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Crossing the Rubicon: When Does IP Owner Become IP Abuser?

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Consider this hypothetical: a company discovered a new compound and obtained a patent on the compound. Later, this compound was discovered to be ten times harder than diamond. Soon, cutting tools made with this new compound replaced all other types of cutting tools, including diamond tools. Two years later, the company was garnering more than 90% of the cutting tool market in China. If the company refuses a reasonable licensing request, would this refusal be viewed as anticompetitive under the Chinese Anti-Monopoly Law?

> 1. What if the company engages in aggressive patent enforcement activities against all infringers and is successful in courts?
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> 2. What if the company has a policy of never licensing any IP to anyone?
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> 3. What if the company participated in the drafting a national standard that mandates the use of this patented compound, whereby the patent is a standard-essential patent encumbered with an obligation to license the patent on a fair, reasonable and non-discriminatory ("FRAND") basis?
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> 4. What if this new compound is later found to be ten times more effective against lung cancer than that of the closest competitor's?
> 5. What if this new compound cures a rare cancer for which there had been no cure?

Over the last two years, China has ramped up its efforts to curb IP abuse. To address the questions raised, it is necessary to understand the current landscape for IP abuse enforcement in China.

Agency Actions

China has three separate antitrust regulators: (i) the Ministry of Commerce reviews antitrust issues in merger control cases; (ii) the National Development and Reform Commission ("NDRC") is responsible for price-related conduct; and (iii) the State Administration for Industry & Commerce ("SAIC") focuses on non-price-related

conduct. Thus far, the NDRC has been the most active in enforcement against IP abuse.

For example, in May 2014 InterDigital, Inc. ("InterDigital") settled anti-monopoly charges with the NDRC. As a condition for terminating the investigation, InterDigital has made the following commitments regarding the licensing of its patent portfolio for wireless mobile standards to Chinese manufacturers of cellular terminal units, as follows:

> 1. Whenever InterDigital engages with a Chinese manufacturer to license InterDigital's patent portfolio for 2G, 3G and 4G wireless mobile standards, InterDigital will offer such Chinese manufacturer the option to take a worldwide portfolio license of only its standard-essential wireless patents, and comply with FRAND principles when negotiating and entering into such licensing agreements with Chinese manufacturers.
> 2. As part of its licensing offer, InterDigital will not require that a Chinese manufacturer agrees to a royalty-free, reciprocal cross-license of such Chinese manufacturer's similarly categorized standard-essential wireless patents.
> 3. Prior to commencing any action against a Chinese manufacturer in which InterDigital may seek exclusionary or injunctive relief for the infringement of any of its wireless standard-essential patents, InterDigital will offer such Chinese manufacturer the option to enter into expedited binding arbitration under fair and reasonable procedures to resolve the royalty rate and other terms of a worldwide license under InterDigital's wireless standard-essential patents. If the Chinese manufacturer accepts InterDigital's binding arbitration offer or otherwise enters into an agreement with InterDigital under a binding arbitration mechanism, InterDigital will, in accordance with the terms of the arbitration agreement and patent license agreement, refrain from seeking exclusionary or injunctive relief against such company.

On February 10, 2015, the NDRC concluded its antitrust investigations against Qualcomm Inc. ("Qualcomm") and held that Qualcomm had abused its dominant market position and violated the Anti-Monopoly Law. As a result of the violation, a record-breaking administrative penalty of RMB6.088 billion (~USD975 million) was imposed by the NDRC, which is the largest fine for antitrust violations ever imposed by the Chinese government. The fine was based on 8% of Qualcomm's Chinese sales in 2013.

The NDRC ordered Qualcomm to (1) provide a patent list and stop charging patent fees for expired patents, (2) cease imposing grant-back conditions without paying reasonable considerations, (3) cease to insist on a relatively high royalty rate while using the wholesale net sales price of handset devices as the royalty base, (4) stop bundling of non-standard essential patents with standard essential patents, and (5) with respect to sales of its baseband chipsets, cease demanding a buyer to take out a license in violation of the Anti-Monopoly Law and/or including no-challenge clauses as a prerequisite to supplying the products.

The NDRC is not the only agency that was busy with antitrust enforcement in 2015. Last year, the SAIC initiated twelve new antitrust cases: four related to monopoly

agreements and eight to abuse of dominance investigations. The industries targeted included pharmaceuticals, telecommunications and public utilities. With the promulgation of its Rules for Curbing IP Abuse in April 2015, the SAIC is poised to show its prowess against IP abuse (although to date there has not been a reported case).

Court Actions

In 2015, Chinese courts saw more private antitrust actions than in previous years, increasing from 86 cases in 2014 to over 140 cases in 2015. However, there have been few IP abuse cases. Huawei v. InterDigital (Guangdong High Court, October 21, 2013) is the first such case.

