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The tension between competition law and IP rights in China: What IP rights holders should know

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Speed read

In April 2015, China's SAIC released its long-awaited guidelines on curbing abuses of intellectual property rights ("IPRs"). It introduces a new basis for forced licensing of IPRs where such rights constitute an "essential facility".

Therefore, assessing market position and reviewing licensing policies under competition law has become critical to safeguard IP rights in China. These assessment and review must be made in the markets for the products protected by IPRs, and for the technologies involved, and they should be well documented.

Rules finally adopted by SAIC after cautious process

China's State Administration for Industry and Commerce (the **SAIC**) eventually released on April 13, 2015 its long awaited guidelines, which clarify the way the authority intends to apply competition law to the exercise of intellectual property rights in China: "Rules on the prohibition of abuse of intellectual property rights to eliminate or restrict competition" (the **Rules**)*(1)*. They are the result of a very long process – which started as early as 2009 – involving multiple stakeholders, numerous discussions and public consultations on several different drafts.

As the first guidelines issued by Chinese competition authorities in the highly sensitive field of IP and technology, the Rules will likely mark the beginning of a new era in the application of China's Anti-Monopoly Law (the **AML**), which entered into force on August 1, 2008. They will be of interest to any company, from both China and overseas, whose business relies on the use of IPRs.

The Rules will become effective on August 1, 2015. In the absence of any provision in the Rules dealing with the validity of agreements entered into force before the Rules were adopted, companies operating in China should conduct their own independent assessment of their agreements and business practices and ensure that they comply with the Rules by no later than August 1, 2015.

Scope of application of the Rules

As in many other jurisdictions, the exercise of IPRs is not immune to the application of antitrust rules in China. Article 55 of the AML explicitly provides that the AML applies to abuses of intellectual property by undertakings to eliminate or restrict competition.

The SAIC also shares the view of other competition authorities throughout the globe, i.e. that there may be tensions between antitrust and IP protection, but that these tensions should be resolved as both competition law and IP law share the same objectives: encouragement of competition and innovation; enhancement of economic efficiencies; protection of consumers and public interest*(2)*.

Despite a rather broad formulation, the Rules are not binding on the other Chinese antitrust agencies or on the Chinese judiciary. However, the Rules may be persuasive authority to other agencies and courts.

Contrary to what preceding drafts provide for, the SAIC specifically excluded anticompetitive conduct in relation to prices*(3)* as this falls within the ambit of the National Development Reform Commission (the **NDRC**) – the Chinese agency in charge of enforcing the AML against price-related anticompetitive conduct. The NDRC's recent decision against Qualcomm's royalty practice is the latest example of NDRC's enforcement activity in this field (see our alert on the subject*(4)*).

The division of tasks between the NDRC and the SAIC creates a risk of conflicts or diverging interpretations between these agencies. Both are now actively pursuing investigations for alleged IP abuses. The NDRC may follow the same set of principles as the SAIC but there is no guarantee that it will do so. This is particularly problematic as the distinction between price-related and non-price-related conduct is not always obvious. Issues typically raised in antitrust disputes over licensing practices include not only royalty-setting provisions but also other provisions (e.g. fields of use, license-back, exclusivity, etc.). Moreover, it is paradoxical that the NDRC would focus on investigating companies seeking injunctions against willing licensees, as it publicly declared it, although it is not obvious how this relates to royalties as such, whilst the SAIC declined to include in the final version of the Rules the provisions on the aggressive litigation strategy (including the seeking of injunctions) that featured prominently in previous drafts.

The Rules are also not binding on the judiciary. In a context of a rise in private antitrust litigation in China, the protective value and reliability of the safe harbors defined in the Rules will need to be assessed by companies operating in China in light of this uncertainty. It is also unclear whether the judiciary will take inspiration from the Rules, for instance on setting out a judicial doctrine on what constitutes an essential facility under Chinese competition law.

Overall Approach

The Rules are not entirely adverse to IPR holders. In particular, the Rules insist that only the exercise of IPRs in an anticompetitive way is illegal*(5)*. Of course, this begs the question of what kind of IPRs are covered by the Rules – arguably all of them – and what kind of exercise of IPRs constitutes "abuse of intellectual property".

