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WHITE PAPER

October 2020

China Publishes Anti-Monopoly Guidelines on Intellectual Property

In August 2020, the Anti-Monopoly Bureau of China's State Administration for Market Regulation released four long-awaited sets of anti-monopoly guidelines addressing issues relating to leniency, commitments, the automobile industry, and intellectual property rights. The subjects of this *White Paper*, the *Anti-Monopoly Guidelines on Intellectual Property Rights* ("IPR Guidelines"), are intended to provide more clarity and guidance on issues at the intersection of antitrust and intellectual property rights.

The IPR Guidelines cover five topics: (i) general principles for analyzing antitrust issues relating to IPR; (ii) IPR-related agreements that may constitute monopoly agreements prohibited under Articles 13 and 14 of the Anti-Monopoly Law of China; (iii) abuse of dominant market position involving IPR; (iv) concentrations of undertakings (i.e., transactions potentially requiring premerger notification and antitrust review) involving IPR; and (v) other IPR-related issues, such as patent pools, standard-essential patents, and collective management of copyrights. This commentary highlights the issues in the IPR Guidelines that are most relevant to IP-intensive companies doing business in China.

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GENERAL PRINCIPLES

The *Anti-Monopoly Guidelines on Intellectual Property Rights* ("IPR Guidelines")[1] recognize as a general principle that China's State Administration for Market Regulation ("SAMR") will not presume that an owner of intellectual property rights ("IPR") has a dominant market position.[2] SAMR will assess the competitive conditions in each relevant market, the specific conduct involved (taking into consideration, *inter alia*, whether the relevant parties would be competitors or potential competitors in the absence of the conduct in question), and any procompetitive effects related to innovation or efficiencies.

ASSESSMENT OF IPR-RELATED AGREEMENTS

The IPR Guidelines set forth SAMR's criteria for assessing whether certain technology agreements, including those relating to joint R&D, cross-licensing, exclusive grant backs, no-challenge clauses, standard setting, and other restrictions on licensees, are "anticompetitive monopoly agreements" prohibited under Articles 13 and 14 of the Anti-Monopoly Law of China ("AML").

Safe Harbor for Technology Agreements

The IPR Guidelines include several safe harbors within which SAMR presumes technology agreements are not anticompetitive monopoly agreements, absent evidence showing an anticompetitive effect.

1. Agreements between competitors in which the combined share of the parties in the relevant market is no more than 20%.

2. Agreements between non-competitors in which the share of each party in any relevant market affected by the technology agreement is no more than 30%.

3. If market share information is difficult to obtain or does not accurately reflect the market positions of the parties, where, apart from the technologies controlled by the parties, there are at least four additional substitutable technologies in the relevant market that are independently controlled by third parties and obtainable at reasonable cost.

SAMR will condemn agreements that fall outside of these safe harbors as unlawful only if there is evidence of a substantial anticompetitive effect.[3] Of course, this treatment does not apply to "hardcore" cartel-like offenses identified in Articles 13(1)-(5) and 14(1)-(2) of the AML, i.e., price-fixing, market allocations, and other cartel offenses, as well as resale price maintenance, for which SAMR presumes an anticompetitive effect.

By comparison, in the EU, aside from "hardcore" cartel-like offenses, other restrictive IP licensing agreements are exempt as long as the parties meet the market share thresholds of the safe harbor.[4] Similarly, in the U.S., the agencies will not challenge practices that fall within its safe harbor "[a]bsent extraordinary circumstances."[5]

Exclusive Grant Backs

Under the IPR Guidelines, exclusive grant backs refer to license provisions in which (i) only the licensor (or its designee) or (ii) only the licensor and the licensee may exploit the licensee's improvements to licensed IPR, but that prohibit the licensee from licensing the improvement to third parties.

According to the IPR Guidelines, exclusive grant backs are more likely to give rise to anticompetitive effects because they discourage licensee innovation. Despite this concern, SAMR does not treat exclusive grant backs as illegal *per se*. Instead, the IPR Guidelines set forth criteria under which antitrust enforcers will conduct further analysis. SAMR considers whether:

- The licensor provided substantive consideration for the grant back;
- Grant backs are reciprocal;
- The grant back will strengthen the market power of the licensor; and
- The grant back will dampen the incentive of the licensee to make improvements.[6]

In contrast, Chinese Contract Law[7] and the Interpretation of the Supreme People's Court regarding Several Issues on the Application of Laws to Disputes over Technology Contracts[8] ("SPC Interpretation on Technology Contracts") both take a harder line, prohibiting non-reciprocal exclusive grant backs as well as non-challenge clauses. Although the IPR Guidelines adopt a more permissive approach, at least in one sense, to exclusive grant backs, they merely state SAMR's policy toward

administrative enforcement, and therefore there is risk that PRC courts will find such provisions unenforceable.

