A Rational Thinking on the Refusal to License Intellectual Property under China’s Antitrust Legal Framework

Dr. Zhan Hao & Ms. Song Ying

1. Introduction

This article will address the perplexing issue of refusal to license a patent or copyright to other undertakings conducted by intellectual property proprietors under China’s antitrust legal framework. The issue of refusal to license is at the interface of Intellectual Property Rights (IPRs) and antitrust law. It argues from theoretical perspective that refusal to license is a right inherent in patent rights or copyright, and that compulsory license based on antitrust law should only be ordered in exceptional circumstances. It further illustrates the legislations applicable in China and how they should be applied to disputes regarding refusal to license. We will further examine a high-profile antitrust case related to license of Standard Essential Patents (SEPs), namely, the Huawei v. IDC case, which is seen as the model case dealing with IP antitrust matters. In the final analysis the author shares caveats for assessing issues regarding refusal to license under China’s antitrust legal framework.

2. Coordination between IPRs and Antitrust Law

The purpose of antitrust law is to encourage competition so as to maximize consumer welfare by promoting lower prices, better quality, and more choices. The target is achieved by imposing limits on behavior of firms with market power. The goal of IPRs is to incentivize innovation by bestowing on inventors an exclusive right to use its IPRs such as patent or copyright in a limited period. Ultimately the goal of IPRs is to advance consumer welfare by propelling dynamic competition. It should therefore be recognized that IPRs and antitrust law have no fundamental conflicts in light of their converging goals.

The means by which IPRs and antitrust law depend to realize their common targets are different and in some instances, on the outset, contradictory. It is therefore not surprising that conflicts between IPRs and antitrust law could frequently happen especially in disputes regarding refusal to license issues. One should however bear in mind that IPRs and antitrust law are not fundamentally conflicted; the simple approach of contending supremacy of either competition or IPR protection seems too emotional or imprudent.

In the case of a patent for example, a patent holder’s refusal to license is exactly the proper exercise of patent rights which reflects not only the immanent demand of patent right’s exclusivity, but also the fundamental doctrine of “freedom of contract”. Patent laws in most jurisdictions already institute limits on the exercise of patent
rights; for instance, the Patent Law of P.R.C mainly provided 6 limits on the exercise of patent rights: (1) time-limit for patent rights; (2) system of patent invalidity; (3) system of patent exhaustion; (4) exceptions to infringement of patents; (5) popularization and application of invent of state-owned entities; (6) and system of compulsory licensing. Therefore, patent holders have no obligation to license its patents to others as a general principle. The ban on refusal to license which is the reasonable exercise of the rights conferred by patent law, on antitrust grounds, could be tolerated only in very exceptional cases.

By assessing whether or not a specific scenario should be defined as an “exceptional circumstances”, theoretically speaking, a comparative approach of outweighing the pro-competitive effects and the anti-competitive effects of refusal to license is plausible. The approaches of analysis under the antitrust framework however, vary in different jurisdictions.

3. Refusal to License under China’s Antitrust Legal Framework

In dealing with issues regarding application of antitrust law in IPRs, the Anti-Monopoly Law of P.R.C. (AML) has only one general provision which addresses this issue. Article 55 of the AML stipulated that “This Law shall not apply to the exercise of intellectual property by undertakings pursuant to the relevant laws and administrative regulations on intellectual property; however, this Law shall apply to the abuse of intellectual property by undertakings to eliminate or restrict competition.”

Article 55 of the AML basically establishes the principle for application of the AML in IP related behaviors; specifically the exercise of IPRs in accordance with relevant laws and regulations should not be determined as a violation of the AML. It is however possible that exercise of IPRs violated the AML if two conditions are satisfied. First, the relevant behavior is an abuse of IPRs; and second, the relevant behavior will lead to the effect of eliminating or restricting competition. In other words, simple abuse of IPRs will not be regulated by the AML, but by IP laws. AML only regulates abuse of IPRs which has the effect of excluding or restricting competition.

It is important to be cognizant however that an abuse of IPRs which leads to the effect of eliminating or restricting competition does not necessarily violate the AML, but only means a possibility. Whether an abuse constitutes a violation of the AML should be assessed on a case-by-case basis. Besides, the AML have not designed a special and specific legal framework for IP related behaviors. The assessment should be conducted under the same framework that regulates abuse of dominant positions as stated in Article 17 of the AML.

In contrast Article 55 of the AML is only a general provision and does not clearly
interpret how provisions on abuse of dominance should be properly applied to IP-related behaviors. The State Administration on Industry and Commerce (SAIC) enacted a supplemental antitrust regulation for the abuse of IPRs, namely, the Regulation on the Prohibition of Conduct Eliminating or Restricting Competition by Abusing Intellectual Property Rights (the Regulation), which entered into force on August 1, 2015. The Regulation clarifies how Article 17 of the AML should be applied to issues regarding refusal to license.

Article 7 of the Regulation provides that “Where its IPRs constitute an essential facility for production and business operation, an undertaking in a dominant position shall not refuse to confer license to other undertakings to use such IPRs under reasonable conditions, without legitimate reasons. When determining whether an intellectual IPR constitute an essential facility, factors that need to be considered include: (1) such IPR has no reasonable substitutes in the relevant market and is necessary for other undertakings to compete in the relevant market; (2) refusal to license will have a negative impact on competition or innovation in the relevant market, harm consumer welfare or social welfare; (3) licensing such IPR will not cause unreasonable harm to the IPR proprietor.”

