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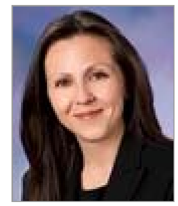
# How Far Patent Licensors Can Go In US, China And Korea



Koren Wong-Ervin

Law360, New York (June 14, 2013, 11:55 AM ET) -- Frances Marshall, special counsel for intellectual property at the U.S. Department of Justice, along with Jonathan Gleklen, a partner at Arnold & Porter LLP, Hwang Lee, a professor at Korea University School of Law and former Korean Fair Trade Commission enforcer), and Yizhe Zhang, a partner at Jones Day and former Ministry of Commerce of the People's Republic of China enforcer, recently spoke on a panel titled “How Far Can Patent Holders Go?” covering licensing issues in the United States, China and Korea.[1]

The panel began with an overview of the law in each jurisdiction.

Marshall explained that, today, the U.S. agencies’ approach is set forth in the 1995 DOJ and Federal Trade Commission Antitrust Guidelines for the Licensing of Intellectual Property and the 2007 DOJ and FTC intellectual property report, titled "Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition," as well as various business review letters and a number of speeches. According to Marshall, these documents tell us that:

- Antitrust and intellectual property law are not at odds;
- Intellectual property rights do not necessarily confer market power; instead, we first need to determine whether there are substitutes that might prevent the existence of market or monopoly power;
- We need to take into account “the special characteristics of intellectual property,” such as the ease of misappropriation and dynamic efficiencies such as innovation incentives;
- Most licensing restraints are analyzed under the rule of reason; and
- When analyzing competitive effects, they must be analyzed in comparison to what would have happened in the absence of a license.

Jonathan Gleklen added that practitioners should be aware that, under U.S. law, there are a lot of “bad old cases” out there, which can make counseling challenging depending on the jurisdiction. Such cases include antitrust, patent misuse, and cases that hold that while the restraint does not amount to either an antitrust violation or patent misuse, the restraint is nonetheless unenforceable.

In China there are multiple sources of law governing licensing, including: the Anti-Monopoly Law (the “AML”), which, among other things, prohibits certain behavior classified as abuse of dominant market position; the Anti-Unfair Competition Law, which requires principles of voluntariness, equality, fairness, and good faith and prohibits certain conduct such as tying; the Price Law, which prohibits “unfair pricing behaviors”; Patent Law, which provides for compulsory licenses; Contract Law, which prohibits, among other things, technology contracts that “monopolize technology or impede technological progress”; and the Regulation on Administration of Import and Export Technologies, which includes competition-related provisions that target technology licensing.

According to Zhang, China is “several years behind other jurisdictions, and many governing regulations reflect the thinking from the past.” For example, contract law prohibits tying that is not necessary for utilizing or applying technology even without market power. Similarly, grantback clauses that do not provide for compensation to the licensee may be unenforceable under contract law. Also, noted Zhang, the legal framework in China is very different than in the United States. For example, noncompetition elements such as industrial policy may be factored into the analysis, regulators enjoy very broad discretion, and there is a lack of case law and transparency in the decision-making process.

In the spring of 2013, the State Administration for Industry and Commerce (the “SAIC”) issued draft provisions of the Administrative Authorities for Industry and Commerce on Prohibition of Abuse of Intellectual Property to Exclude or Restrict Competition. In general, the SAIC Draft IP Rules reflect most of the basic principles in the DOJ-FTC IP guidelines, but there are some important differences such as the adoption of the essential facilities doctrine and liability for dominant firms that charge “unfairly high prices.”

Hwang Lee stated that enforcement of intellectual property licensing in Korea is “very favorable” because innovation is considered critical to economic growth. However, enforcers also recognize the need to prohibit abuses of intellectual property rights, and both enforcement and civil litigation in this area has increased annually, particularly since 2009.

The Korean Fair Trade Commission (“KFTC”) has adopted three guidelines on intellectual property, the most important of which is the Review Guidelines on Unfair Exercise of Intellectual Property Rights, amended in 2010, which contain specific provisions on numerous types of licensing restraints.

The other two guidelines, both of which were adopted in 2012, are the Guidelines for Fair Patent License Agreements and the Model Operating Guidelines for Standard Setting Organizations for Voluntary Compliance with the Monopoly Regulation and Fair Trade Act. In Korea, there are no per se unlawful categories. Instead, in most cases legality turns on whether the restraint is reasonably related to a legitimate business justification.

