COMMENT OF UNITED STATES FEDERAL TRADE COMMISSIONER JOSHUA D. WRIGHT AND JUDGE DOUGLAS H. GINSBURG ON THE JAPAN FAIR TRADE COMMISSION'S DRAFT PARTIAL AMENDMENT TO THE GUIDELINES FOR THE USE OF INTELLECTUAL PROPERTY UNDER THE ANTIMONOPOLY ACT

This comment is submitted in response to the Japan Fair Trade Commission's (JFTC's) request for public comments on the Draft Partial Amendment to the Guidelines for the Use of Intellectual Property under the Antimonopoly Act (Draft Amendment).[1] We appreciate the opportunity to comment and commend the JFTC for its transparency. We submit this comment based upon our extensive experience and expertise in antitrust law and economics generally, and specifically with respect to the intersection of intellectual property and antitrust.[2]

The Draft Amendment specifies that seeking injunctive relief to enforce a standard-essential patent (SEP) encumbered by a commitment to license on fair, reasonable, and non-discriminatory (FRAND) terms against a party that is willing to take a license on FRAND terms "may" constitute an unlawful exclusion of business activities in violation of Article 3 of Japan's Antimonopoly Act (AMA) (Draft Amendment Part 3(1)(e)) or an unfair trade practice in violation of Article 19 of the AMA (Draft Amendment Part 4(2)(iv)). The Draft Amendment further specifies that liability may attach regardless of whether the act is taken by a patent holder that makes the FRAND commitment, by a party that accepts assignment of the FRAND-encumbered SEP, or by a party who is "entrusted to manage" the FRAND-encumbered SEP.

The Draft Amendment is premised upon the assumption that seeking injunctive relief "generally makes it difficult to research & develop . . . products adopting the standards," which in turn deters widespread adoption of standards.[3] This assumption lacks empirical support. Further, as we explain below, ordinary contract law makes an AMA sanction unnecessary to deter any instances of anticompetitive patent holdup that might arise; indeed, an AMA sanction is likely to reduce incentives to innovate and deter participation in standard setting, thereby depriving consumers of the substantial procompetitive benefits of standardized technologies. For these reasons, we respectfully recommend that Parts 3(1)(e) and 4(2)(iv) be deleted in their entirety. Should the JFTC decide to retain these provisions, however, they should at the very least be amended to limit liability to situations when there is proof that a FRAND-encumbered SEP holder has engaged in patent "holdup," i.e., that the patent holder used the threat of injunctive relief to demand supra-competitive royalties.

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[1] The views reflected in this statement are our own and do not necessarily represent the views of the United States Federal Trade Commission or of any other Commissioner.

[2] One of us is a United States Federal Trade Commissioner, antitrust law professor, and Ph.D. economist. The other is a judge on the United States Court of Appeals for the District of Columbia and former head of the Antitrust Division of the United States Department of Justice. We have each written extensively on the law and economics of regulation, intellectual property rights, and antitrust.

[3] Draft Amendment Parts 3(1)(e) and 4(2)(iv), *available at* http://www.jftc.go.jp/en/pressreleases/yearly-2015/July/150708.files/Attachment1.pdf.

I. AN AMA SANCTION IS LIKELY TO REDUCE INCENTIVES TO INNOVATE AND DETER PARTICIPATION IN STANDARD SETTING

A FRAND commitment is, of course, a contractual commitment.[4] Economists have long understood that contractual relationships involving asset-specific investments between transactors generate the potential for opportunism. Similarly, a patentee participating in the standard-setting process can, once the standard is adopted by a standard-setting organization (SSO), "holdup" potential licensees by exploiting asset-specific investments to demand a higher royalty rate than would have prevailed in a competitive process. The view that contractual opportunism alone gives rise to an antitrust problem rather than a contract problem is in tension with substantial economic literature on the subject.[5] Consistent with this view, no United States court has held that seeking injunctive relief on a FRAND-encumbered SEP violates the antitrust laws. Instead, United States courts that have addressed the issue have done so under contract law principles.

