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China Publishes the 2nd Version of the Anti-Monopoly Guidelines on the Abuse of Intellectual Property Rights

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Abstract

Article 55 of the *Anti-Monopoly Law of the People's Republic of China* ("**AML**") provides that the AML is not applicable to the exercise of intellectual property rights by undertakings in accordance with laws and administrative regulations on intellectual property rights; however, the AML shall be applicable to conducts of undertakings that eliminate or restrict competition by abusing intellectual property rights. Article 55 AML serves as the legal basis for anti-monopoly law's intervention in the abuse of intellectual property rights ("**IPRs**") in China.

Since the implementation of the AML in 2008, the interplay between the AML and the exercise of IPRs has been scrutinised on several occasions by the AML public enforcement agencies and courts. For instance, the National Development and Reform Commission ("**NDRC**") in 2015 fined Qualcomm approximately US$ 975 million for having abused its dominant position by charging unfairly high price when licensing wireless standard essential patents ("**SEPs**") as well as tying and imposing unreasonable trading conditions without justification. Another example is the private action of *Huawei v. IDC* in which the appellate court, the Guangdong Provincial High People's Court in 2013 upheld the judgment of the court of first instance and found IDC to have abused its dominant position by excessive pricing practice and tying non-SEPs to SEPs. In 2014, the Ministry of Commerce ("**MOFCOM**"), the merger control authority, approved Microsoft's takeover of Nokia's devices and services business on conditions that Microsoft and Nokia would respectively license their certain SEPs on fair, reasonable and non-discriminatory ("**FRAND**") terms and Microsoft would licence on a non-exclusive basis its certain non-SEPs to smart phone makers within China.

The first legal document endeavouring to clarify the relationship between AML enforcement and the exercise of IPRs is the *Provisions on the Prohibition of Excluding and Restricting Competition by Abusing Intellectual Property Rights* ("**IP Provisions**") which was issued by the Administration for Industry and Trade ("**SAIC**") and went into effect on August 1, 2015. However, since SAIC is only empowered to regulate non-price AML violations, the IP Provisions has its inherent limitations due to its inapplicability to price-related AML violations and was also constrained in its degree of illustration.

The efforts toward drafting a guidelines governing the abuse of IPRs started in June 2015, when the NDRC was commissioned with the task. The first version of the *Anti-Monopoly Guidelines on the Abuse of Intellectual Property Rights (Draft for Comments)* ("**1st Draft Guidelines**") was published for public comments on December 31, 2015 and it contained yet no information on concentration of undertakings (or merger control) involving IPRs.

On March 23, 2017, MOFCOM published on its website for public comments the revised *Anti-Monopoly Guidelines on the Abuse of Intellectual Property Rights (Draft for Comments)* ("**2nd Draft Guidelines**"). The 2nd Draft Guidelines combines the experiences and opinions of the three AML enforcement agencies and the State Intellectual Property Office and makes a number of changes to the 1st Draft Guidelines. This brief will discuss its highlights and major issues raised and will suggest that although the 2nd Draft Guidelines makes positive contributions such as introducing a safe harbour applicable to the evaluation of both price and non-price related restrictive agreements and identifies a number of specific conducts

which could be caught by the catch-all provisions of Article 13 AML and Article 14 AML, it still lacks a satisfactory degree of clarity on the AML assessment of particular conducts, the wanting of which may result in the over-enforcement of IPR licensing activities by undertakings, and therefore requires further improvement.

Highlights of the 2nd Draft Guidelines

As a starting point, it is noticeable that the 2nd Draft Guidelines does not define "intellectual property right". Therefore it is unclear what types of intellectual property rights are governed by the 2nd Draft Guidelines. Pursuant to Article 123 of the newly promulgated *General Provisions of the Civil Law of the People's Republic of China* which will be in force only on October 1, 2017, "intellectual property right" refers to seven specified proprietary rights, namely patent (invention, utility model and design), copyright, trademark, geographic mark, trade secret, integrated circuit layout design, and new plant species. Although this Article 123 contains an additional clause stipulating that "intellectual property right" can also refer to other proprietary rights as provided for by law, absent explicit indication it is unclear whether know-how will be considered to constitute the intellectual property right that falls in the ambit of the 2nd Draft Guidelines. It looks clear, though, that patent and copyright should constitute the intellectual property that falls in that ambit because both are explicitly mentioned in the 2nd Draft Guidelines.

