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Key Takeaways of China's New Antitrust Guidelines for Standard Essential Patents

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NEWSLETTER

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Executive Summary

On November 8, 2024, the State Administration for Market Regulation of the People's Republic of China (SAMR) officially issued the Anti-Monopoly Guidelines of Standard Essential Patents (SEP Guidelines). This finalized version retained most parts of the draft version published on June 30, 2023 (Draft SEP Guidelines), while introducing new rules and changes to previously proposed clauses. The SEP Guidelines build upon the Anti-Monopoly Guidelines of Intellectual Property by establishing comprehensive rules that address specific antitrust issues related to SEP. The Guidelines reflect the Chinese antitrust authority's focus on SEP and provide insight into the framework companies involved in SEP will navigate going forward.

SAMR has taken a balanced approach to SEP regulation. Both SEP holders (Licensors) and standard implementers (Licensees) will find rules beneficial to either side, as well as guidelines for their commercial practices. This article analyzes the anticipated impacts of the SEP Guidelines on Licensors and Licensees.

A. Key Aspects Aimed at Ensuring Fair License Terms for Licensees

1. Licensees may benefit from more proactive ex-ante and preventive regulations.

Article 5 of the final SEP Guidelines requires antitrust enforcement agencies to enhance "ex-ante and preventive regulations." This is a major addition to the Draft SEP Guidelines.

The ex-ante regulations entail requiring and overseeing the establishment of antitrust compliance and risk prevention mechanisms for relevant SEP parties, including standard-setting organizations (SSO), patent pool operators, Licensors, and Licensees. It also encourages relevant SEP parties to seek prior consultation and guidance with the antitrust enforcement authorities regarding SEP antitrust issues in the grey zone.

As part of the measures to prevent antitrust infringement, enforcement agencies are empowered to issue a letter reminding relevant SEP parties of potential antitrust risks, urge changes in their practices, and require written reports on the implementation of practice changes, without initiating formal investigation or issuing formal penalty decisions against relevant SEP parties' commercial practices that fall afoul of the PRC Anti-Monopoly Law (AML).

Ex-ante regulations and preventive measures taken by the enforcement agencies allow for wider, more flexible, and more proactive antitrust enforcement than conventional ex-post formal investigations, creating greater deterrence to potential disputable abuses of SEP. Licensees will benefit in general, particularly by filing complaints and pursuing license terms in their own interest, while Licensors will face the pressure to properly respond to the enforcement authority even before any formal investigation is initiated. The SEP Guidelines also affirm all parties' right to report any potential antitrust infringements to the antitrust authorities.

2. Licensees may benefit from the introduction of "Good Practices" mechanisms which impose requirements on Licensors' disclosure of patent information and license proposal during the license negotiation.

Articles 6, 7, and 8 of the SEP Guidelines introduce a set of "good practices" and encourage relevant SEP parties to comply with them. Although failure to comply with good practices does not directly constitute antitrust law violations, it would increase the risk of being considered as restricting or foreclosing competition. Compliance with good practices is explicitly mentioned as one of the factors to be considered in the abuse of dominance in Chapter 4 of the SEP Guidelines. Accordingly, it is anticipated that Licensors will need to comply with the good practice requirement for compliance purposes.

SEP Disclosure: Article 6 of the SEP Guidelines requires Licensors to "timely and sufficiently" disclose their SEPs in accordance with SSO's relevant rules during the standard-setting process. Licensors asserting patent claims or seeking patent injunctions without having first made the required disclosures run elevated risks of abuse of dominance. The SEP disclosure requirement will thus reduce patent claims based on undisclosed SEPs and protect Licensees from patent ambush. This approach is consistent with that of the EU, where Rambus's patent ambushes were once considered potentially abusive, though the case was later settled with a commitment to license patent. In recent years, while Licensors' failure to disclose SEPs have been identified by Licensees frequently in SEP disputes, it is not yet clear what exact consequence will result from this type of behavior. Based on the SEP Guidelines, it is at least clear that the risk of restricting and foreclosing competition would be increased if there is such a failure.

FRAND commitment: Article 7 of the SEP Guidelines codify the Fair, Reasonable, and Non-Discriminatory (FRAND) principle by requiring Licensors to make explicit FRAND commitments to license their SEPs in accordance with SSO's relevant rules while also recognizing that FRAND principle should be honored by both Licensors and Licensees in their SEP license negotiation. For the first time, the SEP Guidelines also clarify that deviations from the FRAND commitments are not a violation of AML *per se*, but would be considered an important factor when evaluating abusive conducts, such as excessive pricing and refusal to deal.

Good-faith negotiation: Article 8 of the SEP Guidelines introduces detailed requirements for good-faith negotiations, with obligations imposed on both Licensors and Licensees, promoting procedural fairness in bilateral negotiations. Whether the parties have used good faith in negotiations serves as an important factor in determining whether any abuse of dominance has occurred.

