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Inside The Latest Draft Of SAIC's IP Antitrust Rules

Law360, New York (August 06, 2013, 1:24 PM ET) -- Earlier this year, China's State Administration for Industry and Commerce released the sixth draft of regulations implementing the Anti-Monopoly Law with respect to intellectual property rights. The regulations describe the agency's enforcement policies, standards of proof and types of relevant evidence in the agency's analysis of conduct involving IPR. The current draft contains a number of improvements from the perspective of IPR holders and demonstrates the agency's willingness to consider feedback from legal and business organizations. Still, in a number of areas, the draft regulations would benefit from greater clarity.

Evolution of the Regulations

In 2008, pursuant to Article 9 of the AML, the State Council established the Anti-Monopoly Commission, which, among other things, is responsible for preparing guidelines relating to the AML. The Commission gave SAIC the task of preparing guidelines describing the framework for evaluating potentially abusive uses of IPR. In broad strokes, the goal was to promulgate guidance akin to the Federal Trade Commission and U.S. Department of Justice's 1995 IP Guidelines or the European Commission's Transfer of Technology Block Exemption Regulation. The first draft was circulated in 2009, and the most recent draft was shared with a number of industry participants and other government bodies this spring.

The most recent draft provides an overview of the evidence that SAIC will use in most investigations involving IPR, such as market concentration and entry barriers. It goes on to identify specific IPR practices that may constitute an abuse, including boycotts, refusals to license, tying, exclusive grantbacks, certain patent pools, misleading a standards development organization (SDO), and sending baseless IPR litigation threat letters. There is a rebuttable safe harbor for most practices based on market share thresholds or, where market shares cannot be calculated, on the number of competitors.

Consistent with prior versions, the sixth draft includes language recognizing the value of IPR to the Chinese economy and that the exercise of IPR is not antithetical to the AML. For example, Article 1 states that the draft regulations are intended to protect the legitimate exercise of IPR and to encourage innovation. Article 7 says that IPR may be a factor in determining whether a party is dominant, but dominance will not be presumed based on IPR ownership. Article 4 states that dynamic considerations, such as the effect of the IPR at issue on the promotion of innovation, should be part of any rule of reason analysis.

Unlike prior drafts, which were in the form of guidelines, the current draft is in the form of regulations. Guidelines, while nonbinding, would apply to all three Chinese competition agencies; in contrast, regulations bind SAIC but not the other agencies. Although SAIC will likely be the primary AML enforcer with regard to potential IPR abuses, some investigations will fall under the jurisdiction of China's Ministry of Commerce (e.g., acquisitions of IPR) or the National Development and Reform Commission (e.g., pricing

conduct). Clarification from these agencies would be beneficial as to whether they intend to follow SAIC's regulations, develop their own IPR guidelines or regulations, or follow another approach.

Improvements From the Prior Draft

From the perspective of IPR holders, the current draft contains a number of improvements. Some of these changes appear to be based on comments on the prior draft from outside parties, including the American Bar Association's Section of Antitrust Law.

Perhaps the most significant improvements affect SDOs and SDO participants. According to the fifth draft, when patented technology was included in a national or sector standard, the patent holder would be required to state the upper limit of the royalty, which could not be significantly higher than the royalty assessed prior to the development of the standard. These provisions raised particular concerns given the fifth draft's broad extraterritorial reach, which arguably encompassed some U.S. and EU SDOs and their participants. The sixth draft omits these provisions.

The current draft also narrows the definition of abusive SDO conduct. The fifth draft stated that the failure to disclose relevant information to an SDO during the standards development process, followed by assertion of the patent, would violate the AML. Neither scienter nor dominance was required. The sixth draft clarifies that nondisclosure to an SDO may constitute an abuse, but only if (1) the patentee has a dominant market position and is an active member of the SDO, (2) the patentee deliberately conceals the information, and (3) the SDO would have adopted a different technology if the patentee had disclosed the information. As a result, the prohibition is now limited to behavior designed to game the standard-setting process, while permitting companies to protect their investments in research and development.

