Antitrust Regulation of IPRs – China's First Proposal

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Introduction

On June 11, 2014, the State Administration for Industry and Commerce (SAIC) published the Regulation on the Prohibition of Conduct Eliminating or Restricting Competition by Abusing Intellectual Property Rights (Consultation Draft) (draft SAIC IPR Regulation).[2] This will be the first regulation dealing with the application of China's Anti-Monopoly Law[3] (AML) to the intellectual property rights (IPRs) domain. The draft SAIC IPR Regulation is expected to be formally adopted later in 2014.

Even though it has yet to be enacted in final form, the draft SAIC IPR Regulation has already received waves of reactions from stakeholders.[4] As it is the first time in history that China attempts to regulate IPRs through antitrust enforcement, it is natural to hear comments such as that the draft regulation may be overreaching or that it appears to "discourage innovation."[5] In our view, while the draft SAIC IPR Regulation is about IPRs and hence about innovation, it is itself as cautious as it is conservative. After close to five years of researching, drafting and consultations, the draft regulation reflects a compromise – *i.e.*, mixing both foreign and domestic elements and reconciling various interests.

As it currently stands, the draft regulation is a relatively cautious attempt to bridge the gap to related pre-existing laws in China, while at the same time attempting to follow international practices in the antitrust/IPR space – namely, European Union (EU) and US rules[6] – to the extent possible. While some controversial articles have been removed during the drafting

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2 Regulation on the Prohibition of Conduct Eliminating or Restricting Competition by Abusing Intellectual Property Rights (Consultation Draft), available at http://www.saic.gov.cn/gzhd/zqyj/201406/t20140610_145803.html.

3 Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No. 68, Aug. 30, 2007.

4 *See* for example, International Bar Association, *Submission to the Administration for Industry and Commerce on the Proposed Rules on the Prohibition of Abuses of Intellectual Property Rights for the Purposes of Eliminating or Restricting Competition*, Jul. 10, 2014; American Bar Association, *Joint Comments of the American Bar Association Section of Antitrust Law, Section of Intellectual Property Law, and Section of International Law on the SAIC Draft Rules on the Prohibition of Abuses of Intellectual Property Rights for the Purposes of Eliminating or Restricting Competition*, Jul. 9, 2014; and US-China Business Council, *US-China Business Council Comments on Draft Regulations on the Prohibition of Conduct that Eliminates or Restricts Competition through Abuse of Intellectual Property Rights (IPR)*, Jul. 10, 2014.

5 *See*, for example, US-China Business Council, *id.*, at 2.

6 For the EU, *see*, mainly, European Commission Regulation on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements, [2014] OJ L93/17, and European Commission Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements, [2014] OJ C89/3; for the US, *see*, mainly, Antitrust Guidelines for the Licensing of Intellectual Property [1995] U.S. Department of Justice & Federal Trade Commission, Apr. 6, 1995.

process, the draft SAIC IPR Regulation still manages to deliver some fresh thinking, and offer a relatively comprehensive antitrust regulation of IPRs, within SAIC's parameter of jurisdiction. Importantly, SAIC failed to reach a common position with the National Development of Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM), and the scope of the draft regulation does therefore not explicitly include price-related anticompetitive conduct and IPR issues in merger control.

This article aims to provide an overview on the pre-existing Chinese law in this area, and then give a brief introduction to some of the key provisions of the draft SAIC IPR Regulation.

Prior antitrust enforcement in the IPR area

We can see three areas of Chinese law where some of the issues addressed in the draft SAIC IPR Regulation have come up: (a) the Contract Law and related provisions; (b) the Patent Law and related provisions; and (c) AML developments.

Contract Law

There are a number of provisions in Chinese law that regulate technology licensing. The Contract Law and its implementing rules, as well as the Foreign Trade Law and its implementing measures, are two important sources of regulation. Some of the applicable provisions have antitrust-oriented effects.