First, the licensor is obligated to make a clear offer of license, containing a list of the SEP portfolio, a reasonable number of claim charts, and the method and basis to calculate the license fee. Then the obligation shifts to the licensee to express within a reasonable amount of time its bona fide willingness to obtain the licenses. Once the licensee responds, the obligation shifts back to the licensor to offer license terms that conform with the FRAND principle including mainly the calculation method of the licensing fee and the reasonableness of the terms as well as other necessary information. Finally, the licensee is obligated to accept the licensing terms within a reasonable amount of time, or else make a counteroffer complying with the FRAND principle within a reasonable amount of time. Should disputes regarding the negotiation process arise, each party bears the burden to prove its own good faith.

The imposition of good-faith obligations and the duty to prove such good faith on both Licensees and Licensors reflects SAMR's endeavor to strike a delicate balance between Licensees and Licensors. If future enforcement practices prove that SAMR is willing to more closely scrutinize the SEP negotiation process, Licensees will stand to enjoy greater protection during the negotiation process against undue influence resulting from unbalanced negotiation leverage.

3. Licensees may benefit from additional factors in determining excessive SEP pricing.

Traditionally, courts and enforcement agencies consider three major factors in determining whether certain SEP licensing fees are excessive: (1) whether they are significantly higher than those charged for comparable licenses; (2) whether the licensing scheme contains apparently unfair conditions of license, for example, forcing the Licensees to grant back their patents free of charge; and (3) whether the licensor leverage legal means, such as injunctions, to force the licensee to accept the licensing fees. For instance, in NDRC's (one of the former antitrust enforcement authorities in China) penalty on Qualcomm for abuse of market dominance in its SEP market in 2015.

Article 13 of the SEP Guidelines introduces three additional factors, namely: (1) whether the parties complied with the "good practices" of patent disclosure, FRAND commitment, and good-faith negotiation; (2) whether the licensor adjusted its licensing fees in response to quantity, quality, and value of the SEPs; (3) whether the licensor double-charge licensing fees through non-practicing entities. The additional factors provide a layer of procedural protections on top of the more substance-focused traditional considerations. Licensees will now have more arguments at disposal, pointing to both the process of the negotiation and the resulting price, to persuade courts and enforcement agencies that the Licensees have been charged with excessive royalties.

Separately, we note that the final SEP Guidelines removed the R&D cost from the factors that was included in the Draft SEP Guidelines. Including R&D costs in the determination of excessive pricing may potentially be used for either Licensors or Licensees depending on the specific amount of the R&D costs involved. In most of the cases, Licensors tend to justify their claimed royalty by looking into the revenue of the implementor which is a much larger number than the R&D costs. In practice, there are few cases in which the damages for patent infringement or the licensing fees are precisely quantified by allocating the R&D costs. Therefore, the removal reflects SAMR's pragmatic consideration of business realities.

4. Licensees may benefit from SAMR's clarified stance on refusal to deal issues

Article 14 of the SEP Guidelines clarifies that Licensors are obligated to license to anyone who is willing to obtain a license under FRAND commitments, unless there are justifications not to do so. SAMR will consider whether the parties have complied with good-faith negotiations, whether the licensee has good business and credit records, etc.

The rule signifies that SAMR has taken the position of "license to all" as opposed to "access to all," making a wider range of market participants across the supply chain eligible to become Licensees. This suggests that automotive components manufacture may have a stand to request Licensors for FRAND license and may impact the royalty calculation basis in automotive industry in the future.

5. Licensees may benefit from clarified rules on the imposition of unreasonable conditions

Article 16 of the SEP Guidelines provides a list of conducts that may constitute imposing unreasonable conditions. The list includes, for example, (1) making unfairly priced grant-backs a prerequisite for the SEP licensing, (2) requiring cross-licensing without offering fair compensation, (3) prohibiting Licensees from disputing the SEP's necessity and validity, (4) restricting licensee's freedom in choosing the mechanism and location of dispute resolution, (5) restricting or forcing Licensees to deal or not deal with third-parties, (6) restricting Licensees from developing competing technologies, and (7) requiring Licensees to disclose information irrelevant to the SEP licensing.

The clear rules on what may constitute unfair conditions protect Licensees' negotiation position and help ensure that the resulting licensing schemes are underscored by equity and fairness.

B. Key Aspects That Can Serve as Basis for Licensors to Bring Arguments

1. Licensors Can Justify Their Claims by Proving that Licensees Fail to Act in Accordance with the Good-Faith Negotiation Mechanism.