Another significant improvement that more closely aligns the regulations with the approach of U.S. and EC authorities is with respect to justifications for potentially abusive conduct. The fifth draft set forth a series of requirements for an efficiency defense that were so onerous as to be almost impossible to satisfy in practice. The sixth draft does away with these requirements and affords the respondent the opportunity to put forth a variety of justifications for potentially abusive conduct. The sixth draft also clarifies that whether there is "due justification" for the conduct will be part of the analysis for nearly all categories of potentially abusive conduct, and eliminates language in the prior draft that shifted the burden of proof to respondents to demonstrate efficiencies.

Areas Needing Additional Clarification

Under the draft regulations, some unilateral refusals to license violate the AML. Article 8 states that an undertaking with a dominant market position may not "unequally or discriminatively refuse to license its intellectual property rights" but offers no guidance as to the meaning of the terms "unequally" or "discriminatively." Nevertheless, it is clear that these provisions (1) limit a dominant IPR holder's fundamental right to exclude, (2) limit the licensing terms dominant patent owners can use, and (3) require dominant patent owners to justify any differences in license terms. In effect, Article 8 imposes RAND obligations on IPR licenses by dominant firms.

A unilateral refusal to license may also violate the AML when its IPR is "a necessary facility for the licensee to compete," subject to a number of important limits. Those limitations notwithstanding, it would have been preferable to omit this provision entirely or to align it more closely with EC standards for the essential facilities doctrine.[1] If enacted as currently drafted, Article 8 would conflict with international norms, create disincentives for rivals to develop competing or workarounds IPR, and discourage innovative efforts in

general.

Article 10 prohibits the use of certain licensing provisions by firms with a dominant market position. For such provisions, no proof of an adverse effect on competition is required to establish a violation of the AML. One of these "unreasonable restrictions" is an exclusive grantback. However, as the U.S. IP Guidelines note, grantbacks, even if exclusive, are often pro-competitive because they provide "a means for the licensee and the licensor to share risks and reward the licensor for making possible further innovation based on or informed by the licensed technology." [2] To avoid an overbroad prohibition on exclusive grantbacks (and thus discourage follow-on research), Article 10 should clarify that an exclusive grantback is an unreasonable restriction only if it "eliminates or restricts competition in the relevant market," language that is used elsewhere in the draft regulations.

The sixth draft adds a prohibition on "abusive" IPR litigation threats. Specifically, Article 14 proscribes the sending of infringement warning letters by firms with a dominant market position when the recipients' "conduct obviously does not constitute an infringement." At minimum, Article 14 should clarify that only a pattern of baseless litigation threat letters may be abusive and, consistent with Articles 8, 9 and 10, state that no violation will be found if there is "due justification" for the conduct.

SAIC would have the authority under Article 10(5) to ban "other unreasonable restrictive conditions" in the future, which is similar to the FTC's ability to define "unfair methods of competition" under Section 5 of the FTC Act. Given the time and care spent defining abusive IPR-related practices in the regulations, the need for this provision is unclear. If SAIC feels that it needs this flexibility, the agency may wish to clarify — as the FTC has done — that a violation requires a showing of injury to competition in the relevant market and lack of a pro-competitive justification for the conduct. It would also be helpful for SAIC to explain the procedures it will use to identify additional banned practices (e.g., opportunities for advance public notice and comment).

Notwithstanding the inclusion of several laudatory statements noting the importance of IPR and recognizing the rights of IPR holders, the draft regulations may still leave the impression that common IPR practices, such as initiating litigation, cross-licensing and standard setting, are inherently suspect. In addition, the draft regulations do not state that IPR will be presumed valid. SAIC should consider adding language that IPRs are presumptively valid, that the exercise of IPR is presumptively lawful, that the AML does not prohibit refusals to license, that IPR licensing (including portfolio licensing) is generally pro-competitive, and that standard setting is generally pro-competitive.

Conclusion

SAIC should be commended for the care and patience with which it has developed its regulations for implementation of the AML with regard to IPR, and for its receptiveness to industry input during that process. The sixth draft contains significant improvements that demonstrate the agency's regard for the interests of IPR holders. Nevertheless, the current version of the regulations still contains areas that would benefit from further discussion and input. Although the schedule for conclusion of the drafting process remains unclear, IPR holders with significant activities in China should take advantage of the present opportunity to communicate with SAIC and express their views on the current draft while time still remains.

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[1] Case C-418/01, IMS Health v. NDC Health (dominant firm's refusal to license violates Article 102 only under "exceptional circumstances").

[2] U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property § 5.6 (1995).

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