Brief Comments on China’s First Anti-Monopoly Regulation in the IP Field

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I. Promulgation Background

On 7 April 2015, State Administration for Industry and Commerce of the People’s Republic of China (SAIC) published China’s first anti-monopoly regulation specifically aimed at the abuse of intellectual property rights (IP), namely the Provisions on the Prohibition of Abuse of Intellectual Property Rights for the Purpose of Eliminating or Restricting Competition (the Provisions) which will become effective on 1 August 2015. The drafting of the Measures can be traced back to 2009, when the SAIC established a special task force to carry out the research and drafting of the Guidelines on the Anti-monopoly Enforcement in the Intellectual Property Rights field (the Consultation Draft)(the Guidelines). Based on the draft Guidelines, the SAIC issued the draft Provisions for public consultation (the Consultation Draft) in June 2014. The Official promulgation of the Provisions marks a giant leap for the SAIC in terms of anti-monopoly legislation in the IP field.

The Provisions fill in the legislative gap in China’s anti-monopoly regulations in the IP field, with the legislative objective of balancing the lawful rights and interests among IP holders and other interested parties, and to further innovation and market competition. In recent years, with the ever intensified conflict and collision between the IP field and the anti-monopoly field, issues triggered by abuse of the IP have grown to be a major focus of anti-monopoly enforcement agencies. A recent dispute that resulted from the licensing of Standard Essential Patents (SEPs) between Huawei and IDC and also the whopping RMB six billion penalty issued by the National Development and Reform Commission of the People’s Republic of China (NDRC) against Qualcomm present typical examples of such cases. Although the Provisions, being a ministry regulation issued by the SAIC, only apply to monopolistic cases within SAIC’s jurisdiction (the Provisions grant no jurisdiction over price monopoly cases under the NDRC’s watch and merger control filings supervised by Ministry of Commerce of the People’s Republic of China (MOFCOM)), the principles embodied in the Provisions as to how to deal with cases of this nature provide valuable references to the NDRC, MOFCOM and even to the judicial system, hence the promulgation of the Provisions will undoubtedly facilitate anti-monopoly enforcement and judicial practices over the IP field. For example, near the end of March 2015, Mr. Zhang Handong, the head of the Price Supervision and Anti-Monopoly Bureau of the NDRC, mentioned

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that China needs to strengthen its anti-monopoly enforcement over the IP abuse while pushing forward the emphasis on IP protection at the same time.

II. Brief Summary of the Provisions

Notwithstanding the fact that the Provisions only have 19 articles, it covers many hot, complex and frontier issues with respect to monopolistic conduct in the IP field. Compared with the Consultation Draft published in June 2014, the Provisions basically have not changed much other than adopting some reasonable suggestions received during the consultation period, as well as adjusting or deleting some controversial articles. The Provisions enumerate conduct constituting abuse of dominant market position such as restrictive dealings, tie-in sales, imposing unreasonably restrictive conditions and imposing discriminatory treatment on counterparties with same conditions, and conduct amounting to monopoly agreements and other conduct which abuse the IP. Meanwhile, the Provisions also define and elaborate on several significant anti-monopoly principles and theories for the first time ever, such as the safe harbor principle under monopoly agreements, the essential facility doctrine and the theories regarding SEPs.

Compared with the Consultation Draft, one conspicuous highlight and change is that the words ‘eliminating or restricting competition’ are added right after certain relevant specific conduct, with an aim to emphasize the actual impact of the conduct upon market competition. This indicates that ‘eliminating or restricting competition’ constitutes an important element of the abuse of the IP.

Article 14 of the Consultation Draft refers to regulations over the abuse of the IP for the purpose of eliminating or restricting competition by the copyright collective management organizations. However, this article was completely deleted during the final revision process, in other words, the Provisions does not involve regulations over copyright collective management organizations as the Provisions mainly focus on aspects of patents and know-hows in the IP field, with no particular articles referring to the conduct of the abuse of copyrights and trademarks.

III. Understanding the Key Points

1. Monopoly agreements and safe harbor principle

Article 4 and 5 of the Provisions prohibit undertakings from reaching and concluding monopoly agreements through the exercise of the IP, furthermore, as a significant change, the safe harbor principle has been adopted in legislation for the first time ever. Certain types of agreements are, in principle, exempted under Article 15 of the Anti-Monopoly Law of the People’s Republic of China (AML), but the safe harbor principle that is so clear and specified has never been stipulated in
legislation before, nor has there been any mention of this in the implementing rules issued by Chinese anti-monopoly enforcement agencies. It should be noted that horizontal monopoly agreements which are regulated by Article 13 of the AML, have always been strictly deemed illegal per se, however, according to the Provisions, could now be exempted provided the conditions under the safe harbor principle are satisfied.

