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In contrast, in a 2009 case where there was agreement among the parties about applicable law and exclusive foreign jurisdiction, as reported by Professor Kung-Chung Liu ("Taiwanese Courts Applying Dutch Law"), the Taiwanese Supreme Court and IP Court felt partially bound by that agreement and exercised jurisdiction over the case, and yet applied Dutch law.

## Conclusion

Some observations and tentative lessons can be made and learned.

As shown in Chapter 2, in some civil law jurisdictions such as Japan, Korea, and Taiwan specialized IP Courts (or Divisions) have been set up, which can effectively deal with problems resulting from the bifurcated patent litigation that has haunted those jurisdictions.

There are some lessons to be learned from the six cases of Chapter 3. Firstly, compulsory license is very limited in total number even in Asia, the most populous continent, with hundreds of millions of low-income people. Secondly, for big pharma companies, compulsory license does not necessarily mean loss. Quite the opposite, net gains are more likely to be the longer-term result, as the original

11. According to the 2014 Annual Report and 2015 Proxy Report of InterDigital (available at: <http://ir.interdigital.com/annuals-proxies.cfm>), on July 10 and 11, 2014, InterDigital was served with two complaints filed by ZTE Corporation in the Shenzhen Intermediate People's Court in China on April 3, 2014, which were based on exactly the same reasons and demanded the same amount of damages as Huawei. On August 28, 2014, the court denied InterDigital's jurisdictional challenge with respect to the anti-monopoly law case. InterDigital filed an appeal of this decision. On September 28, 2014, the court denied InterDigital's jurisdictional challenge with respect to the FRAND case, and InterDigital filed an appeal of that decision. On December 18, 2014, the Guangdong High Court issued decisions on both appeals upholding the Shenzhen Intermediate Court's decisions that it had jurisdiction to hear these cases. InterDigital filed a petition for retrial with the Supreme People's Court regarding its jurisdictional challenges to both cases on February 10, 2015, which was rejected. The case is now pending before the Shenzhen Intermediate People's Court.

prices were too prohibitive and could have very limited sales or no sales at all, while the reduced price led to a huge amount of sales. High prices demanded by multinational pharma conglomerates regardless of the suffering of low-income patients are simply bad publicity. Multinational pharma conglomerates should adapt their pricing strategy to the economic and income level of individual economies, especially with the mechanism now put in place to prevent the generic version of their patented drugs from being exported to high-income markets. Thirdly, the abuse of IP can be remedied by compulsory license, so that the patentee is still rewarded with reasonable compensation while the patent enjoys widespread use and dissemination.

Some implications could be derived from the six case reports in Chapter 4: SEPs holders, especially non practicing entities ("NPE") such as InterDigital, are advised to restructure their licensing arrangement by giving up such portfolio licensing that keeps pooling new patents into one package and asking one total royalty, even for expired patents. In addition, SEP holders should avoid asking for royalty-free cross-licensing and imposing no-challenge clauses. Another point worth noticing is that Taiwan's Fair Trade Commission has not yet taken any action against Qualcomm as opposed to its counterparts in China, Japan, and Korea, although Qualcomm's revenues have been mainly generated from these Asian economies.<sup>12</sup> After gaining comparative knowledge of the parallel development in neighboring Asian economies, people could not help wondering why the difference.

Chapter 5 reveals that the traditional and formalistic demarcation between common law and civil law injunctive relief, that the former tends to be recourse in equity and the latter tends to be statutory components of remedies for patent infringement, does not hold rigorously anymore in Asia. Asian courts are divided on this issue. While some court decisions (e.g., lower courts in India) opined that an interim injunction is automatic, some refused to issue an interim injunction when a life-saving drug was involved (e.g., the Delhi High Court), and some granted the patentee's request for an injunction against the making and selling of its generic version and at the same time are ready to review the injunction should

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that damages for patent infringements are generally low.<sup>10</sup> However, the case report by Professor Li Luo (“15% Profit Margin as Damages for Patent Infringement”) tells a different story: the Supreme People’s Court confirmed in a 2009 case that it is within the court’s discretion to decide the reasonable profit margin when calculating the damages, and upheld the decision of the first-instance court that set the reasonable profit margin at 15% based on the total profit margins the two defendants claimed (20%) and the contribution the patent made to the profit, in addition to reasonable expenditures for stopping infringement (RMB 20,000) and the attorney’s fees (RMB 110,000).

Quite a few Asian patent regimes take the infringer’s profit as proxy for damages that the patentees have suffered, such as mainland China, Japan, and Taiwan. In Japan there is provision on the rebuttable presumption of the amount of damages based on profit gained by infringement (Article 102(2) of the Patent Act), whereas in Taiwan, Article 97(1) of the Patent Act provides the infringer’s profit as one of the three methods from which the patentee can choose to calculate the damages. The Tokyo IP High Court via the grand panel opined in a 2013 decision, as reported by Professor Yoshiyuki Tamura (“Requirements for Presumption of Damages Based on an Infringer’s Profit”), that Article 102(2) of the Patent Act is applicable in circumstances where “the patent holder would have obtained a profit but for the patent infringement by the infringer” and if there is a difference between the type of business of the patent holder and that of the infringer, this may be considered to be a factor, as well as other various circumstances, that could eliminate the presumed amount of damages. As a result, it is not a requirement that the patent holder have exploited the patented invention being infringed.

In Taiwan the IP Courts in its capacity as appellate court in a 2012 case, as reported by Professor Su-Hua Lee (“Infringer’s Profits and Deductible Expenses and Costs”) opined that the amount of infringer’s profits should be calculated by the invoices issued from 2007 to 2009. Among them, only the items of the online market survey service should be taken into consideration, and the profits resulting from the customized market survey service targeting companies should be excluded. As a result, the profits obtained by the defendant due to the patent infringement

10. A study of the IPR Center of Zhongnan University of Economics and Law alleges that damages are low for patent infringement in mainland China, available at: [www.legaldaily.com.cn/bm/content/2013-04/16/content\\_4367323.htm?node=20734](http://www.legaldaily.com.cn/bm/content/2013-04/16/content_4367323.htm?node=20734).

were NTD 5,793,247 (about USD 180,000). However, there are expenses and costs to be deducted. The IP Court took into consideration the certified annual financial reports from 2007 to 2009 submitted by the patentee showing net profits of 29%, 31%, and 27% in 2007, 2008, and 2009 respectively, deducted expenses and costs, and determined the infringer’s profits resulting from the patent infringement were NTD 1,771,265 (about USD 55,350).

### Chapter 7: Choice of Jurisdiction and Law in Cross-border Patent Litigation

The decision of applicable law and court with jurisdiction in a patent infringement context in the absence of agreement centers on the principle of territoriality and *ordre public* and is a difficult choice for courts to make. An even thornier task for courts is how to treat the agreement over the choice of jurisdiction and law, especially exclusive foreign jurisdiction and/or exclusive application of foreign laws, as national courts and laws would be excluded. The dilemma is exacerbated when competition law issues are involved. This Chapter collected three cases from Japan, Korea and mainland China that dealt with the first scenario and one case from Taiwan that dealt with the second.

In Japan, the Supreme Court decided in a 2002 case as reported by Professor Yasuto Komada (“Applicable Law When an Act Implemented in Japan Allegedly Infringed a U.S. Patent Right”), where there was no agreement on the applicable law among the parties, that the law applicable to the effect of a patent right is the law of the country in which the patent is registered, and that the injunctive order to make the infringer cease his/her act in Japan on the grounds of an infringement of a foreign patent right must fail because such an order violates *ordre public*. The court added that a damage claim must be justified under the Japanese law, and an act infringing a foreign patent right in Japan is not illegal because there is no provision in the law that makes a patent right valid outside the country that granted the right. In Korea, the Seoul District Court in a 2012 case as reported by Professor Chang-Hwa Kim and Professor Byungil Kim (“Korean Court Applying French Law”), applied the French law to decide whether an injunction can be imposed on a Korean legal entity which was accused of infringing FRAND-encumbered SEPs. In China, according to the report by Dr. Jia Wang, (“Jurisdiction and Applicable Law over Disputes Involving Patent Holders without Domicile in China”), Shenzhen Intermediate Court exercised jurisdiction over the dispute in the 2013 *Huawei v. InterDigital* decision. The defendant InterDigital raised an objection to

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patent would constitute an abuse of rights,<sup>1</sup> unless it could be demonstrated that circumstances existed which justified special treatment. In so holding, the Supreme Court reversed prior decisions handed down by the Court of Cassation<sup>2</sup> that differed from the above-mentioned interpretation, including Case No. 1903 (Re) 2662 of September 15, 1904 (Criminal Record No. 10, p.1679) and Case No. 1916 (O) 1033 of April 23, 1917 (Civil Record No. 23, p.654).

4. Finally, clear and convincing evidence existed that the Patent was invalid and no extenuating circumstances, such as pendency of a request for correction, had been cited which could have warranted a different conclusion. The Supreme Court affirmed the judgment of the Tokyo High Court that TI's claim for damages based on the Patent would be an abuse of rights.

## Legal Analysis

### Problems under the Conventional View

As explained earlier, it is not the courts but invalidation trials of JPO that may invalidate patents with binding effects on third parties. Taking this premise into account seriously, the conventional view expressed in a series of decisions by the Court of Cassation prevented the infringement courts from deciding on whether the patent might be invalid. The underlying rationale was considered to be the special effects associated with administrative acts in general and the separation of authority between the judicial courts and JPO.<sup>3</sup> In other words, since patents were granted by administrative acts, it was believed that they had to be invalidated only by administrative acts such as trial decisions of JPO. The notion originated from general administrative law theories. In addition, since JPO had the expertise to

1. The Supreme Court does not use the expression of "abuse of rights" in its English translation of this case. Instead, it states "an extension of rights beyond the scope contemplated under the act." However, the original text of the judgment uses the Japanese expression that corresponds to "abuse of rights." It is also noted that the Supreme Court indicates that "This translation is provisional" at the end of the English translation. Taking these facts into account, I choose to use the expression "abuse of rights."

2. The Court of Cassation is the predecessor of the Supreme Court. It was abolished in 1947 after World War II, and replaced by the Supreme Court under the current constitution.

3. Takabe, M. Hankai. (Commentary on Cases). In *Saiko Saibansho Hanrei Kaisetsu Minjihen Heisei 12 Nendo Jyo*, 427 (The First Volume of Commentary on the Supreme Court Civil Cases of FY 12 of Heisei Era 2003).

initially determine the validity of patents, it was considered to be reasonable for judicial courts to only review whether the trial decision was appropriate. It is the institutional argument specific to patent law.

However, the conventional view gave rise to a serious problem. As the Supreme Court pointed out correctly, it would be hardly justified if patentees were able to seek an injunction and damages, even when it was evident that the patent was invalid. Thus, courts had explored various solutions to avoid such an unjust result under the conventional view.

One option is to suspend the court proceedings and wait for the trial decision (Article 168(2)). If the trial decision invalidates the patent, the infringement courts have no problem dismissing the patentee's claims in infringement actions. However, if no invalidation trial is requested, this option is not available. Even when there is such a request, it might take a long time until a trial decision is finalized.

Another option is to manipulate the claim construction. There is no doubt that judicial courts are authorized to interpret patent claims. By using this power, some courts had tried to narrowly interpret so that the patent claims may not extend to prior art in the public domain in order to exempt the alleged defendants working on the prior art from infringement liability. In other words, when the court finds a patent partly invalid, it can interpret the claim narrowly by excluding the invalid part. Such a narrow claim construction was approved by the Supreme Court decisions.<sup>4</sup> However, there would be no room for claim construction when it finds a patent wholly invalid, namely all elements of the patent claims were already known in the public domain at the time of patent applications, and it can hardly find any valid part of the claim. It could be also criticized as an arbitrary interpretation.

A third option is to apply general law doctrine such as the abuse of rights, as Tokyo High Court did\*in this case. The Abuse of Rights Doctrine is regarded as one of fundamental principles in civil law and codified in Article 1(2) of the Civil Code in Japan; "No abuse of rights is permitted." The Tokyo High Court applied this fundamental principle to the case where patentees sought a claim for damages based on patent that the court found highly likely to be invalid. It is whether to

4. The Supreme Court of Japan, 1961(O)464 (December 7, 1962), *Minshu* Vol.16, No.12 at 2321; 1962(O)871 (August 4, 1964), *Minshu* Vol.18, No.7 at 1319.

endorse this option that the Supreme Court in this case was supposed to give an answer.

### Abuse of Rights Approach

#### *Endorsing abuse of rights approach*

The Supreme Court approved of the abuse of rights approach taken by the Tokyo High Court because of the reasons described earlier. It also expressly allowed courts in infringement cases to decide on whether it was evident that the patent was invalid. Otherwise, courts would not be able to determine whether the patentees abused the rights. In holding so, the Supreme Court denied the long-standing practices under the conventional view that forced courts to find ways to dismiss the patentee's claims without having to address the validity issue. It is considered to be a significant change.

