UNITED STATES INTERNATIONAL TRADE COMMISSION
Washington, D.C.

In the Matter of **CERTAIN 3G MOBILE HANDSETS AND COMPONENTS THEREOF**	**Inv. No. 337-TA-613 (REMAND)**

REPLY OF J. GREGORY SIDAK, CHAIRMAN, CRITERION ECONOMICS, TO THE WRITTEN SUBMISSION OF CHAIRWOMAN EDITH RAMIREZ OF THE FEDERAL TRADE COMMISSION ON THE PUBLIC INTEREST

July 20, 2015

The U.S. International Trade Commission (ITC) issued a Notice of Request for Written Submission and Reply to Written Submissions regarding its investigation, *In the Matter of Certain 3G Mobile Handsets and Components Thereof*. I take no position on the outcome of this Investigation. I respectfully submit these reply comments solely to respond to the statement of Chairwoman Edith Ramirez of the Federal Trade Commission, who urges the ITC to adopt a particular interpretation of law that I do not understand to be confined in any way to the facts of the current Investigation. I do not submit these comments on behalf of or at the request of any company or organization, and I have no economic interest in the outcome of this Investigation.

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. I have held academic positions at the American Enterprise Institute for Public Policy Research, Yale, Georgetown, and Tilburg (The Netherlands). As an expert economic consultant, I have served clients in the Americas, Europe, and the Pacific. I have worked extensively 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 legal proceedings, including investigations before the ITC. I have published a number of scholarly articles on the legal and economic implications of the FRAND commitment, and I have presented that research at universities, think tanks, and international academic 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.

I attach three recent articles that amplify the ideas expressed in these comments. The first article, *The Meaning of FRAND, Part I: Royalties*, analyzes the economic methodology to determine a FRAND royalty for SEPs. The second article, *The Meaning of FRAND, Part II: Injunctions*, analyzes how the FRAND commitment affects the SEP holder's right to request and obtain an injunction against an infringer of an SEP. The third article, *The Antitrust Division's Devaluation of Standard-Essential Patents*, evaluates the theoretical conjectures of patent holdup and royalty stacking. In the footnote below, I also include links to these three articles.[1]

I.

In her Written Submission, Chairwoman Ramirez says that Investigation No. 337-TA-613 (Remand) raises the important question of "what standard should the ITC use to evaluate evidence concerning patent hold-up" when an SEP holder seeks an exclusion order against an implementer of a FRAND-committed patent.[2] The Chairwoman proposes that, "as part of its public interest analysis before issuing an exclusion order, the ITC [should] require a SEP holder to prove that the implementer is unwilling or unable to take a FRAND license."[3] The Chairwoman says that the SEP holder "may demonstrate an implementer's unwillingness in a number of ways."[4] She suggests that "an implementer may be unwilling if it affirmatively

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; 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; 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.

2. Written Submission on the Public Interest of Federal Trade Commission Chairwoman Edith Ramirez at 2, In the Matter of Certain 3G Mobile Handsets and Components Thereof, USITC Inv. No. 337-TA-613 (July 10, 2015) [hereinafter Ramirez ITC Submission].

3. *Id.*

4. *Id.* at 6.

demonstrates that it will not negotiate" with the SEP holder[5] or if the implementer engages in a constructive refusal to negotiate a FRAND license (for example, by insisting on terms that are clearly outside a reasonable interpretation of FRAND).[6] The Chairwoman argues that imposing the burden of proving the implementer's unwillingness on the SEP holder would "establish a balanced approach to ITC remedies by ensuring that a SEP holder follows through with its FRAND licensing commitment, while at the same time recognizing that both the SEP holder and the standards implementer have a duty to negotiate in good faith towards a meaningful resolution of FRAND issues."[7]

II.

Although the Chairwoman correctly recognizes that the SEP holder should have the right to obtain an exclusion order against an unwilling implementer, her proposal that the ITC make the SEP holder bear the burden of proving an implementer's unwillingness is problematic and misguided.[8] The Chairwoman's recommendation would produce the perverse result that an SEP holder that has made a FRAND offer could not obtain an exclusion order against an implementer that has rejected that FRAND offer.

Suppose that the FRAND range for an SEP portfolio is between $3 and $15 per infringing device and suppose further that the SEP holder has made an offer within the FRAND range—say, $14 per infringing device. The exact duties that arise from a contract between an SEP holder and an SSO are determined by the nature of the specific FRAND commitment, and by the intellectual property rights (IPR) policies of the SSO, which may differ depending on the

5. *Id.*
6. *Id.* at 6–7.
7. *Id.* at 2–3.
8. Ramirez ITC Submission, *supra* note 2, at 2.

SSO. For most SSOs, however, a voluntary FRAND commitment means that the SEP holder undertakes a duty to offer to license its SEPs on FRAND terms to anyone seeking to implement the standard. Thus, by making an offer of $14 per infringing device, the SEP holder has discharged its FRAND obligation as a matter of contract law.