The rule of prohibiting undertakings from reaching or concluding monopoly agreements in the Provisions is basically cited from relevant provisions under the AML, but the principle of safe harbor has indeed originated from the Provisions. The principle of safe harbor means that, under certain circumstances prescribed by law, certain kinds of conduct by the undertakings would not be considered as monopolistic and therefore can be exempted from penalties. According to the Provisions, in the following situations the exercise of the IP by such undertakings shall not be deemed as reaching or concluding monopoly agreements: ‘The combined market share of the competing business undertakings in the relevant market does not exceed 20 percent; or, there exist at least four independently controlled substitutable technologies that are available at reasonable cost in the relevant market’ or ‘The respective market share of each of the business undertakings and their transaction counterparties in the relevant market does not exceed 30 percent; or, there exist at least two independently controlled substitutable technologies that are available at reasonable cost in the relevant market’.

The Provisions provide helpful guidelines for IP holders as to how to refrain from violating the AML when exercising the IP. However, this safe harbor principle may present a high degree of uncertainty in calculating specific market shares in practical applications since how to define the relevant market being affected, the reasonable cost and the range of market shares and substitutable technologies are questions that remain to be answered through the actual practice of the enforcement agencies and the judicial system, especially when it comes to certain emerging fields such as the Internet field or the digital products field, the boundaries between products and technologies have became rather indistinct as the society develops therefore defining the relevant market has became extremely difficult. In addition, with respect to certain new revolutionary technologies, it is also really hard to determine or evaluate the substitutability of such technologies before the mass production stage begins.

2. Essential facility

The concept of an essential facility never existed in the AML. Article 7 of the Provisions introduces the doctrine of essential facilities, a concept that originated from competition laws of the western countries, which is defined as an anti-competitive conduct where an undertaking with dominant market position prevents other competitors in the market from acquiring and using
certain essential facilities and further impedes other competitors from entering the market, and to some extent could be interpreted as a refusal to deal. However, including the IP, especially patents, into the scope of essential facilities by the Provisions reaches far beyond the applicable scope of essential facilities in other jurisdictions.

For example, in the United States, the doctrine of essential facilities generally applies to monopolistic conduct in fields of public infrastructure like railway, electricity and communication, rather than in the IP field.

The Provisions stipulate that, without justifiable reasons, a business undertaking having a dominant market position shall be prohibited from refusing licensing to other business undertakings to use its IP under reasonable conditions to eliminate or restrict competition, where the said IP serves as an essential facility in manufacturing or business operation. This article raised significant controversy during the consultation period and many western scholars and practitioners in the competition law area seem to think that this article may suppress the motivation to research and innovate, violating IP holders’ justifiable pursuit of the core value of the IP as exclusive rights. Eventually, the article of essential facilities was retained in the Provisions, but with a very limited scope within which the compulsory licensing clause could be applied. According to the Provisions, factors such as the reasonable substitutability of the IP, whether it is essential for other business undertakings to compete in the relevant market, whether the refusal to license will impose adverse impact on competition or innovation in the relevant market and thereby harming consumers’ or public interests and whether the licensing of the IP will cause unreasonable damage to the IP holder, etc shall be taken into account when determining what constitutes an essential facility. Carrying out comprehensive analyses with all these factors would, to a certain degree, ease the concern over unreasonable application of the doctrine of essential facilities.

3. Tie-in sales

Article 9 of the Provisions clearly defines the conduct of tie-in sales when exercising the IP which includes the following two elements:

(1) Carry out compulsory tie-in activities or bundling sales of different products, which are inconsistent with trade practice or consumption habits or ignores the product function; and

(2) The tie-in practice can enable the IP holder to extend its dominant position in the tying product market to the tied product market, eliminating or restricting competition in the tying product market or the tied product market.

The Provisions may have drawn references from the interpretation regarding tie-in sales in the final judgment of Qihoo v. Tencent, the well-known abuse of dominant market position case heard
by the Supreme People’s Court of the People’s Republic of China (SPC) at the end of last year. The SPC, in its rulings, elaborated on the elements of tie-in sales as follows: the tying product and the tied product are separate products; the undertaking possesses a dominant market position in the market for the tying product; the undertaking implemented some kind of compulsive conduct upon customers so that the customers would have no other choices but to accept the tied product. Furthermore, tie-in sales lack legitimacy, are inconsistent with trade practice or consumption habits or ignores the product function. This sufficiently reflects the positive facilitation effect of anti-monopoly judicial practice upon the legislation.

4. Conduct imposing unreasonable restrictive conditions

Article 10 of the Provisions lists common conduct which imposes unreasonable restrictive conditions in the IP field, such as requiring the counterparties to render exclusive grant-back rights for their improvements in the licensed technology, prohibiting the counterparties from challenging the validity of the IP and continuing to exercise the expired IP or IP that have been declared invalid. These are some of the illegal acts of Qualcomm as held by the NDRC in the recently-closed anti-monopoly investigation. As can be seen, the investigation method of the NDRC in analyzing the complex and influential Qualcomm case had laid a solid foundation which serves as a practical reference for the SAIC to draft and revise the Provisions.