Although the IPR Guidelines appear to broaden the scope of potentially prohibited exclusive grant backs to include clauses that permit a licensee to exploit its own improvements, the IPR Guidelines adopt a "rule of reason" approach that is a fulsome analysis of competitive effects (including the benefits). This approach contrasts to the Contract Law and the SPC Interpretation on Technology Contracts that have held certain exclusive grant backs to be unenforceable.

Non-Challenge Clauses

The IPR Guidelines also set forth factors that SAMR uses to assess the competitive effects of non-challenge clauses. A non-challenge clause is an agreement that a licensee will not challenge the validity of the licensor's IPR. These factors include whether:

- The non-challenge requirement applies to all licensees of the relevant IPR by the licensor;
- Royalties are charged for the licensing of the IPR associated with the non-challenge clause;
- The IPR associated with the non-challenge clause may constitute an entry barrier in the downstream market;
- The IPR associated with the non-challenge clause may hinder the implementation of competing IPR;
- The licensing of the IPR associated with the non-challenge clause is exclusive; and
- The licensee may suffer material damage when challenging the validity of the licensor's IPR.

Although the IPR Guidelines take a rule of reason approach to non-challenge clauses, the IPR Guidelines are not legally binding on courts. Licensors therefore must be careful about using such clauses in Chinese licenses, because the Contract Law and SPC Interpretation on Technology Contracts prohibit such clauses.

Other IPR Restrictions

Under the IPR Guidelines, SAMR analyzes other restrictions on licensed IPR, including restrictions on the scope of implementation; the quantity, sales channel, geographic scope, or customers of products provided using the licensed IPR; and restrictions on using competing technologies or selling competing products under the rule of reason, considering the following factors:

- The specific contents of the restrictions, the degree thereof, and how they are implemented;
- The characteristics of the products provided using the licensed IPR;
- Whether, and to what extent, these restrictions are imposed as the conditions to the IPR licensing;
- Whether there are multiple restrictions; and
- Whether other undertakings with substitutable technologies impose the same or similar restrictions.

Some of the restrictions above, such as restrictions on using competing technologies, also are *per se* unenforceable under the Contract Law and the SPC Interpretation on Technology Contracts.[9] For example, in a 2007 case, the Beijing High People's Court invalidated an IPR-related agreement that prohibited the licensee from using similar technologies from other sources because it violated Article 329 of the Contract Law.[10]

ABUSE OF DOMINANCE INVOLVING IPR

As mentioned above, the IPR Guidelines clarify that ownership of IPR itself does not constitute a dominant market position. Instead, SAMR establishes a dominant market position by considering the series of factors in Articles 18 and 19 of the AML. The IPR Guidelines also set forth additional factors to consider for finding dominant market position that are specific to IPR:

- Existence of accessible alternative technologies or products, including the cost of switching;
- Reliance on the products provided using the IPR in question in the downstream market; and
- Competitive restraints on the IPR owner from its counterparts.

Unfairly High Pricing

The IPR Guidelines outline five factors to consider when determining whether licensing royalties imposed by a "dominant" licensor are "unfairly high" (thus violating AML Article 17(1)), including:

- How the royalties are calculated, and how much the IPR contribute to the value of the products;
- The commitments made by the parties as to the licensing of IPR (for example, fair, reasonable, and non-discriminatory ("FRAND") commitments made in standard-setting processes);
- The licensing history of the IPR or any standard royalties that can be used as reference;
- Whether the royalties charged go beyond the geographic scope or scope of products covered by the IPR; and
- Whether the licensor charges royalties for expired or invalid patents.

Historically, China has been more willing than most other major jurisdictions to weigh in on whether royalties are "fair," especially when standard-essential patents ("SEPs") are involved. For example, in the 2011 *Huawei v. IDC* case, the Guangdong High People's Court found that the royalties charged by IDC to Huawei to be "unfairly high" in part because they were "significantly higher" than those IDC offered to other licensees such as Apple, Samsung, and RIM.[11] Similarly, in its 2015 penalty decision against Qualcomm,[12] NDRC found that Qualcomm charged unfairly high royalties for its wireless SEPs, because, *inter alia*, (i) the base for calculation of royalties was the wholesale price of terminal wireless devices, which contained many parts not related to the licensed wireless SEPs; (ii) the licensed patents included expired patents; and (iii) Qualcomm required its licensees to provide free grant backs, and also did not consider the value of its licensees' own patents cross-licensed to Qualcomm.

In contrast, the U.S. agencies have indicated that they will rarely, if ever, intervene with respect to the question of the proper price to be charged for intellectual property. However, in some circumstances, it may be unlawful to collect royalties that extend beyond the scope of the IPR, or after the IPR have expired.

