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Person in Charge of the Partial Amendment of
the IP Guidelines (Draft)
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Re ***Comments on the Guidelines for the Use of Intellectual Property Under the Antimonopoly Act (Draft)***

Ladies and Gentlemen:

The Japan Fair Trade Commission (JFTC) has invited public comments on the draft version of its Guidelines for the Use of Intellectual Property Under the Antimonopoly Act (IP Guidelines). I respectfully submit my comments and suggestions to the IP Guidelines.

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, *The Meaning of FRAND, Part I: Royalties*, analyzes the economic methodology to determine a FRAND royalty for SEPs.[1] The second article, *The Meaning of FRAND, Part II: Injunctions*, analyzes the SEP holder's right to request and obtain an injunction against an infringer of an SEP.[2] The third article, *Patent Holdup and Oligopsonistic Collusion in Standard-Setting Organizations*, evaluates the risk of horizontal collusion within standard-setting organizations (SSOs).[3] The fourth article, *The Antitrust Division's Devaluation of Standard-Essential Patents*, examines the errors of legal and economic reasoning contained in the business review letter that the Antitrust Division of the U.S. Department of Justice issued in February 2015 with respect to the IEEE's watershed change in patent policy concerning the licensing of SEPs.[4]

I. The SEP Holder's Right to an Injunction

A FRAND commitment is a contract between the SEP holder and the SSO, to which the implementer of the standard is a third-party beneficiary. The obligations arising from a FRAND commitment must be interpreted in accordance with the provisions of the FRAND contract and the intent of the parties when specifying the terms of that contract. The bylaws and policies of most SSOs determine that the primary purpose of a FRAND commitment is to grant implementers of the standard access to the SEP holder's patented technology that has been incorporated into the standard and to fairly compensate the SEP holder for its contribution to the standard.

A FRAND commitment typically imposes on an SEP holder a duty to grant access to its SEPs on FRAND terms to any party seeking to implement the standard. However, the SEP holder's duty to make a FRAND offer does not ensure that a negotiation with the potential licensee will result in a licensing agreement. Even if the SEP holder makes a FRAND offer and negotiates the licensing terms in good faith, the negotiation might fail. For example, the potential licensee might refuse to accept a FRAND offer. As a general principle, if an SEP holder makes an initial licensing offer that is in the FRAND range, then the SEP holder has discharged its FRAND obligation. Any further negotiation of the licensing terms is solely at the discretion of the SEP holder. A potential licensee cannot refuse an offer that is in the FRAND range and hope to avoid an injunction because it wants a better deal.

The draft version of the IP Guidelines correctly recognizes that an SEP holder should be able to request and obtain an injunction, without triggering antitrust concerns, against an infringer that is not willing to accept FRAND licensing terms. The draft version of the IP Guidelines also correctly emphasizes that whether a potential licensee is willing to license the SEP holder's technology on FRAND terms depends on the specific circumstances of each case. However, without future clarifications, the draft version of the IP Guidelines risks inviting opportunism by the potential licensee. It suggests that a potential licensee is a "willing licensee," as long as it agrees to be bound by the FRAND licensing terms that a

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1. 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.
2. 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.
3. J. Gregory Sidak, *Patent Holdup and Oligopsonistic Collusion in Standard-Setting Organizations*, 5 J. COMPETITION L. & ECON. 123 (2009), https://www.criterioneconomics.com/patent-holdup-oligopolistic-collusion-frand-standard-setting.html.
4. J. Gregory Sidak, *The Antitrust Division's Devaluation of Standard-Essential Patents*, 104 GEO. L.J. ONLINE 48 (2015), https://www.criterioneconomics.com/antitrust-divisions-devaluation-of-standard-essential-patents.html.

court or an arbitral body sets as a result of litigation or arbitration. That is, the IP Guidelines would confer the status of "willing licensee" even to a party that initiates litigation against the SEP holder (for example, by alleging that the SEP holder breached its contractual FRAND obligations) or to a party that disputes the validity, essentiality, or infringement of the SEP. Such an approach would allow a licensee to use the SEPs free of charge—that is, without compensating the SEP holder for the use of its technology—and delay compensating the SEP holder until the final decision of a court or arbitration tribunal. That behavior would prevent the SEP holder from obtaining compensation for its innovative contribution in a timely manner and could negatively affect innovation and the quality of the standardization process.