First, the scope covered by the Chinese Contract Law is broad, and includes a section on "technology contracts."[7] Article 329 of the Contract Law states that a technology contract, which illegally monopolizes technology, impairs technological advancement or infringes upon the technology of a third party, is invalid. A Judicial Interpretation by the Supreme People's Court (SPC) sheds further light on how Article 329 is to be interpreted by the courts.[8] The Judicial Interpretation lists examples of "illegal monopolization or impairment of technological advancement:" unfair grant-back obligations; non-compete for technology, and exclusive dealing for input products; unreasonable use restrictions; tying with unwanted technology or products; and prohibitions to challenge the validity of IPRs.[9] The rules only appear to apply if the governing law of the underlying contract is Chinese law.

Second, the Foreign Trade Law and an implementing regulation by MOFCOM contain provisions that list a number of prohibited clauses which are very similar to those of the Judicial

[7] Contract Law of the People's Republic of China, [1997] Presidential Order No. 83, Mar. 15, 1999, Chapter 18.
[8] Interpretation of the Supreme People's Court concerning Some Issues on the Application of Law for the Trial of Cases on Disputes over Technology Contracts, [2004] Judicial Interpretation No. 20, Dec. 16, 2004.
[9] Id., art. 10.

Interpretation.[10] The rules under the Foreign Trade Law and its implementing regulation govern cross-border transfers of technology.

Patent Law

Since 2001, the Patent Law has had a clause allowing the patent regulator, the State Intellectual Property Office (SIPO), to order the compulsory licensing of patents if certain exceptional situations – such as a public health crisis – arise.[11] In 2008, the Patent Law was amended, and one of the insertions was the possibility to order compulsory licensing as a remedy for anticompetitive patent practices. This amendment was made to echo the entry into effect of the AML whose Article 55 prohibits the "abuse of IPRs" to restrict competition.

Initially, the 2008 amendment raised concerns over which authorities – antitrust or IPR authorities – had the power to deal with anticompetitive patent practices. In 2012, SIPO stated that this should be done by antitrust authorities or courts.[12] Thus, the amendment serves only as a reference to the AML. It does not provide a new venue to tackle anticompetitive IPR practices under the Patent Law. To the best of our knowledge, SIPO has never ordered compulsory licensing so far.

In comparison, a separate string of developments in the patent law arena has had a bigger impact on antitrust law. The developments concern patents in standards. Government bodies in China had been drafting rules on how to draft and implement industry standards that incorporate patents for a long time.[13] At the beginning of this year, the rules were finally enacted.[14] Over five years earlier, the SPC handed down a key ruling that paved the way for the drafting and issuance of those rules.[15]

In *Chaoyang Xingnuo*, the SPC was asked the question whether the unauthorized use of a patent incorporated into an industry standard constituted patent infringement. Its answer was in the negative. The court explained that by participating in the standard-setting process the patent holder was deemed to have granted consent that implementers of the standard use the

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10 Foreign Trade Law of the People's Republic of China, [2004] Presidential Order No. 15, Apr. 6, 2004, art. 30; and Regulation of the People's Republic of China on the Administration of Import and Export of Technologies, [2001] State Council Order No. 331, Dec. 10, 2001, art. 29.

11 Patent Law of the People's Republic of China (2000 Amendment), [2000] Presidential Order No. 36, Aug. 25, 2000, art. 48.

12 Measures on Compulsory Licensing of Patent Implementation, [2012] SIPO Order No. 64, March 15, 2012.

13 *See* Sina News, *Provisions of national standards involving patents might be announced this year*, Sep. 30, 2004, available at http://finance.sina.com.cn/roll/20040930/04011057831.shtml.

14 Provisions on the Administration of National Standards Involving Patents, [2013] Standardization Administration of China and SIPO Order No. 1, Dec. 19, 2013.

15 Letter of the Supreme People's Court on the Issue of Whether the Exploitation of a Patent in the Specification for the Design of Ram-compaction Piles with a Composite Bearing Base, an Industry Standard Issued by the Ministry of Construction, by Chaoyang Xingnuo Company Which Has Conducted Design and Construction according to the Standard Constitutes a Patent Infringement, [2008] Judicial Interpretation No. 4, Jul. 8, 2008.

patent. Nonetheless, the court also ruled that the standard implementer needs to compensate the patent holder, although the royalty rate should be significantly lower than "normal" rates.

