Intellectual Property Right Holders and Dominance

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Introduction

More than six years have passed since China's Anti-monopoly Law ("AML") came into effect on 1st August 2008. In that time, significant changes have taken place in the legislation and enforcement of the AML, which have achieved both domestic and international recognition. Technology has been drawing particular attention from the Chinese antitrust agencies recently, particularly in relation to abuse of dominance by intellectual property right ("IPR") holders, the Qualcomm case being the latest example. The analysis of abuse of dominance in the context of IPR requires some special considerations, in particular in relation to the definition of the relevant market and establishing dominance. As one of the first firms, which took part in the drafting of the AML and provided anti-monopoly related services, we are fortunate to have witnessed the trend of expanding technology industries and have gained many valuable observations in our practice.

This article reviews the current practice of the Chinese competition authorities in defining the relevant market and assessing whether an IPR holder is dominant, and makes some suggestions for improvements by reference to EU and US law and practice.

1. Definition of the Relevant Market in IPR Cases

Importance of Market Definition

According to Guide of the Anti-Monopoly Committee of the State Council for the Definition of the Relevant Market (the "Market Definition Guide"), the definition of the relevant market plays an important role in identifying market participants, actual competitors and potential competitors; in measuring the market shares of business operators and the market concentration; in determining the market position of the business operators; in analyzing the impact of certain behavior of business operators; and in deciding whether such behavior violates the AML, and if so, in measuring the legal liabilities[2]. In addition, according to the Market Definition Guide, an analysis of monopoly agreements, abuse of dominance and mergers with potential anti-competitive effects all require the relevant market to be defined.

According to the Market Definition Guide, the scope of a relevant market depends on the competitive constraints, which the business operators are subject to. Therefore, a relevant market should include all the competitive constraints, which a business operator is subject to. This position aligns with the US IP Guidance and the EU Rules.

The General Approach to Defining the Relevant Market

Article 12 of the AML sets out the principles for defining a relevant market for competition law purposes. It states that a relevant market refers to both the product market and the geographic market in which "business operators" compete in relation to certain products or services within a certain period of time. A business operator is defined as natural persons, legal persons and other organizations, which engage in

[2] Article 2 of the Market Definition Guide.

product manufacturing, operations or service provision.

According to this definition, the elements of the definition of a relevant market are: i) the relevant market consists of a product market and a geographic market; ii) business operators compete in this market; iii) the market may change over time so it is necessary to define the market within a certain time period. Thus, based on these three elements, a definition of the relevant product market and a relevant geographic market may be different over the time depending on the current technology[3].

According to the Market Definition Guide, a relevant product market is defined as a market consisting of a group or a category of products or services which customers or clients consider substitutable[4]. A relevant geographic market is defined as the geographic area for products or services which the customers or clients consider substitutable[5]. In addition, the Market Definition Guide also further clarifies the necessity of considering the dynamic nature of a market in defining a relevant market, where the production cycle, duration of usage, seasonality and trends of certain products or protection period of IPR are indispensable features of the underlying products or services.

The Market Definition Guide states that the scope of a relevant market depends on the competitive restraints the business operators are subject to. Such restraints are mainly the products/services or geographic area, which customers or clients consider to be substitutable for the product/services or geographic area in question, which is referred to as demand-side substitutability. In addition, if the supply-side substitutability provides similar competitive restraints, these will be taken into account as well. For demand-side substitutability, the similarity of the functions or features of the product/service and the comparability of the costs are the main factors. The supply-side substitutability depends on the costs for restructuring the production equipment, extra liabilities borne, and the time for entering the target market.

The Market Definition Guide includes a Hypothetical Monopolist Test for evaluating a relevant market. The SSNIP (a small but significant and non-transitory increase in price) is employed as a methodological tool for performing the hypothetical monopolist test. This approach is borrowed from US and the EU [6].

Market Definition in IPR Cases

The Market Definition Guide explains that in antitrust enforcement involving IPRs, the relevant technology market also needs to be defined[7]. The definition of a relevant technology market should consider various factors, including IPRs and innovation[8]. Thus, when a certain technology can be separately transferred or licensed, a separate technology market should be defined.