Specifically, in analyzing the contractual nature of the FRAND commitment, courts have held that: (1) a commitment to an SSO to license on FRAND terms constitutes a binding contract between the SEP holder, the SSO, and its members[6]; (2) potential users of the standard are third-party beneficiaries of the agreements with standing to sue[7]; (3) seeking injunctive relief on a FRAND-encumbered SEP may violate the universal duty of good faith and fair dealing when an SEP holder has made a contractual commitment to license on FRAND terms[8]; and (4) FRAND

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[4] *See, e.g.*, *In re Innovatio IP Ventures, LLC Patent Litig*., 2013 WL 5593609 at *4 (N.D. Ill. Oct. 3, 2013); *Microsoft Corp. v. Motorola, Inc.,* 2013 WL 2111217 at *1-2 (W.D. Wash. Apr. 25, 2013); *Apple, Inc. v. Motorola Mobility, Inc.*, 886 F. Supp. 2d 1061, 1083-84 (W.D. Wis. 2012); *Microsoft Corp. v. Motorola, Inc*., 854 F. Supp. 2d 993, 999-1001 (W.D. Wash. 2012), *reaffirmed*, 864 F. Supp. 2d 1023, 1030-33 (W.D. Wash. 2012), *aff'd in relevant part*, 696 F.3d 872, 884 (9th Cir. 2012).

[5] Joshua D. Wright & Douglas H. Ginsburg, *Patent Assertion Entities and Antitrust: A Competition Cure for a Litigation Disease*, 79 ANTITRUST L.J. 501, 509 (2014); *see also* Benjamin Klein, *Market Power in Antitrust: Economic Analysis After Kodak*, 3 SUP. CT. ECON. REV. 43, 62-63 (1993) ("Antitrust law should not be used to prevent transactors from voluntarily making specific investments and writing contracts by which they knowingly put themselves in a position where they may face a 'hold-up' in the future . . . . [C]ontract law inherently recognizes the pervasiveness of transactor-specific investments and generally deals with 'hold-up' problems in a subtle way, not by attempting to eliminate every perceived 'hold-up' that may arise.").

[6] *See, e.g.*, *Innovatio*., 2013 WL 5593609 at *4 (citing *In re Innovatio IP Ventures Patent Litig*., 2013 WL 427167 at *17); *Microsoft Corp*., 854 F. Supp. 2d at 999; *Apple, Inc.*, 886 F.Supp.2d at 1083-85.

[7] *See, e.g.*, *Innovatio*, 2013 WL 5593609 at *17; *Microsoft Corp*., 854 F. Supp. 2d at 999; *Apple, Inc*., 886 F.Supp.2d at 1083-84; *Research In Motion Ltd. v. Motorola, Inc*., 644 F.Supp.2d 788, 797 (N.D.Tex.2008); *ESS Technology, Inc. v. PC–Tel., Inc*., 1999 WL 33520483 at *4 (N.D.Cal. Nov. 4, 1999).

[8] *See, e.g.*, *Realtek Semiconductor Corp. v. LSI Corp*., 2013 WL 2181717 at *7 (N.D. Cal. May 20, 2013) (holding that it was a breach of the RAND commitment to seek injunctive relief from the United States International Trade Commission before offering a license to a party implementing the standard and willing to accept a RAND license); Verdict Form at 3, *Microsoft v. Motorola*, Case No. C10-1823JLR (W.D. Wash. Sept. 4, 2013) (the jury found that Motorola's conduct in seeking injunctive relief violated its duty of good faith and fair dealing with respect to its contractual commitments to the IEEE and the ITU); *Apple v. Motorola, Inc*., 869 F. Supp. 2d 901, 913-14 (N.D. Ill. 2012); *see also Microsoft Corp. v. Motorola, Inc*., 696 F.3d 872, 884-85 (9th Cir. 2012).

licensing "includes an obligation to negotiate in good faith," and that obligation is "a two-way street."[9] Similarly, the failure of a successor in interest to abide by a FRAND commitment is also properly a contract and not an antitrust law violation.[10]

AMA remedies prohibiting or limiting the ability of a FRAND-encumbered SEP holder to seek injunctive relief are not likely in the public interest for the following three reasons.

First, an AMA remedy is not only unnecessary to protect consumer welfare given that the law of contracts is sufficient to provide optimal deterrence, but is likely to be harmful.[11] Significant monetary sanctions are likely to over-deter procompetitive participation in SSOs. Significant monetary fines are likely to over-deter FRAND-encumbered SEP holders that need the credible threat of an injunction to recoup the value added by their patents and have no other adequate remedy against an infringing user. Indeed, excessive deterrence is particularly likely because, with liability turning upon whether the infringing user was truly a "willing licensee"—a factual determination that may be far from clear in many cases—the outcome of an AMA case would necessarily be uncertain. The prospect of penalizing a FRAND-encumbered SEP holder for seeking injunctive relief diminishes the value of its patents and hence reduces its incentive to innovate.

Second, the prospect of AMA liability for a patentee seeking injunctive relief would enable an infringing user to negotiate in bad faith knowing that its exposure is capped at the FRAND licensing rate, and therefore requires an SEP holder to take a below-FRAND rate from an unscrupulous or a judgment-proof infringing user.