The Rules also usefully clarify that there shall be no presumption of dominance of companies merely for holding IPRs*(6)*. Using the same approach as adopted internationally, the Rules remind that the relevant markets in which dominance must be assessed comprise relevant product markets **and** relevant geographical markets. A relevant product market may be either a technology market or a product market containing specific IPRs. A relevant technology market refers to the market constituted by the technology encompassed by the relevant IPRs and all other substitutable technologies of the same type*(7)*.

The Rules cover both potentially anticompetitive agreements and abuses of dominant position**(8)*, but it does not create any new type of breach of the AML, as Article 55 of the AML suggests at first sight when referring to "abuse of intellectual property rights" (i.e. an abusive conduct that does not require any dominance). This is clearly positive.

Agreements exercising IPRs covered by the Rules: Safe Harbors

The Rules reiterate the principle enshrined in Article 55 of the AML that agreements exercising IPRs are not immune to the general prohibition on anticompetitive agreements**(9)*. The Rules, however, purport to define limited safe harbors for agreements between competitors ("horizontal agreements") as well as for agreements between non-competing undertakings ("vertical agreements").

• As far as agreements between competitors are concerned, the exercise of IPRs may be found not to constitute an anticompetitive agreement if either (i) the combined share of the parties on the relevant market affected by the parties' behavior is no more than 20%, or (ii) there are at least 4 substitutable technologies that are controlled by independent third parties and can be obtained at reasonable cost in the market.

• As far as vertical agreements are concerned, the exercise of IPRs may be found not to constitute an anticompetitive agreement if either (i) each share of the parties on the relevant market affected by the parties' behavior is no more than 30%, or (ii) there are at least 2 substitutable technologies that are controlled by independent third parties and can be obtained at reasonable cost in the market.

The different thresholds depending on whether the agreements are horizontal or vertical reflect the fact that vertical relationships are generally considered more innocuous to competition than agreements between competitors. The market share thresholds defined in the Rules are comparable to those defined in other jurisdictions, e.g. in the European Technology Transfer Block Exemption Regulation (the **TTBER**)**(10)*. Interestingly, however, the Rules go further than the TTBER in that they also consider the number of alternative technologies, and not merely the market shares of the parties. This means that even competitors with a combined market share in excess of 20% could fall within the safe harbor if there are 4 or more alternative technologies controlled by independent entities. The proper definition of the relevant market (e.g. of the "affected" relevant market) and the identification of all alternative technologies (i.e. the ones that are controlled by independent entities and are readily available on the market for a reasonable cost but not those proprietary technologies that are not licensed out) will be key in that context.

However, one extremely important point to bear in mind is that the safe harbors are not automatic and do not confer an absolute protection:

• First, the safe harbors only cover agreements that do not fall within one of the categories of anticompetitive agreements defined in Article 13(1) to (5) and Article 14(1) and (2) of the AML prohibiting, inter alia, agreements between competitors relating to price-fixing, quotas, or market allocation, and agreements with non-competing licensees containing "resale-price maintenance" provisions. In other words, an agreement can benefit from the safe harbor only to the extent that it could otherwise have fallen in one of the "catch-all" categories of Article 13(6) and Article 14(3).

This limitation is substantial as many licensing agreements often include genuine price, use or territorial restrictions. In particular, Article 13(4) of the AML specifically prohibits agreements between competitors in relation to “restricting the purchase of new technologies or equipment, or the development of new technologies or products”. As the majority of the IP-related anticompetitive agreements between competitors may fall within the scope of Article 13(4), it remains to be seen whether the condition for applying the safe harbor to licensing agreement between competitors will eventually be very limited or extremely difficult to prove.

• Second, Article 5 of the Rules makes clear that safe harbors are not available where there is evidence that an agreement has the effect of eliminating or restricting competition. In other words, the safe harbor remains valid until the SAIC decides that it generates anticompetitive effects.

In practice, this means that contracting parties should be very cautious, even in cases where they are below the market share thresholds or there are multiple alternative technologies readily available. A minimal assessment of the actual or potential effects of the agreement on competition should be conducted in order to avoid any risk under the Rules.

Agreements exercising IPRs: Patent Pools and Standards

There are two other provisions in the Rules dealing specifically with the risk of anticompetitive agreements. These provisions relate to patent pools and standards, which are also covered by the sections on abuses of dominant position of the Rules:

• Article 12 of the Rules provides that patent pool participants shall be cautious not to exchange commercially-sensitive information or agree to anticompetitive provisions in the course of entering into patent pool agreements. The Rules make clear, however, that such anticompetitive provisions could be exempted if the general conditions set out at Article 15 of the AML are met*(11)*.

