COMMENTS OF THE AMERICAN BAR ASSOCIATION’S SECTION OF ANTITRUST LAW, SECTION OF INTELLECTUAL PROPERTY LAW, AND SECTION OF INTERNATIONAL LAW ON THE PUBLIC COMMENT DRAFT OF THE SUPREME PEOPLE’S COURT’S DECISION ON REVISING APPLICATION OF THE LAW IN THE HEARING OF PATENT DISPUTE CASES

August 15, 2014

The views stated in this submission are presented on behalf of the Sections of Antitrust Law, Intellectual Property Law, and International Law of the American Bar Association. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and therefore may not be construed as representing the policy of the American Bar Association.

The Sections of Antitrust Law, Intellectual Property Law, and International Law of the American Bar Association (“the Sections”) are pleased to submit comments on public comment draft of the Supreme People’s Court’s Decision on Revising Application of the Law in the Hearing of Patent Dispute Cases (“the Consultation Draft”). The Sections’ comments reflect the expertise and experience of its members with competition and intellectual property law.

The Sections welcome the Supreme People’s Court (“SPC”) efforts to provide increased transparency and guidance through amending the Consultation Draft and appreciate the opportunity to provide comments. The Sections’ comments focus on discussion in Article 21 regarding the calculation of royalties damages.

General Comments

Effective remedies for patent infringement are crucial to promote innovation and competition by protecting innovators’ ability to reap benefits from their investments in research and development and commercialization of new products. In order to adequately protect incentives to innovate, remedies should compensate for past infringement, prohibit future infringement, and deter infringement in the first instance. In the United States, patent remedies provide three types of redress to achieve these goals: (1) compensatory damages, which seek to return the patentee to the financial condition it would have been in but for the infringement; (2) enhanced damages, which are designed to deter willful infringement; and (3) injunctive relief where appropriate, which seek to preserve the patentee’s exclusivity and deter infringement in the first instance.

Patent remedies that undercompensate or overcompensate patentees compared to the market reward, absent infringement, can harm consumers. Remedies that

systematically undercompensate patentees reduce incentives to innovate. Denying the ability to seek injunctions in all circumstances can undermine the ability of patentees to obtain the full market reward from the commercialization of their inventions. Remedies that overcompensate patentees beyond the market reward can result in price increases if excessive damages awards are passed on to the consumer. Thus, it is important that damage awards attempt to accurately replicate the market reward an invention could have earned absent infringement.

**Article 21**

Article 21 identifies factors courts may consider when they assess reasonable royalties damages based on prior licensing fees. It provides that when prior licensing fees are “manifestly unreasonable,” the court can disregard them.

The goal of a reasonable royalty damages calculation is to replicate the market reward for the invention in the absence of infringement. It accordingly should depend on what a willing licensee and a licensor would have agreed to in a hypothetical negotiation. The seminal case in the United States, *Georgia-Pacific Corp. v. United States Plywood Corp.*, describes the proper measure of damages as “[t]he amount that a licensor (such as the patentee) and the licensee (such as the infringer) would have agreed upon (at the time the infringement began) if both had been reasonably and voluntarily trying to reach an agreement.” The central tenet of this framework is the willing licensor/willing licensee model, under which the awarded amount must be acceptable to both parties. The royalties must adequately compensate the patentee for permitting the use while leaving the infringer an appropriate level of anticipated profits from using the invention.

U.S. courts apply two assumptions when implementing the hypothetical negotiation. First, the finder of fact must assume that the hypothetical negotiation takes place at the time the infringement began. This timing determines the information available to the parties during the negotiation. Thus, in setting a reasonable royalty rate, considerations such as the infringer’s expected profit and available alternatives are “to be determined not on the basis of the hindsight evaluation of what actually happened, but on the basis of what the parties to the hypothetical license negotiations would have considered at the time of the negotiations.”

Second, courts require the fact-finder to assume that at the time of the negotiations the parties know with certainty that the patent is valid and infringed by the defendant’s product or process. This assumption ensures that the patentee, having incurred the risk and burden of trial and prevailed, is fully compensated.