The Court of Justice of the European Union (CJEU) has recognized the risk of opportunism by the potential licensee and found that an infringer that is already using the SEPs should not be able to avoid an injunction by merely stating that the SEP holder's offer is not FRAND. On July 16, 2015, in *Huawei Technologies Co. v. ZTE Corp.*, the CJEU addressed the question of whether an SEP holder has the right to request an injunction against an infringer.[5] The CJEU addressed the question from the perspective of EU competition law and found that an SEP holder does not abuse its dominant position by requesting a remedy against an infringer if (1) the SEP holder has made a written offer to the implementer, and (2) the infringer continues to use the SEPs, has not promptly replied to the offer, or has engaged in delaying tactics.[6] The CJEU emphasized the general principles that a patent holder—including a holder of FRAND-committed SEPs—"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."[7] The CJEU found that a FRAND commitment does not alter those basic principles, as long as the SEP holder makes an offer to license its SEPs on FRAND terms.

U.S. competition authorities have similarly acknowledged that an SEP holder should be able to obtain an injunction against an infringer that demonstrates a "constructive refusal to negotiate, such as by insisting on terms clearly outside the bounds of what could reasonably be considered to be F/RAND terms in an attempt to evade the putative licensee's obligation to fairly compensate the patent holder."[8] By the same logic, the JFTC should revise the IP Guidelines to clarify the implementer's duties when negotiating the licensing terms for SEPs.

II. The Need to Balance the Possibility of Opportunism by the SEP Holders Against the Possibility of Opportunism by the Implementer

The draft version of the IP Guidelines states that opportunism by the SEP holder might impede research and development of technologies related to a standard and the production or sale of products that implement that standard. However, it would be helpful to clarify that parties to a FRAND dispute need to support a reference to theoretical conjectures about the possibility of opportunism by an SEP holder with empirical evidence. Otherwise, there is

5. Case C-170/13, Huawei Tech. Co. v. ZTE Corp. (July 17, 2015), ¶ 44, http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1437080250973&uri=CELEX:62013CJ0170.
6. *Id.* ¶ 71.
7. *Id.* ¶ 58.
8. U.S. DEP'T OF JUSTICE & U.S. PATENT & TRADEMARK OFFICE, POLICY STATEMENT ON REMEDIES FOR STANDARD-ESSENTIAL PATENTS SUBJECT TO VOLUNTARY F/RAND COMMITMENTS 7 (2013).

a risk that abstract conjectures with no relation to the specific facts of the case would unduly distort analysis of the lawfulness of the SEP holder's conduct.

Two seminal articles from 2007 introduced the patent-holdup and royalty-stacking conjectures most closely associated with economists Carl Shapiro and Joseph Farrell of Berkeley and lawyer Mark Lemley of Stanford.[9] The patent-holdup conjecture posits that, when a potential licensee has made a sunk investment to implement an industry standard and thereby becomes locked into the use of SEPs, the SEP holder can demand from the potential licensee a royalty exceeding the value of the SEP holder's technology. Lemley and Shapiro argued that an SEP holder's use of (or even its threat to use) an injunction would exacerbate the risk of patent holdup. In their view, an SEP holder's mere threat to exclude a licensee's standard-compliant products from the market, even if only for a limited period of time, could enable the SEP holder to extract licensing fees from that licensee that exceed the SEP's genuine economic value. Apple, Cisco, Intel, and Microsoft provided funding for the Lemley-Shapiro article, and those companies remain major proponents of policies that would decrease the value of SEPs.

