

# 8 Commitments to License on Fair, Reasonable, and Nondiscriminatory Terms: Comparing the Japanese Approach to Technology Standards with Emerging Trends around the World<sup>(\*)</sup>

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*Standard Setting Organizations (SSOs) often require members to commit to licensing patented technologies on fair, reasonable, and nondiscriminatory (FRAND) terms. FRAND commitments may be viewed as contracts. However, enforcing the commitment in favor of a standard implementer will generally require recognizing the implementer as a third party beneficiary under the contract, and many countries may be hesitant to give third party beneficiaries full rights to enforce a contract. Attempting to evade a FRAND commitment may be viewed as anticompetitive, but jurisdictions differ as to when such behavior is sufficiently anticompetitive to be actionable. The public benefit of standards and the possibility that this benefit could be harmed by patent holdout also raises the issue of how to determine if a patent right is being abused.*

*My research examines these questions from an international perspective because of the global nature of technology standards, with additional attention given to the application of the law of Japan. To gain a variety of perspectives on this topic, I also conducted interviews with several industry professionals in Tokyo to obtain the perspective of those who practice in relevant fields in Japan.*

## I Introduction

The recent patent wars involving standardized technology span the globe and stretch across many jurisdictions. Patent litigation in this area has been making headlines, in part because some of these cases are between two parties that are already household names, including some of the major smartphone manufacturers. Many of the technologies involved are implicated by technology standards, and most of them are subject to commitments to license essential patents on fair, reasonable, and nondiscriminatory (FRAND) terms.

In this report, I will examine issues that arise in the context of standard setting, especially issues relating to FRAND commitments, from an international perspective and with special attention to Japanese law. This summary is designed to follow the organization of the full report, so the reader can quickly turn to a relevant section to learn more.

## II Japanese Law

Historically, the legal system of Japan has been very different from the U.S. legal system.

These differences include matters of both content and behavior. As a civil law system, the primary source of Japanese law is its written codes. The Japanese Civil Code also includes general provisions aimed at ensuring fairness in transactions and in the application of law.

There are other sources of law in Japan as well, including custom and case law. Article 92 of the Civil Code indicates that custom prevails over laws or ordinances that do not concern public policy. Case law has persuasive effect, but is generally not legally binding to the same extent as case law in common law countries. Though it lacks stare decisis effect in Japan, case law is nonetheless very influential, and in many cases a lower court's failure to follow Supreme Court precedent is grounds for appeal.

Coming from the common law legal system of the United States, one of the first things that I wanted to understand was the practical implications of Japan's civil law system. Comparative lawyers often focus on the differences between the common law and civil law systems.

Reference to the civil law system of Japan sometimes implicates the ideas of "bukken" and "saiken" characterizations of rights. Bukken is

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the term used to refer to “real rights,” and is generally equivalent to the idea of in rem rights. On the other hand, saiken refers to obligation rights, or rights in personam. Real rights pertain to a specified thing and generally can be claimed against all others, while in personam rights allow the holder to require specific action or inaction of another person and generally can only be claimed between the parties to the specific contractual relationship.

## **a Patents**

Under Japanese law, when a patent has been infringed, the patent owner may seek an injunction, damages, and “measures for recovery of the patent owner’s reputation.”<sup>1</sup> Damages under the Patent Act can include a demand that the defendant pay the patent owner a reasonable royalty, which is an amount that may be determined by a court. When an infringer has sold infringing products, damages can also include the lost profits that the patent holder could have obtained, though this amount is limited by the patent owner or licensee’s production capacity. Under Article 100 of the Patent Act, an injunction is available when there is a likelihood of infringement of a patent.

### **1 Licenses – Exclusive and nonexclusive**

The Japanese patent licensing system includes more complicated procedures than the patent licensing system under U.S. law. Under Japanese law, the holder of a sen-yo exclusive license has most of the same rights to assert a patent as the patent owner, but in order for the sen-yo license to be effective, it must be registered with the JPO.