Anti-Monopoly Law

Before the draft SAIC IPR Regulation, the main development in the area of the application of antitrust to IPRs *under the AML* may be the *Huawei v. InterDigital* cases.[16]

In those cases, each of the Shenzhen Intermediate People's Court (at first instance) and the Guangdong High People's Court (on appeal) issued two judgments – an AML judgment, which found the defendant's conduct to amount to abuse of dominance, and another judgment, which set a specific FRAND (fair, reasonable and non-discriminatory) rate.

In the AML judgment, the courts at both instances found that InterDigital had abused its dominant position by demanding excessive royalties and by bundling the licensing of its standard essential patents (SEPs) with non-SEPs.[17] In the other judgment, the courts at both instances actually determined the applicable royalty rate for the licensing of the standard essential Chinese patents – at 0.019%, significantly down from the royalty rate initially required by InterDigital.[18]

Background for draft SAIC IPR Regulation

Some of the issues that came up in relation to the Contract Law and related rules have been taken up by the draft SAIC IPR Regulation. For instance, the draft regulation features a list of conditions considered "unreasonable" if inserted in licensing agreements that are similar to those under the Contract Law framework.

In contrast, since price-related issues are not the focus of the draft SAIC IPR Regulation, the reasoning set out in the *Chaoyang Xingnuo* ruling and the *Huawei v. InterDigital* judgments are not directly reflected in the draft regulation, but they may still provide relevant context and background.

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[16] Shenzhen Intermediate People's Court, *Huawei v. InterDigital*, Feb. 4, 2013, [2011] Shen Zhong Fa Zhi Min Chu Zi No. 857; and No. 858; and Guangdong High People's Court, *Huawei v. InterDigital*, Oct. 16, 2013, [2013] Yue Gao Fa Min San Zhong Zi No. 305 and Guangdong High People's Court, *Huawei v. InterDigital*, Oct. 21, 2013, [2013] Yue Gao Fa Min San Zhong Zi No. 306.

[17] *See* Ye Ruosi, Zhu Jianjun & Chen Wenquan, *Determination of Whether Abuse of Dominance by Standard Essential Patent Owners Constitutes Monopoly: Comments on the Antitrust Lawsuit Huawei v. InterDigital*, Electronic Intellectual Property No. 3, 46-52 (2013).

[18] NDRC also made an investigation against InterDigital, which however ended in a settlement as InterDigital put forward commitments. *See* National Development and Reform Commission, *NDRC suspends the investigation into IDC for price-monopoly conduct*, May, 22, 2014, available at http://www.ndrc.gov.cn/gzdt/201405/t20140522_612466.html.

Draft SAIC IPR Regulation

The draft SAIC IPR Regulation is comprised of 21 articles, and may be roughly divided into five parts: (a) goals and principles; (b) analytical approach; (c) safe harbors; (d) abuse of dominance; and (e) investigation procedures.[19]

Goals and principles

Building upon previous developments, the draft SAIC IPR Regulation starts by pointing out that the AML and IPR laws have shared goals to promote innovation and competition, improve efficiency, and safeguard the interest of consumers and the public interest.

Moreover, the draft regulation is to be enacted with the purpose of clarifying the uncertainties left by Article 55 of the AML; that provision contains the very high-level principle that "abuses of IPRs" to eliminate or restrict competition are prohibited, while the use of IPRs in line with IPR laws and regulations is exempted from the AML.

The draft regulation makes it clear that "abuses of IPRs" refer to anticompetitive agreements, abuse of dominance or other types of conduct that are not compatible with the AML and IPR laws.

Analytical approach

The draft SAIC IPR Regulation puts forward a five-step analysis.

In an investigation, SAIC needs to identify, first, the characteristics and form of the conduct and, second, the type of relationship (*i.e.*, horizontal or vertical) between the companies involved. In somewhat cumbersome language, the draft regulation specifies that an agreement is not considered horizontal where the parties are not competitors at the time the agreement is concluded, even if they become competitors afterwards.