Many scholars in economics and law since 2007 have exposed the flawed logic of the patent-holdup and royalty-stacking conjectures. Scholars have shown that the patent-holdup conjecture fails to account for economic circumstances that restrict the SEP holder's incentive and ability to demand exploitative licensing terms. Legal and economic scholars have also empirically analyzed sectors that use SEPs the most and have found no evidence of patent holdup. In 2013, Commissioner Joshua Wright of the U.S. Federal Trade Commission (FTC) emphasized that, "[d]espite the amount of attention patent hold-up has drawn from policymakers and academics, there have been relatively few instances of litigated patent hold-up among the thousands of standards adopted."[10] In 2014, Alexander Galetovic, Stephen Haber, and Ross Levin found that, "over long periods[,] SEP industries tend to show better performance than most other industries" in terms of quality-adjusted price decreases, and that innovation appears to be most rapid in SEP-reliant industries.[11] Those empirical findings are inconsistent with the predictions of the patent-holdup and royalty-stacking conjectures. Economic scholars and legal scholars also dispute the proposition, associated with the patent-holdup conjecture, that an SEP holder would use an injunction to extort excessive royalty rates from a potential licensee.

In December 2014, the U.S. Court of Appeals for the Federal Circuit addressed the evidentiary significance of the patent-holdup and royalty-stacking conjectures. In *Ericsson, Inc. v. D-Link Systems, Inc.*, the Federal Circuit clarified that a jury may be instructed that a theoretical conjecture can affect the computation of a FRAND royalty only when empirical evidence supports that conjecture.[12] Mere invocation of an abstract risk of patent holdup does not suffice. In April 2015, Administrative Law Judge Theodore Essex of the U.S. International Trade Commission similarly found that unsubstantiated claims about the risk

9. Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEX. L. REV. 1991 (2007); Joseph Farrell, John Hayes, Carl Shapiro & Theresa Sullivan, *Standard Setting, Patents, and Holdup*, 74 ANTITRUST L.J. 603, 603 (2007).

10. Joshua D. Wright, Comm'r, Fed. Trade Comm'n, Remarks at the Center for the Protection of Intellectual Property Inaugural Academic Conference: The Commercial Function of Patents in Today's Innovation Economy 20 (Sept. 12, 2013), http://www.ftc.gov/sites/default/files/documents/public_statements/ssos-frand-and-antitrust-lessons-economicsincomplete-contracts/130912cpip.pdf.

11. Alexander Galetovic, Stephen Haber & Ross Levine, *Patent Holdup: Do Patent Holders Holdup Innovation?*, 11 J. COMPETITION L. & ECON. (forthcoming 2015).

12. Ericsson, Inc. v. D-Link Sys., Inc. 773 F.3d 1201, 1233–34 (Fed. Cir. 2014).

of patent holdup were insufficient to prevent the issuance of an exclusion order that would exclude the importation into the United States of products infringing the valid U.S. patents at issue.[13] The skepticism of the Federal Circuit and Judge Essex is economically sound. Abstract theories can assist the finder of fact only when they relate to the specific facts of the case. When there is no evidence that an abstract theory applies to the specific facts of the case, then that theory cannot assist the finder of fact in answering the questions that it must address.

Furthermore, if one assumes that patent holdup might occur, one should consider that the symmetric risk of reverse holdup might also occur. Commissioner Wright of the FTC has said that "weakening the availability of injunctive relief for infringement—including infringement of F/RAND-encumbered SEPs—may increase the probability of 'reverse holdup' and weaken any incentives implementers have to engage in good faith negotiations with the patent holder."[14] Randall Rader, former Chief Judge of the U.S. Court of Appeals for the Federal Circuit, made a similar observation in *Apple, Inc. v. Motorola, Inc.* that "'hold out,'" a different term used to refer to reverse holdup, "is equally as likely and disruptive as a 'hold up.'"[15] Therefore, it would be helpful for the IP Guidelines to adopt a balanced, symmetric approach to considering the risk of opportunism by the SEP holder and opportunism by the implementer (that is, patent holdout or reverse holdup). Empirical evidence should support any allegation of patent holdup or patent holdout.

Respectfully submitted,

J. Gregory Sidak
Chairman

Attachments

13. Certain 3G Mobile Handsets and Components Thereof at 30, USITC Inv. No. 377-TA-613 Initial Determination (Apr. 27, 2015).
14. Wright, *supra* note 10, at 29.
15. Apple Inc. v. Motorola, Inc., 757 F.3d 1286, 1333 (Fed. Cir. 2014) (Rader, C.J., dissenting in part).