A NEW ERA OF LICENSING WITH CHINA

BY MARK A. COHEN[1]

1 Lecturer in Law, Distinguished Senior Fellow and Director of the Berkeley Center for Law and Technology Asia IP Project. The author has represented and continues to represent various parties to licensing transactions in China in addition to conducting research on these topics. The views expressed here are the author's own.

CPI ANTITRUST CHRONICLE SEPTEMBER 2019

CPI Talks…
…with Makin Delrahim

5G and the Global Economy: How Static Competition Policy Frameworks Can Defeat Open Innovation
By David J. Teece

Due Process in International Antitrust Enforcement: An Idea Whose Time has Come
By Christopher S. Yoo

5G and Anticipated Intellectual Property and Antitrust Policy Issues
By Kirti Gupta

Understanding "Balance" Requirements for Standards-Development Organizations
By Jorge L. Contreras

The IP Guidelines: Lessons from History
By Willard K. Tom

Stealth Commoditization: The Misuse of Smartphone Antitrust
By Jonathan M. Barnett

Antitrust and Balance of Interests in Standards Development – Lessons from *NSS Labs. v. Symantec*
By Justus Baron & Pierre Larouche

A New Era of Licensing with China
By Mark A. Cohen

Visit www.competitionpolicyinternational.com for access to these articles and more!

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

I. INTRODUCTION

This is a tale of two trends. The first trend is the positive developments in China that are reducing regulatory burdens on inbound technology transfer including the elimination of certain discriminatory provisions imposed on foreign licensors. The second set of trends are the continuing difficulties that foreign licensors encounter in getting deals done with Chinese licensees, including U.S. government pressure to curtail technology transfer to China, and continued domestic-leaning IP-enforcement practice and policy in China. These positive and negative developments are attributable to both developments arising from the U.S.-China trade war and China's own "techno-nationalist" drive to innovate.

II. CHINA DEVELOPS A MORE WELCOMING REGIME FOR FOREIGN TECHNOLOGY TRANSFER

Despite the focus on "forced technology transfer" ("FTT") and "IP Theft" of the current U.S.-China trade war, there have been many recent positive developments in foreign technology transfer to China. Most of these developments have failed to capture the attention of the media. Among these reforms, China now provides increased flexibility for foreign licensors negotiating technology transfer transactions with China. China has also sought to mitigate foreign complaints about FTT in the context of investment decisions through legislative changes prohibiting such coercion. China's Foreign Investment Law ("FIL") and Administrative Licensing Law ("ALL") now mandate that technology transfer cannot be made a condition of foreign investment approval and that trade secrets should be not be disclosed as part of the investment review process. Amendments to the joint venture ("JV") regulations have also abrogated provisions that required ownership by Chinese joint ventures of technology licensed to the JV by a foreigner after a 10-year period had elapsed. China has also opened up sectors of the Chinese economy to majority or exclusive foreign investment.

Among the important recent changes in licensing which have a direct link to China's antitrust regime, are the elimination of the prior non-negotiable requirements of China's Administration of Technology Import-Export Regulations ("TIER") (eff. 2002). The TIER required that: foreign technology transferors indemnify Chinese recipients against third party infringement and other risks; the Chinese licensees have a non-negotiable right to improvements they create to any transferred technology; and that Chinese licensees should have reasonable access to foreign markets. Failure to comply with these provisions arguably constituted "monopolization of technology" under China's Contract Law (Article 329), whether or not there was any demonstrable harm to competition and regardless of whether transaction was itself profit-oriented.

Although violation of the TIER provisions could result in a foreign party being accused of monopolization of technology under China's Contract Law, there were several important distinctions between the TIER and China's AML. First, the relevant TIER provisions only applied to foreigners licensing to China. Second, it established *per se* rules that were otherwise non-negotiable. Third, it applied to profit and non-profit motivated technology transfer. Fourth, enforcement mechanisms were unclear. Fifth, there were no implementing regulations and very limited case law to guide market actors in structuring their transactions to minimize its impact. Sixth, the broad, vague language and structure of the TIER, including its relationship with the Contract Law, may also have unnecessarily impeded China's acquisition of leading-edge technology from foreign sources.

