



The Magic of China IP Misuse Guidelines

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The drafting process of various China IP misuse guidelines, circulated by National Development and Reform Commission (NDRC) and State Administration for Industry and Commerce (SAIC), have taken up lots of attention in recent months. The multiple editions of the drafts, which are all made public to local and global legal community, attracted rounds of discussions and submissions among professional groups and government agencies. At the same time, the access to the other two draft IP misuse guidelines, being drafted by State Intellectual Property Office (SIPO) and Ministry of Commerce (MOFCOM), is restrictive. Now, it is believed that all the work drafts of the IP Misuse Guidelines have been sent, if not, will soon be sent to the State Council Anti-monopoly Commission for review and consolidation. We may anticipate something for public comments later this year.

The intensive drafting work has contrasted with somewhat less aggressive antitrust enforcement activities involving IP in China. People may wonder whether China intends to make some adjustment through such rule-making process, or this is simply silence before next storm.

This article is intended to examine the motivations, the history and current status of the China IP Misuse Guidelines that are being made by multiple regulatory authorities. In particular, we will compare the two key drafts that are drafted by NDRC and SAIC in order to reveal something that signals what may come into being in the future. One interesting finding is that SAIC somehow regains attention and comes out as an equally important force, in formulating the IP misuse guidelines. All the attention that were given to NDRC, partly due to its enforcement decisions, may prove to be not so justifiable.

Review of the history

The word “IP Misuse” became popular as far as back in 2004. A Chinese generic battery company TSUM sued SONY Corp. for illegal bundling of its infoLITHIUM batteries. This case was touted as the first IP anti-competitive court case as the plaintiff argued that Sony misused its encryption technology to bundle the batteries. Eventually, the court dismissed the plaintiff’s claim and ruled there was no tie-ins.

IP-related antitrust issues were given much deeper thought when China started experimenting with patent pooling efforts for homegrown standards in 2004. The widely known video codecs group AVS took an unusual move in setting out IPR policy for standardization setting activities, which addressed FRAND and standard essential patents.

Between 2004 and 2014, the issue of IP misuse had been brought up from time to time, often in the context of accusing patent owners' enforcement actions. Serious discussions over IP-related antitrust issues mostly relate to standard-setting activities. The draft measures on national standards-related patent rules, which were driven by Standard Administration Commission, consistently attracted the interest until the rules were finally issued in 2014. Chinese courts also played an active role in this area, by issuing advisory opinions on specific cases and put down rules in draft judiciary interpretation.

What shifted the legal landscape is the AML, which went into effect as of August 1, 2008. Its Article 55 directly addresses intellectual property rights. Although Art. 55 seems to acknowledge that IPR owners are entitled to exercise IP rights, it essentially dictates that any alleged IP misuse are subject to the jurisdictions of the AML.

After the passage of the AML, the SAIC took on the job to come up IP Misuse Guidelines. International legal community, notably, American Bar Association International Law Section/Antitrust Section/IP Section, has spent a lot of efforts in commenting and many of the changes appeared to have been adopted. To the surprise of many, SAIC switched gears and eventually converted parts of the guidelines into the IP Misuse Rules in April 2015, which are counted as administrative measures in the China legislative hierarchy. To some extent, this SAIC move is questionable for both practicality and legality reasons. Art. 72 of the Law of Legislation clearly requires that any administrative rules involving multiple ministries' jurisdictions shall be jointly issued or be set forth as administrative regulations by the State Council. SAIC apparently did not follow this.

SAIC's IP Misuse Rules also came out at a time that numerous significant decisions were handed down in China, including MOFCOM's 2012 decision of Merger Review of Google and Motorola, the decisions of Shenzhen Intermediate Court and Guangdong High Court in Huawei Technologies v. InterDigital Corporation, the NDRC's 2013 decision in Investigation of Qualcomm, MOFCOM's 2014 decision of Merger Review of Microsoft and Nokia, etc. SAIC's imposition of an entire set of new normative rules in the IP related antitrust field caught many people by surprise.

