Huawei v. InterDigital: China t the Crossroads of Antitrust and Intellectual Property, Competition and Innovation

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Summary

The recent rulings of the Shenzhen Intermediate People's Court and the Guangdong Higher People's Court in *Huawei v. InterDigital* addressed several important issues at the crossroads between antitrust law and intellectual property in China in respect of standards essential patents (***SEPs***).

On the issue of how the holders of standards essential patents can enforce their rights, it appears from this case that the Chinese courts share similar competition concerns with regulators and courts in developed jurisdictions such as the US and EU.
However, a China-specific consideration may impact the courts decisions in relation to SEP cases: the encouragement of indigenous innovation and the government's efforts to help Chinese companies to get around the perceived technology barriers (often in the form of industry standards) set by foreign companies.

Background

On December 5, 2011, Huawei filed two complaints[1] before the Shenzhen Intermediate People's Court (the ***Shenzhen Court***) in China, alleging that, by engaging in certain patent practices, InterDigital had (1) abused its dominant market position, contrary to the Anti-Monopoly Law of the People's Republic of China (***AML***), and (2) as an owner of several SEPs for 2G, 3G and 4G telecommunications technologies, had failed to negotiate on fair, reasonable and non-discriminatory (***F/RAND***)[2] terms with regard to licensing those patents.

The Shenzhen Court delivered its rulings on February 4, 2013. While these are sealed and are therefore not available to third parties, InterDigital's annual report and an article published in an IP law journal by three judges of the Shenzhen Court[3] provide a good summary of the main facts and findings of the Shenzhen Court:

(1) With respect to the abuse of dominance claim, the Shenzhen Court found that InterDigital had abused its dominant market position and thus violated the AML by (i) tying its SEPs with non-SEPs during licensing negotiations[4] and (ii) seeking injunctive relief against Huawei before the United States District Court for the District of Delaware and before the United States International Trade Commission (***ITC***), while still in negotiations

[1]*See* InterDigital's 10-K for the year of 2012, available at http://www.sec.gov/Archives/edgar/data/1405495/000140549513000010/idcc-20121231x10k.htm#sB8CBDEB8939B47C8E810BD0438747BFA.

[2] The US uses "reasonable and non-discriminatory" (RAND) while EU uses "fair, reasonable and non-discriminatory" (FRAND), but they basically mean the same thing. we choose the abbreviation "F/RAND" to accommodate both the "RAND" and "FRAND."

[3] *See* Ye Ruosi, Zhu Jianjun & Chen Wenquan, Determination of Whether Abuse of Dominance by SEP Owners Constitutes Monopoly: Comments on the Antitrust Lawsuit *Huawei v. InterDigital*, Digital Intellectual Property (2013 No. 3).

[4] But the court did not find that InterDigital's bundling of its SEPs for 2G, 3G and 4G technologies or its bundling of its global patents constituted tying.

with Huawei to force Huawei to accept unreasonable licensing terms including excessive royalties. The court ordered InterDigital to cease its unlawful practices and pay Huawei 20 million CNY (approximately 3.2 million USD) in damages.

(2) As to the F/RAND claim, the Shenzhen Court concluded that InterDigital failed to comply with the F/RAND commitments in relation to its SEPs by (i) commencing injunction proceedings and asking Huawei to pay much higher royalties than those paid by Apple and Samsung and (ii) insisting on Huawei's licensing, to InterDigital, all of its own patents obtained globally on a royalty-free basis. The court determined that the F/RAND royalty rate for the InterDigital SEPs concerned should not exceed 0.019 percent of the actual sales price of each product manufactured by Huawei.

On May 9, 2013, a media report indicated that InterDigital had appealed to the Guangdong Higher People's Court against the above rulings and it has now been reported that the Guangdong Higher People's Court, on October 28, 2013, affirmed most of the rulings of the Shenzhen Court (including the award of CNY 20 million in damages). However, the Guangdong Higher People's Court's ruling with respect to Huawei's tying claims appears to be unclear in the media reports. It did find that the bundled licensing of SEPs of a global scope can be justified on efficiency grounds and that, therefore, this conduct did not violate the AML. But due to the fact that the judgment of the Higher People's Court has not been published, it is currently unclear whether the Court dismissed all of Huawei's claims relating to tying or only some of them.