According to Article 3 of the Rules of the Administration for the Industry and

[3] Explanatory Notes to Chinese Anti-Monopoly Law, issued by Legal Committee of Standing Committee of the National People Congress.

[4] Guide of the Anti-Monopoly Committee of the State Council for the Definition of the Relevant Market, art.3.

[5] Guide of the Anti-Monopoly Committee of the State Council for the Definition of the Relevant Market, art.3.

[6] US Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines; the European Commission Notice on the definition of the relevant market for the purposes of Community competition law.

[7] Guide of the Anti-Monopoly Committee of the State Council for the Definition of the Relevant Market, art.3.

[8] Guide of the Anti-Monopoly Committee of the State Council for the Definition of the Relevant Market, art.3.

Commerce on the Prohibition of Abuses of Intellectual Property Rights for the Purpose of Eliminating or Restricting Competition (Draft for Comments) issued by the State Administration of Industry and Commerce (the “SAIC IP Guidelines”), a relevant technology market consists of the underlying technology being licensed and existing substitutable technology of same category[9].

This definition does not give a clear guidance as to what would be considered as “existing substitutable technology of the same type” means. As a persuasive precedent, in MOFCOM’s decision for the merger between Microsoft and Nokia, MOFCOM stated that patent families, which perform the same or similar functions, may constitute a separate market[10]. A patent family refers to patent claims filed in numerous jurisdictions to protect the same technology[11]. Furthermore, MOFCOM specifically stated that, in light of the bundled licensing practice, it would evaluate collective patent families that are usually licensed as a package to smart mobile device manufacturers.

All the patents and technologies which perform the same functions should be included in one relevant market as competing technologies. In addition, the actual licensing practice should be taken into consideration in evaluating the competitive effects.

In the final decision of Guangdong Province Supreme Court on Huawei v InterDigital (“IDC”), the court adopted a three-step analysis in defining a relevant market: firstly, based on the basic features and characteristics of products, whether the products have actual or potential similar substitutes; secondly, from demand-side substitutability, whether there are alternatives and whether the downstream customers would incur significant costs for switching.

It is noteworthy that such costs include sunk costs, which have been incurred by the business operator, switching costs and market risks. Thirdly, from the perspective of supply-side substitutability, whether it is possible for another business operator to enter this market.

Based on the published precedents involving abuse of dominance by IPR holders, the enforcement agencies do not appear to have taken into account the downstream goods market incorporating the technology, and substitutes for those goods, when defining the relevant market. The downstream market has only been taken into account when the authorities are considering the impact of the alleged abusive conduct on competition[12]. Furthermore, the agencies did not include substitute technology used to produce these goods in the relevant technology market. This is not consistent with China’s rules, nor is it consistent with the approach taken in other jurisdictions.

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9 According to PaRR report on February 9, 2015, China’s State Administration for Industry and Commerce (SAIC) aims to launch this year the long-awaited antitrust rules on intellectual property rights that it has been drafting, said Zhao Guobing, a director of the Anti-monopoly and Anti-Unfair Competition Enforcement Bureau under the SAIC.

10 MOFCOM Decision [2014] No. 24

11 See http://www.cnipr.com/yysw/yycx/201304/t20130426_177257.htm?COLLCC=2285468345&. This definition is identical to the definition in European Patent Office at http://www.epo.org/searching/essentials/patent-families.html: A patent family is a set of either patent applications or publications taken in multiple countries to protect a single invention by a common inventor(s) and then patented in more than one country. A first application is made in one country – the priority – and is then extended to other offices.

12 See, for example, Huawei v InterDigital, Guangdong Supreme People’s Court, No. [2013] 306.

The European Commission sets out specific guidelines for assessing the market definition and determining market shares in the context of IPRs in its Transfer of Technology Block Exemption Regulation (No 316/2014) ("TTBER")[13] and accompanying guidelines (the "TTBER Guidelines"). The TTBER Guidelines state that the Commission's approach to defining the relevant market is the same as that set out in its Notice on the Definition of the Relevant Market for the Purposes of Community Competition Law, but there are aspects of particular importance in the context of licensing of technology rights[14]. Technology transfer agreements are defined in the TTBER as (i) a technology rights licensing agreement entered into between two undertakings for the purpose of the production of contract products by the licensee and/or its sub-contractor(s); or (ii) an assignment of technology rights between two undertakings for the purpose of the production of contract products where part of the risk associated with the exploitation of the technology remains with the assignor[15].