It should be noted, however, that the Supreme Court clearly stated in the judgment that a patent retained its validity and enforceability until a conclusive decision was reached in JPO's invalidation trials that publicly invalidate the patent. The Supreme Court appeared to have no intention to change such a premise. It means that the patent still remains registered and effective even after courts find that the patent is highly likely to be invalid and regarded its exercise as the abuse of rights. In other words, courts' decision on invalidation may be sufficient to bind parties in patent infringement cases, but may not bind any third parties.

Nonetheless, thanks to the Supreme Court, defendants in patent infringement cases acquire an effective tool, namely, an abuse of rights defense. This newly-created defense was named "Kilby defense."

#### *What constitutes abuse of rights?*

According to the Supreme Court, the defendants invoking the abuse of rights defense are not required to show the patentees' bad faith. All they need to prove is clear and convincing reasons to invalidate a patent. Since the Supreme Court imposed no restriction on the grounds for invalidation, the defendants may assert any grounds. On the other hand, the proof of invalidity needs to be clear and convincing. The purpose of this requirement was to prevent inconsistent decisions

between infringement actions and invalidation trials.<sup>5</sup> It was believed that the proof for invalidation should be so evident that both the infringement judges and examiners in invalidation trials would come to the same conclusion on the validity issue.

The Supreme Court suggested that exceptional circumstances may exclude the abuse of rights defense. It briefly mentioned an example of pending trial for correction. A trial for correction is a different JPO trial that may be requested by the patentee for the correction of the claims, the description and drawings under certain conditions and requirements (Article 126). It is usually filed when the patentees try to remove grounds for invalidation in order to avoid the invalidation of the patent as a whole. If successful, grounds for invalidation would disappear. In such a case, the abuse of rights defense might fail because the patent would no longer be invalid. In sum, while the defendant may submit an abuse of rights defense when he believes that the patent is invalid, the patentee may rebut such a defense by asserting the counter defense of correction.

#### *Codification*

The judicially created "Kilby defense" was later codified. In the 2004 amendment, a new provision of Article 104-3(1) was introduced: "Where, in litigation concerning the infringement of a patent right or an exclusive license, the said patent is recognized as one that should be invalidated by a trial for patent invalidation, the rights of the patentees or exclusive licensee may not be exercised against the adverse party." The defense is no longer a judicially created doctrine, but a statutory defense based on the grounds of invalidation. It is simply called the "invalidation defense."

It should be noted, however, that the newly-codified provision does not require the proof of invalidation to be evident. Instead, Article 104-3(1) simply states, "the said patent is recognized as one that should be invalidated." According to the drafters of this provision, it is so provided because it may not be clear whether evidence of

5. Takabe, *supra* note 3, 441.

invalidation is clear and convincing.<sup>6</sup> As explained earlier, the requirement of the evident proof of invalidity was aimed to prevent inconsistent decisions between infringement lawsuits and invalidation trials. This aim is now expected to be achieved by the exchange of information between JPO and the infringement courts. More specifically, the 2004 amendment obliges the infringement courts to inform JPO of the submission of the invalidation defense (Article 168(5)) and allows JPO, once it receives such a notice, to request the courts to deliver copies of the record of the infringement actions (Article 168(6)). However, the exchange of information does not necessarily ensure the same conclusion between JPO trials and the infringement courts.

Commentators observe that there is no substantial difference between the abuse of rights defense and the codified invalidation defense, with or without the requirement of the evident proof for invalidation. Several explanations are made: both defenses are substantially the same in the sense that judges are confident that the patent is invalid;<sup>7</sup> the statutory language of “the said patent is recognized as one that should be invalidated” is designed to prevent the inconsistent decisions and thus, performs the same functions as the evident proof for invalidation;<sup>8</sup> and the requirement of the evident proof for invalidation had not functioned in practice.<sup>9</sup>

Another point to be noted is that the statutory language of Article 104-3(1) does not mention the patentees’ counter defense of correction. Nonetheless, correction may continue to rebut the invalidation defense because, if the patentee successfully removed grounds for invalidation by correcting the patent claims, it would be no longer considered that “the said patent should be invalidated” and accordingly Article 104-3(1) may not be applied. Subsequent lower courts have developed the requirements for the counter defense of correction.<sup>10</sup> The patentee submitting the counter defense of correction has to prove: (1) that it filed a request for correction

6. Kondo, M. and Saito, T. 2004. *Chiteki Zaisan Kankei Nihou Roudoushinpanho (Two Acts Relating to Intellectual Property and Labor Tribunal Act)*, 58.

7. Nakayama, N. 2016. *Tokkyoho Dai San Pan (Patent Law)*, 3rd ed., 446.

8. Takabe, M. 2006. “Tokkyoho 104 Jo No San Wo Kangaeru (Examining Article 104-3 of Patent Act).” In *11 Chiteki Zaisan Hoseisakugaku Kenkyu (Intellectual Property Law and Policy Journal)*, 132.

9. Shimizu, M. 2008. “Muko No Kouben (Invalidity Defense).” In *Chitekizaisan Kankei Soshou (Intellectual Property Related Lawsuits)*, edited by T. Imura & R. Shitara, 127.

10. IP High Court, 2008(Ne)10068 (August, 25, 2009) Hanrei Jiho No.2059 at 125, Tokyo District Court, 2003 (Wa) 16924 (February 27, 2007) *Hanrei Times* No.1253 at 241.

in compliance with the patent act; (2) that correction could remove grounds for invalidation; and (3) that the defendant’s product or method could fall within the technical scope of the corrected claims.

### Institutional Issues: Expertise in (District) Courts

One of the concerns about the application of the invalidation defense is the courts’ competence to adequately judge patent validity. Whenever defendants assert that the patented invention is obvious based on the prior art publicly known at the time of patent applications, courts need to understand the prior art in the field and determine whether the person ordinarily skilled in the art of the invention would have been able to easily make the invention based on the prior art, which requires expertise to understand complicated and advanced technologies.

In broader context, it is just an example to illustrate the challenges that courts are facing in dealing with patent cases. To address that challenge institutional reforms were introduced. The Intellectual Property High Court was established in 2005 as a special branch of the Tokyo High Court. It has exclusive jurisdiction over technology-related IP cases (Article 6(3), Code of Civil Procedure, Article 2, Act for Establishment of the Intellectual Property High Court). As a specialized court, the IP High Court has been making various efforts to enhance its capabilities, including designating judges with knowledge and experiences in patent law, and appointing judicial research officials (Article 92-8, Code of Civil Procedure) or technical advisors (Article 92-2, Code of Civil Procedure) to help judges understand complicated technologies.

As far as the invalidation defense is concerned, district courts play a more important role in practice because it is first submitted to the district courts. In that regard, prior to the establishment of the IP High Court, the Code of Civil Procedure was amended in 2004 to concentrate the jurisdiction over IP cases. More specifically, civil cases, excluding the administrative cases that review JPO’s trial decisions,<sup>11</sup> relating to patents, shall be under the exclusive jurisdiction of the Tokyo District Court for Eastern Japan, or the Osaka District Court for Western Japan, respectively (Article 6(1), Code of Civil Procedure). Both courts

11. As explained earlier, an appeal against a trial decision is under exclusive jurisdiction of the Tokyo High Court (IP High Court) (Article 178(1), JPA).

have several divisions specializing in IP cases, made similar efforts as the IP High Court, and have increased their expertise in patent law over the years. However, it is still an open question whether the two district courts have the same expertise as JPO in deciding issues such as non-obviousness that require the understanding of complicated technologies.

### Commercial/Industrial Significance

When the Supreme Court first introduced the abuse of rights defense, it was considered to be exceptional because the abuse of rights doctrine as a fundamental legal principle may not be regarded as an interpretation tool for daily use. Since then, the defense has been gaining practical importance, especially after the codification of the invalidation defense. Today, the invalidation defense is no longer an exceptional one. It is a statutory defense that has a significant impact on IP strategies across industries. As the data shows, the invalidation defense plays an important role in practice. According to a JPO survey, the abuse of rights defense or the invalidation defense was submitted in about 60–80% of the infringement cases from 2001 to 2013.<sup>12</sup>

The abuse of rights defense and the invalidation defense have led to the development of the “Dual Track System.” It is the system under which the validity of the patent may be challenged in both invalidation trials and in the infringement lawsuits. No doubt it is favorable to the defendants because they do not have to separately file a request for invalidation trials. Consequently, the invalidation defense has been frequently submitted in the infringement actions.

However, the Dual Track System imposes a heavier burden on patentees because their risk of facing challenges to patent validity has increased. It would not be a grave problem if the patent were truly invalid. However, if it were truly valid, they would have to devote more energy to defend its validity. Thus, some patentees in Japan seem to be hesitant about asserting the patent rights in courts. In fact, according to a survey by the Institute of Intellectual Property (IIP), about one quarter of the respondents answered that the invalidation defense made it more

12. JPO, 2014. *Shinpan No Gaiyo Seido Unyo Hen* (Outlines of Trials: Rules and Implementation), 14.

difficult to exercise the patent right.<sup>13</sup> The same IIP survey reveals that about 34% of the respondents answered that the various measures available under the current patent law were more advantageous to the defendants than to the patentees, whereas only 5% answered that they are more advantageous to the patentees.<sup>14</sup> Although these figures did not reach the majority, they are nonetheless substantial.

As a response, policymakers begin to pay attention to the issues associated with the invalidation defense. The IP Strategic Program 2015 proclaimed a close examination of the invalidation defense as one of its priorities.<sup>15</sup> It did not mean, however, abolishing the invalidation defense. The 2016 report made by the committee under the IP Strategy Headquarters made it clear that abolishing it would re-create the same problem that the Supreme Court criticized in this Kilby Patent case.<sup>16</sup> Instead, it was discussed whether there might be any room for modifying it.

No major changes are, however, expected according to the draft report published in February 2017 by the subcommittee affiliated with JPO.<sup>17</sup> One of the issues was whether the Patent Act should stipulate the evident proof for the successful invalidation defense to make sure that the patent was presumed to be valid. The draft report was reluctant. It argued that there was no need for such a stipulation because it was obvious that a patent granted by an administrative action was presumed to be valid. Conversely, strong presumption might make it harder to decide the invalid patents as invalid.

Another issue was whether the patentee submitting the counter defense of correction should file a request for correction. As described earlier, the prevailing practice requires it. The IP High Court explained that it was required in general to do so in order to clarify the would-be corrected claim that was the subject in

13. IIP, 2015. *Tokkyokentou No Funsokaikeisu No Jittai Ni Kansuru Chosakenkyu Houkokusho* (Research and Study Reports on the Actual Situation of Patent-Related Dispute Resolution), 58.

14. *Id.*, 57.

15. Intellectual Property Strategy Headquarters, 2015. *Intellectual Property Strategic Program 2015*, 15.

16. The Committee Examining IP Dispute Resolution System, 2016. *The Direction Towards Enhancing the Function of IP Dispute Resolution System*, 34.

17. The Patent System Subcommittee, IP Committee, Industrial Structure Council, 2017. *The Draft Report Towards Enhancing the Function of IP Dispute Resolution System in Japan*, 10–12.

dispute.<sup>18</sup> The IP High Court had another concern. If the patentee did not have to correct the claim as it asserted in infringement actions, it could assert the original claim of the registered patent that might be broader than the would-be corrected claim in infringement actions. Filing a request for correction would prevent such an abuse. On the other hand, the IP High Court allowed the waiver of such a requirement in exceptional circumstances where the equity consideration justified its waiver on a case-by-case basis. These arguments are endorsed by the 2017 draft report. In sum, the current discussion suggests that the invalidation defense is unlikely to be abolished or drastically changed in the near future. Consequently, industries have to continue to adjust their patent strategies to the Dual Track System.

## 2.2

### Recognizing the Abuse of Rights Defense and the Invalidation Defense

Professor Byungil Kim, Hanyang University

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#### Case Information

Korean Supreme Court (en Banc) January 19, 2012, 2010 Da 95390

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#### Summary

The case discussed here is a leading Supreme Court case on the "dual litigation system" for patent enforcement in Korea. The court rendered a unanimous en banc decision which held that Korean civil courts (i.e., the District Courts and High Courts) could dismiss a patent injunction or damages claim for lack of non-obviousness (inventive step) even before a patent is formally invalidated by the Intellectual Property Tribunal ("IPT") of the Korean Intellectual Property Office ("KIPO"). While patent enforcement in Korea used to be bifurcated into two forums where the question of infringement was handled by the civil courts, and the question of novelty and inventive step was handled by administrative tribunals, the Supreme Court's en banc decision opens the door for the civil courts to consider the questions of validity when trying a patent infringement action thereby ushering in more fierce battles in civil court actions.

