ABA Spring Meeting 2015
Antitrust and IP in China: Quo Vadis?
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The following is a detailed outline that provides an overview of China's Anti-Monopoly Law (AML), summarizes recent AML investigations and draft rules involving intellectual property rights (IPRs), and concludes with a section on key takeaways.

I. Introduction: China's AML

China's AML came into effect on August 1, 2008. Its three substantive chapters cover:

- monopoly agreements,
- abuse of dominant market position, and
- concentrations (mergers).[1]

These chapters are roughly analogous to Sections 1 and 2 of the Sherman Act, which prohibit anticompetitive agreements and monopolization, and Section 7 of the Clayton Act, which prohibits anticompetitive mergers.

However, unlike U.S. antitrust laws, China's AML explicitly provides for the consideration of non-competition concerns, such as protecting "fair" competition and "social public interest," and "promoting the healthy development

*The views expressed here are those of the author alone and do not purport to represent the views of the FTC or any of its Commissioners.

[1] Anti-Monopoly Law of the People's Republic of China, *available at* http://www.cecc.gov/resources/legal-provisions/prc-anti-monopoly-law-chinese-and-english-text.

of the socialist market economy."[2] Article 24 of the AML states that when reviewing a transaction, the Ministry of Commerce (MOFCOM) should consider factors such as "the effect of the concentration on national economic development."

With respect to IPRs, Article 55 of the AML provides that the law does not apply to the legitimate exercise of IPRs; however, it does apply to abuse of IPRs that eliminates or restricts competition.

The AML is enforced by three agencies:

- MOFCOM, which is responsible for merger review;
- The National Development and Reform Commission (NDRC), which is responsible for price-related conduct (agreements and abuse of dominance); and
- The State Administration for Industry and Commerce (SAIC), which is responsible for non-price related conduct.

II. 2014 IP-Related Investigations and Draft Rules[3]

There were a number of IP-related investigations and Draft Rules in 2014, most notably including:

- MOFCOM Decision in *Microsoft-Nokia;*
- MOFCOM Decision in *Merck-AZ* ;
- NDRC Settlement with InterDigital;
- NDRC Decision in Qualcomm; and
- SAIC 8th Draft AML/IP Rules.

A. ***Microsoft-Nokia*** **(April 2014)**

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[2] *Id.* Art. 1.

[3] The case summaries provided in this section are based on unofficial English translations of the official publicly available decisions.

In April 2014, MOFCOM conditionally approved Microsoft's acquisition of Nokia's devices and services business, imposing numerous conditions on both Microsoft and Nokia, including commitments:

- to honor fair, reasonable, and non-discriminatory (FRAND) commitments to standard-setting organizations (SSOs),

- not to seek/enforce injunctive relief against smartphones made by smartphone manufacturers within China, and

- not to increase royalty rates on specified non-standard-essential patents (SEPs) for a period of 8 years.

Based on its published decision, MOFCOM appears to have based its decision in large part on its conclusion that, following the acquisition, both Microsoft and Nokia would have changed incentives. According to MOFCOM:

- Microsoft would become a smartphone manufacturer, achieving integration of operating systems and smartphone production, which would give it the incentive to raise royalty rates to raise its rivals' costs; and

- Nokia would exit the downstream market of devices and services, no longer needing cross-licenses for its mobile phone business, which would both decrease its incentives to maintain low royalty rates for the mobile phone industry and increase its incentives to earn higher profits from patent licensing.

In contrast, enforcers in both the United States and the European Union (EU) cleared the transaction without conditions. In the European Commission's closing statement, it concluded that:

- the transaction would not raise any competition concerns, in particular because there are only modest overlaps between the parties' activities;

- several strong rivals, such as Samsung and Apple, would continue to compete with the merged entity; and

- any competition concerns that might arise from Nokia's licensing conduct post-transaction fall outside the scope of EU merger regulation because Nokia is the seller, whereas the investigation relates to the merged entity.[4]

B. *Merck-AZ* (April 2014)

In April 2014, MOFCOM conditionally approved Merck's acquisition of AZ, prohibiting bundled sales of liquid crystal and global photoresist products and requiring that any licenses shall be implemented on FRAND-like terms.