While the TIER should no longer apply to newly negotiated licenses, its retroactive impact remains uncertain. The amended TIER has no provisions with respect to retroactivity. China's Law on Legislation generally provides that laws do not have retroactive force, except where a special provision is made in the law to better protect rights (this provision of the Law on Legislation has been applied in the intellectual property context to restrictive retroactive application of progressively more restrictive patent examination guidelines for pharmaceuticals). In addition, certain other laws and regulations which implemented the TIER or overlapped with the TIER need to address the retroactivity issue, notably a 2004 judicial interpretation on technology transfer contracts and provisions on China's contract law regarding monopolization of technology (Article 329). In addition, neither the Patent Law, AML, or guidance issued by the antimonopoly agencies on IP-related antitrust doctrines, have been amended during this time period or specifically disavowed application of the TIER to foreign-related technology transfer.

Nonetheless, China's accomplishments in amending the TIER should be acknowledged. Although the U.S. continues to threaten escalating tariffs and other sanctions in the trade war, those sanctions are now effectively delinked from FTT claims regarding the TIER and JV law. Those claims of FTT were advanced in the original USTR report into China's technology transfer practices in March 2018 and became the subject of a WTO dispute filed at about the same time. The United States has *de facto* acknowledged that delinkage by suspending this WTO case in 2019.

In the absence of other factors, these legislative amendments taken in response to aggressive pressure from the United States, along with China's own advantages such as a growing economy, enormous talent pool, and its commitment to developing an innovative economy should serve to encourage more foreign technology transfer to China. As Dan Prud'homme & Taolue Zhang have noted in their discussion of the TIER amendments in their recent book *China's Intellectual Property Regime for Innovation* (2019), "[t]hese changes should, at a minimum, reduce some arguably unnecessary transaction costs" and "make foreign firms somewhat more likely to conduct more advanced forms of innovation in China." In addition, the amendments to the joint venture regulations may also "have a[n] impact on innovation activities… similar to… the TIER."[2] Prud'homme & Zhang have also described changes in the FIL and ALL as "helping, at least somewhat, deter and provide recourse against some FTT policies."[3]

III. LICENSING TO UNRELATED PARTIES APPEARS TO DOMINATE

Prior to the changes to the TIER, recent trends in licensing to China were positive. U.S. exports to China of technology were $5.7 billion in 2017, including both "industrial processes" and "software." While this is a small fraction of bilateral trade, China's purchases of U.S. technology had grown about 23 times from 2004 to 2017. Equally significant, according to U.S. census data, the nature of the Chinese licensee had changed. Until 2016, the vast majority of U.S. licenses of technology to China had historically been to related parties (parent to subsidiary). Today, the majority of Chinese licensees of American technology are unrelated parties. Although it is too early to tell how long this change in licensee will persist, the change to unrelated party or "merchant" licensing may suggest that China's licensing markets, including its legal system, have improved in recent years.

The turning point in 2016 preceded the Trump Administration's arrival in Washington, DC. It may have been due to a number of factors such as an improvement in the litigation environment with increased damages, a long-awaited new national appellate IP court similar to the U.S. Court of Appeals for the Federal Circuit, the widespread availability of injunctive relief without an "eBay" doctrine, a recognition of the importance of outbound licensing to Chinese companies, a more relaxed approach to SEP assertions, increased Chinese participation in patent pools and standards setting bodies, and increasing reliance by foreign merchant licensors on the Chinese market for revenue. In fact, the importance of licensing was recognized by some Chinese authorities as early as 2016, when the Ministry of Commerce had publicly expressed an interest in amending the TIER to European officials and to domestic Chinese lawyers.

---

2 P. 76.

3 P. 82.

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing
this article is forbidden by anyone other than the publisher or author.