Suppose further that the implementer has refused the $14 FRAND offer in an attempt to persuade the SEP holder to accept an offer at the lower bound of the FRAND range and that the implementer has made a counteroffer of $3.01 per infringing device. After a lengthy negotiation, the parties fail to reach an agreement, and the SEP holder initiates a procedure at the ITC, requesting that the ITC issue an exclusion order against the implementer. If the ITC were to adopt the Chairwoman's approach, the SEP holder could not obtain an exclusion order, even though it has fully discharged its FRAND obligation as a matter of contract law. On the facts of this hypothetical example, the SEP holder could neither (1) show that the implementer was unwilling to negotiate a license nor (2) show that the implementer had made an offer "clearly outside a reasonable interpretation of FRAND" (assuming, in this example, that $3.01 per infringing device is within the FRAND range).[9] On the basis of the Chairwoman's suggested approach, an SEP holder that had fully discharged its FRAND obligation as a matter of contract law still would have no exclusionary remedy against an infringer that continued to use its SEPs and refused to accept a FRAND offer.

The Chairwoman further says that "if, during the course of the Section 337 investigation, a FRAND range is determined," the ITC should delay the effective date of an exclusion order and provide the parties an opportunity to agree on the FRAND license terms.[10] The Chairwoman reasons that, in such a case, both parties would face "respective risks that the exclusion order will

9. Ramirez ITC Submission, *supra* note 3, at 7.
10. *Id.*

(1) go into effect if the respondent refuses to make a FRAND offer; or (2) be vacated if the ITC finds that complainant refuses to accept a FRAND offer."[11] This language deserves the ITC's careful parsing. The suggestion that the ITC should examine whether the *implementer* has made a FRAND offer and whether the SEP holder has accepted that offer (rather than examining whether the implementer has rejected the SEP holder's FRAND offer) is either a typographical error by Chairwoman Ramirez or a breathtaking deviation from the contractual obligation that an SEP currently accepts pursuant to its FRAND commitment. Focusing the analysis, as Chairwoman Ramirez would, on whether the SEP holder has rejected the *implementer's* offer would grant the implementer the right to obtain a FRAND rate at the lower bound of the FRAND range. Chairwoman Ramirez would thereby achieve a massive wealth transfer from SEP holders to implementers. In the above example of the Chairwoman's rule in operation, the SEP holder would be compelled to accept a FRAND royalty only one penny above the FRAND floor—that is, $3.01.

In its economic effect, Chairwoman Ramirez's outcome would bear no resemblance to the SEP holder's original contractual commitment to license its SEPs on FRAND terms to anyone implementing the standard. As I explained in detail in *The Meaning of FRAND, Part II: Injunctions*, by making a FRAND offer, the SEP holder discharges its FRAND obligation as a matter of contract law.[12] Thereafter, the SEP holder has no duty to accept an offer at the lower bound of the FRAND range. Chairwoman Ramirez's proposal would subject the FRAND obligation to a fundamental transformation.

11. *Id.* at 7–8.
12. Sidak, *The Meaning of FRAND, Part II: Injunctions*, supra note 1, at 240–44.

III.

Although European public law obviously does not control the ITC in addressing the issue that Chairwoman Ramirez raises, it is worth noting as a prudential matter (since FRAND disputes are contractual disputes that are typically global in scope) that, on July 16, 2015, the Court of Justice of the European Union (CJEU) ruled in *Huawei Technologies Co. v. ZTE Corp.* on a similar question—whether an SEP holder has the right to request an injunction against an implementer.[13] 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 the implementer if (1) the SEP holder has made a written offer to the implementer, and (2) the implementer continues to use the SEPs, has not promptly replied to the offer, or has engaged in delaying tactics.[14] The CJEU emphasized the general principles 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."[15] The CJEU found that a FRAND commitment does not alter those basic principles.

The CJEU recognized the important principle that an infringer cannot use SEPs, refuse to pay, and yet hope to avoid an exclusionary remedy sought by the SEP holder. At the very least, the Chairwoman's recommendation conflicts with the reasoning in the CJEU's recent decision in *Huawei Technologies Co. v. ZTE Corp*.

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13. Case C-170/13, Huawei Tech. Co. v. ZTE Corp. (July 17, 2015), at 44, http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1437080250973&uri=CELEX:62013CJ0170.
14. *Id*. at 71.
15. *Id*. at 58.

IV.

The Chairwoman reasons that imposing the burden of proof on the SEP holder would mitigate the risk that an SEP holder will use the threat of an exclusion order as a tool to hold up the implementer. Implicit in the Chairwoman's suggestion is a presumption that an SEP holder would attempt to hold up the implementer.

However, the Chairwoman's presumption that patent holdup routinely occurs in the real world has no support in economic theory or empirical fact. Economists Carl Shapiro and Joseph Farrell of Berkeley and lawyer Mark Lemley of Stanford proposed the patent-holdup and royalty-stacking conjectures in two articles from 2007.[16] The Lemley-Shapiro article was funded by companies that remain major proponents of policies that would devalue SEPs.[17] As of 2015, many scholars in economics and law 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 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."[18] Alexander Galetovic, Stephen Haber, and Ross Levin have found that, "over long periods[,] SEP industries tend to show better performance than most other industries," and that innovation appears to grow

16. 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 Hold-Up*, 74 ANTITRUST L.J. 603 (2007).