Third, AMA liability is likely to deter patent holders from contributing their technology to an SSO under FRAND terms if doing so will require them to forfeit their right to protect their intellectual property by seeking an injunction against infringing users. These possibilities, far from protecting the public interest in competition and innovation, actually threaten the gains from innovation and standardization.

II. THERE IS NO EMPIRICAL EVIDENCE THAT ANTICOMPETITIVE PATENT HOLDUP IS PREVALENT

The Draft Amendment states that seeking injunctive relief on a FRAND-encumbered SEP against a party who is willing to take a license "generally makes it difficult to research & develop, produce or sell the products adopting the standards diffused broadly."[12] This

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[9] *Ericsson Inc. v. D-Link Systems, Inc.*, 2013 WL 4046225 at *25 (E.D. Tex. Aug. 2013), *affirmed-in part, reversed-in part, and vacated-in-part on other grounds by Ericsson v. D-Link Sys*., 773 F.3d 1201 (Fed. Cir. 2014).

[10] *See, e.g.*, Bruce H. Kobayashi & Joshua D. Wright, *Federalism, Substantive Preemption, and Limits on Antitrust: An Application to Patent Holdup*, 5(3) J. COMPETITION LAW & ECON. 469, 493-501, 506-13 (2009).

[11] Douglas H. Ginsburg, Taylor M. Owings, & Joshua D. Wright, *Enjoining Injunctions: The Case Against Antitrust Liability for Standard Essential Patent Holders Who Seek Injunctions*, THE ANTITRUST SOURCE at 5-6 (Oct. 2014); *see also* Bruce H. Kobayashi & Joshua D. Wright, *The Limits of Antitrust and Patent Holdup: A Reply to Cary et al.*, 78(2) ANTITRUST L.J. 505 (2012).

[12] Draft Amendment Parts 3(1)(e) and 4(2)(iv).

incorrectly presumes that an SEP holder who seeks injunctive relief will use that relief to gain undue leverage and demand supra-competitive royalties, i.e., will engage in anticompetitive patent holdup. But just because an SEP holder seeks injunctive relief does not mean that it is using that relief (or the threat of it) to gain undue leverage.[13] For one thing, market mechanisms impose a number of constraints that militate against acting upon the opportunity for holdup. For example, as the U.S. Federal Trade Commission has pointed out in testimony before Congress, reputational and business costs may deter repeat players from engaging in holdup and "patent holders that have broad cross-licensing agreements with the SEP-owner may be protected from hold-up."[14] In addition, "patent holders who manufacture products using the standardized technology 'may find it more profitable to offer attractive licensing terms in order to promote the adoption of the product using the standard, increasing demand for its product rather than extracting high royalties.'"[15]

The Draft Amendment also essentially prohibits an SEP holder from seeking injunctive relief unless the infringing user is simply unwilling to take a license. This broad prohibition implicitly reflects presumptions both that patent holdup is frequent and that it has significant negative consequences for competition and innovation. While serious and important scholarly work exists exploring the theoretical conditions under which patent holdup might occur, this literature merely demonstrates the *possibility* that an injunction (or the threat of an injunction) against infringement of a patent *can* be profitable and *potentially* harmful to consumers. This same literature has long recognized the threat of reverse holdup and holdout with regard both to intellectual property and to real property.[16]

It is important to distinguish the hypotheses generated in the theoretical literature on patent holdup from empirical evidence that would substantiate those hypotheses. Our own assessment and that of other close students of the subject is that the existing empirical evidence is not consistent with the view that holdup is a prevalent or systemic problem that is causing harm to consumers.[17] The evidence required to support the JFTC's proposed approach—which

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[13] *See* Anne Layne-Farrar & Koren W. Wong-Ervin, *Methodologies For Calculating FRAND Damages*, LAW360 at 3-4 (Oct. 8-10, 2014) (explaining that "the actual practice of hold-up requires two elements: opportunity and action," listing a number of market mechanisms that militate against the opportunity for holdup), *available at* https://www.ftc.gov/system/files/attachments/key-speeches-presentations/wong-ervin_-_methodologies_for_calculating_frand_damages.pdf.

[14] *See, e.g.*, Prepared Statement of the Federal Trade Commission Before the U.S. Senate Committee on the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights Concerning "Standard Essential Patent Disputes and Antitrust Law" at 6 (July 30, 2013), *available at* https://www.ftc.gov/sites/default/files/documents/public_statements/prepared-statement-federal-trade-commission-concerning-standard-essential-patent-disputes-and/130730standardessentialpatents.pdf.