The 2nd Draft Guidelines runs to a length of 27 articles altogether and features several highlights. First, the 2nd Draft Guidelines contains five chapters as opposed to three chapters in the 1st Draft Guidelines. Second, the 2nd Draft Guidelines dedicates Article 12 to a "safe harbour" within which Article 13(1)(vi) and Article 14(iii) of the AML will generally not apply.[1] Third, the 2nd Draft Guidelines seeks to harmonise the inconsistency in the thresholds of the safe harbour between the 1st Draft Guidelines and the IP Provisions. Fourth, the 2nd Draft Guidelines completes the 1st Draft Guidelines in the sense that it introduced six new articles governing the assessment of concentration of undertakings involving IPRs. Fifth, the 2nd Draft Guidelines introduces for the first time the idea that copyright collecting societies, in the course of going about their businesses, may exclude or restrict competition depending on the features and forms of their specific conducts.

1. The chapter on general issues

This chapter contains the following five articles setting out respectively: (i) principles of analysis; (ii) analytical framework; (iii) relevant market; (iv) factors to be considered in assessing anti- competitive effects; and (v) conditions required to be met in establishing "positive effects".

Article 1 of the 2nd Draft Guidelines acknowledges four "basic principles" to be respected when determining whether the exercise of IPRs excludes or restricts competition. There are several points to be noted in this regard. First, the 2nd Draft Guidelines removes from the 1st

Draft Guidelines the principle of justice and transparency as well as the principle of affording sufficient consideration to the justifications of undertakings. On the other hand, improving transparency is mentioned in the preambles of the 2nd Draft Guidelines as one of the purposes of drafting. Second, while this Article 1 calls for consideration being given to the characteristics of IPRs in general, the 2nd Draft Guidelines does not shed much light on what these characteristics are and how they might affect the analysis of pro- and anti-competitiveness of conducts. Third, Article 1 of the 2nd Draft Guidelines makes it clear at the outset that the mere ownership of IPRs cannot be the basis for the presumption of dominance. Fourth, Article 1 of the 2nd Draft Guidelines emphasises that consideration should be given to the pro-competitive effects on efficiency and innovation based on the circumstances of individual cases. The 2nd Draft Guidelines however does not expressly recognise that the exercise of IPRs has inherent pro-competitiveness.

Article 2 of the 2nd Draft Guidelines provides the framework of analysis in assessing whether the exercise of IPRs is anti-competitive or not. As this framework exists in the chapter governing general issues, such framework would apply to analysis under restrictive agreements, abuse of dominance, and concentration of undertakings. Sections (iii) and (iv) of this article suggest a balancing test (although it is not expressly acknowledged as such) under which both the anti- competitive effects and the pro-competitive effects of the conduct in question will be evaluated. These two sections are further elaborated in Article 4 and Article 5 of the 2nd Draft Guidelines respectively. Section (iv) of this article, in particular, gives a very short enumeration of the efficiencies innate to IPRs which being: the promotion of the dissemination and utilisation of technologies and the improvement of efficiencies in the utilisation of resources.

Article 3 of the 2nd Draft Guidelines provides that it may be necessary to define a relevant technology market when merely defining the product market is insufficient. The second paragraph of Article 3 suggests that both the present and potential areas of use of the technology should be considered when determining whether a technology is substitutable or not. This article further provides that the territoriality of IPRs should be taken into consideration when defining the relevant geographic market.

Article 4 of the 2nd Draft Guidelines sheds light on the factors to be considered in analysing the anti-competitive effects of a conduct. Article 4(i) enumerates the factors to be considered when assessing the competitive conditions on the relevant market - these are broadly the same with the factors involved in assessing the competitive conditions for other non-IPR related conducts, except the consideration of the "dynamics" on the relevant technology market, namely technological updates, trends, research and development, etc. This section also contains a non-exhaustive enumeration of the methods to calculate market shares on the relevant technology market. Article 4(ii) suggests that when determining the competitive relationship among undertakings, considerations may be given to whether the undertakings are actual or potential competitors absent the impugned conduct. It goes on to conclude that in general circumstances, the likelihood of excluding and restricting competition is higher if the undertakings are competitors.