Huawei v. InterDigital On July 26, 2011, InterDigital sued Huawei and others in the U.S. International Trade Commission for infringing its standard-essential patents on wireless technologies. On December 5, 2011, Huawei filed a suit against InterDigital in the Shenzhen Intermediate Court in China. The suit alleged that InterDigital held a dominant market position in China and the United States in the market for the licensing of essential patents owned by InterDigital and had abused its market power by engaging in unlawful practices, including differentiated pricing, tying, refusal to deal, etc.

On February 4, 2013, the Shenzhen Intermediate Court held that InterDigital had violated China's Anti-Monopoly Law by (1) seeking royalties from Huawei that the court believed were excessive, (2) tying the licensing of essential patents to non-essential patents, and (3) requesting as part of its licensing proposals that Huawei provide a grant-back of certain patents to InterDigital. The court ordered InterDigital to cease the alleged excessive pricing and bundling of non-essential patents with essential patents and pay Huawei approximately USD3.2 million in damages.

InterDigital appealed to the Guangdong High Court, which affirmed the Shenzhen Intermediate Court's decision in its entirety. According to the High Court, the relevant market is the licensing of InterDigital's essential patents. ***The licensing of each standard-essential patent forms an independent relevant market.*** The High Court stated that when a patent is incorporated into a standard, such patent is necessary and un-substitutable for manufacturers of products complying with the standard to implement the patent. Therefore, ***the owner of such standard-essential patent has more market dominance than an ordinary patent inherently confers.*** The High Court made the following statements.

> InterDigital, being the only source for its essential patents in the relevant licensing market, holds the entire market share in the relevant market and has the ability to impede or affect the entry by others to the market. Moreover, InterDigital is a non-practicing entity and therefore not dependent upon cross licensing (to access others' patents). Therefore, its market dominance is unfettered.

Having found that InterDigital had a dominant position in the relevant licensing market, the High Court stated that ***being dominant is not per se illegal. There must be an abuse of that position which restricts or eliminates competition.***

The High Court found the two acts of InterDigital to constitute an abuse of its market dominance. First, InterDigital had demanded an unfairly high price. Specifically, the price InterDigital had demanded was found to be excessive in comparison with those offered to Apple, Samsung, LG, and other companies in similar situations. Second, InterDigital had used the essential patents to pressure Huawei into accepting the tie-in of non-essential patents. Such coercive conduct included the filing of the USITC suit against Huawei. For these reasons, the High Court found that InterDigital had violated the Anti-Monopoly Law and affirmed the lower court's decision.

Huawei v. InterDigital concerns the licensing of standard-essential patents and should not be extrapolated to non-essential patents. There is as yet no reported IP abuse case on non-essential patents. In late 2014, the Chinese Supreme Court issued the seminal antitrust case: Qihoo v. Tencent, which demonstrates a proper analytical framework for determination of antitrust violation.

Qihoo v. Tencent Tencent and Qihoo are two of China's largest eCommerce giants. Tencent is a provider of social networking services, including its popular instant messaging (IM) service. Qihoo, on the other hand, provides Internet security software, including its 360 Guard anti-virus software. When 360 Guard blocked Tencent's QQ IM pop-up ads (which was a precaution taken by Qihoo to prevent Tencent from accessing its customers' personal data), Tencent responded by making its QQ software incompatible with 360 Guard. Customers had to choose between QQ IM and 360 Guard, which prompted many QQ IM users to uninstall 360 Guard. Qihoo sued Tencent in the Guangdong High Court for abuse of dominance. The Guangdong High Court ruled in favor of Tencent, finding that Tencent had not been in a dominant market position and had not abused its market power.

Specifically, the Guangdong High Court found that Qihoo had not provided sufficient evidence to prove that Tencent had enjoyed monopoly power in the relevant market. It stated that ***market share alone is not sufficient for a finding of dominance. Other factors to consider include the ability to control price, quantity, or other transactions, or to prevent others from entering the market, and the competitiveness in the relevant market.***

Dissatisfied, Qihoo appealed to the Chinese Supreme Court, which affirmed the Guangdong High Court's rulings. Three issues took center stage before the Chinese Supreme Court:

1. How to determine the relevant market
2. Whether Tencent had a dominant position in the relevant market.
3. Whether Tencent's alleged inappropriate conduct constituted abuse of dominance prohibited by the Anti-Monopoly law.

The Supreme Court reviewed the determination of the relevant market de novo and defined it as the instant messaging services market in China, including both PC-based IM services and mobile IM services. In making the determination, the Supreme Court applied the hypothetical monopolized test ("HMT") and rejected the Small but Significant Non-transitory Increase in Price ("SSNIP"). The SSNIP test was rejected because it applies to situations where price competition is more prominent. In this

case, IM services were provided free of charge. As such, the HMT was more appropriate.