The TTBER defines "relevant market" as the combination of the relevant product or technology market with the relevant geographic market[16]. "Relevant product market" is defined in the TTBER as the market for the contract products and their substitutes, namely all those products which are regarded as interchangeable or substitutable by the buyer, by reason of the products' characteristics, their prices and their intended use[17]. The TTBER Guidelines add that contract products can be part of a final and/or an intermediate product market[18].

"Relevant technology market" is defined in the TTBER as the market for the licensed technology rights and their substitutes, namely all those technology rights which are regarded as interchangeable or substitutable by the licensee, by reason of the technology rights' characteristics, the royalties payable in respect of those rights and their intended use[19].

The TTBER Guidelines explain that it may be necessary for some licensing agreements to define both the relevant product market(s) and the relevant technology market(s)[20], providing some examples of when this has been done in practice[21]. The Guidelines also give an example of an agreement between two parties which sell competing products downstream and which also cross license technology rights relating to the production of these products upstream. The Commission observes that such an arrangement may restrict competition on the downstream product market

[13] The TTBER creates a safe harbour from Article 101(1) of the Treaty on the Functioning of the European Union for licenses of technology rights (including know-how, patents, utility models, design rights and software copyrights, among others) which meet the specified criteria.

[14] Paragraph 19 of the TTBER Guidelines

[15] Article 1(1)(c) TTBER

[16] Article 1(1)(m) TTBER

[17] Article 1(1)(j) TTBER

[18] Paragraph 21 of the TTBER Guidelines

[19] Article 1(1)(k) TTBER

[20] Paragraph 20 of the TTBER Guidelines

[21] See for example Commission Decision COMP/M.5675 Syngenta/Monsanto where the Commission analysed the merger of two vertically integrated sunflower breeders by examining both (i) the upstream market for the trading (namely the exchange and licensing) of varieties (parental lines and hybrids) and (ii) the downstream market for the commercialisation of hybrids. In COMP/M.5406, IPIC/MAN Ferrostaal AG, the Commission defined besides a market for the production of high-grade melamine also an upstream technology market for the supply of melamine production technology. See also COMP/M.269, Shell/Montecatini. The Commission also looked at the downstream market in the Intel case (Case COMP/C-3/37.990)

concerned and the cross licensing may also restrict competition on the upstream market for technology and possibly also on other upstream input markets. Therefore it may be necessary to define the relevant product market as well as the relevant technology market to assess the competitive effects of the license agreements[22].

Similarly, the US IP Guidelines state that there may be instances where the relevant market for the goods needs to be analyzed and other instances where the markets for technology need to delineate[23]. In relation to technology markets, the US IP Guidelines state that technology markets consist of the intellectual property that is licensed and its close substitutes, which include not only other processes for making the downstream product, but also other goods that compete with the downstream product and the processes used to produce those other goods[24]. This appears to go beyond the EU's approach, by including the technologies used to produce the substitutable downstream products in the market definition.

According to Article 9 of the Guide for Market Definition, the demand-side substitutability and supply-side substitutability also apply to define a relevant geographic market. In particular, the following factors should be considered:

- Evidence showing that demands shift or consider shifting to other geographic areas to buy commodities due to changes in the price or any other competitive factor of commodities.
- Transport costs and transport features of commodities.
- Customer/Clients' preference for geographic areas. Actual areas where most demanders buy commodities and distribution map of the commodities of major business operators.
- Trade barriers between geographic areas, including factors such as tariff, local regulations, environmental protection and technology. If tariff is higher than the price of commodities, the relevant geographic market is highly probably a regional market.
- Other important factors, such as the preference of demanders in a particular area and the quantity of commodities shipped in and out of the geographic area.