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<sup>18</sup> . IP High Court, 2013 (Ne) 10090 (September 17, 2014) Hanrei Jiho No. 2247 at 103.



## Legal Context

The patentee or the exclusive licensee of a patent is entitled to sue for infringement of a patent (Article 126,<sup>1</sup> Patent Act ("PA")). The patentee or the exclusive licensee can also apply to the IPT for an "offensive claim scope confirmation" (Article 135(1),<sup>2</sup> PA). A person sued for an alleged infringement of a patent might challenge the validity of the patent, claiming that it should be revoked because it has been anticipated or that it is obvious or not highly advanced (Article 133(1),<sup>3</sup> PA). He can apply to the court for a declaration that his activities are non-infringing, and apply to the IPT for a "defensive claim scope confirmation" (Article 135(1), PA).

1. Article 126 (Right to Seek Injunction, etc. against Infringement): (1) A patentee or exclusive licensee may demand from a person who infringes or is likely to infringe the patent right to discontinue or refrain from such infringement. (2) A patentee or an exclusive licensee acting under paragraph (1) may demand the destruction of the articles by which the act of infringement was committed (including the products obtained by the act of infringement in cases of a process invention for manufacturing the products), the removal of the facilities used for the act of infringement, or other measures necessary to prevent the infringement.
2. Article 135 (Trial to Confirm Scope of Patent Right): (1) A patentee, an exclusive licensee or an interested person may request a trial to confirm the scope of a patent right. (2) Where a trial is requested to confirm the scope of a patent right under paragraph (1), the confirmation may be requested for each claim if the patent contains two or more claims.
3. Article 133 (Invalidation Trial of Patent): (1) In any of the following cases, an interested party or an examiner may request a trial to invalidate a patent. In cases where the patent contains two or more claims, a request for the invalidation trial may be made for each claim: Provided, that if no more than three months have passed since the date the registration of the patent right has been published, any person may request an invalidation trial on the grounds that the patent falls under any of the following subparagraphs (excluding subparagraph 2): 1. Where a person has violated Articles 25, 29, 32, 36 (1) through (3), or 42 (3) 1 or (4); 2. Where the patent has been granted to a person not entitled to obtain the patent under the main sentence of Section 33 (1), or in violation of Article 44; 3. Where a person was unable to obtain the patent under the proviso to Article 33 (1); 4. After the grant of the patent, where the patentee is no longer capable of enjoying the patent right under Section 25, or the patent becomes contrary to a treaty; 5. Where a person is unable to obtain the patent for violating a treaty; 6. Where the application is amended beyond the scope under Article 47(2); 7. Where the application is a divisional application filed beyond the scope of Article 52(1); 8. Where the application is a converted application beyond the scope of Article 53(1). (2) A trial under paragraph (1) may be requested even after the extinguishment of a patent right. (3) Where a trial decision invalidating a patent has become final and conclusive, the patent right shall be deemed never to have existed: Provided, that where a patent falls under paragraph (1) 4 and a trial decision invalidating the patent has become final and conclusive, the patent right shall be deemed not to have existed at the time when the patent first became subject to the said subparagraph. (4) Where a trial under paragraph (1) has been requested, the presiding administrative patent judge shall notify the exclusive licensee of the patent right and any other person having registered rights relating to such patent of the purport of such request.

Jurisdiction over cases involving intellectual property in Korea are divided between the civil district courts,<sup>4</sup> the high courts, and ultimately the Supreme Court. The Supreme Court has jurisdiction over infringement actions (but not over the invalidation of patents). The IPT of the KIPO and the Patent Court are competent to hear invalidation, cancellation, and confirmation-of-scope cases (but not patent infringement cases). However, it should be noted that an IPT determination of scope is not binding on the courts.

Appeals of decisions from the district courts are generally taken to the high courts.<sup>5</sup> The high courts undertake a de novo review of the district court's decisions on matters of both law and facts. In other words, the high courts will accept new evidence and arguments in addition to reviewing the record of the district court trial. Appeals of decisions from the high courts go to the Supreme Court, which has discretion to accept an appeal. Cases at the Supreme Court are reviewed by panels typically consisting of four judges (though cases of special importance may be heard en banc). Supreme Court judges are supported by judicial assistants who specialize in IP matters and have a rank equivalent to high court judges. A Supreme Court decision is not necessarily a binding precedent in subsequent cases of a similar nature, but constitutes persuasive authority only. However, the Supreme Court's interpretation of a law in a particular case is binding on the lower courts in the same case if the case is remanded back to the lower courts.

The Patent Court, created by Article 3(1) of the Court Organization Act of July 27, 1994 (Act No 4765, in force since March 1, 1995), hears appeals from decisions made by the IPT under the KIPO. The Patent Court operates as an appellate court, and like the high courts, its decisions with respect to matters of law are appealable to the Supreme Court.<sup>6</sup> The Patent Court is comprised of three panels, each panel consisting of three judges. These judges have experiences in patent cases or an academic background in science and/or engineering. The Court Organization Act also provides for the appointment of up to 15 technical examiners, to act as judicial

4. The civil district courts are the courts of first instance for both civil and criminal matters. Most infringement actions are heard by a panel of three judges, although for cases with smaller damages claims, a panel may comprise a single judge. District court judges are typically transferred to other positions or jurisdictions every two years, pursuant to the regular reshuffling of judges within the Korean court system.
5. A high court panel consists of three judges, and some high courts have panels of judges with expertise in IP matters.
6. Unlike the other high courts, however, the Patent Court has nationwide jurisdiction.

assistants. These examiners play an important advisory role, explaining to the judges the technical issues and arguments presented by the parties, and answering any questions that the judges may have regarding the disputed invention. After the oral arguments have been concluded, the technical examiner submits his opinion to the panel as he does not have the authority to make decisions in the case. The Patent Court has exclusive jurisdiction in reviewing decisions rendered by the IPT regarding industrial property applications and the validity of industrial property rights.<sup>7</sup> Any appeal before the Patent Court should be brought within 30 days from the date of receiving a certified copy of the decision from the IPT.

Under Korea's dual patent litigation system, only attorneys-at-law may handle infringement litigation in the district courts (and appeals therefrom), while both attorneys-at-law and patent attorneys may handle invalidation, confirmation-of-scope, and correction trials<sup>8</sup> before the KIPO and the IPT (and appeals of these actions to the Patent Court and the Supreme Court). Therefore, patent attorneys may represent clients in trial proceedings at the KIPO, and in appeals against KIPO decisions at the Patent Court and the Supreme Court, but may not act as trial counsel at the district courts or in appeals therefrom. The dual patent litigation system has raised serious issues regarding the non-uniform and inefficient application of the PA. In particular, problems and delays have arisen due to the fact that patent invalidation or confirmation-of-scope actions are often used as defenses to stall infringement actions.<sup>9</sup>

## Facts

The plaintiff, LG electronics, had two patents (Patent No. 457,429 & 434,303) involving an invention related to a drum-shaped washing machine. The defendant, Daewoo electronics, sold drum-shaped washing machines, which were allegedly made by using the plaintiff's patents. The plaintiff sued for damages and injunction

7. The Patent Court has jurisdiction over cases set forth in the Article 186(1), PA; Article 166(1), the Design Act, and Article 85-3(1) the Trademark Act, and other first instance proceedings of cases coming under its jurisdiction pursuant to legislation such as Article 103(1), the Plant Variety Protection Act.

8. This trial is intended to protect an invention by providing the opportunity for a patentee to make corrections on the condition that there are not any unexpected losses or damages incurred upon any third parties.

9. Yang, Jay Young-June. 2005. "The Enforcement of Patent Rights in Korea." In *Patent Enforcement Worldwide IIC Studies*, edited by Christopher Heath and Laurence Petit, 362.

by claiming patent infringement. The Seoul Central Civil Court decided that the defendant infringed the plaintiff's patent, and the injunction could be granted for some reasons.<sup>10</sup> The defendant appealed.

A patent invalidation action and confirmation of scope action (e.g., an IPT action to confirm whether a product or method falls within the scope of the patent claim) were also pending between the parties. The Seoul High Court reviewed the inventiveness issue and dismissed the patentee's petition to stay infringement during the appellate trial.<sup>11</sup> The Supreme Court affirmed lower courts' power to refuse injunction application based on a registered patent when the patent is obviously invalid, but reached a substantively different determination and found that the patent did not lack inventiveness. The case was remanded back to the Seoul High Court.

## Reasoning

### Patents Should Be Exercised According to Their Substantive Value in the Spirit of Justice and Fairness

The Supreme Court especially emphasized the purpose of the patent system and the Patent Act, namely to contribute to the development of industry by protecting the public welfare and the inventor's interests. The Supreme Court reasoned that, if a patent lacks an inventive step, it does not make any contribution to the development of industry and should be part of the public domain for anyone to use for free. Accordingly, if an exclusive right is erroneously granted to an invention which lacks an inventive step and thus should have been part of the public domain, the public interest would be harmed and such a grant would be contrary to the purpose of the patent system. In addition, since a patent is a form of IPR, it should be exercised according to its substantive value in the spirit of justice and fairness. Allowing a patentee of a patented invention which lacks an inventive step to obtain an injunction or damages award against a person practicing the invention would give the patentee an unfair advantage and do harm to the person practicing the invention, therefore causing an injustice to the parties.

10. The Seoul Central Civil Court, October 14, 2009 (2007 Gahap 63206).

11. The Seoul High Court, September 29, 2010 (2009 Na 112741).

### **If It Is Obvious That the Patent Will Likely Be Invalidated, the Court Should Not Allow Injunctive Relief**

Under the Patent Act, a patent can be invalidated on certain grounds in a separate patent invalidation proceeding. Even if there are invalidation grounds for a patent, once registered, the patent should be considered valid unless and until an invalidation action decision holding the patent invalid becomes final. However, if the patented invention lacks novelty, then the patentee cannot assert the patent right even if there is no invalidation decision.<sup>12</sup> Further, if it is obvious that the patent will likely be invalidated in an invalidation action, the court should not allow injunctive relief against infringement to prevent patent abuse unless there are special circumstances, even if an invalidation action against a patented invention is still pending.

### **Legal Analysis**

#### **The Dual System for Patent Enforcement Matters**

The Korean patent litigation system is a dual system where questions of infringement are handled by the civil courts and questions of validity are handled by the IPT in the KIPO. The IPT is the first ex parte appeal review board for patent prosecution appeals. The IPT is also an inter partes forum where opposing parties may resolve disputes on the validity and scope of enforceability for a granted patent. For issues on the validity of a patent, the IPT has exclusive subject matter jurisdiction. The patentee, the alleged infringer, or any other interested party may file such patent-related administrative actions, either in parallel with or independent of a district court action. The IPT decides whether a patent is valid when there is a formal challenge. Under the dual system in Korea, only the IPT is empowered to decide the validity of a patent, not the civil courts. A civil court is required to treat a patent as valid since there is a presumption that a patent remains valid in Korea unless or until there is a final and conclusive invalidation of the patent through an administrative invalidation action.

12. Supreme Court en banc, July 26, 1983 (81 Hu 56).

Traditionally, when a defendant raises a patent invalidity defense and the invalidation decision is still pending, the civil courts can only review the infringement issues or stay the infringement action pending a decision from a patent invalidation action. The courts, however, recognize certain situations where it would be unfair to enforce a patent or delay the infringement action for a period of time when the patent is likely to be invalidated. In order to resolve this conflict, the Supreme Court allowed the civil court to dismiss the infringement action when the patent lacks “novelty.”<sup>13</sup>

#### **Abuse of Right Might Lead to Denial of Injunctive Relief, Damages, etc.**

The Supreme Court was once divided by the two following views: (1) “for a patent that is novel but obvious, the infringement court does not have the power to deny the patent rights before a separate invalidation proceeding is concluded,”<sup>14</sup> and (2) “a court seized of an infringement matter may decide on whether there is a clear ground for invalidation based on obviousness, and in presence of such clear ground for invalidation, an infringement action based on such patent is deemed a patent misuse and barring any special circumstance, such action is not permitted.”<sup>15</sup>

On January 19, 2012 the Supreme Court en banc issued a unanimous decision finding that “even if an invalidation action against a patented invention is still pending, if it is clear that the patent will be invalidated on the basis of obviousness, barring any special circumstances, an infringement action or an action for damages based on such patent shall be deemed a patent misuse, and therefore, not permitted.” The Supreme Court has made it clear that, even before the IPT’s decision invalidating a patent has become final and conclusive, the court that tries an infringement claim may consider whether there is clear evidence of invalidity and, if there is, deny the granting of injunctive relief, damages, and the like on the basis that it would constitute an abuse of right.

13. The Supreme Court, December 9, 1986 (86 Do 51147).

14. The Supreme Court, June 2, 1992 (91 Ma 540); October 27, 1998 (97 Hu 2095); December 22, 1998 (97 Hu, 1016, 1023, and 1030); and March 23, 2001 (98 Da 7209).