17. Lemley & Shapiro, *Patent Holdup and Royalty Stacking, supra* note 16, at 1991 n.* (disclosing funding from Apple, Cisco, Intel, Micron Technology, Microsoft, and SAP).

18. 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).

fastest in SEP-reliant industries.[19] Those empirical findings are inconsistent with the predictions of the patent-holdup and royalty-stacking conjectures. There consequently exists no valid economic justification in the scholarly literature to introduce into the ITC's procedure the presumption that the SEP holder will routinely engage in opportunistic licensing behavior.

Furthermore, if one assumes that patent holdup might occur, one should consider that the symmetric risk of reverse holdup might also occur. Commissioner Wright 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."[20] Former Chief Judge Randall Rader 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.'"[21] Chairwoman Ramirez herself acknowledges in her Submission the risk of reverse patent holdup.[22] Nonetheless, she does not counsel the ITC to consider that reverse holdup might arise; instead, she posits that the SEP holder should bear the burden of proving the implementer's opportunism.

The Chairwoman thus suggests that the ITC adopt an asymmetric approach to the risk of patent holdup and the risk of reverse holdup. She proposes that the ITC should (1) assume the existence of patent holdup but (2) require the SEP holder to provide evidence of reverse holdup. This asymmetric treatment of the patent-holdup conjecture and the reverse-holdup conjecture has no basis in economic theory. The ITC should not make it a principle of law.

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19. Alexander Galetovic, Stephen Haber & Ross Levine, *Patent Holdup: Do Patent Holders Hold Up Innovation?*, 11 J. COMPETITION L. & ECON. (forthcoming 2015).
20. Wright, *supra* note 18, at 29.
21. Apple Inc. v. Motorola, Inc., 757 F.3d 1286, 1333 (Fed. Cir. 2014) (Rader, J., dissenting in part).
22. Ramirez ITC Submission, *supra* note 2, at 8.

V.

The Chairwoman's proposal that the ITC presume the existence of patent holdup would contradict what the Federal Circuit has said concerning FRAND-committed patents. In *Ericsson, Inc. v. D-Link Systems, Inc.*, the Federal Circuit clarified that a jury may be instructed that a theoretical conjecture of patent holdup can affect the computation of a FRAND royalty only when empirical evidence supports that conjecture.[23] That is, the Federal Circuit said that abstract theorizing about the risk of patent holdup does not suffice. The Federal Circuit's standard for instructing the jury about patent holdup comports with the general principle that 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, that theory cannot assist the finder of fact in answering the questions it must address. Given the choice of Chairwoman Ramirez's proposal and the Federal Circuit's decision in *Ericsson, Inc. v. D-Link Systems, Inc.*, the ITC should endorse the Federal Circuit's logic that empirical evidence must support an allegation of patent holdup before such an allegation can have any legal consequence for the scope of remedies available to an SEP holder for patent infringement.

The Chairwoman's proposal also contradicts Ambassador Michael Froman's recommendations to the ITC in 2013.[24] The Ambassador expressed concern over patent holdup *and* reverse patent holdup, but he did not imply that either was more likely to arise in practice. Rather, Ambassador Froman emphasized that the ITC's decision whether to issue an exclusion order should depend on the specific circumstances of the case, and he instructed the ITC to "seek

23. Ericsson, Inc. v. D-Link Sys., Inc., 773 F.3d 1201, 1234 (Fed. Cir. 2014).

24. Letter from Michael B.G. Froman, Exec. Office of the President, to the Honorable Irving A. Williamson, Chairman, U.S. Int'l Trade Comm'n (Aug. 3, 2013).

proactively to have the parties develop a comprehensive factual record related to these issues . . . including . . . the presence or absence of patent hold-up or reverse hold-up."[25]

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For the foregoing reasons, the Commission should reject the recommendations contained in Chairwoman Ramirez's comments.

Sincerely,

J. Gregory Sidak

Attachments

I certify that I have obtained consent to file on behalf of Mr. J. Gregory Sidak.

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25. *Id*. at 3.

CERTIFICATE OF SERVICE

I, J. Gregory Sidak, certify that on July 20, 2015, copies of the foregoing REPLY OF J. GREGORY SIDAK, CHAIRMAN, CRITERION ECONOMICS, TO THE WRITTEN SUBMISSION OF CHAIRWOMAN EDITH RAMIREZ OF THE FEDERAL TRADE COMMISSION ON THE PUBLIC INTEREST were delivered, pursuant to Commission regulations, to the following interested parties as indicated:

The Honorable Lisa Barton Secretary to the Commission U.S. International Trade Commission 500 E Street, S.W., Room 112A Washington, D.C. 20436	Via EDIS and 8 Copies Via Hand Delivery

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