Patent law in the United States currently does not have any mandatory recordation requirements in most situations, though the USPTO has recently considered requiring recordation at least for patent assignments. While conducting interviews, I asked representatives of Japanese industry for their opinions concerning the recordation system of Japan. The general consensus among those whom I interviewed is that there are some issues with the Japanese recordation system, but that having a recordation system is better than not having a recordation system.

## **b Contracts**

My primary interest in this report is to

understand FRAND commitments from the Japanese perspective. To this end, Japanese contract law is essential to my analysis. Japanese courts have concluded multiple times that patent license agreements are governed by normal contract law. Laws governing IP infringement also may apply when the transferred right is exclusive, but in the context of technology standards, it is unlikely that a sen-yo exclusive license will be granted for standard essential patents (SEPs). Thus, Japanese contract law is especially important to understanding the implications of FRAND commitments.

FRAND commitments are a contract between the patent owner and the SSO, but most SSOs state that they will not intervene in licensing disputes. Therefore, the right of a standard adopter to enforce the FRAND commitment is very important for FRAND commitments to have any real meaning. Under U.S. contract law, third party beneficiaries can enforce contracts under the right circumstances. In some European countries, like Germany, the recognition of third party beneficiaries under contracts is more difficult.

In Japan, Article 537 of the Japanese Civil Code will apply, under which a third party obtains a right to claim performance, which Tamura says may create an interest for FRAND commitment beneficiaries.<sup>2</sup> Under Article 538 of the Civil Code, other parties may not modify or extinguish the right held by the third party beneficiary. However, under Section 537(2), the right does not accrue when the contract is formed, and instead depends on the beneficiary expressing an intention to receive the benefit. Thus, the intention of the FRAND commitment is preserved under Japanese law, but it is limited. The fact that the third party beneficiaries are not identified might also cause problems for standard adopters, but a lower court case supports the proposition that under Japanese law, unidentified third party beneficiaries may be able to claim the benefits of the contract.

## **c Competition law**

The Japanese Fair Trade Commission (FTC) is the primary government body charged with enforcing Japanese competition law. The FTC has quasi-legislative and quasi-judicial power, similar to an administrative agency in the United States. When preliminary evidence is presented to the FTC, the FTC can initiate an investigation into possible anticompetitive behavior. This

preliminary evidence may come from complaints made by the public, detection by the FTC, or notification by the Public Prosecutor General. Complaints made by the public are the most important source. Decisions of the FTC can be reviewed by the Tokyo High Court. While the FTC is formally entrusted with enforcing the Anti-Monopoly Act, some private causes of action may be available to address anticompetitive actions. However, it is not clear if the Anti-Monopoly Act creates a right to demand a private law injunction to prevent the rescission of a contract.

#### **d Property law**

Japanese property law emerged to address the needs of a collectivist society in managing potentially conflicting interests in property in the geographically isolated Japanese archipelago. Japanese property law, or *zaisan ho*, has remained largely unchanged since the Civil Code was adopted in 1896.

The *numerus clausus* principle applies strongly in Japan, where new rights generally cannot be created without legislative intervention. Because of the *numerus clausus* principle, it is very difficult for real rights to be recognized if they are not within a specific preexisting category under the Civil Code. The statutory real rights under the Japanese Civil Code are: possessory rights, ownership, superficies, *emphyteusis*, easements, rights of retention, preferential rights, pledges, and hypothecs.<sup>3</sup>

Japanese law contains several provisions addressing use rights in the property of others. Under Article 209 of the Japanese civil code, the owner of land may request the necessary access to or use of neighboring land to the extent necessary for completing work around the boundary. Article 209 could either be understood as an extension of the land ownership rights of the neighbor, or as a constraint on the ownership rights of the owner of the servient land. The principle underlying Article 209 is also reflected in Article 92 of the Japanese patent law, where the owner of a patent that relies on an earlier innovation is permitted to request a compulsory license for the earlier invention to allow the practice of their later invention. Japanese property law also has a concept that is similar to the “servitude by necessity” under U.S. law. Article 210 of the Civil Code gives a landowner a right of access over adjoining land when the first landowner otherwise has no access to public

roads, though Article 212 requires the owner of the servient tenement to be compensated by the landowner who uses the right of access.