15. The Supreme Court, October 28, 2004 (2000 Da 69194).

### Infringement Courts May be More Inclined to Render Decision without Awaiting Final Decision in the Invalidation Action

To challenge the validity of an asserted patent is a very common defense strategy. Invalidation challenges are more frequently based on a claim of lack of non-obviousness rather than lack of novelty. However, most district courts were reluctant to make a determination on these defenses without official guidance from the IPT. The Supreme Court's en banc decision has affirmed that if it is shown in an infringement trial that the asserted patent lacks novelty or non-obviousness and would likely be invalidated by the IPT, the district court may refuse to enforce the patent and dismiss the infringement action as an abuse of patent rights like civil courts in the United States.<sup>16</sup> Korean courts will still maintain the validity of a patent until a final administrative patent invalidation decision, even when the civil court finds the patent invalid. However, as a practical matter, one might expect significant difficulties in bringing another or a related infringement action once the previous infringement action is dismissed due to the lack of novelty or obviousness. However, the Supreme Court's en banc decision will have an important impact on Korean patent litigation because it recognizes that the courts of general jurisdiction have the power to review the validity of a patent in the context of an infringement action. The civil courts reviewing the infringement action can now review the lack of novelty or non-obviousness, and disputes regarding patent validity issues will probably be more vigorously argued during infringement actions. Civil courts may even begin to render decisions without waiting for the first instance decision from the patent invalidation action, and may be more inclined to grant an injunction or damages award by finding inventiveness without awaiting a final decision in the invalidation action.<sup>17</sup>

16. Yang, Jay Young-June. 2015. "Issues of Enforcement." In *Intellectual Property Law in Korea*, edited by Byungil Kim and Christopher Heath, 2nd ed. 280.

17. Kim, Ji-Eun and Kang, Gregory B. 2012. "Patent Validity: A Landmark Decision on Validity." In *Managing Intellectual Property*, May 30. [www.managingip.com/Article/3038445/Patent-validity-A-landmark-decision-on-validity.html](http://www.managingip.com/Article/3038445/Patent-validity-A-landmark-decision-on-validity.html).

### Commercial/Industrial Significance

The dual patent litigation system has raised serious issues regarding the non-uniform and inefficient application of the PA. In particular, problems and delays have arisen due to the fact that patent invalidation or confirmation-of-scope actions are often used as defenses to infringement actions.<sup>18</sup> Recently, the Supreme Court has been considering an amendment to the Court Organization Act which is expected to give the Patent Court the exclusive appellate jurisdiction over industrial property infringement cases in addition to its existing jurisdiction over IPT decisions.

18. Yang, supra note 9, 362.

## 3.2

## Government Use of Patented Drugs to Facilitate Access to Medicines

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### Case Information

The Malaysian government's invocation of section 84 of the Patents Act 1983, authorization issued on November 1, 2003

### Summary

In 2003, the Malaysian government exercised the right given under section 84 of the Patents Act 1983 to authorize the importation of antiretroviral drugs (hereinafter "ARVs") from an Indian company for the purpose of providing HIV/AIDS patients in the country with better access to such drugs. With the exercise of that flexibility under patent law, Malaysia became the first Asian country, following the adoption of the Doha Declaration on TRIPS and Public Health, to issue a government use license for public health purposes. The success of the government using license in providing HIV/AIDS patients with improved access to essential medicines demonstrates that flexibilities exist within the Patents Act 1983, which could be utilized to serve the broader public interest by providing access to essential medicines even though patent law is essentially designed to confer inventors with exclusive rights.

### Legal Context

The statute governing patents in Malaysia is the Patents Act 1983.<sup>1</sup> While the Act is primarily concerned with the protection of the interests of the patent holder, there are provisions in the Act which seek to strike a balance with the interests of the public at the same time. An important means of achieving a balance is through the compulsory licensing of patents, which includes the government use of patented inventions. Compulsory licensing refers to the non-voluntary authorization by a government, either to itself or to a third party, to exercise a patent holder's right without his authorization, for various reasons, such as national or public interest, public health, anti-competitive practices, failure to work a patent for a period of time, and the inter-dependency of patents. Under the Patents Act 1983, compulsory licensing is dealt with in Part X (sections 48 to 54) and in the case of government use of patented inventions, it is governed by section 84. Part X itself provides for the granting of compulsory licenses in two distinct situations, namely, abuse of monopoly status and interdependence of patents. Although Part X is titled "Compulsory Licenses" while section 84 bears the heading "Rights of Government," both are essentially concerned with the non-voluntary authorization by the government of a patent holder's exclusive right and, accordingly, would fall within the umbrella term of "compulsory licensing."

The grant of a compulsory license under Part X is made by way of an application to the registrar of Patents by any person, which includes an individual or a corporate body.<sup>2</sup> In contrast, the government exploitation of a patented invention under section 84 is a decision made by the Minister of Domestic Trade, Cooperatives, and Consumerism based on the grounds specified in the provision. The right of exploitation may be given to a government agency or a third person designated by the Minister. Such government agencies are defined in section 84(13) to mean the Federal Government or the Government of a State. Unlike compulsory licenses under Part X which can only be granted after the expiration of a time period specified in section 49(1), no time limit is imposed on the government's use of a patented invention under section 84.<sup>3</sup>

1. Act 291.

2. Interpretation Acts 1948 and 1967 (Act 388) section 3.

3. An application under section 49 may only be made after the expiration of three years from the grant of a patent, or four years from the filing date of the patent application, whichever is later.

Section 84 provides two separate grounds upon which the government may exploit a patented invention. These are as follows:

1. Where there is national emergency or where the public interest, in particular, national security, nutrition, health or the development of other vital sectors of the national economy as determined by the government, so requires; or
2. Where a judicial or relevant authority has determined that the manner of exploitation by the owner of the patent or his licensee is anti-competitive.<sup>4</sup>

Prior to its amendment by the Patents (Amendment) Act 2000,<sup>5</sup> section 84 merely provided that the government may make, use, and exercise any patented invention without specifying the grounds upon which such exercise may be made. This position was less than satisfactory as it meant that there was no obligation on the part of the government to provide any justification for interfering with the exclusive rights of a patent holder. The Amendment Act in the year 2000, which was enacted to ensure that the Patents Act 1983 complied with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS"), introduced the two grounds mentioned above, thereby bringing the provision in line with Article 31 of TRIPS.

Once a decision has been made by the government to use a patented invention in circumstances where no agreement has been obtained from the patent holder, section 84(2) requires that a notification be given to the patent holder as soon as is reasonably practicable. Adequate remuneration for such exploitation is required to be made to the patent holder under section 84(3). Pursuant to the subsection, the exploitation of the patented invention shall be limited to the purpose for which it was authorized and shall be subject to the payment to the patent holder of an adequate remuneration for such exploitation. In determining what constitutes

4. In relation to semi-conductor technology, different considerations apply when deciding whether the government should exploit a patented invention. Pursuant to section 84(5), the exploitation by the government in this sector shall only be authorized either for public non-commercial use or to remedy anti-competitive practice of the patent holder or his licensee. In addition, such authorization shall not exclude the continued exercise by the patent holder of his exclusive rights nor shall it exclude the issuance of any compulsory license under Part X.

5. Act A1088.

"adequate remuneration," the subsection lays down two guiding principles which are as follows:

1. The economic value of the Minister's authorization as determined in the decision; and
2. Where a decision has been taken on the basis that the manner of exploitation by the patent holder is anti-competitive, the need to correct such anti-competitive practices.

The patent holder and any other interested person are given the opportunity to be heard under section 84(4) when the Minister deliberates on the quantum of "adequate remuneration." Section 84(8) makes it clear that the government use of a patented invention shall be predominantly for the supply of the market in Malaysia.

The possibility that circumstances may change with time, which may necessitate a revision of the government's decision to use a patented invention, is dealt with in subsections 84(9) to (11). Pursuant to section 84(9), the patent holder, the government agency, or the third person authorized to exploit the patented invention may request the Minister to vary the terms of the decision on the ground that changed circumstances justify such variation. This includes termination of the authorization under section 84(10), upon request of the patent holder, if the circumstances that originally warranted the government's use no longer exist and are unlikely to recur, or the government agency or the appointed third person has failed to comply with the terms of the decision. However, the Minister shall not terminate the authorization if he is satisfied that the need for adequate protection of the legitimate interests of the government agency or the third person designated by him justifies the maintenance of the decision. Any decision of the Minister made under section 84 may be appealed to the court by the patent holder, the government agency, or the third person authorized to exploit the patented invention.

Apart from section 84, an application for a compulsory license may be made under Part X of the Act, specifically on the grounds of abuse of monopoly under section 49 and the inter-dependence of patents under section 49A. Section 49(2) requires the person making the application to demonstrate that he has made prior efforts to obtain authorization from the owner of the patent on reasonable

commercial terms and conditions, but such efforts have not been successful within a reasonable period of time. The grounds upon which such an application may be made are as follows:

1. Where there is no production of the patented product or application of the patented process in Malaysia without any legitimate reason, or
2. Where there is no product produced in Malaysia under the patent for sale in any domestic market, or there are some but they are sold at unreasonably high prices or do not meet the public demand without any legitimate reason.

A compulsory license that is issued based on the inter-dependence of patents under section 49A (1) aims to address the difficulty that arises when the invention in a later patent cannot be worked in Malaysia without infringing an earlier patent. The invention claimed in the later patent must constitute an important technical advancement of considerable economic significance in relation to the invention claimed in the earlier patent. Clearly, this provision ensures that the exclusive rights of an earlier patent holder do not pose a barrier to technological developments that could be brought about by a later invention. Unlike a compulsory license under section 49, an application for a compulsory license on the ground of the inter-dependence of patents may be made at any time the patent is granted to the earlier invention. The application may be made not only by the owner of the later patent but also by the licensee of a contractual license under the later patent or the beneficiary of a compulsory licensee under the later patent. Section 49(2) provides that if a compulsory license is granted under section 49A(1), a reciprocal compulsory license under the later patent may be granted to the owner of the earlier patent at his request. Such cross-licensing is intended to balance the relative positions of the interested parties, particularly when the production and sale of products based on the later patent will result in obsolescence of products under the earlier patent.<sup>6</sup>

A compulsory license granted either under section 49 or 49A shall be limited to the supply of the patented invention predominantly in Malaysia. The beneficiary

6. See Lim, HG. 2004. "The Compulsory Licensing Provisions in the Patents Act 1983 – A Potent Weapon or an Emasculated Deterrent?" 1 MLJ lxx at lxxii.

of a compulsory license is prohibited by section 53(2) from concluding license contracts with third parties under the patent in respect of which the compulsory license was granted. Upon the granting of a compulsory license either under section 49 or 49A, the Intellectual Property Corporation of Malaysia is required under section 52 to fix the following terms:

1. The scope of the license specifying in particular the period for which the license is granted;
2. The time limit within which the beneficiary of the compulsory license shall begin to work the patented invention in Malaysia; and
3. The amount and conditions of the royalty due from the beneficiary of the compulsory license to the owner of the patent.

A compulsory license may be amended by the Intellectual Property Corporation of Malaysia pursuant to section 54(1) on the request of the owner of the patent if new facts justify any amendment. Cancellation of a compulsory license may be made on one of the following grounds:

1. If the ground for the grant of the compulsory license no longer exists;
2. If the beneficiary of the compulsory license has, within the time limit fixed in the decision granting the license, neither begun the working of the patented invention in Malaysia nor made serious preparations towards such working;
3. If the beneficiary of the compulsory license does not respect the scope of the license as fixed in the decision granting the license; or
4. If the beneficiary of the compulsory license is in arrears of the payment due, according to the decision granting the license.

### Facts

Since the first reported case on AIDS in Malaysia in 1986, the number of HIV cases in the country has escalated significantly to a total of 58,012 that were reported to the Ministry of Health as of December 2003. Of this number, there were 8,294

AIDS cases. The number of deaths from AIDS was 6,130.<sup>7</sup> It was in that year that the Malaysian Ministry of Health invoked section 84(1)(a) of the Patents Act 1983 to issue a contract to a local Malaysian company to import four types of ARVs from a company in India for the treatment of HIV and AIDS infection.

In 2003, the Ministry of Health was allocated a sum of USD 193.6 million for pharmaceutical drugs and of this amount a sum of USD 3.6 million was for ARVs.<sup>8</sup> However, most of the HIV/AIDS patients were intravenous drug users who could not afford the high cost of the ARVs and had to turn to the government for treatment. Faced with this situation and compounded by the spiraling number of HIV/AIDS patients, the government was confronted with the difficult task of ensuring access to affordable ARVs. At that time, the government's practice of providing HIV/AIDS patients with access to ARVs was as follows:<sup>9</sup>

1. Monotherapy was given free in government hospitals.
2. Highly Active Antiretroviral Treatment ("HAART") was given free to selected groups of patients, namely, infected mothers after delivery, infected children, healthcare workers infected in the line of duty, and patients infected through contaminated products or blood transfusion.
3. Other patients on HAART were required to purchase two drugs, but a third drug was provided free of charge.