In the court decision in the Huawei v IDC case, the court decided that the relevant geographic market for patents should be nationwide, because patents are granted in each jurisdiction, so the legal basis for the patent holders and their license must be subject to the patent-related laws in that jurisdiction. In the MOFCOM's decision in Microsoft's acquisition of Nokia, MOFCOM decided that the relevant geographic market for Android Project IP should be nationwide. MOFCOM's reason for its decision was that the downstream product market, smart mobile devices, is manufactured within China, targeting Chinese customers, and the operating system of

[22] Paragraph 20 of the TTBER Guidelines

[23] Paragraph 3.2 of the Antitrust Guidelines for the Licensing of Intellectual Property issued by the US Department of Justice and the Federal Trade Commission

[24] Article 3.2.2 of the US IP Guidelines

the mobile devices is mainly in Chinese and targeting Chinese customers.

So both cases seem to focus on supply-side substitutability, which means the IPR holders would license their IPR based on their nationwide strategies. However, the analysis seems not to take into consideration the demand-side substitutability, such as whether downstream product manufactures would license the IPR from other jurisdictions, and whether the downstream products target customers in other jurisdictions.

The TTBER defines “relevant geographic market” as the area in which the undertakings concerned are involved in the supply of and demand for products or the licensing of technology rights, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighboring areas because the conditions of competition are appreciably different in those areas[25].

The EU and the US therefore expressly allow for both the relevant product market and the relevant technology market to be taken into account when determining the relevant market for competition law purposes in IPR cases. The Chinese Market Definition Guide states that the scope of a relevant market depends on the competitive constraints that the business operators are subjected to. In reality, goods that are substitutable for a product incorporating the licensed technology, and the technology used to produce those goods, can all impose competitive constraints on the relevant IPR holder and, therefore, it is correct that they should all be taken into account when defining the relevant market.

2. Market Power of the IPR Holder

In order to determine whether an IPR holder has abused a dominant position, it is of course necessary to establish that it is in fact dominant in the relevant market.

Article 17 of the AML defines a dominant undertaking as an entity, which possesses the ability to control pricing, output or other trading conditions of the products in the relevant market, or to obstruct or impact market entry of other business operators. Article 18 lists a number of factors which should be considered in finding the dominance, including the market share of the business operator and its competitive status in the relevant market, the ability of the business operator to control the sales market or the raw material supply market, the financial and technological conditions of the business operator, the extent of reliance on the business operator by other business operators in the transactions, the degree of difficulty for other business operators to enter the relevant market.

The current laws and regulations remain silent on what the ability to control the pricing is. In the Supreme Court’s decision in Qihoo 360 v Tencent, the court stated that the instant messaging services or applications then available in China were free for users. Thus, users would be very price-sensitive. Under such circumstance, no supplier may be able control the pricing due to the fact there is no actual prices and the users are very price sensitive. The court said it would look into the ability of Tencent in decreasing the quality of its instant messaging products without harming its own business sales. The court then decided that Tencent did not have such ability

[25] Article 1(1)(l) TTBER

mainly because of two reasons. Firstly, customers of IM are very quality sensitive, thus, once Tencent intends to decrease its quality, the customers would switch to other product suppliers and such switching would not incur much costs. Secondly, the nature of IM is a two-sided market in which Tencent only makes profits from advertisements and other value-added services. Thus, Tencent would not have any business incentive to decrease its product quality. On the contrary, Tencent has a lot of incentive to increase its product quality in order to attract more users. This approach is reasonable that buyer power from direct downstream customers and the power from ultimate consumers should be taken into consideration in determining a dominant position. This approach also aligns with the position of EU Courts that dominance has been defined by the EU Courts as a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on a relevant market, by affording it the power to behave to an appreciate extent independently of its competitors, its customers and ultimately of its consumers[26].

In addition, as a reference, according to US IP Guidance, "Market power is the ability profitably to maintain prices above, or output below, competitive levels for a significant period of time." However, in practice, economically, it is very hard to define the competitive levels of pricing or output in a relevant market.

Article 19 sets out a presumption system based on market shares: dominance is presumed where one business operator possesses 50% or more of the total market, where two operators possess 2/3 or more of the total market or where three operators possess 3/4 or more. However, these presumptions can be rebutted, for example because of low barriers to entering the market or countervailing buyer power.