In the late summer of 2015, shortly after the issuance of SAIC IP Misuse Rules, NDRC announced that the State Council Anti-monopoly Commission (AMC) had initiated a project to establish the IP Misuse Guidelines and NDRC was asked by AMC to prepare the draft. Soon after, it was said that at least four central government ministries, including MOFCOM, SAIC, NDRC and SIPO were asked to contribute drafts.

This is how the entire IP and antitrust community, inside and outside China, started the frenzy of IP misuse guidelines work.

Progress of Drafting

In August 2015, NDRC issued a questionnaire on Antitrust Guidelines of the abuse of intellectual property for experts' opinion, which contains 24 questions involving the major issues related to IP misuse. It was said that the questionnaire had been sent to at least from 350 companies, 5 research institutes, 45 law firms, 12 universities and multiple international standard developing organizations for seeking comments.

On October 22, 2015, at the 4th China Competition Policy Forum and the International Symposium on IPR and Antitrust held in Beijing, NDRC officials announced that they had completed its first version of the guidelines (NDRC Guideline). After that, the preliminary draft has been sent out for seeking comments to legal experts, scholars, Chinese and foreign parties in the name of State Council Anti-Monopoly Commission for 20 days.ⁱ On 5 November 2015, the three antitrust authorities submitted their progress reports related to drafting IPR antitrust guidelines at an internal seminar organized by AMC.ⁱⁱ The NDRC's working group for the guidelines quickly came up its second edition and started seeking another round of comments in January 2016.

SAIC went along rapidly. Soon after NDRC released its first edition, SAIC restarted the work of the IP misuse guideline. After internal discussions and revisions, SAIC released its 7th draft IP misuse guideline (SAIC Guideline), largely based on the framework of its own IP Misuse Rules, seeking for public comments on February 4th 2016. SAIC even publicized a bilingual version of the draft on its website.

What became immediately noticeable is SAIC referring to its own draft as the 7th edition of the draft, which somehow communicates a sense of history and sophistication.

MOFCOM's position in the IP misuse draft is very unique. MOFCOM's merger review decisions were among the earliest in dealing with IP issues and the official had developed rich experience. In both of the NDRC and SAIC draft, the section of "merger review related IP issues" is flagged for insertion, which is apparently left for MOFCOM's work. The Director General of the Anti-monopoly Bureau under MOFCOM, Mr. Shang Ming, made a speech in the same forum where NDRC announced its starting of the drafting, telling the audience that MOFCOM is currently studying include "whether IPR constitutes a factor that may restrict competition in a merger review, the types of IPR abuse situations in merger reviews, the factors to be considered in evaluating the impacts brought by IPR abuse in merger reviews, and IPR-related remedy choices.

Shang also mentioned that Licensing of SEPs is an issue that a merger review may encounter, citing the Alcatel-Lucent/Nokia case, where the deal obtained MOFCOM's conditional approval with remedies focusing on fair licensing of SEP. As of now, IPR-related remedies adopted by MOFCOM in merger cases include imposing FRAND requirements, restriction on use of injunctions, prohibition of tying and constraint of third party assignments. It will be interesting to see if any of the remedies appear in the future version of the IP misuse guidelines. It is a bit strange that MOFCOM has not released its own draft for public comments, as MOFCOM is normally doing a good job in transparency.

SIPO is the late comer to the game. SIPO has been strongly pushing for effective patent enforcement, through the proposed amendment to the patent law. People have been curious how SIPO would balance pro-innovation and pro-competition considerations in handling accusations of IP misuse. Unfortunately, SIPO has not released its own draft, probably because it does not want to take much limelight in the entire process.

In the analysis below, we will take a deeper look into the latest NDRC and SAIC drafts and make a brief comparison of similarities and differences between the two drafts and their noticeable features.

Brief Observations on the latest NDRC and SAIC Guideline

Both of the NDRC and SAIC guidelines follow the analytical structure in the AML and cover a wide range of IP related antitrust matters having been heatedly debated among policy makers, judges, practitioners and industries.