One reason for providing a limited form of assistance for patients on HAART is that the annual budget of USD 3.6 million for HIV/AIDS treatment was insufficient to meet the needs of the patients in the country. With a large majority of patients being intravenous drug addicts and unable to afford the high prices of patented ARVs, the situation became a matter of grave concern for the government. In 2001, the Ministry of Health sought a price reduction from pharmaceutical companies

7. See Ministry of Health. 2003. *Annual Report*. Retrieved June 15, 2015. from <http://www.moh.gov.my/images/gallery/publications/md/tt/2003.pdf>.

8. Chee, YL. 2005. *Malaysia's Experience in Increasing Access to Antiretroviral Drugs: Exercising the 'Government Use' Option 5*. Penang: Third World Network.

9. *Ibid* at 7.

and the following reduction in percentage terms was obtained after some negotiations:<sup>10</sup>

1. Non-patented ARVs:
  - (i) Ritonavir capsule and oral solution (10%)
  - (ii) Stavudine (25%–34%)
  - (iii) Nevirapine (68.5%)
2. Patented ARVs:
  - (i) Didanosine (36%)
  - (ii) Zidovudine (30%)
  - (iii) Zidovudine + Lamivudine combination (40%)
  - (iv) Indinavir (65%)
  - (v) Efavirenz (65%)

However, the government felt that this reduction was unsatisfactory as the prices of the ARVs were still too high to be within the reach of most HIV/AIDS patients. At that time, the gravity of public health problems afflicting developing and least-developed countries became the focus of international concern. It was recognized that while intellectual property protection was important for the development of new medicines, their high prices became a barrier to access medicines in developing and least-developed countries. It was conceded by the international community that TRIPS should not prevent members from taking measures to protect health. The Agreement should be supportive of WTO members' right to public health, particularly to promote access to medicines for all. Following that, attention was given to the flexibilities contained in TRIPS. Compulsory licensing and parallel importation were seen as suitable alternative approaches. Encouraged by the

10. *Ibid* at 8.



Doha Declaration on TRIPS and Public Health, the Ministry of Health urged the Malaysian Cabinet in November 2002 to agree to the importation of generic ARVs.<sup>11</sup> This recommendation was approved by the cabinet and Section 84(1)(a) was invoked as the legal basis for the importation.<sup>12</sup> When price negotiations with the Mumbai-based pharmaceutical manufacturer, Cipla, began in January 2003, GlaxoSmithKline reduced the price of its ARVs (3TC, AZT and Combivir) by 31–57%. Nevertheless, on October 29, 2003, the government proceeded to authorize the Malaysian pharmaceutical company, Syarikat Megah Pharma & Vaccines (M) Sdn Bhd, to import from Cipla the following drugs:

1. Didanosine 100mg tablets produced by Bristol-Myers Squibb
2. Didanosine 25mg tablets produced by Bristol-Myers Squibb
3. Zidovudine 100mg capsule produced by GlaxoSmithKline
4. Lamivudine 150mg + Zidovudine 300 mg tablets produced by GlaxoSmithKline

The government's authorization given to Syarikat Megah Pharma & Vaccines (M) Sdn Bhd was for a period of two years, commencing on November 1, 2003, and it was subject to the following conditions:<sup>13</sup>

1. The authorization shall be limited to the importation of the generic versions of the named drugs;
2. The imported drugs shall only be for supply to government hospitals;
3. The importation of the drugs shall be subject to the terms and conditions as specified by the Ministry of Health;
4. The quantity to be imported shall be as specified by the Ministry of Health;

11. *Id.* at 11.

12. See letter dated October 29, 2003 from the then Minister of Domestic Trade and Consumer Affairs to the Director of Operations, Syarikat Megah Pharma & Vaccines (M) Sdn Bhd. Retrieved June 15, 2015. from <http://www.cptech.org/ip/health/c/malaysia/arv-license.html>.

13. *Id.*

5. All packaging of the drugs shall be labeled with the words "Kementerian Kesihatan Malaysia" (Ministry of Health, Malaysia);
6. The brand, shape or coloring of the tablets or capsules shall be differentiated from that of the patented products in Malaysia;
7. Syarikat Megah Pharma & Vaccines (M) Sdn Bhd shall be required to register the sale in the scheduled poisons register; and
8. The ceiling price for the drugs to be supplied to the Ministry of Health shall not exceed the following:
 

(i) Didanosine 100mg tablet	MYR 74.58 (per box of 60 tablets)
(ii) Didanosine 25mg tablet	MYR 22.80 (per box of 60 tablets)
(iii) Zidovudine 100mg capsules	MYR 5.89 (per set of 10 capsules)
(vi) Lamivudine 150mg + Zidovudine 300mg tablet	MYR 153.50 (per box of 60 tablets)
9. Payment of compensation, which will be determined at a later date, shall be made to the patent holders within two months of each import of the drugs.

The government proposed a remuneration of 4% of the value of stocks delivered based on the United Nations Development Programme ("UNDP") Human Development Report 2001 recommendation.<sup>14</sup> However, the amounts were not claimed by the patent holders. Three reasons have been suggested for the absence of interest on the part of the patent holders to claim the remuneration.<sup>15</sup> First, the patent holders did not wish to set any precedent for the quantum of remuneration for future government use. Secondly, by accepting the remuneration, it may have put the patent holders in an unfavorable light because they would be seen to have accepted the compulsory licensing and agreed to receive less than the full royalty. Thirdly, the patent holders did not want to be seen as having accepted the rights of the government to use the patented drugs.

14. Chee, *supra* note 8 at 15.

15. *Id.* at 16.

### Reasoning of the Government

The Malaysian government's decision to invoke section 84(1)(a) of the Patents Act 1983 to authorize the importation of ARVs was prompted by the need to assist HIV/AIDS patients in the country with access to the drugs at an affordable price. By the turn of the century, HIV/AIDS had become a serious health issue in Malaysia with a worrying increase in the number of deaths each year from the disease. While acknowledging that patent protection is essential to encourage innovation, the government also took cognizance of the fact that a balance had to be struck in granting monopoly rights to private entities on the one hand and the public interest to have access to the patented invention on the other hand. Unfortunately, patent protection of the ARVs had led to their high prices, causing very limited access to the drugs by the majority of HIV/AIDS patients in the country. In light of this, in the year 2002, the government reasoned that to increase the public's access to ARVs, a HAART policy was adopted with the following four-pronged strategy:<sup>16</sup>

1. Provide free HAART to patients with CD4 count < 400. The target was to increase the number of patients seeking treatment in government hospitals;
2. Negotiate with patent holders to bring down the prices of ARVs;
3. Encourage local production of ARVs that were not patented in Malaysia; and
4. Consider the use of the "Rights of Government" provision in section 84 of the Patents Act 1983.

While these strategies were pursued simultaneously, it became clear that negotiations with patent holders were unsuccessful in bringing the prices of the drugs down to an affordable level. Encouraged by the then international outcry that TRIPS should not prevent member states from taking measures to protect public health and the role of flexibilities in the Agreement in promoting public health, the government reasoned that the circumstances justified the invoking of section 84 of the Patents Act 1983. Accordingly, the decision was made to authorize Syarikat Megah Pharma & Vaccines (M) Sdn Bhd to import the generic ARVs from India. With that step, Malaysia became the first Asian country following the adoption

<sup>16</sup> *Id.* at 9.

of the Doha Declaration on TRIPS and Public Health to issue a government use license even though Malaysia had not ratified Article 31bis of the TRIPS Agreement. Indeed, as of the time of writing, Malaysia has not ratified Article 31bis yet.

The decision to invoke section 84 did not involve the consideration of any legal intricacies in patent law. Instead, it was purely a policy decision made by the government to utilize the flexibilities in TRIPS, and this was also fueled by international developments then taking place with regard to public health. Despite the patent holders and some governmental agencies expressing their concerns that such an action would deter foreign investors, the government stood firm on its decision.

### Legal Analysis

This case shows that when health officials and the government are informed of the rights and flexibilities available under the Patents Act 1983, access to affordable medicines is an attainable possibility. The success in exercising the government use provision under section 84 of the Patents Act 1983 has given many HIV/AIDS patients a new lease of life. By extension, if governments of developing and least-developed countries avail themselves of the flexibilities under TRIPS, access to affordable medicines for their citizens may be improved. That might help to explain why GlaxoSmithKline and Bristol-Myers filed a law suit against the government but it was not activated at all.<sup>17</sup>

The invocation of the government use or compulsory license provisions as a strategy to reduce the costs of medical treatment and provide greater social welfare should be coupled with a scheme which provides adequate remuneration to the patent holder. Neither section 84 nor Part X of the Patents Act 1983 provides any method or guidance on fixing the amount and conditions of the royalty due to the patent holder. In this case, the government fixed a remuneration of 4% of the price charged by the generic competitor based on the 2001 UNDP Human Development

<sup>17</sup> Chee, *supra* note 8 at 14.

he may, within 15 days from the date of receipt of the notification of the order, take legal action before a People's court in accordance with the Administrative Procedure Law of the People's Republic of China. If the infringer neither takes legal action at the expiration of the time limit nor ceases the infringement, the said department may file an application with the People's Court for compulsory enforcement. The administration department for patent-related work that handles the call shall, upon request of the parties, carry out mediation concerning the amount of compensation for the patent right infringement. If mediation fails, the parties may take legal action before the People's court in accordance with the Civil Procedure Law of the People's Republic of China.

Enforcement of patent rights can be carried out by administrative agencies (such as the State Intellectual Property Office ("SIPO") and provincial IP offices. Once an IP administrative agency has intervened, the parties are prevented from directly resorting to courts. However, courts can review the decisions made by the IP administrative agencies. The present case is concerned with an appeal against the decision made by the IP Office of Jiangsu Province.

### Facts

Registered in mainland China as Foxconn Technology Group ("Foxconn") and headquartered in Taiwan, Hon Hai Precision Industry Co. ("Hon Hai") is one of the world's largest electronics manufacturers. It provides supplies to global brands such as Apple Inc., Blackberry Ltd., and Nintendo Co. Ltd. Lotes Co. Ltd ("Lotes") and its subsidiary Lotes Suzhou specialize in the design and manufacture of connectors, CPU sockets, mobile electronic devices and the like. In June 2008, Hon Hai applied for a utility model patent in China with the SIPO. In June 2011, the SIPO granted the patent (patent number: CN200810128623.1) to Hon Hai.

The Contributors Agreement, ratified by the USB Implementation Forum ("USB-IF") and contributors in June 2011, set forth the conditions for licensing a

1. Randles, Jonathan. "Foxconn Schemed To Kick Rival Out Of USB Market, Suit Says." *Law 360*. Retrieved October 10, 2012. <http://www.law360.com/articles/385604/foxconn-schemed-to-kick-rival-out-of-usb-market-suit-says>.

contributor's SEPs. It provides that the contributors, on behalf of themselves and their affiliates, agree that they will grant a "non-exclusive, world-wide license under their Necessary Claims" to any promoter, contributor, or adopter. The criteria for how one could benefit from this license are outlined in the Necessary Claims. As both Hon Hai and Lotes are members of USB-IF, they are required to license the relevant SEPs to other members by reasonable and non-discriminatory terms ("RAND").<sup>2</sup>

In July 2012, Hon Hai brought an administrative enforcement action jointly with Foxconn, accusing Lotes of infringing its patent through production and sale of relevant products. The accused products sold by the defendant included USB 3.0 connectors that were covered by the patent in suit. USB 3.0 is the third major version of the USB and a non-mandatory industrial standard developed by the USB-IF. In defense, Lotes asserted that its products were not infringing Hon Hai's patent, since the accused products received permission from Hon Hai provided under the USB 3.0 Contributors Agreement as well as USB 3.0 Specification, which provides the technical details for USB 3.0 requirements and the design of USB 3.0-compatible products. The USB 3.0 Specification incorporated certain patented technologies owned by Hon Hai and Lotes.<sup>3</sup>

Relying on Article 11 of the Patent Law, Hon Hai refused to grant license to Lotes. Moreover, it accused Lotes of infringing claims 2 and 4 of its patent. Further, Hon Hai threatened to sue Lotes' customers and distributors for patent infringement unless they shifted to "purchasing Hon Hai's USB devices. Hon Hai made those accusations on the ground that it owns the patent rights in the relevant USB technologies. In July 2012, the IP Office of Jiangsu Province issued an administrative decision, finding that Hon Hai's patent right had been infringed. The key issue was whether the products in question were indeed SEPs. The products would be regarded as SEPs if the defendant could rely on the Contributors Agreement and Specification to assert that it has already received authorization to use those patents. The Office found that the Specification did not

2. "RAND" is often regarded as imposing same/similar obligations as a fair, reasonable, and non-discriminatory (FRAND), see Chris Neumeyer (August 2014), "When Is Foreign Patent Licensing Subject to US Antitrust Law?" *The Licensing Journal*, Vol. 34(7). p. 5, available at: <http://techlaw.biz/wp-content/uploads/2014/08/When-is-Foreign-Patent-Licensing-Subject-to-US-Antitrust-Law-201408.pdf>.