#### **1 Property theories**

Japanese property law does not draw much distinction between movable and immovable property. However, intellectual property seems to be treated as a distinct concept under Japanese law, perhaps indicating that Japanese property law is primarily viewed as applying to corporeal objects. This would put Japanese property law in line with German property law, or “*sachenrecht*,” a word that can be literally translated as “the law of things.” On the other hand, the civil law system of France views incorporeal objects as a type of movable property.

My previous research on the topic of FRAND commitments emphasized a property analogy. Specifically, we contemplated interpreting a FRAND commitment as creating an encumbrance, similar to a servitude under real property law, that would run with the patent to subsequent assignees. The Japanese approach to servitudes is similar to servitudes under U.S. law, allowing me to analogize to FRAND commitments in the same way. Applying a servitude theory under Japanese law would resolve the pervasive issue of how to ensure that a FRAND commitment is enforceable against a successor in interest. However, because of Japan’s strict *numerus clausus* doctrine, the interpretation of a FRAND commitment as creating an encumbrance would likely need to be codified in the law, because of the limitations on creating new “real rights” under Japanese law.

#### **e Abuse of right**

Under Article 1 of the Civil Code, there is a requirement that the exercise of private rights must conform to the public welfare, an obligation to exercise rights and perform duties in good faith, and a prohibition on the abuse of rights. The concept of “abuse of right” has sometimes been applied in cases concerning conflicts that would be referred to as nuisances in U.S. property law.

The concept of “abuse of right” is a broad one and is not grounded in a particular area of law. In the patent context, a patent owner can be said to be committing an abuse of rights when the owner’s exercise of the patent right is “contrary to the purpose of the patent act.”<sup>4</sup> Competition law in many countries prohibits abuse of dominant position, which seems thematically similar to an abuse of right.

In the context of technology standards, a Japanese court ruled in 2013 that an abuse of right occurred when a patent owner claimed damages without fulfilling its duty to negotiate in good faith pursuant to a FRAND commitment.<sup>5</sup> However, the response to these circumstances varies across jurisdictions. In proceedings between ICom and HTC, a district court in Germany ruled that ICom's claims against HTC concerning standard essential patents were not abusive to law. Because the United States is a common law jurisdiction, there is no "abuse of rights" concept in the law, but there is a somewhat related concept called patent misuse. Competition law and intellectual property law occasionally overlap in this context. In the United States, patent misuse refers to the anticompetitive assertion of a patent. If patent misuse has been found, the patent owner is limited in his ability to exercise his exclusive patent rights.

### III Standardization

A technology standard can be open or closed (depending on to whom membership is available), and public or non-public (depending on whether the standard is available to the public or only to the parties that drafted the standard). As Kim Junghoon stated in an IIP report, the purpose of standardization is to reduce uncertainty and promote economic transactions.<sup>6</sup>

Standardization has many benefits. It reduces transaction costs, achieves economies of scale, incentivizes investment, promotes intra-standard competition, produces network effects benefiting complementary goods, provides consumers with more choices, and allows for the expansion of the relevant market. The Tokyo district court stated that technology standards can help ensure device compatibility, reduce the costs of producing and procuring technology, make R&D expenditures more efficient, and provide improvements in products and services to end users.<sup>7</sup> However, standardization also carries the risks of producers and consumers being locked-in to a particular type of technology, and can potentially restrict the diversity of the technology. Lock-in reduces uncertainty at first, but over time, a locked-in technology can become outdated, and the standard can make it more difficult to change.