[15] *Id.*

[16] Holdup requires lock-in, and standard-implementing companies with asset-specific investments can be locked in to the technologies defining the standard. On the other hand, innovators that are contributing to an SSO can also be locked-in if their technologies have a market only within the standard. Thus, incentives to engage in holdup run in both directions. There is also the possibility of holdout. While reverse holdup refers to the situation when licensees use their leverage to obtain rates and terms below FRAND, holdout refers to licensees either refusing to take a FRAND license or delaying doing so.

[17] *See, e.g.*, J. Gregory Sidak, *The Antitrust Division's Devaluation of Standard-Essential Patents*, 104 GEORGETOWN L.J. ONLINE 48, 61 (2015) (collecting studies at n.49) ("By early 2015, more than two

is likely to deter procompetitive conduct including participation in standard setting—requires that there be a probability, not a mere possibility, of higher prices, reduced output, and lower rates of innovation.

In fact, evidence from the smartphone market, which is both patent and standard intensive, is to the contrary. Output has grown exponentially, while market concentration has fallen, and wireless service prices have dropped relative to the overall consumer price index (CPI).[18] A recent study by the Boston Consulting Group found that globally the cost per megabyte of data declined 99% from 2005 to 2013 (demonstrating both innovation to make data transmission more cost efficient as well as the healthy state of competition); the dollar per megabyte fell 95% in the transition from 2G to 3G, and 67% in the transition from 3G to 4G; and the global average selling prices for smartphones decreased 23% from 2007 through 2014, while prices for low-end phones fell 63% over the same period.[19] In Japan alone, mobile telephone charges and cellular phone prices have dropped 15% and 14%, respectively, relative to the overall CPI between 2005 and 2014.[20] A recent study of the United States revealed that SEP-reliant industries in the United States have the fastest price declines.[21]

Economic analysis provides the basis upon which to understand the apparent disconnect between holdup theory and the existing evidence. As economic theory would predict, patent holders and those seeking to license and implement patented technologies form their contracts so as to minimize the probability of holdup. As explained above, several market mechanisms are available to transactors to mitigate the incidence and likelihood of patent holdup. This is not surprising. The original economic literature upon which the patent holdup theories are based

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dozen economists and lawyers had disapproved or disputed the numerous assumptions and predictions of the patent holdup and royalty stacking conjectures."), *available at* https://www.criterioneconomics.com/docs/antitrust-divisions-devaluation-of-standard-essential-patents.pdf; ANNE LAYNE-FARRAR, PATENT HOLDUP AND ROYALTY STACKING THEORY AND EVIDENCE: WHERE DO WE STAND AFTER 15 YEARS OF HISTORY? (Dec. 2014), *available at* http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD%282014%2984&doclanguage=en (surveying the economic literature and concluding that the empirical studies conducted thus far have not shown that holdup is a common problem).

[18] According to data from Gartner, worldwide smartphone sales to end-users have increased by more than 900% between 2007 to 2014, and by 320% between 2010 to 2014. Market concentration in smartphones, as measured by HHIs, went from "highly concentrated" in 2007, as defined by the United States antitrust agencies' Horizontal Merger Guidelines, to "unconcentrated" by the end of 2012. *See* Keith Mallinson, *Theories of harm with SEP licensing do not stack up*, IP FINANCE BLOG (May 24, 2013), *available at* http://ipfinance.blogspot.com/2013/05/theories-of-harm-with-sep-licensing-do.html. According to the Bureau of Labor Statistics, the ratio of the CPI for wireless telephone services to the overall CPI has dropped 34% from 2007 to 2014.

[19] JULIO BEZERRA ET AL., THE MOBILE REVOLUTION: HOW MOBILE TECHNOLOGIES DRIVE A TRILLION DOLLAR IMPACT 3, 9 (The Boston Consulting Group Jan. 15, 2015), *available at* https://www.bcgperspectives.com/content/articles/telecommunications_technology_business_transformation_mobile_revolution/#chapter1.

[20] *See* REPORT ON THE CONSUMER PRICE INDEX (Japan Statistics Bureau, Ministry of Internal Affairs and Communications), *available at* http://www.stat.go.jp/english/data/cpi/1588.htm#his.