Nonetheless, the low volume of U.S. licensing revenue might be contrasted with China's high-tech manufacturing prowess for technologies that likely required acquisition of patents or other licenses from the U.S. or other countries. One rough benchmark that I had used while serving at the USPTO was to compare the percentage of China's share of high-tech or information technology exports as compiled by international organizations such as the World Bank or WTO[4] to the percentage of China's share of U.S. licensing revenue. In recent years the gap has narrowed, although it still appears to suggest that there is a large percentage of unlicensed exports. In 2016 China exported 22 percent of the world's high-tech products, but only purchased 6.3 percent of U.S. technology a multiple of 3.5 times, which is a reduction from 27 and 4.1 percent in 2013, a 6.6 multiple. This data is useful in establishing trends, although it cannot be used with 100 percent assurance as an indicator of unlicensed manufacturing.

There are also qualitative signs of an improving environment. Several U.S. law firms and companies have begun to explore possibilities of forming patent pools with Chinese companies, licensing to or from Chinese entities or using the Chinese court system to enforce their rights. In addition, several companies and law firms have brought SEP litigation in China. As Chinese judicial databases do not track settled cases, it is difficult to determine how many of these cases have been brought against Chinese entities or other foreign entities. Often information on licensed transactions will appear in the securities filings of companies listed outside of China.

Chinese companies are also acquiring technology from unrelated foreign licensors. China's high-tech sector is increasingly acquiring technology from U.S. licensors. China's technology transfer regime has become increasingly flexible for foreign licensors in general as well as foreign licensors engaged in investment in China. Quantitative and qualitative data suggest there has been increased licensing activity. However, the current trade war interjects additional uncertainty into these positive trends.

IV. A NEW WORLD FOR SEP LITIGATION

The legal relationship between IP and antitrust, and especially between standards and antitrust has been characterized as "overly ambiguous" and "create[ing] legal uncertainty which can inhibit innovation investments."[5] Perhaps the most concerning provision for SEP licensors has been China's adoption of the "essential facilities" doctrine in its SEP policies which may require a SEP holder to license its patents on FRAND terms if it holds a dominant position and lacks reasonable justification for refusing to license.[6] Chinese policies makers have also called for use of compulsory licenses in appropriate circumstances, such as when a patent is incorporated into a compulsory national standard. There has recently been some momentum for change from these implementor-friendly licensing provisions.

An important aspect of a newly changed environment for SEP licensing is the Trial Adjudication Guidance for Standard Essential Patent Dispute Cases (the "Guangdong Guidance" or "Guidance") issued by the Guangdong High Court on April 26, 2018. The Guidance is intended to govern telecommunications related cases. However, it can also be applied by analogy to non-telecommunication SEP cases. The Guidance's impact has been diminished by the Guangdong High Court ceding intermediate appellate jurisdiction over appeals of SEP cases to the newly established national appellate IP Tribunal at the Supreme People's Court. However, the Guidance should continue to govern first instance court decisions and serve as a summary of practical approaches to resolving SEP disputes based on the experience of a leading jurisdiction in China.

The Chinese approach towards SEPs had been undergoing considerable change prior to the Guangdong Guidance. This Guidance adheres to the basic framework of Beijing Higher Court's ("BHC") Guidance for Patent Infringement Determination 2017 which itself appeared quite similar to the basic framework set forth by Court of Justice of the European Union ("CJEU") in its decision for *Huawei v. ZTE*, as well as in the recent decisions of *Iwncomm v. Sony* in Beijing, and *Huawei v. Samsung* in Shenzhen.[7] Taken together, these approaches of the Chinese courts embody a "fault-based" conduct-evaluation framework.

The Guidance also specifically affords the possibility that Guangdong Courts can establish global licensing rates upon the agreement of the parties (Section 16), and that violation of its terms can form the basis of an antitrust complaint (Chapter IV). The Guangdong Guidance mandates licensors of patents encumbered by obligations imposed by standards organizations to license on Fair, Reasonable, and Non-Discriminatory

4 https://data.worldbank.org/indicator/TX.VAL.TECH.CD; https://www.wto.org/english/res_e/publications_e/ita20years2017_e.htm.

