An Update On China's Anti-Monopoly Law Guidelines On IP

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This fall, two of China's three Anti-Monopoly Law (AML) agencies, the National Development and Reform Commission and the State Administration for Industry and Commerce, issued draft guidelines on the application of the AML to matters involving intellectual property rights.[1] According to a press release issued by the SAIC, all three AML agencies are expected to submit separate (and reportedly competing) versions of the draft guidelines to China's State Council by the end of January 2016. The final guidelines will purportedly bind all three agencies, although there is some dispute over whether they would preempt the AML-IP rules that the SAIC released earlier this year. The outcome of this process is particularly important given the critical role of IP rights to innovation and the demonstrated propensity of the Chinese agencies to apply the AML to foreign rights holders.

The SAIC's AML-IP Rules and Draft Guidelines

The SAIC released its final rules in spring of this year after issuing nine drafts, many of which were open to public comment. In its final rules, the SAIC incorporated a number of recommendations on prior drafts, including eliminating presumptions that certain conduct is anti-competitive, and instead applying a rule of reason or effects-based approach to most types of licensing restraints. However, a number of troubling provisions remain, including the application of the essential facilities doctrine to IP rights and AML liability for failure to license patents found to be essential to a standard even in the absence of a voluntary commitment to license on fair, reasonable and nondiscriminatory terms.

Last week, the SAIC released a draft of its AML-IP guidelines, which are substantially similar to its AML-IP rules with the addition of several provisions, including on merger analysis and price-related conduct, both areas over which SAIC has no enforcement authority. The draft guidelines also add a provision that would subject a standard-essential patent holder to possible AML liability for seeking injunctive relief:

(1) without first providing notice to the alleged infringer, including specifying the alleged infringement;

(2) without considering the expressed intention of the accused infringer to negotiate a FRAND license, or without extending a written offer of license;

(3) when the accused infringer "expressly states its willingness" to be bound by a neutral third-party FRAND adjudication (namely a court or, if agreed upon by both parties, an arbitrator); or

(4) "other events decided by the antitrust law enforcement agency of the State Council."

The SAIC's draft guidelines further provide that an SEP holder "shall" be permitted to seek injunctive relief when it provides evidence that the accused infringer:

(1) "clearly lacks good faith to negotiate,"

(2) "fails to actively engage in the negotiation in accordance with commercial practice or in good faith,"

(3) "deliberately protracts the negotiation process,"

(4) "refuses to pay royalties," or

(5) "is unable to pay royalties and damages."

The NDRC's Draft Guidelines

In fall of this year, the NDRC released a questionnaire on the abuse of IP rights, followed by a draft of its guidelines. Similar to the SAIC's rules, the NDRC's draft guidelines apply a rule of reason or effects-based approach to most types of licensing restraints, yet contain a number of troubling omissions and provisions, including:

- Failing throughout to recognize an IP rights holder's core right to exclude or to incorporate the analytical approach taken by the U.S. antitrust agencies of measuring the potential concerns against the "but for" world; that is, what would have occurred in the absence of a license.

- Applying an exceptionally broad essential facilities doctrine to IP rights.

- Applying the AML's "unfairly high" pricing prohibition to IP rights, both SEPs and non-SEPs.

- With respect to SEPs in particular, among other things, seeming to prohibit an SEP holder from seeking injunctive relief without:
    - requiring proof that that the SEP holder has engaged in patent holdup, i.e., that the patent holder used the threat of injunctive relief to demand supracompetitive royalties;

- taking into account whether the accused infringer has engaged in reverse holdup or holdout, which refer to implementers using their leverage to obtain rates and terms below FRAND, refusing to take a FRAND license, and/or delaying doing so; or
- specifying that the prohibition applies only to FRAND-assured SEPs, i.e., when an SEP holder has voluntarily made a commitment to license its patent(s) on FRAND terms.

Several U.S. organizations and companies submitted comments to the NDRC (and are currently awaiting the opportunity to submit comments to the SAIC), including the Global Antitrust Institute (GAI) at George Mason University School of Law.[2]

With respect to excessive pricing, the NDRC's draft guidelines contain two separate provisions — one governing SEPs and the other governing non-SEPs. Section IV(i) provides that, in analyzing whether an SEP holder has charged "unfairly highly royalties," the following factors can be considered:

(1) the technological value of the SEP;

(2) the technical characteristics of related industries;

(3) the cumulative royalty paid by implementers of the relevant standard;

(4) the licensing commitment taken by the SEP holder;

(5) the licensing history of or comparable royalty for the SEP; and

(6) the reasonable profit margin of the implementers, both upstream and downstream, in the relevant product market.

As the GAI explained in its comment to the NDRC, one problem with applying an excessive pricing prohibition to IP rights is that it is particularly difficult to assess the "fairness" of prices associated with licensing IP rights both because there is no marginal cost to which the price may be compared and because IP rights are highly differentiated products making price comparisons difficult, if not impossible. In addition, in order to determine whether a particular price is excessive, the NDRC would need to calculate a reasonable royalty as a baseline against which to compare the allegedly excessive price. Competition agencies are generally ill-equipped to calculate royalty rates, a task that is best left to the market or, as a last resort, to the courts.