In constructing the hypothetical negotiation, U.S. courts consider evidence of market factors that the negotiating parties would consider in determining the royalty

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3 Hanson v. Alpine Valley Ski Area, Inc., 718 F.2d 1075, 1081 (Fed. Cir. 1983).
rate. Because each technology and market is different, the evidence considered and the weight placed on each factor will vary based on the circumstances.4

We recommend that the Supreme People’s Court consider amending Article 21 to specify that courts seek to re-create the hypothetical negotiation and willing licensor/willing licensee model as the conceptual framework for determining a reasonable royalty. The courts would then consider evidence of market factors that would bear on the appropriate royalty. This approach would serve to protect incentives to innovate and guard against under- or overcompensation.

With respect to standard-essential patents (“SEPs”) on which the SEP holder has made a voluntary commitment to license on reasonable and nondiscriminatory (“RAND”) terms, U.S. courts have considered specific factors to re-create a hypothetical negotiation between the parties. For example, courts have held that “the parties in a hypothetical negotiation would set RAND royalty rates by looking at the importance of the SEPs to the standard and the importance of the standard and the SEPs to the products at issue.”5 Furthermore, “a RAND commitment should be interpreted to limit a patent holder to a reasonable royalty on the economic value of its patented technology itself, apart from the value associated with incorporation of the patented technology into the standard.”6

Lastly, Article 21 prohibits the use of licensing fees previously agreed to in the market with licensees if those fees are “manifestly unreasonable.” The vagueness of the standard for what is “manifestly unreasonable” could lead to decisions that deviate from a market-based approach.7 To induce innovation and market growth, a patent holder should generally be permitted to charge whatever price the market will bear.8 Absent evidence that the prior licensing fees were the result of anticompetitive conduct, such fees that are negotiated at arms-length provide an indication (and may be the best available evidence) of the market value of the patent.

To the extent that Article 21 refers to licenses for the infringed patent, such evidence may reliably assist the trier of fact when

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4 The Georgia-Pacific court identified a list of 15 non-exhaustive factors. Factor 15 is the hypothetical negotiation amount and the other 14 factors list categories of evidence. Georgia-Pacific Corp., 318 F. Supp. at 1120.
6 Id. at *12.
7 Daniel F. Spulber, “How Do Competitive Pressures Affect Incentives to Innovate When There Is a Market for Inventions?,” 121 J. POL. ECON. 1007, 1040 (2013) (“[A]ntitrust and IP policies that weaken IP rights reduce participation in markets for inventions. Antitrust policies thus should avoid restricting IP rights through limits on royalties, technology standards, or market transfers of IP. Limiting appropriability of IP, by constraining markets for inventions, generates competitive pressures from imitation and expropriation that decrease incentives to innovate.”).
8 See, e.g., Mark A. Lemley, “Distinguishing Lost Profits from Reasonable Royalties,” 51 WILLIAM & MARY L.R. 655, 657 (2009) (“The traditional conception of patent protection is to give patent owners a means of excluding competitors from selling the patented product, thereby increasing their profits and therefore the incentive of putative patent owners to invent. This traditional conception requires exclusivity; the value of a patent is accordingly commensurate with the value of the market or market niche it controls.”).
the patented invention and its infringing use are sufficiently similar to those of the comparable license. Key attributes for evaluating similarity include the technology, the rights licensed (one patent or a portfolio), royalty type (running royalty or lump sum), and terms of the license (one product or many). When a license is found comparable and negotiated at arms length, it should be considered as evidence without regard to whether the terms are “manifestly unreasonable.”

Thus, we respectfully suggest that Article 21 be amended to delete this prohibition and permit courts to consider all prior and comparable licensing fees and not exclude those deemed to be “manifestly unreasonable.”

**CONCLUSION**

The Sections appreciate the opportunity provided by the SPC to comment on its Consultation Draft. We would be pleased to respond to any questions the SPC may have regarding these comments, or to provide additional comments or information that may be of assistance to the SPC.