5 *Id.* at 77.

6 See SAIC Provisions on the Prohibition of the Abuse of IPR to Eliminate or Restrain Competition (2015). SAIC has since been merged into a new agency, the State Administration for Market Regulation or "SAMR."

7 Cui Yabing, *Across the Fault Lines*, Chinaipr.com (June 5, 2018), https://chinaipr.com/2018/06/05/across-the-fault-lines-chinese-judicial-approaches-to-injunctions-and-seps/.

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing
this article is forbidden by anyone other than the publisher or author.

("FRAND") terms or similar, and to provide a notice to the implementer listing the scope of the patent right in accordance with "commercial practices and trading habits." The licensor must not delay or make an "obviously unreasonable" licensing fee offer.

In practical terms the Guidance not only sets forth standards for adjudication, but establishes normative rules for conducting negotiations where there is a risk of litigation in China. A prospective licensing party must now develop an approach that documents the "reasonableness" of its negotiating behavior. Foreign licensors, for example, might now consider notarization in China of appropriate documents in both English and Chinese. They might also consider providing prompt written summaries of matters in contention, and make sure significant evidentiary matters are not bound by confidentiality agreements or protective orders. Identifying "reasonableness" of a licensing offer, given the historically low royalty rates that Chinese courts and global licensing standards, may also prove difficult. The Guangdong Guidance may also be used strategically to a licensor's favor by helping it to build an evidentiary case that its conduct is reasonable because the licensee's counter offer is unreasonable by industry standards.

Regarding valuation of patents, the Guidance looks to the value of the SEP in the market, including comparable license rates using a "top-down" approach (Article 18 et seq.). Among the factors used to determine a SEP licensing fee are: reference to a comparable licensing agreement; analysis of the market value of the patents for the standards involved; reference to the license information in the comparable patent pool; and other methods. A license agreement for a SEP may be comparable (Article 20) based on factors such as: the subject of the license transaction; the relationship with the license target; the nature of the contracting party for the license fee; and the good faith conduct of the license negotiation. In my estimation, these factors could be read to authorize discretion by a Chinese judge to establish a lower "Chinese price" for technology based on size of the Chinese market or the state of its economic development. Among the factors to be relied upon to determine market value of the SEP (Article 24) are: the contribution of the SEP to product sales and profits, which does not include the impact of the patent being included in the standard; the contribution of the SEP to the standard; the advantages of this patented technology over other alternative technologies prior to standard setting; and license fees paid using SEPs that are related to the case; and other relevant factors.

If a party has evidence to suggest that the other party holds critical information on SEP license fees, the Court may order the other party to provide such information. The Guidance is consistent with other legislative efforts to facilitate limited discovery related to damages in Chinese IP litigation. Considering that China remains primarily an implementor of SEPs. that it is the dominant supplier of the many high-tech products that implement the standards, and that damages in court cases are increasing but remain low, valuations are also likely to remain low for foreign SEPs.

Chapter IV of the Guidance sets forth various standards for evaluating whether licensing activities involving an SEP may constitute an abuse of dominance. The Guidance provides that whether an entity has a dominant position in the relevant market should be determined in a case-by-case fashion. Market share, conditions of competition, and FRAND commitments should also be considered. Importantly, the breach of the FRAND commitments does not necessarily constitute an abuse of the dominant market position. In addition, an SEP owner's petition for injunctive relief to cease infringement does not necessarily constitute an abuse of the dominant market position. Courts should look into other factors such as whether the parties acted in good faith, and the fairness of the licensing terms in determining whether there is an abuse of dominance that restricts competition (Section 29). A similar factor-based approach attaches to portfolio licensing (Section 30).