Article 5 contains five conditions which an impugned undertaking must meet in order to claim the benefits of Article 15 AML (which is the counterpart of Article 101(3) TFEU). It should be noted that these five conditions are cumulative, in other words, undertaking claiming the benefits of Article 15 AML will need to satisfy all of them.

2. The chapter on restrictive agreements involving IPRs

The 2nd chapter of the 2nd Draft Guidelines contains seven articles, setting out several specific conducts from which competition concerns could arise and creating a “safe harbour” for restrictive agreements involving IPRs. The noticeable change made in the 2nd Draft Guidelines is the removal from the 1st Draft Guidelines the labelling of specific conducts as either horizontal or vertical agreements thereby basically acknowledging that the distinction between horizontal and vertical agreements should not overtake the assessment of the pro- and anti-competitiveness of the conduct in question.

Article 6 through Article 10 in the 2nd chapter identify five specific conducts in the exercise of IPRs that could cause competition concerns, namely joint research and development, cross-license, exclusive grant-back, non-challenge clause, and standard setting. In addition to these, the 2nd Draft Guidelines in Article 11 further specifies four other conducts that can arouse competition concerns: (i) restricting the areas in which IPRs are used; (ii) restricting the distribution channels, scope or purchasers of the goods in which IPRs are incorporated; (iii) restricting the quantities of the goods in which IPRs are incorporated; and (iv) restricting the use of competing technologies or the supply of competing goods.

Article 12 of the 2nd Draft Guidelines concerns a “safe harbour” which harmonises only partially the inconsistency between the 1st Draft Guidelines and the IP Provisions. According to Article 12, the safe harbour is delineated by meeting any one of the following conditions: (i) where the combined shares on the relevant market of undertakings in a competing relationship are no more than 20%; (ii) where the share of all of the undertakings in a non-competing relationship on any of the relevant market affected by the agreement involving IPRs is no more than 30%; (iii) where the market share information of the undertaking on the relevant market is difficult to be obtained, or where the market share does not truthfully reflect the market position of the undertaking, apart from technologies controlled by parties to the agreement there are however four or more substitutable technologies on the relevant market that are independently controlled by other undertakings and obtainable at reasonable costs.

While Article 12 of the 2nd Draft Guidelines harmonises the inconsistency between the 1st Draft Guidelines and Article 5(i) of the IP Provisions, it is still at odds with Article 5(ii) of the IP Provisions. Article 5(ii) of the IP Provisions provides that a safe harbour exists where in a vertical relationship “at least two other alternative technologies independently controlled can be obtained at reasonable cost.” This situation will likely result in two different standards when applying the safe harbour. Therefore further alignment will be necessary.

Another point to make about this Article 12 is it suggests that the legal effect of the safe harbour is that such agreements will generally be considered not to fall within the ambit of Article 13(1)(vi) AML and Article 14(iii) AML unless there are evidences proving that the agreement in question excludes or restricts competition. It follows from there that the safe harbour has at least two implications: the first is that such a non-infringement presumption can be rebutted if there are evidences proving anti-competitive effects, and second, that the safe harbour does not apply to "hardcore restrictions" expressly enumerated in the rest parts of Article 13 AML and Article 14 AML.

