holder's commitment related to SEPs, the offered license conditions, and the impact that the IPR holder's request would likely have on competition and consumer interest.

In determining whether to impose antitrust liability for an IPR holder's mere request for an injunction, it is first necessary to consider the likelihood that the IPR holder would actually be able to obtain an injunction. In the United States, for example, there is no automatic right to an injunction. U.S. courts have confirmed that an SEP holder that has committed to license its SEPs on FRAND terms might be able to satisfy the *eBay* criteria—a four-factor test that U.S. courts apply to the specific circumstances of a case to determine whether the issuance of an injunction is appropriate.[20] However, as of January 2016, no U.S. court has granted an SEP holder's request for an injunction. When the likelihood of obtaining an injunction is low, the threat created by the IPR holder's request for the injunction is unlikely to distort the negotiation process in any material way. U.S. antitrust authorities have confirmed that antitrust intervention is unnecessary in such circumstances. For example, in September 2015, Assistant Attorney General Baer said that "the ability of F/RAND-encumbered patent holders to get an injunction in U.S. federal courts has been appropriately limited."[21] That statement suggests that the Antitrust Division finds it unnecessary to address SEP holders' requests for injunctions through antitrust enforcement.

The need for an antitrust intervention might be different in a legal system that entitles the IPR holder to an automatic right to an injunction upon the finding of an infringement, as is the case in Germany, for example. However, even in those conditions, antitrust intervention might be unnecessary, as long as the IPR holder complies with its contractual obligations (if any exist). For example, the Court of Justice of the European Union (CJEU) clarified that an SEP holder that has committed to license its SEPs on FRAND terms does not abuse its dominant position by requesting an injunction against the infringer, if the SEP holder (1) has notified the defendant

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19. *See, e.g.*, HARVEY S. ROSEN, PUBLIC FINANCE 561–62 (McGraw-Hill Irwin 7th ed. 2005).
20. eBay Inc. v. MercExchange, LLC, 547 U.S. 388, 391–95 (2006).
21. Baer 2015 Speech, *supra* note 8, at 5.

about the infringement, and (2) has clearly presented a license offer to the infringer.[22] The CJEU emphasized the general legal principle that a patent holder—including a holder of a FRAND-committed SEP—"may not be deprived of the right to have recourse to legal proceedings to ensure effective enforcement of his exclusive rights, and that, in principle, the user of those rights, if he is not the proprietor, is required to obtain a licence prior to any use."[23] Indeed, the licensee might be able to avoid an injunction by accepting a FRAND offer, or, in case of a disagreement over the license terms, by providing a security payment for the use of the SEPs.

I understand that, under China's Patent Act, the right to an injunction is a legal remedy available upon the finding of an infringement.[24] I also understand that a court nonetheless might diverge from that statutory requirement in cases where the infringer proves that the award of an ongoing royalty would be sufficient to compensate the IPR holder for the infringement.[25] Given the discretion that a Chinese court has in granting an injunction, the NRDC might conclude that there is no need to impose antitrust liability for an IPR holder's mere request for an injunction. Alternatively, the NRDC might choose an approach similar to the one that the European Union adopted. The Guidelines could provide a straightforward test that establishes the steps that an IPR holder that wants to request an injunction should take to avoid any antitrust liability. Clarifying the exact steps that an SEP holder should take would provide a better approach to identifying the limits that China's antitrust law imposes on the SEP holder's right to an injunction.[26]

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I am grateful for this opportunity to submit my views on the proposed Guidelines, and I would be pleased to elaborate upon my comments if the NDRC has any questions.

Respectfully submitted,

J. Gregory Sidak
Chairman

Attachments

22. Case C-170/13, Huawei Tech. Co. v. ZTE Corp. (July 17, 2015), at 71, http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1437080250973&uri=CELEX:62013CJ0170.

23. *Id.* at 58.

24. *See, e.g.*, STEFAN LUGINBUEHL & PETER GANEA, PATENT LAW IN GREATER CHINA 354 (Edward Elgar 2014).

25. *Id.*

26. For an in-depth analysis of the SEP holder's right to an injunction, see Sidak, *The Meaning of FRAND, Part II: Injunctions*, *supra* note 5.