Observations and Comments

As a preliminary note, the decisions of both the Shenzhen Court and the Guangdong Higher People's Court have not been disclosed, possibly due to trade secret issues. Thus, most of the following observations are made based on the above-mentioned judges' article on the Shenzhen Court's decision and on media reports.
This case has touched upon a wide range of important issues at the crossroads between antitrust law, competition policy and intellectual property, which also have been discussed heatedly in the US and EU.

Market definition in relation to technology licensing markets involving SEPs

When evaluating the abuse of dominance issue, the Shenzhen Court determined that the relevant product market should be a collection of the technology licensing market for each single patent essential to the WCDMA, CDMA2000 and TD-SCDMA standards for 3G telecommunications technologies, a decision which the Guangdong Higher People's Court appears to have affirmed. In other words, each of these technology-licensing markets constitutes a separate market in which the SEP owner therefore automatically holds a market share of 100 percent – an undoubtedly dominant market position.[5] In reaching this conclusion, the judges explained in their article that the Shenzhen Court carefully

[5] Under the AML, a company is presumed to have a dominant market position with a 50 percent market share.

considered the interchangeability between substitute technologies, and highlighted two major characteristics of SEPs: uniqueness and non-substitutability. In particular, in the standard-setting process, once one patent has been adopted as essential to a standard, to conform to the standard, market participants forego opportunities to invent around or adopt substitute technologies, and have to obtain the license to use the SEP for their products as their only and irreplaceable choice. In other words, they become "locked in."[6] By making it clear that an SEP owner has a 100 per cent market share in the technology licensing market for that SEP, the Chinese Courts have significantly lowered the barriers an antitrust plaintiff will face in order to establish the element of dominance in similar cases in the future.

Similarly, in *Broadcom v. Qualcomm*,[7] the US Court of Appeals for the Third Circuit noted that in the US, to establish a monopolization claim under Section 2 of the Sherman Act, a plaintiff needs to prove market power in the relevant product market, which can be inferred from dominant market shares and high entry barriers. The court then held that Broadcom adequately alleged that the licensing of Qualcomm's proprietary WCDMA essential technology is a relevant product market, and this essential technology was not interchangeable with other technologies. Adherents to the standard had become locked in. The court seemed to be of the view that a SEP may confer on its owner significant "market power," no matter how the market is defined, as implementing the standard is essential for market entry or continuing stay.

Furthermore, the court shared the same concern as to the "lock in" effect a standard-setting process may have on companies who choose to adhere to the standard and the patent holder's ability to "hold up" them. The court explained:

Industry participants who have invested significant resources developing products and technologies that conform to the standard will find it prohibitively expensive to abandon their investment and switch to another standard. They will have become "locked in" to the standard. In this unique position of bargaining power, the patent holder may be able to extract supra competitive royalties from the industry participants.

Abuse of dominance in the technology licensing market

To establish an abuse of dominance claim under the AML, it is necessary to establish "abuse" in addition to "dominance." Based on information contained in media reports on the appeal judgment in this case, it appears that the Guangdong Higher People's Court agreed with the Shenzhen Court that, by seeking injunctive relief in the US against Huawei, a willing licensee, with respect to its F/RAND-encumbered SEPs InterDigital violated its F/RAND commitments and that this conduct thereby constituted an abuse.

6 This may lead to a superior position of bargaining power held by the SEP holder and may thereby give it an incentive to seek supra competitive royalties from market participants.

7 *See* Broadcom Corp. v. Qualcomm Inc., 501 F. 3d 297 (3d Cir. 2007).

Notably, injunctive relief can be sought not only in court, but also before the ITC. "Section 337 investigation" is a phrase Chinese companies are becoming more and more familiar with. The ITC "adjudicates allegations of unfair methods of competition and unfair acts involving imported articles under Section 337 of the Tariff Act of 1930."[8] The remedies the ITC can impose in such an investigation can be very severe: exclusion of imported products involved in the case from the US. In the US, despite the possible trend that courts may be more and more skeptical about injunctions as a remedy in patent litigation, the ITC seems to enjoy the reputation of "pro patent."