## Refusals to License

With respect to refusals to license, Marshall advised that, in the U.S, “we start at a baseline that generally U.S. companies are free to decide with whom they will deal. ... The issue is how much deference to give the intellectual property right so as not to deter incentives to innovate.” Courts have taken a number of approaches ranging from granting near-absolute immunity to applying various presumptions. For example, in CSU v. Xerox Corp., the Federal Circuit granted near-absolute immunity for refusals to deal, holding that “[i]n the absence of any indication of illegal tying, fraud in the Patent and Trademark Office, or sham litigation, the patent holder may enforce the statutory right to exclude others from making, using, or selling the claimed invention free from liability under the antitrust laws.” [2]

In Data General Corp. v. Grumman Systems Support Corp., the First Circuit created a presumption that “an author’s desire to exclude others from use of its copyright work is a presumptively valid business justification for any immediate harm to consumers.”[3] In Image Technical Services v. Eastman Kodak Co., the Ninth Circuit purported to adopt a modified version of Data General’s rebuttable presumption test, holding that the presumption may be rebutted by evidence of pretext.[4] Gleklen further noted that the DOJ-FTC Innovation and Competition Report states that unilateral, unconditional refusals to license will not constitute a meaningful part of enforcement activity.

With respect to China, Article 8 of the SAIC draft IP rules provides that, without legitimate grounds, a dominant firm shall not, under the following circumstances, refuse to license on reasonable terms: (1) unequally, discriminatorily refuse to license; or (2) the IPR is an essential facility that the licensee cannot in fact or with reasonable effort work around, the refusal to license causes the inability of the potential licensee to compete effectively in the relevant market, the refusal to license has a negative impact on competition and innovation in the relevant market, and consumers' reasonable demand cannot be satisfied.

Lee stated that, in Korea, in 2007 the Korean Supreme Court held that even a monopolist does not have a duty to deal so long as it has a legitimate business justification.

## Exclusive Arrangements

With respect to exclusive arrangements, Marshall stated that the critical question is what is the purpose of the exclusive license? According to Marshall, there are several possible procompetitive business justifications, such as incentivizing the licensee to invest in the licensor's technology, or incentivizing the licensor to promote its technology in the market(s) that it reserves for itself. Gleklen added that if it is truly a pure exclusive, then it is really an acquisition and subject to Section 7 of the Clayton Act.

In China, neither the AML nor the SAIC draft IP rules specifically address sole licensing.

Lee said that, in Korea, the critical question is whether the scope of the restraint is reasonably related to a legitimate business justification.

### *Territorial and Field of Use Restrictions*

With respect to territorial and field of use restrictions, Gleklen stated that, with the caveat that there are some "bad old cases out there," such restraints are likely permissible under U.S. law. Under the DOJ-FTC IP Guidelines, the issue is whether the restraint eliminates competition that would have existed but-for the license.

In China, neither the AML nor the SAIC draft IP rules specifically address such restrictions. However, Article 343 of the Contract Law provides that "[t]he scope of the exploitation of a patent or the use of the know-how by the transferor and the transferee may be agreed upon in a technology transfer contract provided that no restriction may be imposed on technological competition and technological development."[5] Zhang noted that the Supreme People's Court Interpretation on Technology Contracts suggests a reasonableness analysis, under which territorial and field of use restrictions are likely to be permissible unless they are unreasonable.

Lee stated that, in Korea, the legality of such provisions depend on whether the scope of the restraint is reasonably related to a legitimate business justification.

### *Tying and Bundling*

Regarding tying and bundling, Gleklen stated that the modern view in the U.S is that, absent market power (which can be difficult to define in technology markets), tying is permissible. However, for firms with market power, U.S. Supreme Court precedent instructs that tying is still per se illegal. Nevertheless, courts such as the D.C. Circuit in the Microsoft case have analyzed technological ties under the rule of reason.[6] Marshall added that, from an enforcement perspective, U.S. agencies apply the rule of reason to both tying and bundling.

In China, according to Zhang, there has been one enforcement case involving tying under the AML, however, no detailed decision has been published and thus it remains unclear whether anticompetitive effects are required for a tying claim. Article 17(5) of the AML prohibits dominant firms from tying or imposing unreasonable trading conditions without any justifiable cause. In addition, tying arrangements may be unenforceable under the Contract Law or the Anti-Unfair Competition Law without regard to market power.