In its published decision, MOFCOM concluded that:

- Merck owned 60% of the global liquid crystal market (over 70% in China), and AZ owned approximately 35% of the global photoresist market (over 50% in China).

- After the merger, Merck would become the largest supplier of both products while competitors could only supply a single type of product and scale was limited.

- Merck owned more than 3,500 patents, which created barriers to entry that could not be overcome by competitors and new market entrants in a short period of time.

- If Merck bundled the two products, it could lower the price of the products through cross-subsidization, thus increasing sales and profits.

This appears to be the second merger that has been assessed under MOFCOM's controversial "conglomerate effects theory," which examines whether a company can leverage its dominance in one market to gain strength in another. MOFCOM imposed remedies even though the parties had no overlaps in the relevant markets, and although AZ's worldwide photoresist share is only 30% (although its China share is 50%). With very little discussion, MOFCOM concluded that Merck's patents constitute significant barriers to entry.

In contrast with MOFCOM, enforcers in the United States, Germany, and Taiwan cleared the merger without conditions.

C. InterDigital (May 2014)

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[4] European Commission Press Release, "Mergers: Commission clears acquisition of Nokia's mobile device business by Microsoft" (Dec. 4, 2013), *available at* http://europa.eu/rapid/press-release_IP-13-1210_en.htm.

In May 2014, NDRC suspended its investigation of InterDigital based on the following commitments by InterDigital with respect to the licensing of its patent portfolio for wireless mobile standards:

- to offer Chinese manufacturers the option of taking a worldwide portfolio license of only its SEPs and comply with FRAND principles when entering into licenses with Chinese manufacturers;

- not to require Chinese manufacturers to provide a royalty-free, reciprocal cross-license of their similarly categorized standards-essential wireless patents;

- to offer Chinese manufacturers the option of entering into expedited binding arbitration under fair and reasonable procedures prior to commencing any action in which InterDigital may seek injunctive relief for the infringement of any of its wireless SEPs; and

- to refrain from seeking injunctive relief against any Chinese manufacturer that enters into an agreement with InterDigital on a binding arbitration mechanism.

Relatedly, in October 2013, the Guangdong Higher People's Court issued two decisions in *Huawei v. InterDigital*.[5] The first decision held that InterDigital violated China's AML by: (1) making excessive royalty proposals to Huawei for InterDigital's 2G, 3G, and 4G Chinese essential patents; (2) tying the licensing of essential patents to non-essential patents; (3) seeking grant-backs from Huawei; and (4) seeking an exclusion order from the U.S. International Trade Commission against Huawei while negotiations were still in progress regarding InterDigital's Chinese SEPs. The second decision concluded that InterDigital was required to offer its Chinese essential patents on FRAND terms, despite the absence of any explicit commitment to do so, and that InterDigital's offers to Huawei did not comply with FRAND.

D. Qualcomm (February 2015)

In February 2015, NDRC released its penalty decision against Qualcomm,

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[5] For a detailed discussion of these decisions, see Koren W. Wong-Ervin, "Standard-Essential Patents: The International Landscape," Public Domain (Spring 2014), *available at* http://www.ftc.gov/system/files/attachments/key-speeches-presentations/standard-essential_patents_the_intl_landscape.pdf.

concluding that the company had a dominant market position in the market for licensing SEPs involving CDMA, WCDMA, and LTE, and that it abused its dominance by:

(1) Charging excessive or unreasonably high royalties by refusing to provide the patent list and charging royalties for expired patents; requiring royalty-free grantbacks of relevant patents; bundling SEPs and non-SEPs; and charging "relatively high royalty rate[s] based on the wholesale net selling price of devices."

(2) Bundling SEPs and non-SEPs "without justification."

(3) Imposing other "unreasonable conditions" on the sale of baseband chips, including waiving the right to challenge the agreement.

Under the "rectification plan" approved by NDRC, Qualcomm agreed:

- Not to bundle Chinese SEPs and non-SEPs and to provide patent lists during negotiations;

- To charge royalties of 5% for Chinese 3G SEPs and 3.5% for Chinese 4G SEPs using a royalty base of 65% of the net selling price of the device;

- Not to condition the sale of baseband chips on signing a licensing agreement with terms that NDRC found to be unreasonable (i.e., containing a no-challenge clause); and

- To provide existing licensees with an opportunity to elect to take the new terms for sales of branded devices for use in China.[6]

In contrast with China, there is no "excessive pricing" provision under U.S. antitrust law and the U.S. antitrust agencies do not regulate price.