3. Bai, Benjamin. "To Be or Not To BE SEPs." *Walters Kluwer*. Retrieved February 23, 2015. from <http://kluwerpatentblog.com/2015/02/23/to-be-or-not-to-be-seps>.

discuss specifically the products that the defendant was producing, nor mention the technical specifications for the second difference signal connectors and the second weldlegs; that the qualities of the defendant's products did not fall under the definition of SEPs as provided by the Contributors Agreement; and that Lotes failed to show that no other reasonable and non-infringing alternatives were available and therefore had used the patents illegally.

Lotes appealed the decision to the Nanjing Intermediate People's Court, and subsequently to the Jiangsu High People's Court. Both courts ruled in favor of the IP Office of Jiangsu Province in December 2013 and December 2014 respectively, holding that Lotes had infringed Hon Hai's patent rights.

## Reasoning of the Courts

### Technical Features Must Be Explicitly Disclosed in the Specification

First, Jiangsu High People's Court argued that the Necessary Claims must be determined strictly according to the definition under the USB 3.0 Contributors Agreement. Under Article 1.8 of the Contributors Agreement, an SEP is defined in terms of "Necessary Claims" as follows: "claims of a patent or patent application that (a) are owned or controlled by a party or its Affiliates now or at any future time during the term of this agreement; and (b) are necessarily infringed by implementing those portions of the Final Specification within the bounds of the Scope, wherein a claim is necessarily infringed only when it is not possible to avoid infringing it because there is no commercially reasonable and non-infringing alternative for implementing such portions of the Final Specification within the bounds of the Scope."

Meanwhile, the Contributors Agreement also provides that "Necessary Claims" do not include "any claims (x) other than those set forth above even if contained in the same patent or patent application as Necessary Claims; (y) that read solely on any implementations of any portion of the Final Specification that are not within the bounds of the Scope; or (z) that, if licensed, would require consent from, and/or a payment of royalties by the licensor to unaffiliated third parties."

According to the Jiangsu High People's Court, the literal reading of these two provisions leads to two conditions for considering the scope of the Necessary

Claims. First, technical features covered by the Necessary Claims must be explicitly disclosed in the Specification. Second, technical features can be determined as part of the Necessary Claims only when no commercially reasonable, non-infringing alternative can be found.

With regards to the explicit disclosure condition, Lotes argued that, while it was true that the Specification did not describe or disclose the technical specifications in the asserted patent claims, these technical specifications were known technical features, and that any combination of known technical features with the standards must fall within the scope of the Necessary Claims. The Jiangsu High People's Court, however, flatly rejected this argument and ruled that it was obvious that technical features contained in claims 2 and 4 of Hon Hai's patent were not explicitly specified by the USB 3.0 Contributors Agreement. Therefore, they did not fall under the ambit of the Necessary Claims.

Regarding the second condition, Lotes asserted that Hon Hai's patent contains technical features that are necessary to make Lotes' products commercially competitive in the market. This is because only the application of Hon Hai's patent could improve product quality and reduce production costs, rendering other technical alternatives incapable of increasing the commercial competitiveness of Lotes' products. The Jiangsu High People's Court rejected Lotes' reasoning and ruled that Lotes failed to prove that it could legally utilize Hon Hai's patent because it was not able to find a commercially reasonable alternative that would not infringe patent rights concerned. The Jiangsu High People's Court pointed out that under the USB 3.0 Contributors Agreement, the Necessary Claims are only defined as those that do not have commercially reasonable and non-infringing alternatives. Therefore, it is wrong to infer that so long as a non-infringing alternative would make an accused infringer's products commercially competitive, this alternative should be deemed commercially reasonable and then a relevant patent owner's patent claims should be deemed part of the Necessary Claims.

### Contributors Agreement and Specification Do Not Generate Licenses Automatically

Article 3.4 of the Contributors Agreement requires contributor(s) to provide a "non-exclusive world-wide license under any Necessary Claim of a patent or patent application ... on a royalty-free basis and under otherwise reasonable and

non-discriminatory ('RAND-Zero') terms ..." to any adopter. As Lotes also signed the USB 3.0 Contributors Agreement, it alleged that it was entitled to a RAND-Zero license. However, the Jiangsu High People's Court disagreed and ruled that neither the USB 3.0 Contributors Agreement nor the Specification generated patent licenses automatically. The Court opined that a contributor is only obligated to grant patent licenses to the Necessary Claims of its patent. In other words, a contributor is not obligated to grant patent licenses to the technical claims that are not covered by the Necessary Claims. Moreover, the Jiangsu High People's Court pointed out that license terms for Necessary Claims can still be adjusted in certain ways even though RAND-Zero terms apply. Moreover, USB 3.0 Specification itself stipulates that it does not grant any license, "express or implied, by estoppel or otherwise, to any Intellectual Property Rights."

In addition to ruling that the Necessary Claims did not cover claims 2 and 4 of Hon Hai's patent, the Jiangsu High People's Court further held that Lotes did not obtain a license from Hon Hai to use the technical features contained in claims 2 and 4. Moreover, the Court found that the correspondence between Lotes and Hon Hai only showed that the two companies negotiated on the licensing issues. It did not necessarily follow that Hon Hai had agreed to grant a license.

## Legal Analysis

### Strict Reading of SEPs a Threat to Technological Innovation

While some standards are not patented technologies, such as Internet standards TCP/IP, HTML, and XML, many others apply patented technologies. Those patented inventions which are indispensable for the implantation of standards are called SEPs. SEPs come to fruition when companies collaborate to design essential specifications or processes and manufacture key components according to adopted standards. To this end, SEPs help products made by different companies to be interchangeable and interoperable. A classic example for SEP is the agreement in the design of wall plugs and electronic sockets. SEPs also reduce the costs of competition and innovation in a wide range of technology sectors.

Recent developments suggest that when a patent is an SEP encumbered with a FRAND licensing commitment (i.e. FRAND royalty rate), the patent holder should

not be entitled to get injunctive relief against any party who is willing to obtain a license to use the patent. This arrangement is intended to prevent the patent holder from extracting unfair royalties and impeding the implementation of the SEP by unduly exerting the threat of injunction. On the other hand, however, it has also been criticized that a categorical rule barring injunctive relief for FRAND-encumbered SEPs fails to take into account the dispute over the legal nature of FRAND commitments, the fact-specific history of licensing negotiation between the parties, and the market power of patent holders and license-seekers. Such a categorical rule would erode the commercial value of those SEPs.

However, as discussed previously, the Jiangsu High People's Court ruled that only when the technological specifications were specially mentioned in the SEPs agreements or when separate licensing arrangements with the patent owners were established can SEPs be utilized legally. This decision would make the application of SEPs highly fact-dependent and technology-specific, at least in Jiangsu Province. In other words, patent owners can easily argue that disputed products do not fall under the "nonexclusive, world-wide license" granted and subsequently request that courts issue an injunction order and even award damages.

The present decision could have profound negative implications for the application of SEPs in promoting innovation and its application. It basically sets up an extremely high threshold for the agreements of SSOs to grant FRAND licenses to SEPs. If the applicability of SEPs is so narrow as the Jiangsu High People's Court decided, burgeoning technology companies could be susceptible to legal threats posed by aggressive patent holders who could demand injunction and/or as much damages as possible.

### Statement by Foxconn to the USB-IF Neglected

Apart from the strict interpretation of the scope of Necessary Claims, the Jiangsu High People's Court used a very narrow understanding of whether a license for using an SEP had been granted. In a letter sent by Foxconn to the USB-IF in February 2012, Foxconn stated as follows:

"Foxconn unequivocally affirms that it will make the 'Necessary Claims' used in connection with all USB 3.0 'Compliant Portions'— i.e. that IP that is necessary

to practice the USB 3.0 specification — available to other USB 3.0 contributors and adopters under RAND-Zero terms pursuant to the USB 3.0 Contributors Agreement. In addition to those Necessary Claims, Foxconn holds other IP that is necessary to practice the USB 3.0 specification, but that may be optionally incorporated into USB 3.0 connectors. Foxconn unequivocally affirms that it will license its IP covering these optional features on RAND terms.”<sup>4</sup>

This document is of vital importance in demonstrating whether Hon Hai, the parent company of Foxconn, has granted automatic licenses to the members of the USB 3.0 Contributors Agreement to use its utility model patent under dispute in the present case. It is obvious that the wording of this statement has shown that Foxconn has unequivocally granted automatic licenses to the members of the USB 3.0 Contributors Agreement. However, it seems that the Jiangsu High People’s Court turned a blind eye to this statement.

### Missing the Public Interest of SEPs for the Construction of License Agreements

U.S. courts and administrative authorities place more emphasis on social and public interests in deciding applications for injunctive relief. In *eBay, Inc. v. MercExchange, L.L.C.* (“the *eBay* case”), the U.S. Supreme Court found that discretion should be exercised before granting an injunction. Therefore, courts should apply the traditional four-factor test for permanent injunction which requires a plaintiff to demonstrate that: “(1) it has suffered an irreparable injury; (2) remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) the public interest would not be disserved by a permanent injunction.”<sup>5</sup> Besides, the International Trade Commission (“ITC”) is required to consider the public interest factors in section 337 of the Tariff Act of 1930. When the ITC issues an exclusion order that directs U.S. Customs and

4. “Catching up on ... Lotes v. Foxconn RAND/antitrust dispute over USB 3.0 standard-essential patents.” Essential Patent Blog. Retrieved February 13, 2013. from <http://www.essentialpatentblog.com/2013/02/catching-up-on-lotes-v-foxconn-randantitrust-dispute-over-usb-3-0-standard-essential-patents/>.

5. *eBay, Inc. v. MercExchange, L.L.C.*, 547 U.S. 389, 391 (2006).

Border Protection to stop the import of products that infringe U.S. patents,<sup>6</sup> it should weigh the effect of the import on “public interest considerations include: (1) public health and welfare, (2) competitive conditions in the U.S. economy, (3) the production of like or directly competitive articles in the U.S., and (4) the U.S. consumers.”<sup>7</sup>

By contrast, the IP Office of Jiangsu Province, the Nanjing Intermediate People’s Court and the Jiangsu High People’s Court in the present case focused too much on the definition of “Necessary Claims” prescribed by the Contributors Agreement and Specification and the analysis of whether Lotes had obtained a license from Hon Hai. They did not consider the public interest of SEPs for the construction of license agreements.

### Commercial/Industrial Significance

The present case triggered litigations in the U.S. Beginning in 2012, Lotes lodged complaints before U.S. federal courts, alleging that Hon Hai’s failure to license and its enforcement of the patents concerned had breached its contract with the USB-IF and violated the Sherman Act. In addition to the antitrust complaints, Lotes also raised the issue of breach of contract, promissory estoppel, and tortious interference, and sought a declaration that Lotes was granted a license. The antitrust allegation was dismissed by the U.S. District Court for the Southern District of New York, which was affirmed by the U.S. Court of Appeals for the Second Circuit in 2014.<sup>8</sup> The Second Circuit focused its ruling on a jurisdiction issue arising from the Foreign Trade Antitrust Improvements Act of 1982 (“FTAIA”). It found that the claim fell outside the jurisdiction of the U.S. court because “any domestic effect resulting from the defendants’ failure to license their U.S. patents did not proximately cause Lotes’ injury.”<sup>9</sup>

6. Jones Day. April, 2013. Standards-essential Patents and Injunctive Relief, available at: <http://www.jonesday.com/files/Publication/77a53dff-786c-442d-8028-906e1297060b/Presentation/PublicationAttachment/270fc132-6369-4063-951b-294ca647c5ed/Standards-Essential%20Patents.pdf>.

7. World Trade Organization. (January 16, 1989). *United States—Section 337 of the Tariff Act of 1930* p. 9, available at: [https://www.wto.org/english/tratop\\_e/dispu\\_e/87tar337.pdf](https://www.wto.org/english/tratop_e/dispu_e/87tar337.pdf).

8. Neumeyer, footnote 2.

9. *Lotes Co., Ltd. v. Hon Hai Precision Industry Co.*, 753 F.3d 395, 414 (2d Cir. 2014).