The SEP Guidelines state that good faith negotiation with the licensee is considered a manifestation of the licensor's FRAND commitments made in compliance with rules set by the SSO. Specifically, Article 8 of the SEP Guidelines outlines the obligations of both parties to meet the requirement of good-faith negotiation (see also Section A.2 for more details). From the licensors' perspective, the good-faith negotiation mechanism aims to strike a balance between both parties and provide room for licensors to justify their strategic decisions in the following ways:

- First, to initiate the negotiation, the licensor should provide a clear licensing offer to the licensee, including the SEP list, a reasonable number of claim charts for the SEPs, the method and basis for calculating licensing fees, and the reasonable response period for the licensee. In practice, licensors have expressed concerns about the difficulty of providing every single claim chart for all SEPs they are prepared to license. In the SEP Guidelines, it is specified that "a reasonable number of the claim charts for the SEPs" may satisfy the requirement of the FRAND principle.

- Second, in the event of a licensing dispute, if licensors succeed in meeting the above requirements, even when facing challenges of abuse of market dominance brought by licensees, the licensors can establish their defense by proving that the licensees failed to act as willing licensees by not responding timely and/or not bringing up a reasonable counteroffer within a reasonable time.

2. Possible Arguments to Rebut the Presumed Dominant Position of Licensors

In previous Chinese antitrust enforcement and judicial cases involving SEP disputes, the relevant market is typically defined as the licensing market either for a single SEP or the SEP portfolio, which means that the licensor would be considered holding a 100% market share and a dominant position. Article 4 of the SEP Guidelines generally recognizes such an approach adopted in previous practices but also retains room for licensors to rebut the presumed dominant position from the following perspectives:

- First, Article 4 of the SEP Guidelines clarifies that for the purpose of defining the relevant product markets, on a case-by-case analysis basis, one can focus on either the technology market or the product and service markets associated with the standard's implementation. This leaves room for licensors to argue for substitutability at the level of products and services adopting the SEPs, which can potentially enlarge the scope of the relevant market.

- Second, the same Article 4 also recognizes the value of evaluating substitutability among different standards, by stating that "SEP holders usually hold all market share in the SEP license market, when the standard itself is not substitutable by other standards."

- Third, even if one single SEP is defined as the relevant market, pursuant to Article 12 of the SEP Guidelines, factors beyond market share may also be evaluated when assessing the licensor's market position, such as the licensor's ability to set licensing terms, block or influence competition, the negotiating constraints faced by licensees, the reliance of downstream markets on the SEP, and the possibility of replacing the SEP with alternatives.

3. Injunctive Relief Available to Licensors

Article 18 of the SEP Guidelines recognizes that the licensor is entitled to request a court or relevant authority to issue a ruling, order, or decision to cease the infringement of the related patent rights, i.e., the injunctive relieves. However, the SEP Guidelines also explicitly state that the licensor must not abusively use injunctive relief to coerce licensees into accepting unjustifiably high prices or other unreasonable terms without engaging in good faith negotiations beforehand. Such conduct may be considered a violation of FRAND terms.

As already discussed in Section A.2, the good-faith negotiation serves as a basis for both parties to establish potential claims and/or defenses. Careful and diligent compliance with the good-faith negotiation process can allow licensors to rightfully seek injunctive relief.

C. Other Highlights Regarding Monopolistic Conduct Involving SEPs

1. Joint Boycott Behavior in Standard-Setting

Article 9 of the SEP Guidelines outlines the potential risks of joint boycotts during the standard-setting and implementation stages:

- **Standard Setting Stage:** Licensors holding SEPs should not, without valid reasons, exclude specific undertakings from participating in the standard-setting process or prevent particular technical solutions from being included in the standard.

- **Standard Implementation Stage:** Licensors should not, without valid reasons, agree to exclude competing standards or block specific undertakings from adopting the standard, for example, by restricting the certification of SEPs.

Moreover, it is prohibited for SSOs or other third parties to provide substantial assistance to potential joint boycotts mentioned above, as doing so could be seen as facilitating cartels (i.e., hub-and-spoke), which may also result in legal liability for such third parties.

2. Potential Horizontal Risk Under the Implementation of Patent Pools

Article 10 of the SEP Guidelines recognizes that patent pools can generally promote competition. However, licensors should be cautious about the risk of sensitive information exchange or horizontal monopoly agreements when using patent pools.

One notable point is that the officially published SEP Guidelines deleted the previously proposed clause which considered setting SEP royalty fees as price fixing prohibited under AML. This shows the enforcement authority's recognition of the operation mechanism of patent pools to coordinate license terms (including royalty fees, geographic scope, duration, fee calculation basis, etc.) among multiple licensors. Meanwhile, given the complexity involved in SEP licensing, including cross-licensing and grant-back arrangements, specific rules are to be further developed based on case-by-case analysis.

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