(1) Basic analytical framework and principles

Both of the guidelines defines the basic issues such as analytical approaches and steps, as well as a group of factors in assessing the influence of excising IPR on the competition. Notably, both of the guidelines confirm that there should be no presumption that owing IPR itself constituting the market dominance and a case by case analysis approach should be adopted.ⁱⁱⁱ

However, it seems SAIC is taking a more cautious attitude towards regulating IPR. The NDRC Guideline states that similar [antitrust] regulatory standards should be adopted in analyzing IPR as other property rights.^{iv} But SAIC Guideline take an economic analysis and indicates that "... ..comparing with other property rights, the production cost is pretty high, while the marginal cost of utilization is low." "The boundary of IPR is not as clear as other property rights." ^v SIPO states that as long as it is proved that

the positive impact exceeds the negative impact the exercising of IPR brings, the regulatory authorities may not interfere.

(2) Definition of relevant market

The two guideline both indicate that relevant technology market should be incorporated where it is insufficient to merely consider the product market. But they differ in whether to incorporate the concept of innovation market. Notably, the concept of the innovation market also appeared in the first draft of NDRC Guideline in October 2015, but NDRC eventually removed it in the following draft, which is likely a result from the submissions from the outside.

In the SAIC Guideline, the concept of innovation market refer to upstream market of technology market^{vi}, which focus on the competition in developing future generations of new technology and products. The incorporation of the innovation market may give SAIC some more powers to assess and regulate technology licensing practice by arguing about the impact on the so-called innovation market.

(3) IP agreement which may eliminate or restrict completion

Both of the guidelines have divided the IP agreements into 2 types, competing licensing agreements and non-competing licensing agreements, which are literally classified as horizontal agreements and vertical agreements^{vii} corresponding to Art 13 and 14 of AML.^{viii} It is further pointed out that IP agreements reached by business operators with competition relationship is more likely to eliminate or restrict competition.^{ix}

But the two guidelines take different classification approaches regarding the specific types of IP agreements. NDRC guideline seems to focus on specific behaviors, while SAIC guideline focusing on the effects of restriction.

Table 1 Specific Types of Competing licensing agreements

NDRC Guideline (Section II(i))	SAIC Guideline (Art.13 - Art.17)
Joint R&D	Price restriction between competitors
Pooling arrangements	Production restriction between competitors
Cross license	Market division among competitors
Standard making	Joint boycott by competitors

Table 2 Vertical IP Related Agreements

NDRC Guideline (Section II(ii))	SAIC's Guideline (Art.22- Art.23)
Price restriction	Pricing restriction
Exclusive grant-back	Region and client restrictions
Non-assertion clause	
Other restrictive clauses	

(4) Exemption of IP agreement.

Both of the guidelines has incorporated the safe harbor rules. However, there are obvious inconsistencies in the conditions of applying the safe harbor between the two guidelines.

Table 3 Exempted IP Monopoly Agreements

NDRC Guideline (Section II(iii))	SAIC Guideline (Art. 21)
Competitive business operators' total market share in relevant market is less than <u>15%</u>.	For horizontal IP related agreements, the aggregate market share of the operators in a competing relationship does not exceed <u>20%</u> in the relevant market that is impacted by their conduct; Or there exist at least four other substitutable, independently controlled technologies which can be obtained at reasonable cost in the relevant market.
Non-competitive business operators' market share in any relevant market related to IP agreements is less than <u>25%</u>.	For vertical IP related agreements, the market share of neither the operators nor their trading counterparts exceeds <u>30%</u> in the relevant market; Or there exist at least two other substitutable, independently controlled technologies which can be obtained at reasonable cost in the relevant market.
If there are evidences showing the IP agreements does not comply with the provision of article 15 of AML, then the IP agreements cannot be exempted.	If there is contrary evidence, then the IP agreements cannot be exempted.