Lotes manufactures USB connectors in factories located in mainland China and typically sells the connectors to other Taiwanese firms known as Original Design Manufacturers (“ODMs”).<sup>10</sup> Therefore, the present case carries profound implications in mainland China for the development of the IT industry in general and ODMs in particular. USB connectors are key components for many IT products. Manufacturers of USB connectors, due to the present case, will need to obtain licenses from Hon Hai in order to use the relevant USB 3.0 technical features. This will not only slow down the manufacturing process, but will also increase the manufacturing costs for USB connectors.

10. ODMs make and assemble computer products incorporating USB connectors for many well-known computer brands, such as Acer, Dell, HP, and Apple. Those name-brand computer products, in turn, make their way into the hands of consumers and businesses around the world, including in the United States. According to industry sources and press reports, “as of 2011, roughly 94% of global notebook computers were assembled by a small number of Taiwanese vendors, primarily ODMs maintaining production facilities in China.” *Id.*, at 7.

## 4.4

### Anti-monopoly Case against Qualcomm’s Patent Licensing Practice

Li Jing, Assistant Professor, Xiamen University, IP Research  
and Professor Lin Xiuqin, Xiamen University

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#### Case Information

National Development and Reform Commission (“NDRC”), China, *Administrative Sanction Decision No. 1* [2015] (February 9, 2015)<sup>1</sup>

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#### Summary

As the first anti-monopoly decision made by Competition Authority against Qualcomm’s patent licensing practice in China, this decision deals with the legality of charging excessive royalty for standard essential patents (“SEPs”), imposing royalty rates based on the net wholesale prices of handset devices, failing to provide patent portfolio, charging for expired patents, bundling SEPs with non-SEPs into packages, imposing free grant-back obligation and conditioning supply of chips on unreasonable terms etc. Qualcomm was found to have abused its dominant power by engaging in excessive pricing, imposing unfair terms, and bundling. A fine of 8% of its 2013 revenue in China, RMB 6.08 billion was levied against Qualcomm in addition to an injunction-like cease order that requests Qualcomm to immediately cease the abusive behavior. Qualcomm accepted the decision and paid the fine immediately.

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1. *NDRC Administrative Sanction Decision, No. 1*. 2015. Retrieved February 9, 2015. from [http://www.ndrc.gov.cn/gzdt/201503/t20150302\\_666209.html](http://www.ndrc.gov.cn/gzdt/201503/t20150302_666209.html).

## Legal Context

According to the Anti-monopoly Law of the People's Republic of China, which came into force on August 1, 2008, operating entities with a dominant position shall be prohibited from abusing the dominant position to eliminate or restrict competition (Article 6); a violation would constitute a monopolistic conduct (Article 3(2)). If an operating entity is presumed or determined to hold a dominant position in a relevant market, the next step should be to evaluate whether such operating entity abuses its dominant position. Article 17 enumerates several types of abuse:

1. Selling commodities at unfairly high prices or buying commodities at unfairly low prices;
2. Selling commodities at prices below cost without legitimate reasons;
3. Refusing to trade with counterparties without legitimate reasons;
4. Requiring its counterparty to trade exclusively with it or the designated operating entities without legitimate reasons;
5. Bundling products or imposing unreasonable conditions for trading without legitimate reasons;
6. Applying dissimilar prices or other transaction terms to equivalent counterparties; or
7. Other conducts identified as abuse of a dominant position by anti-monopoly authorities.

Article 11 of the Regulations of Anti-Monopolistic Pricing issued by the NDRC in 2010<sup>2</sup> provides more detailed factors that shall be considered in the determination of an "unfairly high price":

1. Whether the selling price is obviously higher than the price at which other business operators sell the same goods;

2. Regulations of Anti-Monopolistic Pricing, Article 11 as of December 29, 2010, available at [http://www.gov.cn/jifg/2011-01/04/content\\_1777969.htm](http://www.gov.cn/jifg/2011-01/04/content_1777969.htm).

2. Whether the selling price is increased beyond the normal range when cost is basically stable; or
3. Whether the markup rate of the sold goods is obviously higher than growth rate of cost of transaction by counterparty.

Moreover, the abuse of intellectual property rights ("IPR") is subject to the scrutiny of Anti-monopoly Law (Article 55). Last but not least, when an abuse of dominant market position by the operating entity was found, the anti-monopoly authorities shall order its cessation, confiscate the illegal gains, and impose a fine between 1% and 10% of the turnover from the previous year (Article 47). The anti-monopoly authorities shall consider factors such as the nature, extent, and duration of the violation, to decide the concrete amount of fine (Article 49).

## Facts

Qualcomm is the world's largest smartphone chipmaker based in the United States as well as the owner of a large number of SEPs for 2G, 3G, and 4G wireless communication standards, including in particular the CDMA, WCDMA, and LTE standards. The NDRC launched an investigation in November 2013 against Qualcomm's suspected abusive behaviors in license markets and wireless telecommunication baseband chip market of CDMA, WCDMA, and LTE. On February 9, 2015, Qualcomm announced that "Qualcomm reached a resolution with NDRC," and agreed to undertake rectification measures.<sup>3</sup> The NDRC promulgated its final decision on March 2, 2015 which determined that Qualcomm violated the Anti-monopoly Law, imposed a fine of RMB 6.08 billion and ordered Qualcomm to discontinue abusing its dominant position and to implement the following rectification measures in case Qualcomm licensed its wireless SEPs to wireless telecommunication device makers within China: (1) Qualcomm is required to provide a patent portfolio list and is prohibited from charging royalties for expired patents; (2) Qualcomm is prohibited from requiring cross-licenses of non-SEPs from licensees against their will and without fair compensation; (3)

3. "NDRC Ordered Qualcomm to Rectify its Abusive Behaviors and Impose a Fine of RMB¥6 billion, the NDRC News Release. Retrieved February 10, 2015. from [http://www.sdpc.gov.cn/xwzx/xwfb/201502/t20150210\\_663822.html](http://www.sdpc.gov.cn/xwzx/xwfb/201502/t20150210_663822.html).



Qualcomm is prohibited from charging an excessively high royalty rate which is based on the net sale price of the whole mobile phones, when granting licenses to the wireless telecommunication terminators for sale within China; (4) Qualcomm is prohibited from bundling SEPs and Non-SEPs without justification; (5) Qualcomm is prohibited from imposing unreasonable sales terms, (i.e. requiring potential licensees to pay for expired patents, to cross-license for free, to bundle SEPs with non-SEPs without justification, on its supply of baseband chips to wireless communication device makers within China); it is prohibited from conditioning its supply of baseband chips on licensee's agreement not to challenge licensed patents.

### Reasoning of the NDRC

#### Qualcomm Abused Its Dominant Position in Wireless SEPs License Market

##### *Charging excessive royalty*

##### *Charging for expired wireless SEPs*

The NDRC found that it is unreasonable for Qualcomm not to provide a patent portfolio list in long-term or indefinite licensing agreements irrespective of the fact that Qualcomm constantly changes its patent package or adds new patents to the list. Qualcomm didn't evaluate or clearly indicate whether the newly-added patents are necessary for the licensees or commercially valuable nor did Qualcomm prove that the value of the expired patents was equivalent to that of newly-added patents. Qualcomm charged fixed royalty for long-term or no-fix-term licenses of patent package and put expired SEPs into patent packages. Such practice obscured the actual patents over which license has been granted, and resulted in unfair payment for Qualcomm's expired SEPs. The NDRC thus held that Qualcomm should provide fair opportunity for the licensees to negotiate in order to avoid paying for expired patents.

##### *Demanding free grant-back license*

The NDRC found it unfair that Qualcomm required free grant-back licenses from licensees. Qualcomm failed to provide effective evidences to prove that it had provided fair considerations for cross-licenses and the free cross-licenses were parts

of overall value exchanges. Qualcomm utilized its dominant position in the SEP licensing market to force licensees to provide free cross-licenses and not to deduct the value of cross-licenses of licensees.

Free cross-licenses would reduce the licensees' incentives to invest in technology innovation, hinder innovation, and development in wireless communication technology, eliminate and limit market competition, and extend unfair competitive advantage over other competitors to Qualcomm.

##### *Imposing excessively high royalty rate based on the net wholesale prices of devices*

It is obviously unfair that Qualcomm imposed royalty rate based on the net wholesale prices of devices, which is beyond the coverage of Qualcomm's wireless SEPs and resulting in excessive prices. Device makers have to bear higher IP cost if they would like to procure baseband chips from other chip makers, which hampers market competition and competitiveness of those chip makers. Such extra costs are transmitted to end users to their detriment.

##### *Tie-in*

The NDRC found that Qualcomm tied SEPs with non-SEPs whose values are uncertain to licensees, by only offering package licenses with a single royalty rate without providing the licensees the possibility to choose between a SEPs-only license and SEPs with a non-SEPs package. Qualcomm refused to render the patent portfolio list to licensees. Such tie-in is without justification because it is possible to distinguish SEPs from non-SEPs and to license them separately, and it is a common practice to define the scope of SEPs by a clause in the licensing agreement. In addition, rational licensees in principle would not bear extra cost to design around or resort to alternative technology. Thus, by tying in, Qualcomm deprived the alternative technologies of the possibility and opportunities to compete with Qualcomm's non-SEPs, seriously hampering and restricting non-SEPs market competition, repressing technology innovation, and harming consumer interests.

#### Qualcomm Abused Its Dominant Position in Baseband Chip Market by Imposing Unreasonable Sale Terms on Baseband Chip Customers

The NDRC found that Qualcomm abused its dominant position in the baseband

chip market by imposing unreasonable conditions in the chip purchase agreement. In exchange for chip purchasing, the potential licensee must undertake to conclude and not to challenge the licensing agreement of Qualcomm's whole patent package; if violated, Qualcomm would stop selling chips to the licensee. As above mentioned, the Qualcomm's package licensing agreement contained unfair terms, inter alia, charging excessive royalty for expired patents, demanding free grant-back licenses, imposing excessively high royalty rate based on the net wholesale prices of devices, and bundling SEPs and non SEPs as one patent package license, etc. It is unreasonable for Qualcomm to condition the chips deal with another patent licensing agreement with unfair terms and to deprive the licensees of their legitimate rights to bring actions for disputes. In the case of Qualcomm's refusal to provide chips, the potential or actual licensees not accepting such unreasonable terms would be squeezed out of market due to high dependence on Qualcomm's chip, which would limit or eliminate market competition. It is noteworthy that NDRC's holdings only apply to Qualcomm's wireless SEPs licensing and baseband chip selling that are used for the manufacture or sale of the wireless communication terminals within the P.R.C. and that have a close bearing on the competition of internal market and consumers' interests within the P.R.C.

### Legal Analysis

As Professor Wang Xianlin criticizes, some firms in the current Chinese market with a dominant position wantonly exploit consumers and distort the market competition mechanism. Consumers' interest will be further harmed if excessive pricing is left unchecked.<sup>4</sup> The *Qualcomm* case is a milestone in AMI enforcement in China. It demonstrates the NDRC's growing ability to tackle the complex interplay between competition law and IP law. The NDRC delivered some novel interpretations concerning licensing practices to eliminate certain unfair elements found in Qualcomm's licensing model. However, some issues should be further analyzed and clarified to provide more guidance for future cases.

4. Wang, Xianlin. 2014. Difficulties of Anti-Monopoly Regulation of Excessive Pricing and the Application of System of Price Undertaking (in Chinese), 1 *Theory and Practice of Price* 15.

### Excessive Pricing

Excessive pricing, also called "predatory pricing," exists when a price is being charged to the level that it has no reasonable relation to the costs and economic value of the products. "Unfairly high prices" and "unfairly low prices" are the forms of excessive pricing in China.

However, it has been controversial as to whether the pricing by dominant firms in industries, in which innovation is a significant driver of business success and competitive dynamics, should be regulated under competition law. The E.U. prohibits any abuse of dominant position consisting of "directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions."<sup>5</sup> Although unfair pricing has been considered as an abuse of a dominant position under European law, the European Commission, which is also the competition law authority, holds a cautious position in battling excessive pricing. It has reached only six formal decisions concerning excessive pricing between 1957 and 2013.<sup>6</sup> In the E.U.'s landmark case concerning excessive pricing, i.e. *United Brands Company and United Brands Continental BV v. Commission of the European Communities* ("*United Brands*" hereinafter), the European Court of Justice stated that "charging a price which is excessive" because it has no reasonable relation to the economic value of the product supplied would be such an abuse, and this can be determined by a two-step test: it should be shown that (1) the price-cost margin is excessive and (2) the price imposed "is either unfair in itself or when compared to competing products" (paras 250–252).<sup>7</sup>

On the contrary, the antitrust laws of the United States do not contain any provisions that would regulate or limit the prices which firms with dominant positions could charge their customers. This tenet is well supported by *Verizon Communications v. Law Offices of Curtis V. Trinko, LLP* rendered by the U.S. Supreme Court. In this decision, it was concluded that "the mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only

5. Consolidated Version of the Treaty on the Functioning of the European Union ("TFEU"), Article 102(a).

6. Evans, David and Zhang, Vanessa Yanhua. "Assessing Unfair Pricing under China's Anti-Monopoly Law for Innovation-Intensive Industries." University of Chicago Coase-Sandor Institute for Law & Economics Research Paper, 2014 (678), 6.

