Kluwer Competition Law Blog

High tech under scrutiny in China

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On April 26, 2013, the State Administration for Industry and Commerce ("**SAIC**") – one of China's three antitrust law enforcement bodies – noted on its website that it had held a meeting with certain industry participants to obtain feedback on the latest draft *Regulation on the Prohibition of Conduct Eliminating or Restricting Competition through Abuses of Intellectual Property Rights* ("**Draft IPR Abuse Regulation**"). In a conference at Peking University on April 28, SAIC officials gave additional comments on the draft regulation.

The request for feedback on the draft regulation is just the latest in a series of developments in relation to antitrust enforcement in the field of intellectual property rights ("**IPRs**"). It also illustrates the ever-increasing impact of antitrust law on the high technology sector more generally. In this update, we discuss the development of the Draft IPR Abuse Regulation as well as judgments by the Guangdong High People's Court in the *Qihoo 360 v. Tencent* case and by the Shenzhen Intermediate People's Court in the *Huawei v. InterDigital* dispute.

The Draft IPR Abuse Regulation

SAIC has been drafting guidance on how the Anti-Monopoly Law ("**AML**") should be applied in the IPR context for some time; at least one of the prior drafts was circulated informally for comments. Perhaps the most important change to the latest draft, when compared to the preceding draft, is that SAIC now envisages adopting a regulation (a 'departmental rule') as opposed to guidelines. Whilst the guidelines would have applied to IPR-related activities across the board, the scope of the regulation (if enacted) will be confined to SAIC's regulatory jurisdiction – *i.e.*, anti-competitive agreements between companies and abuses of a dominant market position by a single company which do not directly relate to pricing conduct. Price-related conduct related to IPR falls under the remit of the National Development and Reform Commission, and is not meant to be directly covered by the Draft IPR Abuse Regulation.

The scope of activities caught by the DraftIPR Abuse Regulationis relatively broad, covering the use, licensing, assignment and enforcement of patents, trademarks, copyrights and trade secrets and is non-exhaustive in nature. In short, all the main classes of IPRs are caught. Generally speaking, the Draft IPR Abuse Regulation focuses more on abuse of dominance than anti-competitive agreements. The Draft IPR Abuse Regulation provides some safe harbors for the latter, *i.e.*, 20% total market share in the relevant technology or product market affected if the parties to the IPR-

related agreement are competitors, and 30% if they are not. For abuses of dominance, the Draft IPR Abuse Regulation outlaws the following types of practices, provided that certain conditions are met:

- refusal to license;
- tying an IPR with other IPRs or products; and
- the imposition of 'unreasonable restrictions' when licensing IPRs.

Beyond the specific licensing context, the setting of 'unreasonable conditions' can similarly be illegal under the Anti-Unfair Competition Law, and no showing of dominance is required under that law.

The Draft IPR Abuse Regulation also mentions that exclusive grant-back obligations of improvements to the technology without justifiable reasons, prohibitions to challenging the validity of the underlying IPR or on using competing technology after the expiry of the licensing term, and the requirement to pay royalties after expiry of the IPR (as well as other yet-to-be defined clauses) can be 'unreasonable restrictions.' Many of these types of clauses may already potentially be unenforceable or subject to challenge under the Chinese Contract Law, under which technology contracts which unlawfully monopolize technology, impede technological progress or infringe upon the technological achievements of others are void. These provisions in the Contract Law, in a Supreme People's Court Interpretation on disputes involving technology contracts and in the rules applicable to the import or export of technologies apply even in the absence of dominance. In a way, the proposed new rules in the Draft IPR Abuse Regulation would not represent a paradigmatic shift of the state of the law in China, although a violation of the regulation would trigger the sanctions under the AML – *e.g.*, fines in the amount of 1% to 10% of the perpetrator's annual revenues – rather than simply giving rise to an enforceability and invalidation issue.

In any event, particularly if a company believes it has a dominant market position, its licensing agreements will henceforth need to be robust enough to withstand a much greater degree of legal scrutiny than before.

The Draft IPR Abuse Regulation also defines and contains specific rules on the operation of patent pools, the setting and implementation of standards involving patents, and on the operations of 'collective copyright management organizations' (in Europe mainly referred to as "collecting societies"), all of which have the potential to give rise to antitrust issues (as has been seen in other jurisdictions).

In addition, the draft regulation also contains a broadly worded 'abuse of rights' clause, prohibiting an IPR holder in a dominant market position from issuing infringement warning letters against companies when their "conduct manifestly does not constitute an infringement of intellectual property rights."

The *Qihoo 360 v. Tencent* judgment

On March 20, the Guangdong High People's Court reached its decision in the high-profile *Qihoo 360 v. Tencent* case. The two leading Chinese software/Internet companies – Qihoo 360 (whose main strength lies in anti-virus software) and Tencent (whose flagship product is QQ, an instant messenger service) – have been playing out their dispute in a variety of fora, including the courts in Beijing and Guangdong and with certain government authorities.