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[6] Qualcomm Press Release, "Qualcomm and China's National Development and Reform Commission Reach Resolution - NDRC Accepts Qualcomm's Rectification Plan - Qualcomm Raises Midpoints of Fiscal 2015 Revenue and Non-GAAP EPS Guidance," (Feb. 9, 2015), *available at* http://files.shareholder.com/downloads/QCOM/3864235320x0x808060/382E59E5-B9AA-4D59-ABFF-BDFB9AB8F1E9/Qualcomm_and_China_NDRC_Resolution_final.pdf.

E. SAIC 8th Draft AML/IP Rules

On June 11, 2014, SAIC released the 8th Draft of its AML/IP Rules for public comment, which the ABA Sections of Antitrust Law, Intellectual Property Law, and International Law (collectively referred to as "the ABA" for ease of reference) submitted comments on.[7]

Significantly, in its latest publicly available draft, SAIC appears to have taken into account a number of the ABA's recommendations on prior drafts, including eliminating presumptions that certain conduct is anticompetitive. SAIC did not, however, adopt the ABA's recommendation that SAIC delete in its entirety a provision that would apply the essential facilities doctrine to IPR. In addition to the essential facilities provision, the current publicly available draft contains a number of other troubling provisions, including:

- AML liability for failure to disclose essential patents, without requiring that the patent holder be an active voting participant in an SSO with a written disclosure policy, and without clearing requiring that the failure to disclose resulted in anticompetitive harm; and
- AML liability for failure to license patents found to be essential on FRAND terms, even in the absence of a voluntary commitment to do so.

In its most recent Comments (on the 8th Draft Rules), the ABA made a number of recommendations, including that SAIC:

(1) delete in its entirety the provision applying the essential facilities doctrine to IPRs, or, in the alternative, narrow the test and adopt a rule-of-reason type approach;

(2) revise the disclosure requirement for SEPs to include the factors set forth in the *Rambus* decision by the U.S. Court of Appeals for the D.C. Circuit;

(3) delete in its entirety the provision imposing AML liability for failure to license on FRAND terms, or in the alternative, revise the provision to limit its application to only those situations in which

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[7] *See* ABA Comments to SAIC (July 9, 2014), *available at* http://www.americanbar.org/content/dam/aba/administrative/antitrust_law/at_comments_201407saic.authcheckdam.pdf.

the patent holder has made a prior voluntary commitment to license on FRAND terms; and

(4) adopt a wait-and-see approach to conduct involving patent-assertion entities, pending additional research and study.

With respect to the essential facilities doctrine, the ABA explained that applying the doctrine to IPRs would substantially impinge upon IPR holders' core right to exclude, create disincentives for competitors to develop their own competing IPR, and create long-term disincentives to innovate in general. The ABA further stated that a facility is rarely truly essential, and it has often been the case that those advocating forced sharing have underestimated the ability of determined competitors to compete around the facility, with resulting benefits to consumers. Recognizing these concerns, the U.S. Supreme Court has made it clear that it will treat so-called "essential facilities" claims with great skepticism, stating that courts should be cautious in recognizing exceptions to the general rule that even monopolists may choose with whom they deal.

With respect to the SEP provisions, the ABA took the position that the incorporation of the factors set forth in *Rambus* is necessary to ensure that SAIC's draft rules do not impose AML liability when someone other than the patent holder offers patents for incorporation into a standard, and applies only to conduct that eliminates or restricts competition. According to the ABA, the current draft could be read to create a disclosure obligation on a patent holder that is not a participating member of an SSO, and could have the effect of imposing disclosure obligations that go beyond the requirements agreed to by members of the relevant SSO. The ABA suggested that each SSO is in the best position to determine the appropriate level of disclosure requirements for its own standard-setting activities.