[21] Alexander Galetovic, Stephen Haber, & Ross Levine, *An Empirical Examination of Patent Hold-Up* (Nat'l Bureau of Econ. Research, Working Paper No. 21090, Apr. 2015), *available at* http://www.nber.org/papers/w21090.pdf.

was focused upon the various ways that market actors use reputation, contracts, and other institutions to mitigate the inefficiencies associated with opportunism in the real property setting.[22]

Recognizing the theoretical nature of holdup concerns, the United States Court of Appeals for the Federal Circuit (which has nationwide jurisdiction over patent disputes) has held that claims of holdup must be substantiated with "actual evidence" of holdup, and that the burden is on accused infringers to show that the patent holder used injunctive relief to gain undue leverage with which to demand supra-FRAND royalties.[23]

By deleting Parts 3(1)(e) and 4(2)(iv) of the Draft Amendment, the JFTC would protect incentives to participate in standard setting by allowing SEP holders to seek and obtain exclusion orders when permitted by the SSO agreement at issue and in the absence of a showing of any improper use. In contrast, imposing AMA liability, particularly under a theory that presumes holdup is common and requires the SEP holder to show that the allegedly infringing party is unwilling to take a license at a FRAND rate, threatens to deter participation in standard setting, particularly if an accused infringer can prove its willingness to contract simply by agreeing to be bound by terms determined by neutral adjudication. If the worst penalty an SEP infringer faces is not an injunction but merely paying, after a neutral adjudication, the FRAND royalty that it should have agreed to pay upon demand, then reverse holdup and holdout give implementers a profitable way to defer payment—or if they are judgment proof, to avoid payment altogether—

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[22] Benjamin Klein, *Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships*, 34 ECON. INQUIRY 444, 449-50 (1996); Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriate Rents, and Competitive Contracting Process*, 21 J.L. & ECON. 297, 303-07 (1978); OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS 26-30 (New York: Free Press 1975); *see also* Joshua D. Wright, Commissioner, Fed. Trade Comm'n, "SSOs, FRAND, and Antitrust: Lessons Learned from the Economics of Incomplete Contracts," Remarks before George Mason University School of Law at 2-3 (Sept. 12, 2013), *available at* https://www.ftc.gov/sites/default/files/documents/public_statements/ssos-frand-and-antitrust-lessons-economics-incomplete-contracts/130912cpip.pdf (explaining that "the economics of hold-up began not as an effort to explain contract failure, but as an effort to explain real world contract terms, performance, and the enforcement decisions starting with the fundamental premise that contracts are necessarily incomplete"). There is empirical evidence that SSO contract terms vary both across organizations and over time in response to changes in perceived risk of patent holdup and other factors. *See* Joanna Tsai & Joshua D. Wright, *Standard Setting, Intellectual Property Rights, and the Role of Antitrust in Regulating Incomplete Contracts*, forthcoming 80(1) ANTITRUST L.J. (2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2467939.

[23] *See, e.g.*, *Ericsson v. D-Link Sys*., 773 F.3d 1201, 1234 (Fed. Cir. 2014) ("In deciding whether to instruct the jury on patent hold-up and royalty stacking, again, we emphasize that the district court must consider the evidence on the record before it. The district court need not instruct the jury on hold-up or stacking unless the accused infringer presents actual evidence of hold-up or stacking. Certainly something more than a general argument that these phenomena are possibilities is necessary."); *see also* Anne Layne-Farrar & Koren W. Wong-Ervin, *An Analysis of the Federal Circuit's Decision in Ericsson v. D-Link*, CPI ANTITRUST CHRONICLE at 5-7 (Mar. 2015), *available at* http://www.crai.com/sites/default/files/publications/An-Analysis-of-the-Federal-Circuits-Decision-in-Ericsson-v-D-Link.pdf.

and puts SEP holders at a disadvantage that reduces the rewards to and can only discourage innovation and participation in standard setting.[24]

III. CONCLUSION

For the foregoing reasons, we respectfully recommend that Parts 3(1)(e) and 4(2)(iv) of the Draft Amendment be deleted in their entirety to avoid reducing incentives to innovate and deterring participation in standard setting. We appreciate the opportunity to comment and would be happy to respond to any questions the JFTC may have regarding these comments.

United States Federal Trade Commissioner Joshua D. Wright
United States Federal Trade Commission
600 Pennsylvania Ave., NW Washington DC 20580
Telephone: 202-326-2488
Fax: 202-326-3446
Email: jwright@ftc.gov

The Honorable Douglas H. Ginsburg
United States Court of Appeals for the District of Columbia
333 Constitution Ave., NW Washington, DC 20001
Telephone: 202-216-7190
Fax: 202-273-0678
Email: Douglas_H._Ginsburg@cadc.uscourts.gov

[24] Such delay tactics are magnified when the patent owner has a large worldwide portfolio of SEPs requiring it to file lawsuits around the world in order to adjudicate a FRAND royalty on a patent-by-patent basis. In such cases, international arbitration on a portfolio basis would appear to be the most efficient and realistic means of resolving FRAND disputes.