#### a Essentiality

As a recent IIP Bulletin noted, SEPs are

going to continue to be very important in the Japanese economy.<sup>8</sup> There are many pressing questions concerning SEPs. How can an SSO or a court determine what the SEP's actual value to the standard is? What does it mean for a patent to be essential? Should injunctions be available when a SEP has been infringed?

Determining how to recognize SEPs is thus a very important topic for policymakers to consider. In conducting my research, I interviewed several professionals in Japan who encountered standards-related issues, either through their own practice or through interaction with policy concerns. In multiple interviews, the interviewees stressed that a third party service should be utilized to evaluate whether a declared essential patent was actually essential to the standard.

#### b Patent pools

Patent pools offer a variation on the procedures followed by SSOs, focusing on joint licensing agreements that permit members to place patents into a pool of technologies rather than making a declaration that the member has a standard essential patent. Judging by the feedback that I received during interviews, it appears that patent pools are a favored approach in Japanese technology industries.

Patent pools can reduce transaction costs by regularizing transactions, and can also potentially reduce conflicts when there are mutually blocking patents. Patent pools can also reduce the problem of royalty stacking, where otherwise reasonable licensing fees become excessive when aggregated with a large number of other reasonable license fees for the same standardized technology.

There are several possible disadvantages of patent pools, including the risk of free-riders and the danger that the pool could be misused as a tool for price-fixing. Patent pools have been the target of criticism based on possible price-discrimination issues, so patent pools have historically avoided ex ante discussion of price by setting IPR policies that emphasize FRAND commitments.

When evaluating whether a patent pool is anticompetitive, competition authorities are especially concerned about things like whether the pools are limited to essential patents and if licensing by the pool is nondiscriminatory. The relationship between patents in a pool is also very important when evaluating their status under competition law – for example, are the patents

competitive, complementary, or blocking? Competitive (or substitute) patents are patents that can be commercialized without mutual licensing, while complementary patents are patents that are worth more when they are commercialized together. On the other hand, technologies that rely on blocking patents cannot be commercialized without the patents being infringed.

### **c FRAND**

The primary focus of this report is on the legal implications of commitments to license essential patents on fair, reasonable, and nondiscriminatory (FRAND) terms. Many SSOs only permit patented technologies to be included in a standard if the patent owner promises to license the patent on FRAND terms.

However, SSOs generally do not define what traits a FRAND license would have, and often have specific policies against getting involved in licensing disputes. The Commission of the European Communities has long recognized that fairness and reasonableness are subjective factors that are to be “determined by the circumstances surrounding the negotiation.”<sup>9</sup> Thus, FRAND commitment disputes are typically resolved by courts.

The effect of FRAND commitments on remedies remains unclear. Some research suggests that a FRAND commitment should be understood as precluding an injunction for the infringement of SEPs. In the United States, case law is trending in this direction, and courts currently seem less likely to grant injunctions to SEP owners when the infringed patent is essential to a standard. However, there is not a consensus across jurisdictions on this point, and clarifying the effect of a FRAND commitment on available remedies under Japanese law might require an amendment of the Japanese Patent Act.

### **d IPR policies**

Because of the need to balance the benefits of standard setting against the rights of SEP owners, SSOs enact intellectual property rights (IPR) policies. SSOs typically require members to disclose if the member owns patents that are or will likely become standard essential. The disclosure requirement serves as a reassurance to users of the standard that there is not a significant risk of patent holdup.

IPR policies generally contain terms that do

not place too many burdens on the patent owner. ETSI adopted a more stringent and detailed IPR policy in 1993, but in response to opposition to the policy, ETSI abolished the policy in 1994 and adopted a more flexible approach.

## **IV Legal issues in standardization**

Legal issues relating to standardization have been examined in many different jurisdictions. The Japanese law on these points is developing, so this section of my report focuses primarily on how these issues have been addressed thus far by academics and in other jurisdictions.