The question before the Guangdong High People's Court was whether Tencent had abused its dominant market position in violation of the AML. The court found that it had not. In a lengthy opinion, the court held that plaintiff Qihoo 360 had failed to define the relevant market properly and also rejected Qihoo 360's claim that Tencent was dominant in the instant messaging market. Despite having dismissed the plaintiff's arguments on market definition and dominance – and effectively concluding that Tencent had not breached the AML – the court went on to determine whether Tencent's conduct was abusive. The reason for doing so was to provide guidance to companies in the Internet industry. Interestingly, the court found that Tencent's conduct would indeed amount to 'exclusive dealing' – a type of conduct that is prohibited for companies in a dominant position – but not to 'tying.'

The Guangdong court's judgment is now on appeal, before the Supreme People's Court.

Although China is essentially a civil law jurisdiction and hence court judgments do not have precedential value, the *Qihoo 360 v. Tencent* judgment may nonetheless be of interest to companies involved in other cases in the high technology sector. For example, the court's analysis regarding the definition of the relevant product market is particularly noteworthy: first, the court examined the arguments of the economists acting for the plaintiff in quite some detail. Second, it relied quite heavily on a decision by the European Commission, in *Microsoft/Skype*, a merger case. Third, it emphasized the dynamic nature of Internet-related markets and held that the analysis of the market should not exclusively date back to the time *before* the lawsuit was filed. Fourth, the court got very close to recognizing that competition in the Internet space takes place between platforms, not individual products: "in the development of the Internet industry until today, the choice of any free product or service to attract users is merely a different method of building up a platform, but the essence of competition is competition between Internet companies to develop value-added services and the advertisement business on the basis of their own application platforms."

The judgment by the Guangdong court contains similarly interesting language on the definition of the relevant geographic market – which it found to be worldwide in scope – and the analysis of dominance – finding, for example, that "due to the particular market conditions of the Internet industry, market shares cannot be used as a decisive factor to determine a business operator's dominant market position."

The *Huawei v. InterDigital* judgments

A few weeks earlier, on February 4, 2013, the Shenzhen Intermediate People's Court issued two rulings in the dispute between Huawei and InterDigital.

InterDigital holds patents that are essential to implementing 3G mobile telecommunication standards, and the dispute essentially centered around the terms on which Huawei can use the patents. In July 2011, InterDigital filed actions before the US International Trade Commission ("**ITC**") and the District Court in Delaware against Huawei, ZTE and Nokia, alleging patent infringement. In December 2011, Huawei filed two lawsuits in Shenzhen – the location of its headquarters – *inter alia* claiming that InterDigital had violated the AML.

According to the Shenzhen Intermediate People's Court, InterDigital breached its obligation to license its standard essential patents ("**SEPs**") under fair, reasonable and non-discriminatory ("**FRAND**") terms to any company that wants to implement the relevant standards, as it had promised to the European Telecommunications Standards Institute. The court found that by filing

complaints to the ITC and the Delaware District Court to seek an injunction to ban Huawei from using those patents – while the negotiations with Huawei to license the SEPs were still ongoing – InterDigital violated its FRAND obligation.

The court held the FRAND breach – together with InterDigital's licensing offers – to be a means to extract excessive royalties from Huawei, and condemned it as an abuse of dominance in violation of the AML. Moreover, the Shenzhen court also held that InterDigital's licensing of SEPs with the licensing of non-essential patents in its portfolio constitutes illegal tying.

Finally, in the other judgment issued on the same day, the court reportedly ruled that the FRAND rate for InterDigital's 2G, 3G and 4G essential Chinese patents should not exceed 0.019% of the actual sales prices of Huawei's products incorporating the patent technology.

The judgments are currently also on appeal.

Conclusions

It is possible that the DraftIPR Abuse Regulation may be further amended before it becomes law. By focusing the draft on areas within its scope of competence, notably anti-competitive agreements and abuses of dominance that are not related to pricing, SAIC is likely trying to avoid the scope for regulatory overlap and possible 'turf battles' with other AML enforcement bodies. Meanwhile, in the Chinese courts, proving dominance has been a difficult task. Taking a positive viewpoint, it is interesting to note that the Guangdong High People's Court looked to European Union case law and went beyond simple market shares when making a ruling on dominance in the Internet industry.

In the *Huawei v. Inter Digital* dispute, the ruling by the Shenzhen Intermediate People's Court may have been one of the very first cases worldwide – if not the first – that actually determined a specific FRAND royalty fee. More generally, these recent developments indicate that patents essential to technology standards have increasingly become a focus of the authorities and courts in China. On top of SAIC's Draft IPR Abuse Regulation and the verdict of the Shenzhen Intermediate People's Court in *Huawei v. InterDigital*, the Standardization Administration of China has recently released draft rules on the process of setting national standards, which would in part bring the Chinese system closer to international practice while maintaining some distinct Chinese characteristics.

Against this background, it appears that antitrust claims – whether used as a 'shield' or a 'sword' – are likely to become a prominent feature of high technology-related litigation in China for the foreseeable future, which requires companies to update their licensing agreements, other contracts and compliance policies and consider antitrust issues when drafting IPR-related agreements to stay within the bounds of the fast-changing legal framework.

This entry was posted on Friday, May 17th, 2013 at 1:48 pm and is filed under Source: OECD“>Competition
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