For example, Article 10(4) of the Supreme People's Court Interpretation on Technology Contracts prohibits imposing additional conditions that are unnecessary for utilizing or applying the technology, including purchasing unnecessary technology, raw materials, products, equipment or services, may be unenforceable. Article 29 of Regulation on Administration of Import and Export Technologies further provides that technology import contracts may not include provisions requiring the licensee to accept conditions that are not indispensible for the import of the technologies.

In Korea, tying is analyzed under the rule of reason. Lee stated that the critical question is whether the tie-in is reasonably related to a legitimate business justification.

## Restrictions on Making Competing Products

With respect to restrictions on licensees to make competing products, Gleklen stated that, under U.S. law, the issue is whether such restrictions amount to a sham market allocation agreement.

According to Zhang, in China, prohibiting licensees from using their own technology would likely be unlawful, and prohibiting licensees from obtaining competing technology may be unenforceable under the Contract Law. Neither the AML nor the draft SAIC IP rules specifically address such restrictions. However, Article 13(3) of the AML prohibits dividing markets, and Article 13(4) prohibits restricting the purchase of new technology or new facilities or the development of new technology or new products.

Additionally, Article 329 of the Contract Law provides that a technology contract that monopolizes the technology, impedes technological progress, or infringes upon the technological achievement of others shall be null and void. Article 10(2) of the Supreme People's Court Interpretation on Technology Contracts further provides that restrictions that prevent either party to a contract from obtaining another source technology similar to, or that competes with, that of the providing party shall be null and void.

Lee stated that, in Korea, the KFTC IP guidelines instruct that such restrictions are beyond the legitimate exercise of intellectual property rights. However, the restriction may be lawful depending on whether there is a legitimate business justification, although it is more problematic if the licensor prohibits the licensee from using its own technology.

## Royalties

The panelists next discussed the following four scenarios involving royalties: (1) the licensor proposes a royalty that some licensees view as exorbitant; (2) the licensor charges royalties that vary significantly; (3) the licensor bases its royalties on a percentage of the licensee's resale price; and (4) the licensor extends royalties to nonpatented products.

According to Gleklen, in the United States, such royalties are unlikely to pose antitrust issues, however, this is another area where there are a lot of bad old cases suggesting that such royalty provisions could constitute misuse or be held unenforceable. Marshall added that, under the DOJ-FTC IP guidelines, such royalty provisions would be analyzed under the rule of reason.

In China, Article 17 of the AML prohibits dominant firms from selling at "unfairly high" prices and from charging discriminatory prices. Zhang explained that, while "unfairly high" prices has yet to be defined, courts have held that royalties for standard-essential patents should be significantly lower than normal license fees. With respect to provisions extending royalties to nonpatented technology, Zhang stated that such provisions are likely to be held invalid, however, the parties may license the non-patented technology as know-how.

In Korea, Article III.1.A of the KFTC IP guidelines provide that demanding a "high royalty can be regarded as a fair exercise of patent rights, considering that it is necessary to properly reward patentees for their technical achievement and to encourage technical innovation." However, the following acts may be deemed to be outside the bounds of a fair exercise of patents rights: (1) "imposing a markedly unreasonable level of royalty in light of normal trade practices," (2) “unfairly imposing discriminatory royalty rates,” (3) “unfairly demanding royalty, including royalty for the portion of the licensed technology not used,” and (4) “unfairly imposing royalty by including the period after the expiry of the patent rights.”

## Conclusion

Counseling in the area of international licensing can be challenging. In the U.S., most licensing arrangements are analyzed under the rule of reason, which can create uncertainty. Licensing in China in particular can present unique challenges as there are multiple sources of law and a lack of precedent. In Korea, it appears that legality in most circumstances turns on whether the licensing restraint will be deemed reasonably necessary to achieve a legitimate business justification.

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[1] All speakers spoke in their own personal capacity.

[2] 203 F.3d 1322, 1327-28 (Fed. Cir. 2000).

[3] 36 F.3d 1147, 1187 (1st Cir. 1994), overruled on other grounds by Reed Elsevier Inc. v. Muchnick, 559 U.S. 154 (2010).

[4] 125 F.3d 1195, 1219 (9th Cir. 1997).

[5] Contract Law of the People’s Republic of China, Art. 343, available at http://en.chinacourt.org/public/detail.php?id=97.

[6] See e.g., United States v. Microsoft Corp., 253 F.3d 34, 94 (D.C. Cir. 2001).