When a beneficiary seeks to enforce a FRAND commitment, a court may be tasked with either 1) determining the reasonableness of a proffered royalty, or 2) calculating a reasonable royalty. Much of the recent litigation concerning technology standards involves arguments about royalties.

A district court in the United States recently provided a very detailed analysis for calculating a reasonable royalty in *Microsoft v. Motorola*. During interviews with Japanese professionals, one sentiment that was expressed was the possibility that the test that was applied in *Microsoft v. Motorola* might influence technology holders to be more interested in patent pool arrangements instead of SSOs.

The two areas of law that have been analyzed the most with respect to FRAND commitments and standardization are competition law and contract law, so it is to these areas of law that we will next turn.

### **a Competition law**

The standard setting process can implicate competition law because the process typically involves private companies that are working together doing things that affect a relevant market. Generally, competition authorities are hesitant to challenge standard-setting itself as being potentially anticompetitive because of the voluntary nature of the process and the competitive benefits of standardization.

#### **1 U.S.**

Under U.S. antitrust law, a rule of reason is generally applied to determine if actions relating to standardization violate competition law. For a rule of reason analysis, the court considers the relevant market and the defendant’s market power. The USDOJ has also published several

business review letters approving patent pools like the pools for DVD technology and MPEG-2. In 2006, the USDOJ also approved VITA's proposed policy that would require members to declare the maximum royalty rates that they will seek for SEPs.

The U.S. case of *Rambus Inc. v. FTC* provides a convincing, if somewhat pessimistic, view of how U.S. antitrust law will apply to misbehavior in the standard setting context. In the *Rambus* case, there was evidence that *Rambus* had concealed patents and had amended its patent application to better reflect the planned standard before withdrawing from the SSO. The D.C. Circuit, however, held that this sort of behavior was not anticompetitive, in part because the concealment was done in order to avoid the possible royalty limitations of a FRAND commitment. The Court also held the FTC to a high causation bar, requiring a showing that but for the concealment, a different standard would have been adopted.

## 2 EU

Analysis of FRAND issues in European courts often focuses on competition law claims. Each SEP owner is a monopolist by definition, because the EC considers each SEP to be "a market unto itself."<sup>10</sup> Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU) are especially relevant to competition law concerns and standard setting. Article 101 sets forth a variety of prohibitions on business undertakings, and Article 102 refers to abuse of a dominant position.

### b Contracts

The effect of a FRAND commitment under contract law is likely to vary significantly across jurisdictions. In the United States, FRAND commitments tend to be viewed as valid contracts, and it is not too controversial to say that a third party beneficiary has a right to enforce a FRAND commitment when a SEP owner is seeking an injunction against the potential licensee's use of the patent.

However, contract issues relating to FRAND commitments are less clear in some European courts. In the litigation between *IPCom* and *HTC* in Germany, the District Court of Mannheim held that German law would not recognize a FRAND commitment as executing a partial waiver of in rem rights. This is significant because several interpretations of FRAND commitments

emphasize the role that FRAND commitments play in limiting the scope of the patent owner's exclusive rights. FRAND commitments may also have an uncertain legal status in the United Kingdom, where the courts generally do not recognize "contracts to negotiate."<sup>11</sup> In *Walford v. Miles*, the UK court went so far as to suggest that imposing a duty to negotiate in good faith would be "inherently repugnant to the adversarial position of the parties."

### c Injunctive relief

One of the pervasive issues that arises in the context of standardization and FRAND commitments is the extent to which a SEP owner should be able to seek an injunction as a remedy for infringement of a SEP. Some recent U.S. court decisions rejected requests for injunctive relief under different justifications, such as by interpreting the FRAND commitment as an implicit admission that royalties would be adequate to compensate the patent owner for the infringement. IIP analysis of case law from the Netherlands indicates that under Dutch law, an injunction may be denied if the behavior of the SEP owner amounts to an abuse of right.<sup>12</sup> A FRAND commitment might also restrict the availability of injunctions in South Korea.