Lastly, the ABA urged SAIC to recognize that FRAND commitments are an agreement that patent holders enter voluntarily, and that it is not anticompetitive for a patent holder to choose not to participate in an SSO. The ABA explained that a mandatory FRAND commitment for patent holders that choose not to participate in an SSO would eliminate the right to exclusivity and would thus be likely to decrease incentives to innovate.

III. Key Takeaways

Key Takeaways from recent AML investigations involving IP include:

(1) The AML agencies appear to presume that SEP owners and owners of commercially essential patents possess significant market power, and that patents (both SEPs and non-SEPs) constitute significant barriers to entry.

(2) MOFCOM is willing to intervene in cases when it is concerned about how companies, post-acquisition, may assert both SEPs as well as non-SEPs that it views as technologically or commercially indispensible, and to impose conditions on the seller, which is atypical in merger review.

With respect to how MOFCOM's analysis differs from that of other authorities, it is particularly significant that in both *Microsoft-Nokia* and *Merck-AZ*, MOFCOM adopted different decisions with respect to markets that have worldwide scope. (For example, in *Merck-AZ*, MOFCOM recognized that the markets for liquid crystal and photoresist were worldwide in scope, given the insignificant costs for transportation. Similarly, in *Microsoft-Nokia*, MOFCOM noted that the import restrictions, transportation costs, and technological requirements for the relevant products did not impose significant restraints on a worldwide basis.) In global markets, one would expect the facts to be similar and enforcers around the world to reach similar conclusions.

Two possible explanations for the different outcomes come to mind. First, a fundamental difference in approach to matters involving IP, and second, the consideration of non-competition factors in competition analysis.

As mentioned above, MOFCOM appears to presume that owners of SEPs and/or commercially essential patents possess significant market power and that patents constitute significant barriers to entry. In contrast, in other jurisdictions such as the United States and the EU, these are fact-specific issues that must be established through economic evidence on a case-by-case basis. In *Microsoft-Nokia*, MOFCOM focused on Microsoft's allegedly changed incentives to raise royalty rates in order to raise rivals costs, and then seemed to presume that Microsoft would have the ability to do so.

As previously discussed, the AML provides for the consideration of non-competition factors. Article 24 of the AML states that when reviewing a transaction, MOFCOM should consider factors such as "the effect of the concentration on national economic development." Unfortunately, MOFCOM's decisions do not explicitly state whether such non-competition factors have been considered, which would provide helpful guidance to stakeholders and the public.

IV. Resources

- Chairwoman Edith Ramirez, "Standard-Essential Patents and Licensing: An Antitrust Enforcement Perspective," 8th Annual Global Antitrust Enforcement Symposium, Georgetown University Law Center (Sept. 10, 2014), *available at* http://www.ftc.gov/system/files/documents/public_statements/582451/140915georgetownlaw.pdf.

- Chairwoman Edith Ramirez, "Core Competition Agency Principles: Lessons Learned at the FTC," Keynote Address at the Antitrust in Asia Conference (May 22, 2014), *available at* http://www.ftc.gov/system/files/documents/public_statements/314151/140522abachinakeynote.pdf.

- Testimony of Commissioner Maureen K. Ohlhausen – Hearing on "The Foreign Investment Climate in China: U.S. Administration Perspectives on the Foreign Investment Climate in China" – before the U.S.-China Economic and Security Review Commission (January 28, 2015), *available at* http://www.ftc.gov/system/files/documents/public_statements/621411/150128chinatestimony.pdf.

- Commissioner Maureen K. Ohlhausen, "Antitrust Enforcement In China–What Next?," Second Annual GCR Live Conference (Sept. 16, 2014), *available at* http://www.ftc.gov/system/files/documents/public_statements/582501/140915gcrlive.pdf.

- Koren W. Wong-Ervin, "Standard-Essential Patents: The International Landscape," Public Domain (Spring 2014), *available at* http://www.ftc.gov/system/files/attachments/key-speeches-presentations/standard-essential_patents_the_intl_landscape.pdf.

- Koren W. Wong-Ervin, "Procedural Fairness and the Importance of Focusing Solely on Competition Factors in Competition Analysis," International Antitrust Bulletin (Aug. 2014), *available at* http://www.ftc.gov/system/files/attachments/key-speeches-presentations/wong-ervin_-_procedural_fairness_-_aug_2014.pdf.