Although in China's anti-monopoly law regime there does not really exist such literature as "hardcore restrictions", Article 13(1)(i)-(v) AML and Article 14(i)-(ii) AML serve as such as they set out respectively five horizontal restraints (price fixing, output restriction, market allocation, restriction on purchase and development of new technologies, and collective boycott) and two vertical restraints (fixing resale price and restricting minimum resale price) which are prohibited by presumption of illegality.[2] Article 13(1)(vi) AML and Article 14(iii) AML are the so-called "catch-all provisions" which afford the two public enforcement agencies, NDRC and SAIC, discretion to determine whether a conduct not otherwise named in Article 13 AML and Article 14 AML is anti- competitive or not. The catch-all provisions governing restrictive agreements have caused misconceptions in practice - one such misconception being other than resale price maintenance activities, other types of vertical restraints (vertical market and customer allocation, etc.) do not or are not likely to be caught by AML. Therefore, absent a clear delineation of the scope of "hardcore restrictions", the text of the safe harbour in the 2nd Draft Guidelines could in effect suggest a blanket exemption for conducts such as vertical market and customer allocation if the market share thresholds are met, although it is not clear whether this is the true intention of the enforcement agencies.

3. The chapter on abuse of dominance involving IPRs

Over a length of six articles, the third chapter sheds light on the assessment of exercising IPRs in the context of abuse of dominance. Article 13 of the 2nd Draft Guidelines provides for three additional factors to be considered when determining whether undertakings owning IPRs has dominance on the relevant market. These factors should be used without prejudice to the factors and standards set out in Article 18 AML and Article 19 AML which apply to general circumstances. Article 13 of the 2nd Draft Guidelines also sets out five additional factors to be considered when determining whether the undertaking that owns SEPs is dominant or not.

Article 14 through Article 18 of the 2nd Draft Guidelines each sets out the factors to be considered when determining whether the following specific conducts constitute abuse of dominance: (i) licensing IPRs at unfairly high royalty rates; (ii) refusal to licence IPRs; (iii) tying involving IPRs; (iv) imposing unreasonable trading conditions in transactions involving IPRs; and (v) discrimination in transactions involving IPRs.

Article 14 concerns licensing IPRs at unfairly high royalty rates and deletes from the 1st Draft Guidelines two factors when considering a conduct constitutes abuse of dominance: "whether the IPRs license agreement contains other conditions leading to unfairly high royalty rates" and "whether the undertaking makes licensees accept royalties it offered by improper means". Article 15 concerns refusal to licence IPRs and deletes from the 1st Draft Guidelines "whether the refused licensee is lack of necessary support for qualities and technologies to secure justified use of IPRs or the security and performance of the products" as a relevant factor for consideration. Article 16 concerns tying practices involving IPRs and deletes all the five enumerated factors to be considered in the 1st Draft Guidelines and provides that the factors used in assessing the competitive effects of the general types of tying practices apply to tying practices involving IPRs. Article 16 also recognises that package license can be a form of tying. The deleted clauses are difficult to apply for lack of clear standards and therefore such deletion is commendable.

However, several additional factors are added for assessment of particular abusive conducts, for instance, Article 17 of the 2nd Draft Guidelines which deals with the imposition of unreasonable trading conditions inserts one new factor to consider, namely section (v) which requires the enforcement agencies to take into consideration whether cross licensing comes at a reasonable royalty rate.

4. The chapter on concentrating of undertaking involving IPRs

This 6-article chapter runs from Article 19 to Article 24 and is completely new as compared with the 1st Draft Guidelines.

Article 19 of the 2nd Draft Guidelines enumerates a few factors to be considered when assessing whether the assignment or exclusive licensing of IPRs can result in control in or imposition of decisive influence on other undertakings thereby giving rise to compulsory notification.

Article 20 of the 2nd Draft Guidelines calls for consideration of the special characteristics of IPRs in examining concentrations where arrangements involving IPRs form the substantive part or are significant to the realisation of the purpose of the transaction.

Article 22 through Article 24 of the 2nd Draft Guidelines set out three types of remedies (structural, behavioural and hybrid) that can be available for undertakings when conditional approval of a particular merger notification is relevant. Article 21 of the 2nd Draft Guidelines provides that the application of the remedies will be based on the assessment of the circumstances of each individual case.

Particularly, Article 23 of the 2nd Draft Guidelines enumerates the types of behavioural remedies that may be available in a merger review as follows:

I. IP licensing. Such licensing should generally be exclusive and does not contain restrictions on area of use or territories.

II. Hold separate IP-related The relevant business should be capable of effective competition over a certain period of time.