### d Transfer

In the modern information economy, patents are frequently bought and sold. There have been many large transfers of patents. The CPTN Consortium (made up of Microsoft, Apple, EMC, and Oracle) bought 882 Novell patents for US\$442 million. The Rockstar Consortium (which included Microsoft, Apple, and Research in Motion) bought 6000 patents that formerly belonged to Nortel for US\$4.5 billion. Many of these transactions involve patents that may be SEPs and thus subject to FRAND commitments. When SEPs are acquired, it is unclear if the new owner is bound by the FRAND commitment that applied to the predecessor in interest. *Dolman* and *Ilan* argue that FRAND promises should follow the patent when it is transferred, since to permit otherwise would allow patent owners to avoid FRAND obligations simply by transferring the patent.<sup>13</sup> Contract language can be used to obtain this effect, like when *Rockstar* purchased *Nortel's* patent portfolio and the FRAND obligations were listed in the sale agreement as "permitted encumbrances."

If a FRAND commitment were characterized as a license, it would be easier to argue that the commitment runs with the patent, since nonexclusive licenses are generally enforceable against successors in interest under patent law. At least one case in China seems to have applied this reasoning. There, a court concluded that participating in the standard setting process effectively created a license in favor of parties who use the standard technology. However, judging by recent case law, it is more likely that a FRAND commitment will not be viewed as creating a license.

## V Conclusion

Standard setting activities are very influential across many different jurisdictions. However, courts currently do not agree about how FRAND commitments should be understood or what the effect of the commitment should be. Through this report, I hope to have provided some additional insight into the development of FRAND issues in Japan and around the world.

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<sup>1</sup> Zentaro Kitagawa (General Editor), *Doing Business in Japan*, Vol. 3, Part VI, Intellectual Property, s. 2.17 (2006).

<sup>2</sup> Yoshiyuki Tamura, *Standardization and Patent Rights – Legal Issues Concerning the Application of the RAND Provisions*, Chizaiken Forum, Vol. 90, pp. 18-26 (2012).

<sup>3</sup> Zentaro Kitagawa (General Editor), *Doing Business in Japan*, Vol. 3 (2006), Part IV, Property, 1.02.

<sup>4</sup> IIP Bulletin 2013, Vol. 22, *The Exercise of Essential Patents for Standards (II)*.

<sup>5</sup> Judgment of Tokyo District Court, February 28, 2013 (2011 (Wa) No. 38969) (translation by IIP); IIP Bulletin 2013, Vol. 22, *The Exercise of Essential Patents for Standards (II)*.

<sup>6</sup> Kim Junghoon, *Technical Standard-Setting, Patent Pooling, and Competition Policy 6*, IIP, March 2004.

<sup>7</sup> Judgment of Tokyo District Court, February 28, 2013 (2011 (Wa) No. 38969).

<sup>8</sup> IIP Bulletin 2013, Vol. 22, *The Exercise of Essential Patents for Standards (II)*.

<sup>9</sup> Commission of the European Communities, *Communication from the Commission, Intellectual Property Rights and Standardization*, Com(92) 445 final, 4.3.3, Brussels, 27 October 1992.

<sup>10</sup> Maurits Dolmans and Daniel Ilan, *European Antitrust and Patent Acquisitions: Trolls in the Patent Thickets*, 8 No. 2 COMPETITION L. INT'L 7, 8 (2012).

<sup>11</sup> *Walford v. Miles* [1992] 2 W.L.R. 174.

<sup>12</sup> IIP Bulletin 2013, Vol. 22, *The Exercise of Essential Patents for Standards (II)*.

<sup>13</sup> Dolmans and Ilan, *supra* note 10, at 12.