The holding related to injunctive relief in *Huawei v. InterDigital* is similar to the US Federal Trade Commission (***FTC***)'s complaint, filed on January 3, 2013, against Google, which stated that Google, which acquired Motorola Mobility in 2011, reneged on Motorola's commitments to license its SEPs on F/RAND terms, by seeking injunctive relief against willing licensees of those SEPs, and that this allegedly violated Section 5 of the Federal Trade Commission Act. In the accompanying consent order, Google agreed to license its SEPs to competitors on F/RAND terms and not to seek injunctions against them, subject to a few exceptions.[9]

Similarly, on May 6, 2013, the European Commission sent a Statement of Objections to Motorola Mobility,[10] informing the company of its preliminary view that "the company's seeking and enforcing of an injunction against Apple in Germany on the basis of its mobile phone [SEPs]" gave rise to an abuse of a dominant position in violation of EU antitrust laws, "where the company has given a commitment to license those patents on F/RAND terms" and "where [Apple] has shown to be willing to enter into a [F/RAND] license."

Another similar ongoing investigation in the EU is against Samsung. The cause is again the company's pursuit of injunctive relief against Apple. "To remedy these concerns, Samsung has offered to abstain from seeking injunctions for mobile SEPs for a period of five years against any company that agrees to a particular licensing framework," and the European Commission is seeking comments with respect to such commitments.[11]

While the Guangdong Higher People's Court supported the Shenzhen Court's finding that the seeking of injunctive relief by InterDigital, with respect to its SEPs that are subject to F/RAND commitments, is an abuse of its dominant position, the Chinese appellate court's ruling on Huawei's tying claims is unclear at this point. It is reported to have acknowledged that the bundled licensing of SEPs can generate efficiencies and this position is welcome, as it appears to be in line with broader international practice on the treatment of bundled licensing under antitrust law. For instance, the US Supreme Court in the *Broadcast Music* case recognized the efficiencies that could be achieved by bundled licensing so long as

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8 *See* Facts and Trends Regarding USITC Section 337 Investigations, *available at* http://www.usitc.gov/press_room/documents/featured_news/sec337factsupdate.pdf.

9 *See* In the Matter of Motorola Mobility LLC, a Limited Liability Company, and Google Inc., a Corporation (FTC File No. 121 0120), http://ftc.gov/os/caselist/1210120/index.shtm.

10 *See* http://europa.eu/rapid/press-release_IP-13-406_en.htm.

11 *See* http://europa.eu/rapid/press-release_IP-13-971_en.htm.

licenses for each single intellectual property in the bundle would also be available upon request.[12]

SEPs and F/RAND commitments

The judges of the Shenzhen Court acknowledged in their article that standardization is important to ensure the interoperability of products or services of different companies and thereby to reduce production costs, protect consumer welfare and promote innovation. They defined the term "SEP" as any patented technology that has to be incorporated into a product in order to implement a certain standard.

In this case, both Huawei and InterDigital are members of the European Telecommunications Standardisation Institute (***ETSI***). Under the ETSI Intellectual Property Rights Policy, when its essential patents relating to a standard are brought to ETSI's attention, InterDigital is obliged to give a written undertaking within 3 months to ETSI stating that it will grant irrevocable licenses of its SEPs on F/RAND terms.[13] Also, InterDigital undertook to license its SEPs on F/RAND terms to other members of ETSI when it joined the organization. Despite this seeming clarity, the meaning of the term "F/RAND (fair, reasonable and non-discriminatory)" is a fact-specific question for the courts. In answering deciding this case, the Chinese Courts looked at two issues: (1) did InterDigital's licensing practices violate its F/RAND commitments? and (2) at what level should the F/RAND royalty rate be set?

Regarding the first question, InterDigital's requirement that Huawei pay significantly (sometimes even 100 times) higher royalty rates than those required of Apple, Samsung and other companies for the same set of patents, even while Huawei's global sales were much less than Apple and Samsung, appeared to the Courts to be prima facie evidence of discriminatory treatment. In addition, the Courts noted that InterDigital had also required Huawei to license back all of its global patents on a royalty-free basis (as of 31 December 2010, Huawei owned 31,869 Chinese patents, 8,892 PCT international patent applications and 8,279 overseas patents). This appears to be much harsher than a grant-back requirement[14] and the Courts appear to have taken the view that this was contrary to fair or reasonable principles.

With respect to the second question, the Shenzhen Court reduced the F/RAND royalty rate for InterDigital's 2G, 3G and 4G Chinese SEPs from 2 percent to up to 0.019 percent of actual sales price of each product manufactured by Huawei, and this was affirmed by the appellate court. InterDigital alleged in its 10-K filing that the Shenzhen Court failed to explain how it had reached this number, and the judges' article did not provide any insights into this calculation either. A source familiar with InterDigital was recently reported to

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12 Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., 441 U.S. 1, 21, 24 (1979).

