

# Beijing High Court upholds China's first-ever SEP injunction in Iwncomm v. Sony

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On March 28, 2018, the Beijing High Court issued its decision for *Iwncomm v. Sony*, a high profile case concerning infringement of a standard essential patent (SEP). The appellate court amended the trial judgment on some key findings, but still upheld a permanent injunction and damages of about CNY 9 million (USD 1.3 million). This case has received widespread attention and sparked discussion of both IP professionals and the telecommunication industry. The Beijing High Court's reasoning and conclusions will be likely to impact on SEP licensing negotiations generally.

WLAN Authentication and Privacy Infrastructure (WAPI) is a national standard of China for wireless local area network (WLAN). It is the Chinese counterpart to WIFI and is officially supported by the Chinese government, as a mandatory testing criterion for the Chinese government to grant licenses to wireless terminals. This decision may empower Iwncomm to collect massive royalties from all WAPI implementers in China.

In a previous ZY Partners blog (“Patent Exhaustion, Implied License and Contributory Infringement” in June 2017) we analyzed some of the key issues based on the trial judgment, including contributory infringement, patent exhaustion and implied license. This article provides a further discussion on some debatable issues given that the appellant decision is now available.

## **1. Reversed Contributory Infringement Findings**

The WAPI patent claims a method-of-use on the interaction among three pieces of equipment, namely a mobile terminal (MT), an access point (AP) and an authentication server (AS). Sony was sued by Iwncomm including: (1) direct infringement during R&D testing, manufacturing and pre-delivery inspection; and (2) contributory infringement for selling MT (mobile phones) and thereby facilitating its customers’ use of the WAPI function. These were fully granted by the trial court.

The Beijing High Court reversed a large proportion of the trial court’s findings of infringement. The appellate court found no proof of direct infringement of Sony during manufacturing or pre-delivery inspection. The claim of contributory infringement is also dismissed. The appellant court agreed with the trial court that, contributory infringement could only be recognized with the existence of direct infringement in general, but under some exceptional circumstances, for example, where the direct actor without commercial purposes might not be liable due to certain statutory exemptions, the provision of products exclusively for infringing purpose could also be identified as contributory infringement. However, the appellant court further held that this case does not satisfy the precondition of contributory infringement of a method-of-use patent involving multi-actors, namely, 1) a certain entity has performed all the steps of the patent, or (2) a certain entity “directs or controls” the performance of others, or 3) the actors form a “joint coordination.”

The trial court found that the end users of mobile phones have implemented all the steps of the WAPI Patent. However, the appellate court reversed this finding. End users could only control the operation of the MT, not AS or AP. No any single entity or individual had performed all the steps, and there was no conspiracy or coordination among the actors. Therefore, lwncomm's contributory infringement claim was expressly dismissed.

The appellant court only affirmed the finding of direct infringement at the R&D stage since Sony admitted that it conducted WAPI testing with AS and AP during the R&D process. The appellant court then found Sony to be liable for direct infringement in manufacturing the mobile phones, given that, R&D is part of the manufacture process.

The appellant court decision indicates that, while patent claims on the interaction of multiple actors are easier to attain, they are less likely to achieve full protection during the patent enforcement process. Patent attorneys should try to avoid multi-actors when drafting method claims.

## **2. Patent Exhaustion Inapplicable to Method-of Use Claims**

The appellate court denied Sony's exhaustion defense. The trial court's holding that the exhaustion doctrine does not apply to method-of-use claims is affirmed by the appellant court. It agreed that China's Patent Law only explicitly provides exhaustion defense for product claims and product-by-process claims (products directly obtained through a patented process).

We note that the appellate court's interpretation is relatively conservative compared with the U.S. approach. In *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008), the U.S. Supreme Court held that a method-of-use claim is exhausted by the authorized sale of an item as long as: 1) the only reasonable and

intended use of the item is to practice the patented method; and 2) the item covers all the inventive aspects of the patented method.

Nevertheless, even if the Chinese court would be willing to adopt the U.S. Supreme Court's two-pronged test, the present case may fail to satisfy the second element, because some of the inventive features of the subject patent may be embodied in AP and AS rather than in the accused mobile terminals (MT).

In our previous blog we mentioned that implied license seems more prospective than the patent exhaustion defense. We remain this view and hope Sony to raise this new defense in a potential retrial petition to the Chinese Supreme People's Court (the "SPC").