In general, the Chinese courts appear to be moving closer to the Beijing court's decision in *Iwncomm v. Sony* in making injunctive relief available against recalcitrant licensees. Nonetheless, the *Iwncomm* case does not mandate in practice that injunctions will be freely available to foreign licensors against Chinese licensees in the future. Many observers have noted that *Iwncomm* involved a Chinese State-Owned Enterprise seeking an injunction against a foreign enterprise in China, which makes the case somewhat difficult to compare with prior cases and policy documents which benefitted from a background of the discriminatory technology transfer regime of the TIER, and took more restrictive views towards granting of injunctive relief with respect to FRAND-encumbered patents. Hopefully, foreign access to injunctive relief against Chinese parties will be clarified in forthcoming court cases and other guidance.

Attorneys that are advising their client/licensors regarding how to license patents in China should also carefully consider how the courts consider concepts of licensor "delay" in light of the rapid growth in China's telecom sector and short product cycles including a short statute of limitations for patent litigation in China. Short product cycles and condensed court procedures for patent cases may make a "reasonable" period of time may be much shorter in China than elsewhere. The Guangdong Guidance does not extend these periods of time if a litigant is a foreigner and is thereby inconsistent with the letter and spirit of China's civil procedure rules and practice that permits courts to delay making decisions

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing
this article is forbidden by anyone other than the publisher or author.

on foreign-related cases, while limiting domestic cases to six months duration.[8] Foreign companies now face the dilemma of being compelled to hurry up when they license to a Chinese entity or risk being accused of lack of good faith and thereby losing the ability to enforce their rights. At the same time, they may be forced to slow down by the Civil Procedure Law when they actually litigate.

Some observers contend that there are additional delays now being imposed by Chinese courts when cases implicate issues raised in the current trade war, which may include SEP assertions. However, other observers note that the pressure being put on judges to dispose of cases in China's busy dockets afford an additional basis for courts to withhold final adjudication of complex foreign SEP assertions which are not similarly time-bound. I am unaware of any publicly available policy document or hard data at this time to support either of these two contentions, although it remains reasonable to expect that foreign companies may expect delays in adjudicating their cases and/or that Chinese litigants may seek to sequence their global litigation strategies to maximize the high speed of Chinese court cases and minimize the impact of an adverse foreign decision including, for example, an anti-suit injunction from a foreign court.

From a Chinese "rule of law" approach, the enactment of the Guangdong Guidance is problematic as it appears legislative in nature, and does not simply provide guidance on the "specific application of law" that is permitted of the courts in enacting guidance of this type.[9] Moreover, it also references administrative guidelines such as NDRC guidelines on determination of the relevant market, when these non-binding guidelines are not intended to guide the courts and are not considered a source of legislation for judicial adjudication of cases. Finally, the Guangdong Guidance looks to establish normative procedures for negotiation of global SEP licenses with foreigners, yet it does not appear to have not been prepared in consultation with foreign companies.

V. COURT DOCKETS MAY POSE AN ADDITIONAL CHALLENGE

China's rapidly growing and highly litigious IP environment may also pose challenges for SEP litigants. According to the recent report "Intellectual Property Protection by Chinese Courts in 2018" prepared by China's Supreme People's Court, Chinese courts heard 334,951 civil, administrative, and criminal IP cases in 2018. This was an increase of 41.19 percent over 2017. Civil patent cases of first instance increased to 21,699 or by 35.53 percent. Technology contract cases increased at a less rapid rate, by 27.74 percent to 2,680 cases.

As in prior years, there appear to have been wide differences in docket growth in different parts of China. With the advent of new private IPR-related databases, litigants and their counsel may wish to carefully plan their litigation strategy to ensure that they will be heard in courts with favorable procedures, local policies and experience in SEP cases. Counsel should consult with the various databases now available to look at such issues as how busy the courts may be, their experience in technologies and legal issues being claimed, and the manner in which judges may have disposed of similar cases in the past. As judicial databases do not report on settled cases and a significant cohort of cases may not be reported due to confidentiality or other concerns, it may also be critical to consult with experienced counsel that may also have knowledge of the unreported decisions, trends and predispositions of the judges.