In comparison, the scope of exemption in SAIC Guideline is relatively broader. This is an area that AMC will eventually have to decide and make alignment.

(5) The abuse of dominant position

Both of the guidelines cover specific behaviors which allegedly constitute abuse of dominant market position.

Table 4 Activities of Abusing Market Dominant Position

NDRC Guideline (Section III)	SAIC Guideline (Art. 23 – Art.28)
Licensing IPRs with unfairly high	Excessive Royalties

royalties	
Refusal to license	Refusal to license IPRs
Impose unreasonable conditions	Imposing unreasonable transaction conditions involving IPRs
Tying	Tying involving IPRs
Discriminative treatments	IP related discriminative treatments
Injunctive remedies	Separately prescribed in Chapter 6 for SEP related injunctive remedies

With respect to injunctive remedies that SEP owners are entitled to, the NDRC guideline take the Injunctive remedies as a type of abusing behavior. NDRC specifies that the factors, in the situation of SEP, include “the performance and actual willingness” by the parties, the commitments undertaken by SEPs, the impact of applying for injunctions on negotiation, relevant market, competition of the downstream competition and consumer interest. The way NDRC looks at injunctive relief is quite consistent with the actual practice. NDRC has been very sensitive to what SEP owners are doing in practice, e.g., whether or not using litigations or other enforcement to force potential licensees to sign license or pay royalty.

By contrast, SAIC addresses the same issue in a separate chapter^x at a high level without providing any detailed tests. SAIC simply refers to the abusive act that SEP owners abuses injunctive relief to force licensees to accept unreasonable terms and conditions.

General Comments Applicable to Both Guidelines

(1) Anything missing from the China rule of reason approach?

On the surface, the two guidelines have endorsed a rule of reason approach, which arguably provides much greater flexibility as opposed to a per se approach. For example, although the Draft Guidelines restrict the licensor on the activity of refusal to license, it appears to allow the licensors to justify their refusal to license under specific factors.

Another example is that both drafts have eliminated the most controversial issues such like Smallest Salable Patent Practicing Unit Doctrine (“SSPPU”). Although some licensees have been arguing China has adopted or otherwise should adopt SSPPU, it is encouraging that neither NDRC nor SAIC have been anywhere close to such doctrine.

The progress that has been made is that both SAIC and NDRC have been trying to add more tests and factors in the guidelines, which somehow are more useful. For example, in the NDRC Guidelines, with respect to abuse of injunctive remedies^{xi}, it lists out factors such as “the actual willingness expressed by the parties in the negotiation”

to consider in analyzing and identifying whether the injunction applied by SEP holders eliminates or restricts competition. Such a test arguably is similar as the term of “unwilling licensee” which is accepted in EU practice when analyzing the applicability of injunction in infringement cases.

However, what is still lacking is examples and clearer explanations. The current guidelines are written more as administrative rules and, sometimes, look more scholarly than what is expected. NDRC and SAIC have both retained significant amount of discretion in making the determination and findings. It is worthwhile being reminded that the rule of reason approach may not be what people have been used to in the US. A couple of years ago when SAIC put up one of its earlier draft IP Misuse Guidelines (maybe 4th or 5th edition) for comments, lots of per se rules were included. SAIC promptly added “without justifications” to the beginning of almost all those disputed rules. The phrase “without justification” has given lots of comfort, but such a phrase alone does not mean NDRC or SAIC will apply the rule of reason approach the same way the other jurisdictions will do.

NDRC and SAIC have been growing out of traditional types of enforcement authorities (price supervision or unfair competition acts etc). There is a way to go in learning how to do the job in a rule of law based quasi-judiciary approach.

(2) Encouraging Approach Regarding Relevant market of SEPs

Arguably, one good news in both of the Guidelines is the definition of relevant market of SEPs. As people may well recall, in the Huawei v. InterDigital case and the NDRC decision in the Qualcomm case, it was found that each SEP licensing market constitutes a relevant market and that the IPR holder would naturally take up 100% share in the relevant market. Although neither of these cases are binding as China is not a case law country, the recognition put the SEP holders on an extremely unfavorable position.

