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## China's SAIC Issues Competition Rules Regulating Abuse of Intellectual Property Rights

By Sherry Yin and Lei Ouyang

On April 7, 2015, China's State Administration of Industry and Commerce of the PRC (the "SAIC") issued the long-anticipated *Provisions on the Prohibition of the Abuse of Intellectual Property Rights to Eliminate or Restrain Competition* (关于禁止滥用知识产权排除、限制竞争行为的规定; the "IP Guideline"), which will come into effect on August 1, 2015. The IP Guideline marks the end of a six-year long legislative process for the SAIC that began in 2009 and for the first time, specifically addresses issues with respect to intellectual property rights (the "IPR") in China's competition law area.

Among other things, the IP Guideline restricts horizontal and vertical monopolistic agreements relating to IPR, requires IPR owners with market dominance to license their patents under the "essential facility" doctrine, regulates conduct during standard setting processes, and prohibits patent pool members from undertaking certain activities.

### SCOPE OF APPLICATION

The IP Guideline addresses two categories of IPR-related anticompetitive conduct: monopolistic agreements and abuse of market dominance. The IP Guideline expressly indicates that it will not apply to any price-related monopolistic conduct, which is under the jurisdiction of China's National Development and Reform Commission of the PRC (the "NDRC"). Accordingly, issues related to charging excessive licensing fees by licensors will still be handled by the NDRC.

### PROHIBITION AGAINST MONOPOLISTIC AGREEMENTS

The IP Guideline prohibits operators from entering into horizontal and vertical monopolistic agreements when exercising their IPR. Such prohibition is twinned with a safe-harbor provision. Such safe-harbor provision:

- permits a horizontal agreement, if either the aggregate market share of the operators concerned is no more than 20 percent or at least four substitutable technologies with reasonable costs in the same relevant market are available, and
- permits a vertical agreement, if either the respective market share of each operator concerned is no more than 30 percent or at least two substitutable technologies with reasonable costs in the respective upstream or downstream relevant market are available,

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in each case, so long as evidence does not show that the agreement has the effect of eliminating or restricting competition.

Interestingly, the IP Guideline is silent on whether agreements falling outside of the safe harbor provisions are “*per se*” illegal under China’s Anti-Monopoly Law (the “**AML**”) or whether they might be defensible following a “rule of reason” analysis. Therefore, how the SAIC will exercise its enforcement authority in respect of IPR-related monopolistic agreements in practice remains to be seen.

## PROHIBITION AGAINST THE ABUSE OF DOMINANCE

### Overview

The IP Guideline includes more detailed guidance in regard to the abuse of dominance by operators when exercising IPR, addressing practices such as forcible bundling, restrictive trading, refusal to license IPRs that constitute an essential facility, imposition of unreasonable restrictive conditions, and differentiated treatment towards counterparties with the same conditions.

It is worth noting that several prohibitions specified in the IP Guideline seem to mirror practices of Qualcomm that were recently penalized by the NDRC, such as requiring an exclusive cross-license of improvements, prohibiting licensees from questioning patents’ validity, and restricting licensees’ right to utilize expired IPRs. This may indicate more integrated interagency coordination among the three Chinese competition authorities than has been seen before.

### Essential Facility Doctrine

Despite some objections, the SAIC introduced a tough compulsory licensing requirement on essential facilities that requires patent owners with market dominance to mandatorily license their IPR when the underlying IP constitutes an “essential facility,” also known as *de facto* SEP (as defined below). Factors that suggest that IP does constitute an “essential facility” include:

- (i) if the underlying IPR has no reasonable replacement and is essential for other operators to compete in the relevant market;
- (ii) if refusal to license could have an adverse impact on competition and innovation and could impair consumers’ welfare and the public interest; and
- (iii) if licensing such IPR would not cause an unreasonable damage to the licensor.

Although the SAIC stated that the application of “essential facility” doctrine will require strict conditions in order to strike a balance between encouraging innovation and protecting competition, the broad language will raise tremendous uncertainties in practice. For example, criteria for determining whether the compulsory licensing would cause “an unreasonable damage to the licensor” remain unclear. This will likely pose a threat to multinational corporations in patent-heavy sectors, such as the IT and pharmaceutical sectors. Coupled with the SAIC’s ongoing investigation against Microsoft, the NDRC’s recent penalty against Qualcomm and its suspended investigation against InterDigital, issuance of the IP Guideline is a clear sign of heightened scrutiny of antitrust enforcement in China’s IP field.

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## Standard Setting

The IP Guideline addresses anticompetitive issues during the standard setting process and prohibits a dominant operator from the following: (a) deliberately not disclosing its patent information to standard setting organizations during the standard setting process, or explicitly waiving its right during the standard setting process, but claiming its patent rights afterwards;

(b) after its patent becomes a standard essential patent (the “SEP”), carrying out refusal to license, tying, and imposing other unreasonable trading conditions in violation of the fair, reasonable and non-discriminatory principle, also known as the FRAND principle.

## PROHIBITION ASSOCIATED WITH PATENT POOLS

The IP Guideline defines a “patent pool” as an agreement arrangement under which two or more patentees jointly license the patents they own to a third party in a certain manner, such as through establishing a special joint venture for this purpose and through entrusting a member of a patent pool or an independent third party to administrate. It regulates the activities of patent pools’ members by prohibiting them from exchanging sensitive information and reaching monopolistic agreements. The IP Guideline also prohibits members of patent pools in a dominant market position from abusing their dominance. The IP Guideline provides a list of abusive behaviors, including, but not limited to, restricting patent pools’ members from licensing their patents to parties outside of the patent pools, imposing an exclusive cross-license of improvements, restricting patent pools’ members or licensees from developing competing technologies, and forbidding licensees from challenging patents’ validity. Further, it grants the SAIC the authority to exercise its discretion to determine any other types of abuse by patent pools.

Although patent pools have not been popular in China, they have been widely adopted in western countries for years. With the reality that China is a large technology import country, the IP Guideline will likely target foreign owners of patent pools at least in the near future.

## PENALTIES

Consistent with the AML and rules issued by the NDRC, the IP Guideline appears to grant the SAIC a large degree of discretion to determine penalties, which include monetary fines within a range from 1 percent to 10 percent of violators’ annual sales in the previous year, orders to stop the illegal act, and confiscation of the illegal income. Again, it does not specify whether the sales refer to those in China or globally.

## UNRESOLVED ISSUES

Certain important issues in the IP Guideline remain unclear. For example, the “essential facility” doctrine requires further clarification on its scope of application to avoid being misused. In addition, it remains to be seen how the SAIC will tackle the use of injunctions by dominant operators. For its part, the NDRC has so far focused its enforcement efforts on companies that seek to impose injunctions against willing licensees of SEPs.

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