Consequently, according to Article 7 of the Regulation, only where the following five conditions are all satisfied, refusal to license of patent holder could be determined as violation of the AML, which could be understood as an “exceptional circumstances” under China’s antitrust legal framework: (1) the patent holder possessing a dominant position in the relevant market; (2) the concerning IPR constitutes essential facility (strict criteria are also provided in the Regulation); (3) there is an existence of behavior of refusal to license; (4) there are no legitimate reasons for the refusal; (5) the effect of eliminating or restricting of competition.

Although it seems the legal framework for assessing refusal to license in China is relatively simple, additional intricate issues make antitrust assessment of the refusal behavior more complex in practice. For example, some issues may often arise such as: how to define the relevant market in refusal to license disputes; how to calculate the market share of patent holder; and what grounds could be count as legitimate reasons for such refusal; and finally, how to apply the essential facility doctrine.

4. High-profile Settled Case in China

The AML in China was established in 2008 as such it has a very short history in comparison to the Sherman Act in U.S. and its counterpart in EU. Currently there are no completed cases pertaining to the refusal to license in China, except that there is one case regarding refusal to license case which is still pending before Ningbo Intermediate Court. Nevertheless, there is a high-profile case related to license of Standard Essential Patents (SEPs), which is the Huawei v. IDC case in Guangdong High Court. This case is studied and frequently referred to by many who face or may
potentially face an antitrust assessment of IP related behavior. Given the model effect of the said case on IP antitrust cases as such; details of the case are discussed in this section.

**Huawei v. IDC case**

Huawei is one of the largest telecommunications equipment makers in China and across the world. IDC is a non-practicing entity (NPE) holding certain numbers of 2G, 3G, and 4G SEPs. In September 2009, IDC joined in the European Telecommunications Standards Institute (“ETSI”) and committed to license its SEPs on FRAND terms.

In December 2011, Huawei filed a complaint against IDC and its subsidiaries before the Shenzhen Intermediate People’s Court (“Shenzhen Court”), accusing IDC of abusing its market dominant position, requesting discriminatory royalty rates, and tying the licensing of SEPs with non-SEPs.

The Shenzhen Court supported Huawei’s allegations by finding that IDC had abused its dominant market position by tying SEPs with non-SEPs and initiating investigations in U.S. with the aim of hindering Huawei from using the SEPs. Moreover, the Shenzhen Court held that IDC failed to comply with its FRAND commitments in connection with its SEPs.

Following the decision of the Shenzhen Court, IDC filed an appeal to the Guangdong High People’s Court (“Guangdong High Court”). In October 2013, the Guangdong High Court upheld the previous decision made by the Shenzhen Court. However, the Guangdong Court found that the bundling of SEPs and non-SEPs could be justified on efficiency grounds, and therefore IDC’s tying practice did not violate the AML.

Admittedly, the *Huawei v. IDC case*, which is the first time that the AML is applied to the behavior of exercise of IPRs, and the court’s approach of defining relevant market and dominant position is advanced and novel in China. Some viewpoints shared by the court are controversial though, from the author’s view; for instance, the Guangdong Court confirmed Huawei’s definition of relevant market as every licensing market of each SEP which constitutes an independent relevant product market; and each country of the relevant product market constitutes an independent relevant geographical market. The Guangdong Court made such conclusion based on the theory that every single SEP is unique and non-substitutable, and should not be replaced by other technologies.

This decision by the Court is highly controversial, because the Guangdong High Court reached this conclusion without examining whether competition standards exist. The author contends that licensing of specific SEP should not be defined as independent relevant product market where competing standards exist, given that concerning SEP is substitutable with SEPs of competing standards.
5. Caveats for Assessing Refusal to License

As mentioned, the *Huawei v. IDC case* has a strong precedential effect, as people will be inclined to apply the views of the court on specific issues or to arrive at inferences pertaining to non-SEP cases. In this connection, to avoid the improper application of the judgment of the *Huawei case* when dealing with the antitrust assessment of refusal to license, several caveats are illustrated below.

First, the approach of defining relevant market in the *Huawei case* is quite controversial and specific to SEP cases, and should not be directly employed in non-SEP cases.

Second, generally SEP holders have the obligation to license, while non-SEP holders do not. Therefore, refusal to license a SEP may constitute abuse of dominance under Article 17 of the AML, while refusal to license a non-SEP itself, even by a patent holder with dominant position, should not be presumptively considered as an abuse.

Third, non-SEPs usually do not constitute essential facility while SEPs frequently do satisfy criteria of essential facility, because SEPs are frequently being indispensable for others to compete in the relevant market.

Fourth, refusal to license non-SEP usually will not be detrimental to the consumer’s welfare because its licensing usually promotes only competition by imitation which is excluded by IPR and will not substantially enhance consumer welfare or innovative competition.

6. Conclusion

This article introduces the conflict and coordination between IPRs and antitrust law, and specifically addresses how to rationally assess the refusal to license under China’s antitrust legal framework. Given the demonstrating effect, the *Huawei v. IDC case* is introduced in detail, and some caveats are shared to safeguard against the improper influence of the *Huawei case*. Admittedly, there are many remaining issues to be discussed as a follow up to this article. This article however was geared towards enlightening others for future in depth research.