13 ETSI Intellectual Property Rights Policy, Article 6.1, http://www.etsi.org/images/etsi_ipr-policy.pdf.

14 InterDigital's 10-K described this condition as a "grant-back." However, a grant-back condition is to require a patent licensee to license back any technology it develops upon the licensed technology (in other words, any improvements) on a royalty-free basis, which is much narrower than what InterDigital appears to have required in this case.

have complained that, according to the decision of the Chinese Courts, if a royalty rate exceeded the lowest rate that had ever been applied, such a royalty rate would be deemed unfair.[15]

Interestingly, on April 25, 2013, a US federal district court in Seattle delivered its opinion in Microsoft v. Motorola, which appears to be the first case in the US in which a court has determined a F/RAND rate.[16] In this decision, following a comprehensive analysis taking into account various factors, the F/RAND rate for the licensing of Motorola's video coding SEP portfolio to Microsoft was set by the court at 0.555 cents per unit, and the F/RAND rates of Motorola's WiFi SEP portfolio were determined as 3.471 cents per unit for Microsoft's Xbox products, and 0.8 cents per unit for all of Microsoft's other products.

Patent assertion by non-practicing entities (NPEs)

A patent assertion entity (PAE)'s business model is to purchase and hold patents solely to assert or threaten to assert them in court in order to obtain licensing fees from operating companies that are already using the patents in their products.[17] PAE's business activities are now a heated topic in developed jurisdictions, particularly the US, but they are not common in China. On one hand, PAE's activities may help facilitate the functioning of technology markets. Yet on the other hand, they have received criticism for demanding excessive royalties and hindering the business operations of their licensee companies.

In the US, both the Department of Justice, Antitrust Division (***DOJ***) and the FTC have been concerned about PAE activities' impact on competition. In December 2012, the DOJ and FTC jointly held a Patent Assertion Entities Workshop to explore the benefits and harms to both innovation and competition.[18] The workshop noted the following facts: (1) in the US there was 569 patent lawsuits initiated by PAEs in 2006, while the number jumped to 2,544 in 2012 through 1 December; (2) lawsuits initiated by PAEs used to account for 19 percent of all patent litigation in the US in 2006, whereas the percentage grew to 60 percent in 2012 through December 1; and (3) in the US "PAE-generated revenue cost defendants and licensees 29 billion USD, a 400 percent increase from 2005." Upon the collection of a number of public comments, on September 27, 2013, the FTC decided to conduct a study on PAE activities by issuing information requests to approximately 25 PAEs and several other entities.[19] The study will cover ordinary PAEs as well as "other entities asserting patents in the wireless communications sector, including manufacturers and other non-practicing entities and organizations engaged in licensing." InterDigital-like entities, though not PAEs, appear to be also within the Commission's interest of study.

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15 *See* http://app.parr-global.com/intelligence/view/1031134.

16 Microsoft Corp. v. Motorola, Inc., et al., Case No. C10-1823JLR (W.D. Wash., Apr. 25, 2013).

17 The FTC defined the term "patent assertion entities" as firms whose business model primarily focuses on purchasing and asserting patents. *See* http://www.ftc.gov/os/2011/03/110307patentreport.pdf (p.8).

18 *See* http://ftc.gov/opp/workshops/pae/.

19 *See* http://www.ftc.gov/opa/2013/09/paestudy.shtm.

In the current case, although in addition to patent acquisition, InterDigital is active in technology development, its conduct still shares similarities with PAEs.[20] The Chinese judges expressed in their article similar concerns as a US antitrust regulator may have for PAEs. The judges noted that InterDigital's principal business is patent licensing and that it does not manufacture any product. As a result, Huawei was in a weak bargaining position during licensing negotiations because cross-licensing would not be available, and InterDigital could make use of this advantage to extract more favorable contract terms from Huawei. The Shenzhen Court found that InterDigital had tried to exploit this advantage, by insisting on unreasonably high royalties and requesting Huawei to license back its patents on a royalty-free basis, with which the appellate court appeared to have agreed.

Although PAE activities are less common in China than in the US, it seems that the Chinese courts may view these entities as posing a danger to other businesses, especially to domestic companies' indigenous innovation efforts.