• Article 13 of the Rules provides that holders of IPRs shall not use the formulation and implementation of standards as a means to restrict or eliminate competition. The formulation is somewhat ambiguous and the scope of that provision unclear as the rest of Article 13 of the Rules is applicable only to dominant undertakings (see below).

Abuses of dominant position in the exercise of IPRs

This is effectively the main subject of the Rules. Most of the provisions of the Rules are indeed applicable to undertakings holding a dominant position despite the fact that they could legitimately be applied to companies even in the absence of a dominant position (in particular those rules on standards and patent pools).

Importantly, as already indicated above, the Rules clarify that an undertaking cannot be presumed to be dominant simply because it holds IPRs. The holding of IPRs is only one of the factors in determining dominance.

Various provisions in the Rules cover different kinds of abuse. The most controversial provision, and in any event the one that has fuelled most criticisms during the drafting process, is Article 7 imposing forced licensing in certain circumstances.

A. Forced licensing in case of “essential facility”

Article 7 of the Rules provides that a dominant undertaking shall not, without justification, refuse to license under reasonable conditions to other undertakings an IPR that constitutes an essential facility for manufacturing and operating activities, thus eliminating or restricting competition. It must be emphasized that the effect of "eliminating or restricting competition", not the purpose, is at issue here.

Article 7 of the Rules further provides that, in order to assess whether it is applicable, the following cumulative factors should be considered together:

1. an IP cannot be reasonably substituted in the relevant market such that the IP is essential for other undertakings to participate in [a or the] relevant market;

2. Whether the refusal to license the IPR concerned would negatively affect competition or innovation in [a or the] relevant market, harming the consumer interest public interest;

3. Whether the licensing of the IPR concerned would cause unreasonable harm to the IP owner.

Because it relies on the notion of essential facility, Article 7 of the Rules raises a lot of questions and leaves many of them unsolved. The doctrine of essential facility is controversial in many jurisdictions and not particularly well-suited for IPRs. In particular, it has been argued that it has never been applied to patents (whilst it may have been applied to other types of IPRs). In the absence of proper definition – in China or any other jurisdiction – of what constitutes an essential facility in the context of IPRs, the application of Article 7 will inevitably be highly controversial.

The concept of essential facility as outlined in Article 7 of the Rules is relatively broad as it can apply to both manufacturing activities and operating activities. It appears that it applies to production technologies or technologies (or other IPRs, such as know-how, design rights, etc.) that are used in the marketing and commercialization of the products concerned. There is nonetheless a lack of clarity in what could be covered: for instance, is it limited to the production of goods or does it also cover the provision of services?

Perhaps more importantly, is the concept of essential facility under the Rules limited to technology required to effectively compete in a separate market (as was the case in international precedents such as in the EU *Magill*(12)* or *Microsoft*(13)* cases) or could it relied upon by companies willing to compete in the same markets as the holder of the IPRs? Under the first factor, it is not clear if the two relevant markets are the same or not (thanks in part to the Chinese language that does need to use the definite or indefinite article). The potential scope of application of Article 7 appears to be unlimited and may give rise to very innovative – if not odd – claims by competitors.

There is also no definition or guidelines on what could constitute a "justification" to refuse to grant a license. Will it have to be an objective justification or will the holder of the IPR be able to put forward more subjective factors to justify its refusal? Article 7 of the Rules provides that there should be a balance of interests between, on the hand, the adverse impact on innovation and competition harming consumers' or public interest and, on the other hand, the fact that the licensor's interests should not be unreasonably damaged. The double negation in the proposition that "licensing the intellectual property right would not cause unreasonable damage to the licensor", however, leaves the door open to multiple interpretations – although it clearly and dangerously suggests that inflicting some degree of damage to the licensor will be acceptable. Also left open is the notion of "reasonable compensation" that the licensees should offer as a condition to be granted a license on an essential facility.

According to public reports, the SAIC is conscious that Article 7 is controversial. Following publication of the Rules, SAIC officials emphasized that they would apply extreme caution in enforcing the Rules. There will undoubtedly be much scrutiny of the international antitrust community of the way the duty to deal outlined in Article 7 of the Rules will be implemented by the SAIC. There is a real risk that the threat of forced licensing bring multinational companies' incentives to innovate – or, at the very least, to offer innovative products to Chinese customers – to a halt.