The most significant aspect of the Supreme Court's decision is the emphasis that the statutory presumption of dominance based on market share is rebuttable and not outcome-dispositive. In downplaying the importance of market share as the Guangdong High Court did, the Supreme Court opined that

> [T]he importance of market share in determining dominance must be ascertained based on the totality of the circumstances. Generally speaking, the higher the market share and the longer it has persisted, it is more likely to be indicative of the existence of market dominance. Even so, ***market share is a rough and sometimes misleading factor in dominance determination. A high market share cannot be directly presumed to be dominant where,*** among others, (1) it is easy to enter the market; (2) ***the high market share is due to high efficiency or better-quality products;*** or (3) there is restriction on operators' competitiveness due to products outside of the market.

(Emphasis added)

For the above reasons and in light of the totality of the circumstances, Tencent was found not to have market dominance even though its market share in the IM services market exceeded 80%.

Having found Tencent not to be dominant, the consensus is that it is unnecessary to address the abuse inquiry. However, in cases where the demarcation of the relevant market or the determination of market dominance is not readily apparent, the Supreme Court said that courts may address the abuse issue as further validation. The Supreme Court went on and examined Tencent's alleged inappropriate conduct of making 360 incompatible and software bundling. The Supreme Court found that making 360 incompatible had inconvenienced consumers but had not had a substantial effect of restricting or eliminating competition. As to bundling, the Supreme Court was of the view that there was no credible evidence to prove that Tencent's leading position in the IM services market extended to the software security market. For these reasons, the Supreme Court rejected the assertion that such conduct was abusive. While not an IP abuse case, Qihoo v. Tencent does provide helpful guidance on how to determine IP abuse, especially in the context of non-essential patents.

Hitachi Metals At the time of writing, there is an ongoing litigation on whether a refusal to license non-essential patents constitutes IP abuse. Four Ningbo companies brought this case against Hitachi Metals in the Ningbo Intermediate Court. The dispute centers on neodymium-iron-boron magnets, which are widely used in the electric engineering, wind power, automotive, and high tech industries. About half of the global consumption of rare earth metals relates to this magnetic alloy, whose intellectual property rights are mostly held by Hitachi Metals. It owns more than 600 neodymium-iron-boron magnet patents globally but has only licensed selected patents to eight Chinese companies. Hitachi has refused to license to other Chinese companies.

Hitachi's refusal to license its patents to the plaintiffs is the basis for the suit. The accused abusive conduct includes refusal to license, bundling, etc. This is the first case in which plaintiffs have requested a Chinese court to license non-essential patents based on the notion of "essential facilities". The plaintiffs argue that Hitachi's patent portfolio on neodymium-iron-boron magnets should be considered as essential facilities for the industry because its patent portfolio cannot be substituted and avoided. The plaintiffs seek damages of RMB24 million (~USD3.4 million). A nine-hour hearing was held on December 18, 2015. The court has not yet issued any decision. This case will undoubtedly have a huge impact on the Chinese jurisprudence on refusal to license and IP abuse.

Concluding Thoughts

So, what's answer to the questions posited in this hypothetical?

In the context of standard-essential patents encumbered with a FRAND obligation, a refusal to license such patents (whether an actual or constructive refusal) is susceptible to a finding of IP abuse. This is due to the problematic holding in Huawei v. InterDigital that the licensing of each standard-essential patent forms an independent relevant market and that such patentee dominates in that market. However, the saving grace is that even if market dominance is found, such position is not illegal per se. There must be an actual abuse of that position which restricts or eliminates competition. An outright refusal to license standard-essential patents could be an act of abuse because such refusal is in inconsistent with the attendant FRAND obligation. Other problematic conduct includes excessive license fees, grant-back without consideration, and bundling.

When it comes to non-essential patents, however, the rationale of Huawei v. InterDigital does not apply. Instead, the analytical framework laid out in Qihoo v. Tencent should be followed. According to the Chinese Supreme Court, market dominance refers to the position of an undertaking with the ability to control the price, quality of other transactional terms of products in the relevant market, or the ability to impede or affect the entry into the relevant market by other undertakings. The determination of market dominance is a multifaceted process. No single factor is necessarily outcome-determinative. A high market share in and of itself should not lead to a presumption of market dominance, especially where the high market share is due to high efficiency or better-quality products. Therefore, a high market share conferred by technology superiority might not lead to a finding of dominance.

Even if market dominance is found, it is not the end of the inquiry. Abusive conduct must be found for antitrust liability to attach. Generally speaking, patent law confers the right to exclude – which means that a patentee can itself choose whether or not to license. Therefore, exercising rights conferred by patent law should not constitute abuse. However, the notion of "essential facilities" in the context of patented technology is a dangerous one. This is because the most meritorious inventions (i.e., the ones most worthy of patent protection) are the most susceptible to this notion. We are not aware of such doctrine being applied in patent cases anywhere in the world. Could China be the first to apply it? The Hitachi Metals case will tell.

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