Should the NDRC retain this provision and calculate a reasonable royalty as a baseline, it could employ the hypothetical negotiation framework from U.S. patent damages law, the goal of which is to replicate the market reward for the invention in the absence of infringement. However, this is a complex methodology intended for use by the courts upon development of a full record, which usually includes detailed expert reports and opportunities for direct and cross-examination. In addition, it is essential to keep in mind that a reasonable royalty calculation using the hypothetical negotiation framework sets a minimum royalty; the patentee should have the opportunity to prove, in addition, its lost profits as part of its damages.

With respect to royalty stacking, as the Federal Circuit explained in Ericsson v. D-Link, the burden should be on the implementer to provide evidence establishing the actual cumulative royalty, and that royalty must be assessed to determine whether it is excessive. In addition, it is important to distinguish between an aggregate royalty burden that accurately reflects the cumulative value of the various SEPs included in a given standard from an aggregate royalty burden that includes at least some supra-FRAND rates, i.e., individual holdups. The former is simply the cost of making products that benefit from valuable IP, analogous to any other cost of doing business.

With respect to charging for expired patents, the GAI strongly urged the NDRC not to base an AML violation on the existence of expired patents in a portfolio, explaining that it would be impractical, if not impossible, for portfolio owners to constantly renegotiate licenses (or provide updated patent lists) every time an IP right in a licensed portfolio expires or, conversely, every time new IP right is added to the portfolio, both of which occur commonly. Portfolios include patents with a variety of expiration dates and the parties to the license take the variety of expiration dates into account when negotiating a price.

With respect to SEPs and injunctive relief, Section IV(iii) of the NDRC's draft guidelines provides that, in determining whether an SEP holder's application for injunctive relief excludes or restricts competition, the following factors may be considered:

(1) the real intention for negotiation revealed by the parties during the negotiation; (2) the injunctive relief related commitment taken by the SEP holder; (3) the licensing conditions and its rationality raised by the parties during the negotiation; and (4) the influence of applying the injunctive relief to the negotiating positions of two parties, the competition in relevant market and downstream market, and the consumers' benefit.

As the GAI explained in its comment, this provision is troublesome for a number of reasons.

First, there is no empirical evidence to support the concerns that injunctive relief results in harm to innovation or to consumers, and the burden of establishing any harm from an SEP holder's having sought an injunction should rightly be on those advocating this fundamental policy shift.[3]

Second, reverse holdup and holdout are equally likely to occur and therefore there are likely to be detrimental consequences to disrupting the carefully balanced FRAND ecosystem by creating an AML sanction for the seeking of injunctive relief. Indeed, if the worst penalty an SEP infringer faces is not an injunction but merely paying, after adjudication, the FRAND royalty that it should have agreed to pay when first asked, then reverse holdup and holdout give implementers a profitable way to defer payment.

Third, injunctions issue only upon a court order. This critical gatekeeper minimizes the risk of any potential harm. As such, the mere seeking of injunctive relief alone does not monopolize the market because courts independently assess whether an injunction is warranted, taking into consideration whether the public interest would be disserved by an injunction. As for the notion that the mere threat of an injunction may cause harm, the in terrorem effect of filing for an injunction depends on the likelihood of it being granted.

Lastly, should the NDRC decide to adopt an AML sanction for seeking injunctive relief, at the very least, it should limit liability to situations in which there is proof that a FRAND-assured SEP holder has engaged in patent holdup. This is necessary to avoid the presumption that an SEP holder who seeks injunctive relief will necessarily use that relief (or the threat of it) to demand supracompetitive royalties. That presumption would be unwarranted because, among other things, market mechanisms such as reputational and business costs impose a number of constraints that militate against acting upon the opportunity for holdup.

Conclusion

A central theme of the GAI's comment to the NDRC is the critical importance of adopting an approach that incorporates the economics of innovation. This approach recognizes that, while static efficiency may increase consumer welfare in the short run, dynamic efficiency, including societal gains from innovation, are an even greater driver of consumer welfare. Another essential principle is that if the government is too willing to step in and appropriate the gains from innovation and dynamic competition, then potential innovators anticipating such interventions will have weak incentives to risk investment in new inventions. Adopting an approach that incorporates these principles is likely to best serve competition and consumers, as well as China's goal of becoming an innovation society.

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[1] The third AML agency is the Ministry of Commerce (or MOFCOM), which is responsible for merger review. The NDRC is responsible for price-related conduct (agreements and abuse of dominance) and the SAIC is responsible for non-price related conduct.

[2] For the GAI's Comment to the NDRC, see http://masonlec.org/site/rte_uploads/files/GAI%20NDRC%20Comment_11-12-15_FINAL.pdf; for the GAI's response to the NDRC's Questionnaire, see http://masonlec.org/site/rte_uploads/files/GAI%20NDRC%20Comment_9-30-15_FINAL.pdf.

[3] See, e.g., Douglas H. Ginsburg et al., The Troubling Use of Antitrust to Regulate FRAND

Licensing, CPI Antitrust Chronicle Vol. 10, No. 1 at 2-8 (Oct. 15, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2674759.