It is worth noting that Article 7 is not about compulsory licensing; rather, IP owners within the purview of Article 7 do not have unfettered rights to refuse licensing, resulting in forcing dealing between an unwilling licensor and an arguably willing licensee. Under China's compulsory licensing regime, a violation of Article 7 is a basis for compulsory licensing. Therefore, compulsory licensing can ensue; but the State Intellectual Property Office of China, not the SAIC, is the competent agency to grant compulsory licensing of patents.

B. No exclusivity

Article 8 of the Rules provides that a dominant undertaking shall not prevent its contractual counterpart from dealing with third parties. This is a reminder that the general provision in Article 17(4) of the AML regarding the restrictions on exclusivity provisions in the case of dominant undertakings is – unsurprisingly – also applicable in relation to IPRs. However, in the high-tech market, it is not rare that IP holders may ask their licensee to only use their IPRs for fear that their own IPRs might be mixed up or exchanged with IPRs of their competitors. One may wonder whether this would constitute a "justification".

C. No tying

Article 9 of the Rules provides that a dominant undertaking shall not engage in tying sales. Again, Article 9 of the Rules reflects a more general provision of the AML – in that case Article 17(5) – but, interestingly, provides more details than is the case in the AML on what could constitute a tying practice in the case of IPRs.

In particular, Article 9 of the Rules makes clear that a tying practice could be found only in the case of a tying of goods that is contrary to trade practices, consumer habits or ignores the uses of the goods concerned.

D. No unreasonably restrictive contractual conditions

Article 10 of the Rules provides that a dominant undertaking shall not, in the exercise of its IPRs, impose the following conditions on its counterparts:

• Requiring from the counterpart a grant-back on an exclusive basis on the improvements of the licensed technology;

• Prohibiting any challenge of the licensed IPRs;

• Restraining the counterpart's use of competing goods or technologies upon expiration of the licensed IPRs;

• Continuing to exercise IPRs after they have expired or have been declared invalid;

• Prohibiting counterparts' trading with third parties;

• Imposing other unreasonably restrictive conditions.

This list is rather long but contains largely uncontroversial provisions. Interestingly, non-dominant companies are free to impose these conditions under the Rules, although in other jurisdictions these conditions do raise concerns even when applied by non-dominant companies.

E. No discrimination

Article 11 of the Rules provides that dominant undertakings shall not discriminate between their various counterparts without justification. Again, this is at first sight more a reminder of the general rule under Article 17(6) of the AML that undertakings in a dominant position shall not abuse their position by imposing discriminatory conditions.

However, when coupled with the provision on forced licensing of the Rules, it raises issues as to whether there are effectively limits to the duty to license an IPR that would be found to constitute an essential facility.

F. Patent pools

Article 12 of the Rules deals with patent pools. As indicated above, the AML is not unfavorable to patent pools and standards in general. The AML indeed provides that an agreement that would otherwise be deemed anticompetitive can effectively be exempted if its "objective is to raise product quality, lower costs, improve efficiency, standardize product specifications and standards or implement specialization"**(14)*.

The Rules consider the situation where a patent pool organization would become dominant. This, in itself, raises a number of difficulties as it is not obvious that every patent pool is concluded under the auspices of a specific organization or lead to the creation of an autonomous management body. Article 12 of the Rules intends to tackle this difficulty by defining a patent pool as a scheme of agreement in which two or more patent holders jointly license their respective patents to a third party in forms such as setting up a special joint entity or entrusting a patent pool member or a third party with the responsibilities of management. Depending on the form the patent pool may take, identifying the responsible entity holding a dominant position may be tricky.

It is also not obvious to determine in which market the patent pool organization would need to be dominant.

In any event, leaving aside these difficulties, a dominant patent pool could be found to abuse its dominant position if, without justification:

• pool members cannot license independently outside the pool;

• pool members cannot independently develop competing technologies;

• licensees must provide pool members with exclusive grant-backs on improved or new technologies;

• licensees are prohibited from challenging the validity of a pooled patent;

• pool members can discriminate between pool members or other licensees in the same relevant market.

In themselves, these provisions are not controversial. It should however be noted that the list is not limitative in that the SAIC can determine that other conducts of dominant patent pools could constitute an abuse of dominance. This open-ended provision is more problematic and may, depending on the way the SAIC intends to interpret it, impair the formation of patent pools or their operations in China.