Third, the relevant market needs to be defined and, fourth, the market positions of the parties concerned are to be examined. As the fifth and last step, SAIC needs to appraise the impact of the conduct on competition in the relevant market.

Factors to assess the impact on competition include:

- the companies' market position *vis-à-vis* trading partners;
- the degree of market concentration;
- entry barriers;
- industry practices and the level of development;

[19] The provision about investigation procedure only sets a reference to the AML and an SAIC procedural regulation in 2009, and will therefore not be further discussed in this article.

- the duration and scope of the restraints to competition;
- the impact on encouraging innovation and disseminating technology; and
- the innovation capacity and dynamics of technological change.

Safe harbors

The provisions pertaining to anticompetitive agreements in general repeat the text of the AML. However, a major difference with the AML is that the draft SAIC IPR Regulation introduces safe harbors.

The safe harbor thresholds resemble EU practice. Horizontal agreements are presumed to be compatible with the AML, unless evidence to the contrary is provided, where the aggregate market share does not exceed 20% or there are at least four more substitutable technologies that can be obtained at reasonable cost. For vertical agreements, the safe harbor is set at a 30% market share, or where there are at least two other substitutable technologies that can be obtained at reasonable cost.

Nonetheless, the safe harbors are not applicable to conduct which is explicitly mentioned in Articles 13 and 14 of the AML – *i.e.*, on the horizontal level, cartels fixing prices, limiting outputs, dividing markets, limiting new technologies, and collective boycott, and, on the vertical level, resale price maintenance.

Abuse of dominance

The draft SAIC IPR Regulation contains 10 articles that touch upon abuse of dominance.
As an initial point, the evaluation of dominance is not different from the general approach set out in the AML. Indeed, the draft SAIC IPR Regulation (re-)affirms that the mere ownership of IPRs does not lead to a presumption of dominance.

With regard to the types of abusive conduct, the draft SAIC IPR Regulation focuses on refusal to license; exclusive dealing; tying; imposing unreasonable conditions; discrimination; patent pools; standard essential patents; copyright collecting societies; and abuses through warning letters.

The **refusal to license** clause has probably been the most debated provision within the consultation process so far. This clause extends the "essential facilities" doctrine established by the SAIC Regulation on the Prohibition of Conduct Abusing Dominant Market Position to the IPR field.[20]

Under the earlier SAIC regulation, a request for access to an essential facility may not be rejected by a dominant firm provided that the following factors have been taken into account:

[20] Regulation on the Prohibition of Conduct Abusing Dominant Market Position, [2010] SAIC Order No. 54, December 31, 2010, art.4.

- feasibility of investing in, and building, other facilities;
- dependence of other trading partners on the facility for effective production and operation;
- the ability of the dominant firm to provide access to the facility; and
- the impact of such access on the operations of the dominant firm.[21]

The draft SAIC IPR Regulation appears to go into some more detail in relation to some of the factors laid out in the earlier SAIC regulation. First, the concept of "dependence of other trading partners" is further clarified as that the requested IPR should have no reasonable substitutes and must be "necessary" for the economic activities of those trading partners. In conjunction with the previous regulation, this may mean that it is not economically feasible to self-craft or obtain from third parties an alternative IPR that functions equivalently to the IPR owned by the dominant company. Second, the assessment of the impact on the relevant market should not only include the effect on competition but also on innovation.[22]

The draft SAIC IPR Regulation further prohibits the imposition of **unreasonable conditions** by dominant companies. A list of examples of unreasonable conditions is provided, including:

- exclusive grant-backs for derived technology;
- prohibition to challenge the IPR's validity;
- prohibition to use the IPR after expiry, or not to develop or use competing technologies;
- obligation to pay royalties after expiry or finding of invalidity; and
- exclusive dealing.

Then, the draft SAIC IPR Regulation embarks to regulate specific figures of IPR cooperation and unilateral action.

Unless justified, **patent pools** are not allowed to:

- prevent patent pool members from licensing individually outside the pool;
- prevent members or licensees from developing competing technologies;
- impose exclusive grant-backs;
- prohibit licensees from challenging the validity of the pooled patents; and
- apply different conditions to equivalent transactions.