III. On fair, reasonable and non-discriminatory The undertakings generally will need to comply with such obligations through specific arrangements.

IV. Charging reasonable licensing The undertakings generally shall detail the method of calculation of the licence fee, the method of payment, fair negotiating terms and opportunities.

5. The chapter on other circumstances involving IPRs

The last chapter contains three articles which recognises that it is possible that some conducts in exercising IPRs may constitute different types of monopolistic conducts or concern particular types of undertakings, and in such circumstances a case-by-case analysis should be applied.

Article 25 of the 2nd Draft Guidelines concerns pooling of patents in which two or more undertakings jointly license their own patents to members of the pooling arrangement or third parties.

Article 26 of the 2nd Draft Guidelines concerns the abuse of injunctions by SEP owners that have a dominant position in order to force licensees to accept unfairly high royalty rates or other unreasonable licensing conditions. This article acknowledges that injunctive reliefs are remedial measures that are enjoyed by SEP owners pursuant to law. Five factors need to be considered in assessing the competitive effects of injunction applications: (i) the performance and true intentions displayed in the course of negotiation between the parties; (ii) commitments concerning the relevant injunctive remedy incumbent upon the relevant SEPs; (iii) terms of licensing proposed by the parties in the course of negotiation; (iv) the impact of the injunction application on the licensing negotiation; (iv) the impact of the injunction application on competition on the downstream market and consumer benefits.

Article 27 of the 2nd Draft Guidelines introduced the idea that "copyright collecting societies" may be impugned when they abuse IPRs to exclude or restrict competition. That said, this article does not provide any details about how to assess such a situation and it merely states that the enforcement agencies may identify specific conducts and analyse relevant factors by examining the features and forms of the conduct in question.

Closing comments

The 2nd Draft Guidelines was drafted with the combined efforts of and has the co-endorsements from both the three AML enforcement agencies (NDRC, SAIC and MOFCOM) and the State Intellectual Property Office (SIPO) and therefore displayed the importance China laid on the interplay between the exercise of IPRs and anti-monopoly law. However, as stated above and for the following reasons the 2nd Draft Guidelines is still not ideally placed to give the guidances it is designed to achieve:

First, as noted above, the 2nd Draft Guidelines still contains contents that ought to be harmonised with the existing rules in force, particularly when it comes to the safe harbour.

Failure to align can cause inconsistency and confusion among public enforcement agencies themselves as well as between public enforcement agencies and courts.

Second, the 2nd Draft Guidelines does not shed light on the burden of proof, therefore presumably the general rules of allocating burdens of proof in both restrictive agreements and abuse of dominance scenarios would apply although there already exists a degree of inconsistency between the allocation of burdens of proof among the public enforcement agencies and courts in China, for instance on resale price maintenance.

Third, the 2nd Draft Guidelines removes from the 1st Draft Guidelines many descriptions of the positive effects that a specific conduct involving the exercise of IPRs can bring. It is unclear why but such removal will likely make it more challenging for businesses to assert the efficiencies of their conducts.

Fourth, although the 2nd Draft Guidelines mentions a few times that the special characteristics of IPRs should be considered when analysing the compliance of a particular conduct involving IPRs with the AML, there lacks clarity what special characteristics are being referred to and how such characteristics will be considered in practice. Further, the 2nd Draft Guidelines could have provided examples or hypothetical scenarios in which the factors of consideration are applied to facts and offered corresponding conclusions that could be reached in those scenarios so as to improve the value of reference of the 2nd Draft Guidelines.

A final remarks to make about the 2nd Draft Guidelines is that its legal hierarchy is relatively low. Although it may serve as a source of reference for public enforcement agencies, it is unclear whether and to what extent the courts will be willing to apply it to its reasoning and rulings.

1 Article 13 AML and Article 14 AML governs horizontal and vertical monopolistic agreements respectively and, when combined together, are equivalent to Article 101(1) TFEU.

2 Note the existing different approaches in allocating the burden of proof to resale price maintenance between the public enforcement agency NDRC and the courts, where the courts have in a number of cases adopted a “rule of reason” sort of approach to resale price maintenance.