Chinese Antitrust Agency Renders Milestone Decision on Standard Essential Patent Case

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Background

Just a week before the Chinese New Year, the National Development and Reform Commission of China (NDRC) announced the long-awaited penalty decision against Qualcomm² with respect to its abuse of standard essential patents (SEPs) in the wireless telecommunication industry. The NDRC imposed a penalty of RMB 6.088 billion (about USD 1 billion) on Qualcomm, equivalent to 8% of Qualcomm's China sales in 2013, for its abuse of dominance in China, in addition to an order to cease illegal conduct. This milestone decision demonstrates NDRC’s determination to take a stringent stance against any monopoly activities in China and its ambition to become one of the most powerful antitrust enforcement agencies in the world. The NDRC initiated an antitrust investigation of Qualcomm as early as November 2013 based on a complaint filed with the NDRC. On 10 February 2015, the NDRC made its final decision after a one-and-a-half-year investigation, numerous consultations with external experts and multiple meetings and discussions with senior officers of Qualcomm. The fine imposed on Qualcomm sets the record as the highest antitrust penalty ever issued in China’s anti-monopoly enforcement history which accounts for more than three times the total amount of fines rendered by the NDRC in 2014 which is nearly RMB 1.8 billion.

Key Findings

According to the NDRC’s decision, Qualcomm possesses a dominant market position in the markets of SEPs for CDMA, WCDMA, LTE wireless communication and baseband chips and abused its dominant market positions in the following manner:

(1) Charging unfairly excessive patent royalties, by using the whole-sale net selling price of the device as its royalty base, charging royalties for expired patents and requesting grant-back of licensees’ patents for free;
(2) Tying non-SEPs for wireless communication with the SEPs without justifiable reasons; and
(3) Attaching unreasonable terms in baseband chip sales. Qualcomm conditioned its sale of baseband chip on the chip customer signing a license agreement and a non-challenge agreement and coerced Chinese licensees to accept these unfair and unreasonable licensing terms.

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² The first announcement on the Qualcomm case by the NDRC is available at: http://jjs.ndrc.gov.cn/gzdt/201502/t20150210_663872.html, and the formal administrative punishment decision is available at: http://jjs.ndrc.gov.cn/fjgld/201503/t20150302_666170.html
Penalties

According to the NDRC’s statements, after several rounds of negotiation, Qualcomm finally proposed a rectification plan package addressing the competition concerns raised during the investigation. The rectification plan is related to Qualcomm’s licensing of certain wireless SEPs, requiring:

1. Qualcomm to use a royalty base of 65% of the wholesale net selling price of the device for branded devices sold for use in China;
2. Qualcomm to provide patent lists to Chinese licensees during the negotiation process and will not charge royalties on expired patents;
3. Qualcomm not to seek a grant-back license of the patents from Chinese licensees free of charge;
4. Qualcomm not to conduct tie-in sales of non-SEPs for wireless communication in licensing wireless SEPs; and
5. Qualcomm not to condition the sale of baseband chips on the chip customer signing a license agreement containing unreasonable terms or non-challenge clauses in its license agreement.

The NDRC was satisfied with this rectification plan and rendered a penalty decision on the basis of this plan. Qualcomm accepted NDRC’s penalty decision and paid the fines within four days of the NDRC’s announcement of the decision.

Comments

As the first investigation concluded by the Chinese antitrust agencies against the abuse of SEPs, this case epitomizes the conflict and compatibility in the interaction between the intellectual property law and the anti-monopoly law, and sheds light on how patent holders shall exercise legitimate rights under the Anti-Monopoly Law of China (AML) and refrain from abuse of power.

An interesting point is that on the one hand the NDRC claims that Qualcomm charged unfairly high royalties based on the device value rather than the chipset value, but on the other hand, NDRC does not request Qualcomm to change such model, instead merely requests that Qualcomm revise the model by way of charging 65% of the wholesale net selling price of the device. This is presumably due to the fact that how to determine a fair and reasonable SEP rate is tricky and complex, a controversy issue all over the world, since it involves the balance of interests among patent holders, licensees, consumers and other market participants. The NDRC’s decision might also the result of careful balance between two significant legislative purposes, namely protecting intellectual property rights while at the same time preventing the abuse of such rights. Given that there is no standardized approach with regard to loyalty rate of the SEPs in other more mature jurisdictions, the NDRC takes a prudent approach as to the specific loyalty rates of the SEPs. The NDRC does not set the standard of “fair and reasonable” loyalty rates or directly denounce Qualcomm’s rates level, instead, the NDRC leaves Qualcomm and its Chinese licensees to further negotiate the specific rates. The significance of NDRC’s decision is not only reflected in the
record fine, more importantly, the NDRC forces Qualcomm to change its long-standing business practice such as cancelling the free grant-back clauses, forcing Qualcomm to provide patent lists and to refrain from conducting tie-in sales.

With regard to the analytical method and application of law used by the NDRC in rendering such a decision, certain issues are worth noting, especially compared with that of in *Huawei v. Inter Digital*, a high-profile antitrust case heard by the Guangdong High People’s Court (the “Court”) in 2013, in which the Court ruled that Inter Digital violated China’s AML by licensing SEPs to Huawei Technologies at unfairly high royalty rates, the same cause of action as that in NDRC’s Qualcomm investigation.

Despite the abundant analysis and specific reasoning presented by both the NDRC and the Court in different styles, the conclusions in terms of the definition of the relevant market and the determination of dominant market position are explicit and almost identical.

With respect to the definition of the relevant market in a case involving SEPs, the NDRC and the Court both ruled that each SEP constitutes a relevant market since each SEP has 100% market share in each licensing market of a particular standard.

In addition, with respect to the determination of dominant market position, both the NDRC and the Court concluded that a dominant market position can be presumed by the high market share of the undertaking, as stipulated by Article 19 of the AML. Therefore, these two significant cases serve as important precedents in which market share is one of the most decisive factors in determining undertaking’s dominant market position.

This case is a strong indication of NDRC’s growing competency in investigating complicated cases, not to mention that its innovative approach towards standard essential patents will serve as valuable precedent, not only impacting the Chinese antitrust practice, but also having wider influence to other jurisdictions.