5. Patent pooling arrangements

Article 12 of the Provisions clearly defines possible specific monopolistic conduct of patent pooling arrangements in exercising the IP. The Provisions clearly defines what constitute patent pooling arrangements and stipulates that members of patent pooling arrangements shall not use the pooling arrangements to exchange competitively sensitive information such as output and market share, and reach monopoly agreements. The Provisions further elaborate by providing a detailed list of all the prohibitive conduct for patent pooling arrangements with dominant market position.

6. Standard essential patents

Article 13 of the Provisions specifically defines SEPs and the obligations borne by the SEP holders. In particular, the principle of FRAND (Fair, reasonable, and non-discriminatory terms) in patent licensing, a principle which has been adopted in previous enforcement practices, is clarified by the Provisions.

Article 13.2(1) prohibits undertakings with dominant market positions, without justified reasons, from intentionally refusing to disclose the information of their rights to the standard setting
organization during the standard-setting process; or after explicitly waiving their rights, asserting their patent rights against the standard implementers after the patents are included in a standard. In the previous Consultation Draft, the prerequisite for undertakings to assume such obligations was ‘under the condition of knowing that their patents may be incorporated into relevant standards’, however, in the Provisions, such prerequisite has been revised to ‘during the standard-setting process’, thus the prerequisite for undertakings to assume obligations has become more objective, guiding undertakings to observe the law in a more definite way, but also, making it easier for anti-monopoly enforcement agencies to conduct investigation and collect evidence in specific cases.

Over the last couple of years, on a global scale, the most common form of abusing the IP is the abuse of SEPs. Disputes arising out of SEPs between Qualcomm and relevant cell phone manufacturers, between Apple and Samsung and between Huawei and IDC have triggered anti-monopoly lawsuits and investigations over and over again, and the official promulgation of the Provisions undoubtedly provides a legal basis and guidance for both theoretical research and judicial practices globally with regard to SEPs.

7. Cancellation of the article regarding the abuse of infringement warning letters

In comparison to the Consultation Draft, one commendable improvement of the Provisions is the deletion of Article 15 of the Consultation Draft, an article which caused wide controversy back then, namely:

A business undertaking with a dominant market position shall not abuse its right of issuing infringement warning letters to exclude or restrain competition on the relevant market under any of the following circumstances:

(1) where the protection period of its IP has expired or its IP are invalid; or
(2) where other parties have provided sufficient evidence to prove that no IP infringement is constituted.

Although it is understandable that the purpose of this clause was to prevent false infringement warning letters, the real cause of people’s concerns is how complex it is to determine what constitutes abuse of issuing infringement warning letters, and also, how to define ‘sufficient evidence’ can be really tricky in practice as well.

Precisely because of the complexity in determining whether the IP have been infringed, IP holders claim their legitimate rights against possible infringers by way of warning letters before further damages take place is a rightful and proper move, which shall not be excessively intervened by
legislations. Therefore, the deletion of this article in the Provisions reflects SAIC’s willingness and openness to take external advice.

8. Analysis steps and factors to be considered

Article 15 and 16 of the Provisions summarize the analysis steps when determining the abuse of the IP and the factors need to be considered when determining the impacts of those illegal conducts upon market competition.

With respect to the analytical steps, firstly, the nature and form of the exercise of the IP shall be determined, and then the relevant market as well as the dominant market position must be defined, and eventually one must analyze the impact of conduct upon competition. With respect to analyzing the impacts, such conventional factors as market positions of the business undertakings and counterparties, degree of concentration of the relevant market, degree of difficulties in entering the relevant market and customary industry practices and industrial development stage all need to be taken into account, and factors which represent the IP field features such as impact of exercising the IP on innovation and technology promotion and business undertakings’ capability of innovation and speed of technology changes shall also be considered.

IV. Conclusion and Outlook

The legislative purpose of the IP law and the AML are essentially the same and that is to facilitate innovation and technology advancement. However, abusing the IP would probably restrict or eliminate fair competition of the market, and further impede innovation and technological advancement which requires regulation and enforcement by the AML. Within the framework of the AML, based on SAIC’s particular anti-monopoly function, the Provisions laid down the basic analytical methods and standards as to how to deal with the abuse of the IP for the purpose of eliminating or restricting competition.

The SAIC conducted a useful exploration into this challenging area where the IP law and the AML overlap, introduced the safe harbor principle into legislation, adopted the advice and suggestions from all sources and carefully worked out solutions for certain complex issues, benefitting the regulation of innovative and competitive market conditions in a general way.

The implementation of the Provisions is believed to have immediate directive effect over cases which involve the abuse of the IP such as Microsoft and Tetra Pak, currently under the investigation by the SAIC, in the meantime, other anti-monopoly enforcement agencies and judicial authorities’ handling of similar cases can also benefit from this. With the draft amendment
to the Patent Law soliciting public opinions in April, legislations regarding the IP field have gradually been improved and perfected. From the aspect of legislation, on the basis of summarizing previous enforcement practices, we look forward to a superior comprehensive anti-monopoly regulation over the abuse of the IP.