In MOFCOM's decision in the Microsoft/Nokia, it found that Nokia had a dominant position in the Android Project Licensing market, based on three factors: firstly, the technology was essential in manufacturing Android smart mobile devices; secondly, the technology was indispensable in manufacturing Android smart mobile devices; and thirdly, downstream customers (i.e., manufacturers of Android smart mobile devices) could not find alternatives for such upstream technology. However, MOFCOM did not take into account the buyer power of the downstream customers in its analysis. In contrast, in the court's judgment in Huawei v IDC, it took into consideration the cross-licensing from other IPR holders, which acted as a competitive restraint on IDC, when determining whether it possessed a dominant position in the relevant technology market.

On 16 October 2014, the Supreme Court handed down its final decision in the Qihoo 360 v Tencent case, rejecting Qihoo's appeal and upholding the first-instance court judgment. The Supreme Court determined that Tencent did not have dominance in the relevant market, even though Tencent's market shares in both the PC-end IM service market and the mobile-end IM service exceeded 80%. For the calculation of the market share of Tencent's products, the usage time is reasonable as it is consistent with the nature of instant messaging products. The Supreme Court reached this conclusion after a comprehensive analysis of Article 18 of the AML[27], essentially

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[26] Case 27/76 *United Brads Continental v Commission;* Case 85/76 *Hoffmann-La Roche v Commission*; Paragraph 10 of the European Commission's Article 102 Guidance

[27] Article 18 AML stipulates that the dominant market position of an undertaking shall be determined on the

because of the dynamic nature of the market. We can infer that in dynamic markets such as the Internet industry, it may be difficult to establish that an operator has dominance.

Therefore, although market shares are usually the starting point for assessing dominance, other factors listed in Articles 17 and 18 of the AML should be taken into consideration.

According to the US IP Guidance, market power is the ability profitably to maintain prices above, or output below, competitive levels for a significant period of time. The enforcement agencies will not presume that a patent, copyright, or trade secret necessarily confers market power upon its owner. Although an IPR confers the power to exclude, with respect to the *specific* product, process, or work in question, there will often be sufficient actual or potential close substitutes for such product, process, or work to prevent the exercise of market power.

The European Court of Justice "CJEU") has held that mere ownership of an IPR does not of itself confer a monopoly or dominant position for competition law purposes[28]. The European Commission's Guidance on its enforcement priorities in applying Article 102 TFEU to abusive exclusionary conduct explains the Commission's approach to assessing dominance in Article 102 cases. As with the Chinese authorities, the Commission sets out the main factors that it will take into account, in particular, market shares, barriers to entry by potential competitors or expansion by actual competitors and countervailing buyer power[29].

In the context of market shares, the Commission presumes that dominance is unlikely if the relevant undertaking's market share is below 40% in the relevant market[30] and the CJEU has held that, saving in exceptional circumstances, very large market shares (over 50%) are in themselves evidence of the existence of a dominant position[31]. The TTBER Guidelines suggests that, in the case of technology markets, it may not be practical to calculate market shares on the basis of each technology's share of total licensing income from royalties, of the difficulties involved in obtaining reliable royalty income data. The TTBER Guidance notes that, in addition to the general difficulty of obtaining reliable royalty income data, the actual royalty income may also seriously underestimate a technology's position on the market in the event that royalty payments are reduced as a result of cross licensing or the supply of tied products[32]. Therefore, the market share of the relevant licensor should also be calculated on the basis of sales of products incorporating the licensed technology on downstream product markets in order to assess the market strength of the licensor more accurately and to take into account other available factors, which give a good

basis of the following factors: (1) its share on the relevant market and the competitiveness of the market; (2) its ability to control sales or purchases of raw and semi-finished materials; (3) its financial strength and technical conditions; (4) the extent to which other businesses depend on it in transactions; (5) barriers to entry in the relevant market; and (6) other factors related to the determination of the dominant market position held by an undertaking.

28 Joined Cases C-241/91 and C-242.01P *RTE and ITP v Commission*; reiterated by the General Court in Case T-184/01 *R II, IMS Health v Commission*

29 Paragraph 12 of the European Commission's Article 102 Guidance

30 Paragraph 14 of the Article 102 Guidance

31 Case C-62/86 *AKZO Chemie BV v Commission*

32 Paragraph 25 and 87 of the TTBER Guidelines

indication of the relative strength of the available technologies[33]. This is a helpful suggestion for the Chinese authorities in calculating market shares in the case of technology markets.

33 Article 8(d) of the TTBER and paragraph 25 of the TTBER Guidelines