In litigating any technology contract dispute it is also important to recognize that Chinese courts also remain relatively inexperienced in handling foreign-related licensing disputes. Generally speaking technical contract disputes have been much smaller in number than other IP disputes, mainly filed by domestic entities, and not concentrated in a particular industry. Patent-related disputes cases are typically heard in intermediate courts where foreign IP cases may be heard, while technology contract cases are heard in basic level "grass-roots" courts which may not hear any foreign IP disputes.

8 See Mark Cohen, *China IP and the NY Minute*, Chinaipr.com (November 21, 2012), https://chinaipr.com/2012/11/21/china-ip-time-and-the-new-york-minute/.

9 See the Law on Legislation of the PRC (Section 104).

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

VI. THE TRADE WAR FURTHER DISRUPTS OPPORTUNITIES TO LICENSE

The trade war has had other important immediate impacts on licensing practices. The U.S. government has sought to expand its export control regime to capture as yet undefined "emerging" and "foundational" technologies as well as to restrict Chinese investment in the United States. In addition, efforts by the United States to ban Huawei from the U.S. and other markets are forcing Huawei to reconsider how it needs to monetize its rich FRAND encumbered patent portfolio, including bringing infringement claims against network operators such as Verizon. The United States has also sought to ban Huawei from global 5G standards practices as part of export control sanctions against it. If that ban is fully implemented, it may further disrupt Huawei's ability to cross-license or participate in standards setting and thereby accelerate a global technology decoupling.

Increasingly, these changes may be forcing Huawei to become a unique type of patent assertion entity in certain markets – which I have tentatively labeled an overseas patent assertion entity ("OPE"). Such OPE's may be very rich in patents in a market, but with restricted market access. OPEs create unique challenges to those who believe that companies that do not practice patents should be denied injunctive relief. OPEs may be denied market share through no overt act of their own. They may have a rich product portfolio which they have been adopted by standards. Their products might otherwise be available to satisfy local market demand. They may also have patents that read on critical infrastructure such as telecommunications which may also make granting injunctions difficult. Courts, seeking to impose global licensing rates, may be challenged by the fact that the local market in which the OPE is a party to the litigation may generate little revenue, such as in *Conversant v. Huawei* in the UK. In terms of defensive strategies, an OPE may be reluctant to defend itself in markets where it is already facing governmental and political barriers and may try to leverage its home court advantages to the maximum extent possible. OPE's might consider vigorously ignoring antisuit injunctions, judgments, discovery, etc. In appropriate circumstances, OPE's may also claim that foreign governments' sanctioning of their licensing or marketing activities violate national treatment obligations under the TRIPS Agreement, and are not exempted by existing national security exceptions (TRIPS Agreement, Articles 3, 73).

If the current trade war and its trends towards "decoupling" in 5G and other areas continue, such OPEs may regrettably become more common. Proposed legislation by Senators Rubio and Cornyn that would further restrict Huawei's ability to assert its patents further accelerate this trend. Additionally, the U.S. government continues to place companies on the denied party "entity list" for purposes of U.S. export control laws. The proponents of many of licensing-related sanctions may not fully understand the advantages to having all relevant technological players to participate as a standards-setting process, where they will need to disclose their technologies and ensure that patents are bound by FRAND commitments. Moreover, excluding Chinese companies from foreign markets could result in reciprocal sanctions on foreign companies by China.

VII. CONCLUSION: PROCEED OPTIMISTICALLY, BUT WITH CAUTION

Companies seeking to license to China or litigate in China would also be well advised to carefully study the Guangdong Guidance and negotiate consistent with its mandates. The current moment offers increased Chinese flexibility on license terms and market access for technology transfer contracts with China, while at the same time subjecting them to increased legal and political uncertainty.

Competition Policy International, Inc. 2019© Copying, reprinting, or distributing
this article is forbidden by anyone other than the publisher or author.

CPI COMPETITION POLICY INTERNATIONAL

CPI Subscriptions

CPI reaches more than 20,000 readers in over 150 countries every day. Our online library houses over 23,000 papers, articles and interviews.

Visit competitionpolicyinternational.com today to see our available plans and join CPI's global community of antitrust experts.