The two Draft Guidelines are shifting to a direction different from those decisions above. It is explicitly stated that there should be “no assumption that a business operator has the market dominance solely because of the ownership of IPRs.” Neither of the guidelines even remotely hint that SEP owners must have dominant market position. Hopefully, this is a sign that Chinese antitrust regulators have recognized that analyzing the market position of an IPR owner in a dynamic technology field is extremely complicated, and should be subject to comprehensive assessment of multiple factors.

(3) Are Non-FRAND Encumbered Patents Covered?

One primary concern with the NDRC Guidelines is that an owner of non-FRAND encumbered patents may be prohibited from exploiting their legitimate IP rights,

required to license, or required to lower their negotiated royalty rates. This became a big issue especially when the preliminary draft came out the first time in October 2015. The preliminary draft made it look like NDRC was seriously thinking non-FRAND encumbered patents are also subject to the same scrutiny as SEPs. Even under the latest draft of the NDRC Guidelines, a non-FRAND encumbered patent holder who has a dominant market position would be held liable if its licensing activities constitute the following:

- (a) Refusal to license may lead to negative effect on competition or innovation on relevant market, harm consumers' benefits or public interests; and
- (b) The licensing would cause no harm to licensor.^{xii}

Both conditions still seems overly broad. By applying anti-monopoly scrutiny to typical licensing issues, there is a great risk that there will be a chilling effect on normal and productive commercial negotiations. The same rationale applies to the approach taken by the NDRC Guideline to address royalties for non-FRAND encumbered patents and other forms of IPR.

Comparatively, the SAIC Guidelines have not been extensively analyzed from this perspective. But there is little evidence to convince us that the SAIC Guidelines may not be used to go after non-FRAND encumbered patents. Maybe the only relief is that people might be convinced that SAIC will never go after royalty cases where NDRC thinks it is its sole jurisdiction.

CONCLUSION

We have never recalled another Chinese legal field where four different ministries worked on their own draft rules or guidelines at about the same time. This may be totally unintended by anyone, or it is simply a process of consolidating the wisdom of various government agencies. The State Council AMC will undoubtedly take on a difficult job to review and hopefully, the upper level body will formulate some meaningful rules to guide both licensors and licensees. One annoying issue is how to deal with the future AMC Guidelines and the SAIC IP Misuse Rules, which became effective as of August 1, 2015. One of them needs to be superseded or replaced eventually.

Setting out enforcement guidelines is not something that we often see happens in China. Perhaps this is why all the drafts have gained so much attention from all over the world. Regardless the confusion or fatigue around working on so many different versions of the draft IP misuse rules, we must acknowledge that the approach of setting out guidelines should be encouraged, especially for China. It adds transparency.

It would have been better if SAIC had not changed its mind a few years ago and simply had finished its guidelines. If that is the case, NDRC might never even be bothered by the State Council to start the drafting of the new guidelines. The question is: is there any magic to put back what has come out?

¹ For more information, see: http://jjckb.xinhuanet.com/2015-10/23/c_134741403.htm

² See: http://www.js.xinhuanet.com/2015-11/25/c_1117257078.htm

³ See Section I(i) of NDRC Guideline, Art. 4(2) of SAIC Guideline.

⁴ See Section I(i) of NDRC Guideline.

⁵ Art. 4(1) of 7th SAIC Guideline.

⁶ Art. 8 of 7th SAIC Guideline.

⁷ Section II of NDRC Guideline, Art. 14-Art. 21 of SAIC Guideline.

⁸ Art. 12 of SAIC Guideline.

⁹ Section II of NDRC Guideline, Art. 12 of SAIC Guideline.

¹⁰ Art.28 of SAIC Guideline.

¹¹ Section IV(iii) of NDRC Guideline.

¹² Section III(ii) of NDRC Guideline.