G. Standards

As indicated above, the creation of standards can constitute a reason for exemption of an agreement that may otherwise be deemed anticompetitive. Article 13 of the Rules provides that undertakings can regroup to formulate and implement standards as long as this does not have the effect of impairing competition.

Article 13 of the Rules further provides that dominant undertakings shall not, without justification, do the following when formulating and implementing standards:

• Deliberately conceal information on their patents or expressly abandon their patent rights during their participation in a standard formulation, but claim their patent rights against the parties implementing the standard after the patents become part of the standard (known as a "*patent ambush*" practice);

• After their patents become standard essential patents, violate the fair, reasonable, and non-discriminatory principle and engage in behaviors such as refusals to license, tie-in sales or impose other unreasonable deal terms to eliminate or restrict competition.

The good faith disclosure and the FRAND commitment obligations are inspired by other competition regimes**(15)* and are generally not controversial as long as participation in the standard is not in itself mandatory. Article 13, however, appears to be much more limited in scope as it arguably only targets dominant companies – and not necessarily all standard participants, unless all of them are deemed to hold a dominant position as far as each of their standard-essential patents is concerned. In any event, the formulation of Article 13 is somewhat ambiguous and it is hoped that future enforcement actions by the SAIC will promptly clarify the duties of standard participants in line with generally accepted international practice.

Enforcement of the Rules expected soon

It is very likely that the SAIC, which has long been perceived by the international community as less active than their counterparts at MOFCOM and the NDRC, will want to show its resolve by applying its newly-issued Rules and make its mark in an area prone to attract headline attention. The NDRC had paved the way with its landmark decision in the Qualcomm case in February 2015. Even though their areas of competence are in principle different, one can anticipate that there may be some competition between the SAIC and the NDRC to bring an increased number of cases involving IPRs and, to the extent possible, facilitate the scaling-up of the Chinese economy.

IPR-rich multinational companies operating in China should prepare for the risk of increased enforcement actions. Both the NDRC and the SAIC have conducted numerous dawn raids in the past, involving forensic researches, targeting Chinese and foreign companies alike. This trend is bound to continue. It is key for businesses – even if they have no reason to believe their business practices fall foul of competition law – to prepare for the day Chinese competition officials knock on the door.

Most importantly, for the purpose of the Rules, companies should proactively examine their current operations and their IPR management policies with a critical eye: are they at risk of being found in a dominant position or of having an essential facility in their IP portfolio? What are the products or technologies potentially at risk? What IPRs are relevant to the at risk products/ technologies? Do they have proper procedures for dealing with licensing inquiries (especially relating to the at risk products/ technologies)? How do they monitor the conduct of relevant employees and what kind of records do they create? What are the company's document retention/destruction policies?

It is important to have an internal assessment of the market shares of key IPR protected products and available competing technologies. Such assessment should be well documented. In addition, new standard operating procedures should be implemented. It is most advisable to leave none of the above questions unanswered well in advance of the deadline of August 1, 2015 when the Rules come into force.

> *(1). Article 1 of the Rules.
> *(2). Article 2 of the Rules.
> *(3). Article 3 of the Rules.
> *(4). Available at: http://www.allenovery.com/publications/en-gb/Pages/Antitrust-in-China-NDRC-v–Qualcomm-%E2%80%93-One-All.aspx
> *(5). Article 2 of the Rules.
> *(6). Article 6 of the Rules.
> *(7). Article 3 of the Rules.
> *(8). Article 3 of the Rules.
> *(9). Article 4 of the Rules.
> *(10). Commission Regulation (EU) No 316/2014 of 21 March 2014 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements, OJ L 93 of 28.03.2014, p. 17.
> *(11). Note in particular article 15(2) of the AML which provides that an agreement that would otherwise be deemed anticompetitive can effectively be exempted if its "objective is to raise product quality, lower costs, improve efficiency, standardise product specifications and standards or implement specialisation".
> *(12). Joined cases C-241/91 P and C-242/91 P Radio Telefis Eireann and Independent Television Publications Ltd (RTE & ITP) v Commission [1995] ECR I-743.
> *(13). Case T-201/04 Microsoft v Commission [2007] ECR II-3601.
> *(14). Aarticle 15(2) of the AML.
> *(15). See, for instance, the Communication from the European Commission — Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, OJ C 11, 14.01.2011, p. 1.

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