Refusals to License

During the drafting of the IPR Guidelines, some commentators expressed concerns that the guidelines would require compulsory licensing by prohibiting refusals to license, or through use of the "essential facilities" doctrine.[13] The U.S. agencies have confirmed that "antitrust liability for mere unilateral, unconditional refusals to license patents will not play a meaningful part in the interface between patent rights and antitrust protections."[14] In Europe, the European Commission may consider a refusal to license to be an abuse of a dominant position under certain exceptional circumstances.[15]

Under the IPR Guidelines, SAMR considers the following six factors in analyzing whether a refusal to license by a licensor is an unjustifiable abuse of a dominant market position:

- The commitments made by the parties as to the licensing of IPR;
- Whether license of the IPR in question is necessary for entry into the relevant market;
- The impact of the refusal to license on competition and innovation in the market, and the degree thereof;
- Whether the party refused a license lacks the willingness and capability to pay reasonable royalties;
- Whether the licensor has proposed a reasonable offer to the party seeking a license; and
- Whether the refusal to license will damage the interests of consumers or the public.

Despite the potential concerns suggested by this treatment in the IPR Guidelines, it appears that in practice the Chinese antitrust enforcement agencies and courts have been very cautious about finding IPR to constitute an "essential facility." There are no reported cases in which SAMR or the PRC courts invoked the essential facilities doctrine or other principles to impose a duty to license IPR. For example, in the *Hytera v. Motorola* case in 2020, the Beijing IP Court declined to find that Motorola engaged in an abuse of dominance by refusing to license its IPR because there were other alternative technologies available in the market.[16]

CONCENTRATIONS OF UNDERTAKINGS INVOLVING IPR

Finally, the IPR Guidelines provide that certain technology transactions may constitute "concentrations"—and thus are potentially subject to PRC pre-merger notification and antitrust review—if the licensee or grantee thereby obtains control, or the ability to exert decisive influence, over another business.

The IPR Guidelines set forth three factors to consider when determining whether an IPR transfer or license is a reportable concentration:

- Whether the relevant IPR constitutes an independent business;
- Whether the relevant IPR generated independent and calculable turnover in the last fiscal year;
- The type and duration of the licensing agreement.

The IPR Guidelines also specify potential remedies for transactions involving IPR that raise competitive concerns, including the divestiture of the relevant IPR, the imposition of FRAND licensing, or non-tying obligations.

The IPR Guidelines represent the first time that SAMR has clarified in writing that licensing agreements may be subject to merger review in China.[17] So far, we are not aware of any published precedent in which parties submitted a merger filing in China for a licensing agreement. Nevertheless, companies should carefully assess potential merger filing requirements for their licensing, IPR transfer, and other technology agreements.

SEPs

The IPR Guidelines set forth a number of additional factors that SAMR will consider when analyzing whether a SEP holder has a dominant market position. These factors add to the general factors identified in the AML and the abuse of dominance section of the IPR Guidelines:

- The market value and the scope and depth of application of the relevant standard;
- Existence of substitutable standards or technologies, and the accessibility and switching costs thereof;
- The degree of reliance on the relevant standard in the industry;
- The evolution and compatibility of the relevant standard; and
- The possibility of replacing the SEPs for the relevant standard.

According to the IPR Guidelines, SAMR is likely to find an anticompetitive effect if a SEP owner with a dominant market position seeks an injunction to force licensees to accept unfairly high royalties or other unfair conditions. The IPR Guidelines indicate that SAMR will consider the following factors when analyzing the competition effect of such injunction applications:

- How the parties behaved during the negotiation, and their true intention reflected by their behavior;
- Commitments attached to the relevant SEPs (e.g., the FRAND commitments);
- Terms of licensing proposed by the parties in the course of negotiation;
- The impact of the motion for injunction on the licensing negotiation; and
- The impact of the motion for injunction on competition in the downstream market and the interest of consumers.

In practice, the Chinese courts analyze the negotiation process and substantive licensing conditions of the parties to determine if the SEP holder has fulfilled its FRAND commitments in licensing, or was "clearly at fault" during the negotiation. For example, in the 2016 *Huawei v. Samsung* case,[18] after examining the extensive record of the licensing negotiations between Huawei and Samsung, the court held that Samsung had deliberately "delayed the negotiations" and was "clearly at fault." Based on an assessment of the royalty rates that each party proposed, the court also held that Huawei's offer

to Samsung was consistent with FRAND terms, but Samsung's offer was not. Based on above findings, the court granted Huawei's request for an injunction.

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ENDNOTES

1 By way of comparison, antitrust agencies in the United States and European Union previously have provided similar guidance. *See* U.S. Dep't. of Justice and Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property (January 12, 2017) (hereinafter "U.S. IP Licensing Guidelines"); European Commission, Technology Transfer Block Exemption Regulation (May 1, 2014) (hereinafter "TTBER"); European Commission, Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements (March 28, 2014) (hereinafter "Technology Transfer Guidelines").