Abusing IPRs in relation to **SEPs** represents the second most hotly debated provision in the draft SAIC IPR Regulation.

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[21] Id., art.4.

[22] This approach appears to be similar to the principles employed by the EU courts in cases such as *Magill*, *IMS* and *Microsoft*. *See*, for example, Liyang Hou, *The Essential Facilities Doctrine – What was Wrong in Microsoft?*, IIC- International Review of Intellectual Property and Competition Law 43(4), 251-271 (2012).

The draft SAIC IPR Regulation appears to set out the general principle that patent holders are not allowed to abuse their SEPs, irrespective of whether these patents are essential because they are compulsorily set by the government, voluntarily organized by the industry, or have evolved as a *de facto* industry standard.

The draft then provides specific prohibitions of SEP-related conduct, unless justifications can be provided. The first specific prohibition concerns patent assertion after the deliberate failure on the part of the SEP holder to disclose information during the standard-setting process and/or after "giving up" the right to assert the SEP to be included in the standard. The second prohibition refers to violations of the principle of licensing SEPs on FRAND terms; refusing to license under reasonable conditions; licensing under unfair conditions; or tying in licensing. The draft SAIC IPR Regulation also attempts to regulate **copyright "collecting societies**." The draft regulation notes that their conduct could potentially restrict competition on two fronts.

First, the draft regulation prohibits agreements between copyright collecting societies, and between copyright collecting societies and companies, which set unreasonable conditions on membership or geographic scope, and restrict freedom of choice of copyright holders or users. Second, the draft regulation deems the following types of conduct as abusive:

- refusal to license;
- discriminatory treatment in equivalent transactions;
- obligations upon licensees to accept unwanted copyrights; and
- preventing copyright holders from withdrawing from the society.

Another relatively controversial provision is the prohibition upon dominant IPR holders from sending **warning letters** where the IPR at stake has expired or become invalid and where recipients of the letters have provided sufficient evidence that they do not infringe the IPR. Stakeholders have voiced concern that this provision could inappropriately limit the right of access to court.[23]

The provision seems to be aimed at the phenomenon of "patent trolls," which Chinese industry claims hamper domestic innovation and competitiveness.[24] A look at the EU and United States shows that the perceived "patent troll" issue is discussed there as well. The questions remain as to whether the drafting of this provision is sufficiently tailored to what appears to be its objective, and whether it is properly structured as an antitrust offense (with the threat of fines of 1%-10% of annual revenues).

Finally, exclusive dealing, tying and discrimination are touched upon by the draft SAIC IPR Regulation. That said, the provisions related to those types of conduct closely reflect the

[23] *See* International Bar Association, *supra* note 4, at 14.
[24] *See*, for example, Yi Jiming, *Prevention from Patent Trolls: Comments on New Patent Deal in US and Its Implications for China*, Legal Science (Journal of NorthWest University of Politics and Law) No. 2, 174-183 (2014), at 181; and China IPR newspaper, *Do patent trolls hurt innovation?*, Jul. 21, 2014.

wording of the AML provisions. Few details are provided that would discuss any differences as to their application to IPR issues.

Conclusions

Access to technology and development of domestic, "indigenous" technology are key factors in China's development strategy. Often, technology is protected by IPRs, and hence policies relating to IPRs can play an important role in implementing the strategy. One such policy is IPR protection, but – increasingly in Chinese government circles – antitrust law is viewed as an instrument to tackle perceived "monopolistic" strangleholds in technology development and transfer.

The draft SAIC IPR Regulation is the first attempt by Chinese antitrust authorities to lay out a general framework on how to apply the AML rules to the IPR field. In the past, antitrust enforcement against IPR-related offenses was more of a patchwork under a variety of rules – such as the Contract Law, the Patent Law and *ad hoc* court cases under the AML – which lacked consistency.

If drafted properly and implemented fairly, the draft SAIC IPR Regulation has the potential to provide welcome guidance to market players and government bodies alike on what constitutes anticompetitive and pro-competitive conduct in the IPR field, and what the analytical framework behind any enforcement would be.