An implied license defense is typically available when a patentee sells a product without an express disclaimer, and the use of the product necessarily involves a patented method. Pursuant to Article 131(4) of the *Guideline for Patent Infringement Determination* (2017) issued by the Beijing High Court, when the patentee or licensee of a method patent sells equipment specially used for implementing the patented method, anyone who exploits the method patent with said equipment may not be deemed to commit an infringing act. This provision indicates that the Beijing High Court is willing to grant implied licenses concerning method patents. In practice, an implied license is available on the condition that 1) the product involved has no non-infringing uses; and 2) the patentee or licensee places no express restriction on the purchaser's use or sale of the product. We note that the SPC has granted an implied license concerning a product patent, but we are unable to locate any precedent expressly granting an implied license for a method patent.

In the present case, to justify its WAPI testing activities at the R&D stage, one available argument for Sony is that lwncomm's sale of the router (including a special module to serve as AP and AS in WAPI testing) to Sony constitutes granting

Sony an implied license to practice the WAPI Patent by using the device. An additional argument could be that, the WAPI testing for R&D satisfied the supposed purpose of the said special module of lwncomm’s router.

### 3. Unwilling Licensee

In SEP related infringement lawsuits, Chinese courts will examine whose fault led to the failure of licensing negotiations. The scenarios for an injunction order were expressly summarized by the appellate court as follows.

SEP Owner	Implementor	Injunction Order
In Fault	No Fault	Not applicable
No Fault	In Fault	Applicable
No Fault	No Fault	Not applicable if a guarantee was provided
In Fault	In Fault	To be decided upon weighing the fault of each side

The controversy lies in whether a FRAND licensor must provide a claim chart BEFORE signing a non-disclosure agreement (NDA). Sony insisted that it is necessary. The appellate court disagreed and identified Sony as an unwilling licensee applying delay tactics. The court further opined that 1) a claim chart is not compulsory, especially when the SEP owner has provided other materials sufficient for the implementer to conclude whether the WAPI Patent has been implemented; and 2) the SEP owner’s requirement of an NDA prior to substantive negotiation is generally reasonable.

From our knowledge of SEP licensing practices, SEP owners treat their claim chart as a kind of trade secret, because earlier disclosure of the claim chart to a potential licensee may offer some bargaining power to the other side in settlement

discussion. Usually a potential licensor may have a big SEP portfolio. The earlier a potential licensee can access to the claim charts for the most valuable SEPs, the better understanding to the strength of such portfolio, which may sharply decrease the cost of potential licensee on decision-making. As a result, the provision of a claim chart without an NDA is unacceptable to most patent owners. With this in mind, the appellate court's decision makes sense.

#### **4. Suspended Enforcement of WAPI Standard**

The WAPI Patent was adopted by the national standard GB15629.11-2003/XG1-2006 (the "WAPI Standard"), but has never been officially put into effect. The WAPI Standard was first published on May 12, 2003 and intended to become effective on December 1, 2003. On December 1, 2003, the General Administration of Quality Supervision, Inspection and Quarantine ("AQSIQ") and the Certification and Accreditation Administration of the PRC ("CNCA") collectively announced ([2003] No. 113) that any wireless LAN products without China Compulsory Certification ("CCC") would be prohibited from import, sale or other commercial activities since June 1, 2004. However, on April 29, 2004, the AQSIQ and CNCA made a contradictory announcement ([2004] No. 44) that enforcement of the WAPI Standard was suspended as of June 1, 2004. There has since been no governmental announcement resuming the enforcement of the WAPI Standard.

Thereafter, in around 2009, WAPI function testing became a pre-condition for the China Ministry for Industry and Information Technology (the "MIIT") to grant a wireless LAN Network Access License. However, the legitimacy of the WAPI function testing requirement for the Network Access License is questionable due to lack of express legislative authorization and the suspension in 2004. The MIIT has never published any legal basis in support of the WAPI testing requirement for granting an administrative license. This indicates that handset producers may have a cause of action to sue the MIIT to avoid having to include the WAPI module in mobile phone products. A successful invalidation of the MIIT WAPI testing requirement may not exempt Sony from patent infringement liability though, it can

support a sharp reduction of damages.

## **5. Controversy over the Awarded Damages**

The trial court's damages award was affirmed by the appellate court, even though the appellant court overturned a large part of the trial court's infringement findings. The rationality of the appellant court damages award caused a question mark. First, WAPI testing during the R&D stage was only carried out on a limited number of mobile terminals, far less than the number of mobile terminals produced and sold. Second, the appellant court's reasoning was vague by equaling the WAPI testing at the R&D stage to direct infringement in the whole manufacturing process.

In sum, the appellate judgment is not the end of the story. Iwncomm is seeking to license its WAPI patent portfolio to many leading mobile phone providers and on the other hand, we believe Sony will likely file a retrial petition before the SPC. We hope the controversial issues discussed here will be clarified by the SPC, and we will keep watching for any new development.