2 It appears that the AML enforcement agencies have followed this principle in their practice. For example, in the 2015 *Qualcomm* case, the Chinese antitrust authority found that Qualcomm had a dominant market position in the wireless SEP licensing market based on several factors, including the nonexistence of any alternative patents, Qualcomm's ability to control the SEP licensing market, licensees' reliance on the SEPs for market entry, and the high entry barriers in the SEP licensing market. *See* NDRC Penalty Decision regarding Qualcomm's Abuse of Dominance (2015).

3 In practice, AML enforcement agencies and courts typically will not find an agreement to be unlawful solely based on a finding of an anticompetitive effect, but will look at whether the effect was substantial. For example, in the 2013 *Qihoo v. Tencent* case, the court found that Tencent's conduct was not unlawful because it had "not substantially eliminated or restricted competition in the market of security software," despite the inconveniences its conduct caused for users. According to the court, Tencent made Qihoo's security software incompatible with Tencent's software, thus preventing Tencent's users from using Qihoo's software if they wanted to keep using Tencent's software. *See* the court decision.

4 *See* EC Technology Transfer Guidelines, at para. 79.

5 The first and third elements are similar to elements of a safe harbor created under U.S. IP Licensing Guidelines, but the concept of a safe harbor is applied in a fundamentally different manner. Under the U.S. IP Licensing Guidelines, most practices *outside* the safe harbor do not violate the antitrust laws absent evidence of an anticompetitive effect, and the U.S. agencies will not challenge practices that fall within the safe harbor "[a]bsent extraordinary circumstances." U.S. IP Licensing Guidelines, § 4.3.

6 The U.S. IP Licensing Guidelines confirm that the U.S. antitrust agencies evaluate grant backs pursuant to the rule of reason, and consider similar factors in that analysis. U.S. IP Licensing Guidelines, § 5.6. In the EU, exclusive grant backs are not covered by the exemption provided in TTBER, but rather require individual assessment. TTBER 5.1.a. and Technology Transfer Guidelines § 125-126.

7 *See* Contract Law of the People's Republic of China (Adopted by the 9th National People's Congress on March 15, 1999, effective as of October 1, 1999), at art. 329, *available in Chinese.* ("A technology contract that illegally monopolizes technology or impedes technological progress, or infringes upon the technological achievement of others shall be null and void.")

8 *See* Interpretation of the Supreme People's Court regarding Several Issues on the Application of Laws to Disputes over Technology Contracts ("SPC Interpretation on Technology Contracts") (Adopted by the Supreme People's Court on November 30, 2004, effective as of January 1, 2005), at art. 10, *available in Chinese.* ("The following shall constitute 'illegal monopolization of technology and impediment of technological progress' referred to in Article 329 of the Contract Law: … requiring the exclusive or joint holding of rights to improvements without compensation; … prohibiting the receiving party of a technology from challenging the validity of the intellectual property rights in the subject technology, or imposing additional conditions on making such challenges.")

9 *See* SPC Interpretation on Technology Contracts, art. 10, ("The following shall constitute 'illegal monopolization of technology and impediment of technological progress' referred to in Article 329 of the Contract Law: … preventing a counterparty from acquiring from other sources technologies similar to, or in competition with, the technology provided by the other party.")

10 *See* Wu Qi vs. Beijing Silugaogao Technology Development Co., Ltd., (2007) Gao Min Zhong No. 592, unofficial copy of court decision.

11 *See* Huawei v. IDC, (2013) Yue Gao Fa Min San Zhong Zi No. 305.

12 *See* NDRC Penalty Decision regarding Qualcomm's Abuse of Dominance (2015), *available in Chinese.*

13 Under the essential facilities doctrine, a monopolist's refusal to deal may be unlawful because it would allow a monopolist to extend its control of an essential facility (or a "bottle neck") to other markets.

14 U.S. Antitrust & IP Report at p. 32.

15 *See*: EC cases: Magill case, IMS Health case, and Microsoft case.

16 See a press report on the case. The full text of the court decision is currently not available.

17 Certain transfers of intellectual property in the U.S. and Europe may be reportable in those jurisdictions, and whether not reportable, may be subject to antitrust review, *see* EC Consolidated Jurisdictional Notice under Council Regulation (EC) No. 139/2004 on the control of concentrations between undertakings (Consolidated Jurisdictional Notice), at para. 24. For example, in *Microsoft/Yahoo! Search Business*, EC found Microsoft's proposed acquisition of a 10-year exclusive license to Yahoo's core search technologies amount, together with the transfer of employees and customers to Microsoft, to the acquisition of the whole or a part of a business to which market turnover can be attributed. See Case No. COMP/M.5727 – Microsoft / Yahoo! Search Business.

18 *See* the full court judgment; a high-level summary of the case is also available.

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