Damages calculation for abuse of dominance

When bringing the abuse of dominance action, Huawei sought damages as well as injunctive relief. The Shenzhen Court ordered InterDigital to cease its 'excessive pricing' and tying activities and to pay Huawei exactly what it had requested, equaling approximately USD 3.2 million, a very large damages award by the standards of the courts in China. This award was subsequently upheld by the Guangdong Higher People's Court, although it is not clear whether the tying claim was affirmed.
In terms of the calculation of the damages, the judges of the Shenzhen Court stated that neither the plaintiff nor the defendant provided satisfactory evidentiary proof for damages.

The Court therefore made its own calculation based on (1) the attorney fees paid by Huawei in both the US and China, (2) the notarization fees paid by Huawei, (3) the harm to Huawei's competitiveness, (4) the characteristics of InterDigital's anticompetitive activities, (5) InterDigital's intent, and (6) the seriousness of the harms caused to Huawei. However, other than the first two elements (which may only count for a small proportion of the total damages), it is difficult to speculate how the Shenzhen Court considered the other four factors, how these translated into damages and how the appellate court upheld the damages award.

Conclusion

As elaborated above, *Huawei v. InterDigital* is a landmark case in which the Shenzhen Court and Guangdong Higher People's Court decided a series of important issues at the intersection between antitrust law and IP, including the first example of the establishment of a F/RAND royalty rate for patent licensing in China. It sends a clear message that China

[20] InterDigital may be more of a non-practicing entity (NPE). According to the FTC, NPE also includes patent owners that primarily seek to develop and transfer technology, such as universities and semiconductor design houses.

wants to encourage indigenous innovation and lower technology barriers against the development of domestic technology companies.

On one hand, *Huawei v. InterDigital* provided some useful guidance on how competition issues in relation to standard-setting and patent litigation may be dealt with by Chinese courts. One the other hand, however, it also created uncertainty regarding to what extent a patent holder, particularly a *bona fide* operating company, may protect and enforce its legal rights, especially considering the relatively challenging IP enforcement environment in China.[21] This is something that multinational companies need to bear in mind in China when enforcing their IP rights.

It has been perceived that multinational companies have controlled standard-setting processes and patents, and they have much greater bargaining power over them with respect to essential technologies. Perhaps under this perception, Qiu Yongqing, a senior judge at the Guangdong Higher People's Court presiding over the case, is reported to have stated that Huawei "used antitrust law as a weapon to counterattack" monopolization by multinationals in the technology sector, and that other Chinese companies should learn from Huawei. He went on to suggest that Chinese companies should utilize antitrust litigation to overcome technology barriers and thereby better develop themselves.[22] Such encouragement by a senior judge and the *Huawei v. InterDigital* decision may lead to an increase in the confidence of domestic companies to file litigation for abuse of dominance and the relatively lower cost of litigation in China will certainly present a low barrier to those companies that do wish to make claims.

Therefore, for Chinese companies, the *Huawei v. InterDigital* decision may have set a successful example that antitrust litigation can be utilized as a relatively inexpensive and effective tool to avoid the payment of unreasonably high patent royalties. For IPR-rich multinationals, however, this should act as a warning that they face an increasing risk of antitrust litigation in China.

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21 For instance, in 2010, Microsoft filed a complaint against Guangzhou Kamhing (***Kamhing***) with the relevant government authorities, alleging Kamhing was using pirated Microsoft software, and Kamhing was subsequently penalized by the authorities. Microsoft and Kamhing then tried to negotiate a software purchasing agreement but failed to reach an agreement. In March 2012, Microsoft filed a copyright infringement claim against Kamhing in the district court in Nansha, Guangdong, asking for damages of CNY 4.7 million. In November 2012, Kamhing initiated an antitrust lawsuit in the same court against Microsoft. One week later, the Nansha court notified Kamhing that it should file the antitrust case in the Guangzhou Intermediate People's Court. In late November, Kamhing re-filed the case in Guangzhou, alleging Microsoft abused its dominant market position by, among other things, charging customers in mainland China unreasonable and excessive prices (almost 1/3 higher than the prices for the same products in Hong Kong). *See* http://tech.ifeng.com/internet/detail_2012_11/23/19461439_0.shtml.

22 *See* http://finance.sina.com.cn/chanjing/gsnews/20131028/214517140841.shtml.