7. Case 27/76, *United Brands Company and United Brands Continental BV v. Commission of the European Communities*, 1978 E.C.R. 207.

not unlawful; it is an important element of the free-market system. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anti-competitive conduct.”<sup>8</sup>

The *Qualcomm* case in China shows that the enforcement agency is inclined to assess whether the dominant firm charges excessive pricing for SEPs. However, this case provides limited and vague instructions on how price comparison should be conducted and how the royalty standard under the FRAND principle be applied.

### A Two-Step Method to Assess “Unfairly High Price”

Under the mechanism of AML, when assessing “unfairly high price,” the authority is advised to take a two-step method. First, determine whether a high price exists. Second, determine whether the formation of such high prices involves an unfair element.

#### High price

Licensing royalty is decided by two parts: its base and rate. The fluctuation of each part will influence the royalty.

#### Royalty base

The NDRC held that Qualcomm’s royalty base is unreasonable since non-SEPs bundled by Qualcomm are not always commercially valuable to licensees, and the SEPs owned by Qualcomm only contributed partly to the value of the entire device. This holding is well-based and well-received. However, from the wording of the decision,<sup>9</sup> the NDRC only prohibited Qualcomm from setting royalties on the price of the entire device while maintaining royalty charges on a relatively high rate. It did not completely prohibit Qualcomm from using the entire value as royalty base. This may be the result of a negotiated compromise. However, it affects the precedential value.

8. *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, 124 S. Ct. 872, at 879 (2004).

9. *NDRC Administrative Sanction Decision No. 1*. (2015), Part 3 1(3).

As to royalty base, several cases have been decided in other countries (i.e. *Microsoft v. Motorola*,<sup>10</sup> *Ericsson v. D-Link Systems*,<sup>11</sup> *Realtek v. LSI* and *Agere*,<sup>12</sup> *CSIRO v. Cisco*,<sup>13</sup> *Golden Bridge Technology Inc. v. Apple*).<sup>14</sup> These cases show a tendency of adopting the “smallest saleable compliant implementation” standard, rather than the price of entire device. What’s more, the well-recognized standard setting organization—the Institute of Electrical and Electronics Engineers (“IEEE”) recently approved the changes to its IPR policy. According to which, the determination of reasonable royalty for SEP should be based on the smallest saleable compliant implementation that practices such SEPs.<sup>15</sup> Put alternatively, the reasonable royalty should be the value that SEPs contribute to the particular component of the device. From this perspective, the *Qualcomm* case seems not to be entirely in line with current practices elsewhere.

#### Royalty rate

Although the NDRC held that Qualcomm insisted on “a relatively high royalty rate,” it didn’t clarify the logic to determine “a relatively high royalty rate.” In order to determine “a relatively high royalty rate,” it is reasonable to first set a price comparison benchmark. The probable candidate for the benchmark is the rate based on FRAND principle. However, neither data related to reasonable level of profit/value/cost, nor method to determine “reasonable rate” had been referred to in the case. Such vague practice provides no sufficient guidance for future cases, and anti-monopoly enforcement agencies still enjoy great flexibility.

#### Unfair element

High prices may be the result of different reasons and in themselves do not necessarily constitute abuse of dominant position. Whether there exists abuse of

10. *Microsoft Corp. v. Motorola, Inc.*, 904 F. Supp. 2d 1109 (W.D. Wash. 2012).

11. *Ericsson Inc. v. D-Link Corp. et al.* (No. 10-cv-00473, E.D. Tex.).

12. *Realtek v. LSI et al.* (No. 12-cv-03451, N.D. Cal.).

13. *Commonwealth Scientific and Industrial Research Organization v. Cisco Systems, Inc.*, 6:11-cv-00343-LED (E.D. Tex. 2014).

14. *Golden Bridge Tech., Inc. v. Apple Inc.*, No. 13-1496 (Fed. Cir. 2014).

15. Ning, Susan, Peng, Kate and Lingbo Wei King & Wood Mallesons’ Antitrust Group. NDRC’s Qualcomm Decision: A Warning to Patent-heavy Companies, available at <http://www.chinalawinsight.com/2015/03/articles/corporate/antitrust-competition/ndrcs-qualcomm-decision-a-warning-to-patent-heavy-companies/>.

market dominant position should be determined by assessing if there are unfair elements involved in the formation of high price. In the context of contract law, “unfair” means that a party does not receive the proper consideration for the value it provides. Therefore, the values that two parties provide are out of balance. In *Scandlines Sverige AB v. Port of Helsingborg*,<sup>16</sup> the European Commission evaluated whether the price was unfair in itself. It focused on the economic value of the service and considered that the economic value of a service cannot simply be determined by adding to the approximate costs incurred in the provision of the service a profit margin which would be a pre-determined percentage of the costs (para. 221). Rather, the economic value must be determined with regards to the particular circumstances of the case and also take into account non-cost related factors, such as the demand for the product/service (para. 232).

In the instant case, the NDRC found unfair elements from two perspectives: charge on expired patents and free cross-licenses. There exists substantial controversy on the first perspective. Under Qualcomm’s licensing model, it provided a large patents package on wireless telecommunication for long-term or indefinite licensing. Within this running patent package, the patents were under constant change. Some patents expired and entered into public area, while some new patents kept being added to the package. Qualcomm added new patents into the package annually which commercially makes sense given the swift change of information technology. The NDRC rightly pointed out that Qualcomm failed to provide a patent list to licensees which obscured what the exact subject matter of the transaction was the base for consideration. Moreover, it would be obviously unfair if Qualcomm continued to charge for expired patents at the same rate as for new patents. In this situation, it doesn’t seem to be convincing to negate the newly-added patents into the calculation while assessing the fairness of the price for patent licensing. The determination as to whether the royalty rate is excessive should be evaluated by conducting a comprehensive investigation into the dynamics of a patent package. However, on the overall balance, the NDRC laid great emphasis on “charging for expired wireless SEPs,” yet paid little attention to the value of newly-added patents.

16. COMP/A 36568/D3 *Scandlines Sverige AB v. Port of Helsingborg and Sundbusserne AS v. Port of Helsingborg* [July 23, 2004]

Nevertheless, the NDRC did state that Qualcomm failed to provide evidence to prove that the value of newly-added patents equaled that of expired patents. It remains questionable how “unfairly high price” can be concluded without assessment and evaluation as to value difference between expired patents and newly-added patents under a dynamic patent package. The reasoning of the NDRC raised more questions than answers. Is it relevant whether licensees may take advantage of the added values? What’s more, did the NDRC presume ex-ante that Qualcomm’s royalty was unreasonably high since it was liable for its “failure to provide evidence to prove that value of newly-added patents equals the expired ones”? If that is the case, would it impose excessive burden of proof on the suspect? Would it be better for the society as a whole, or the potential licensee in particular, if the patentees withheld the newly-added patent and renegotiated the license annually?

Before we find proper answers to these critical questions, it is difficult to reach any sound conclusion. In this case, instead of mere reliance on charging for expired patents, it would seem to be a more rational and straightforward approach to establish the unfairness of the Qualcomm license based on its failure to provide the patent portfolio list. Such failure deprived the licensees of their right to know, to choose and to negotiate, because it was impossible for them to know the detailed subject matters of the licensing agreement, and which patents expired and which patents were added.

## Commercial/Industrial Significance

### Impact on Qualcomm

To Qualcomm, this case is obviously the result of mutual compromise, which can be proved by the fact that Qualcomm released news on its official website with the title that “Qualcomm reached a resolution with the NDRC,” almost one month before the NDRC released the final official decision. The costs of settlement are that Qualcomm must adjust its licensing royalty base and reduce the licensing rate, change the manner of under-table licensing dealing by providing patent portfolio list, give up bundled sales and forced patent cross-license, and pay for cross-license based on the principle of fairness.

On the other hand, as Derek Aberle, President of Qualcomm commented: “the result is that our business model and licensing model is intact, and actually more

certain than it was before the investigation.”<sup>17</sup> The benefits of the settlement are that Qualcomm’ keeps the core of its business model unchallenged, namely bundling sale of chips with licensing agreements, and reserves the right not to sell chips to any manufacturer which is not a Qualcomm licensee, and not to sell chips to any client that refuses to report its sales of licensed devices as required by its patent license agreement.<sup>18</sup>

### Impact on Chinese Enterprises

Based on the rectification plan by Qualcomm, Chinese enterprises will enjoy a lower SEP royalty rate (5% for 3G devices and 3.5% for 4G devices) and royalty base (65% of the net selling price of the device), which will lower the royalty burden of Chinese licensees. At the same time, the NDRC’s decision rejects the forced non-SEP cross-license and free cross-license,<sup>19</sup> which shakes the competitive dynamic of patent market in China. In the original model, when Qualcomm licenses its SEPs to a licensee, it will obtain the cross-license for the patents in chip from this licensee, and such cross-license extends to Qualcomm’s other chip clients, forming an umbrella-like patent pool against attack by potential patent claims from this licensee.<sup>20</sup> Following the new rules set by the *Qualcomm* case, Chinese enterprises would lose the protection of the patent umbrella of Qualcomm, which means they will pay for SEPs held by other patent holders. Therefore it may not always be true that future overall royalties paid by each Chinese enterprise will be reduced; different enterprises may face different competitive dynamics.

17. Clover, Charles. Qualcomm Chipped But Not Broken, *Financial Times*. Retrieved February 10, 2015. from <http://www.ft.com/intl/cms/s/0/cdde17a0-b0d2-11e4-9b8e-00144feab7de.html>.

18. Qualcomm China, the NDRC Accepts Qualcomm’s Rectification Plans. Retrieved February 10, 2015. from <http://www.qualcomm.cn/news/releases/2015/02/09/qualcomm-and-chinas-national-development-and-reform-commission-reach>.

19. The second part of the cease order of the decision indicated that: “Qualcomm is prohibited from requiring grant-back of non-SEPs from licensees against their will or requiring grant-back to Qualcomm without fair compensation.” It is interesting that Qualcomm avoided mentioning this part in its official news release.

20. Qualcomm argued that “grant-back is to protect Qualcomm’s business and provide protection to its chip clients from worries of patent infringement,” which is indicated in the NDRC’s decision.

### Patent-rich enterprises

It is expected that the *Qualcomm* case will benefit local patent-rich companies, (i.e. Huawei and ZTE). Such companies will not be obliged to cross license non-SEPs to Qualcomm, which means Qualcomm should pay for such cross-license. Furthermore, such companies could charge other companies for such non-SEPs. As a result, the competition position of such companies will be enhanced to some degree.

### Patent-poor SMEs

For patent-poor companies, although on the one hand they can enjoy the lower royalty rate and royalty base in the short run, on the other hand they may pay royalties to more patent holders or face a new round of patent litigations after the elimination of Qualcomm’s patent protection umbrella. For example, Mr. Yu Chengdong, the chairman of Huawei Terminal claimed that “it is highly unfair that local companies only pay royalty to Qualcomm ... local terminal peers should prepare at least 10% of the sale revenue to pay the royalties for the patent holders besides Qualcomm.”<sup>21</sup> If local patent-poor companies have to pay royalty as high as 10%<sup>22</sup> and their patent-poor situation doesn’t change, they will suffer severe loss or even have to exit the market entirely.

21. Wang, Xiaoxing. “Huawei Yu Chengdong: Xiaomi Can Only be a Short While Based on Marketing and Hying,” *Tencent Technology*. Retrieved December 19, 2014. from <http://tech.qq.com/a/20141219/012326.htm>.

22. Please note that Xiaomi, the representative of local patent-poor smart phone supplier, only had a net profit rate as low as 1.3% in 2013 Zhang, Xiaobin, “Media Report Disclosed that the Net Profit Rate of Xiaomi is 1.3%, Who is Lying?”, *China Times*. Retrieved December 19, 2014. from <http://www.chinatimes.cc/hxsb/news/gongsi/141219/1412192203-139066.html>.

## 4.5

## NDRC's Antitrust Remedies Against Qualcomm's SEP Package Licensing

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### Case Information

China's National Development and Reform Commission ("NDRC"), *Administrative Sanction Decision No. 1* [2015] (February 9, 2015)<sup>1</sup>

### Summary

The NDRC undertook an antitrust investigation of Qualcomm's patent licensing practices and concluded that Qualcomm had abused its dominant position in the wireless communication standard essential patents ("SEP") licensing market and the baseband chip sale market in violation of China's Anti-monopoly Law. The NDRC ordered Qualcomm to cease its abusive acts and imposed a fine of RMB 6.088 billion (approx. USD 975 million), the severest fine ever imposed by the NDRC or any other anti-monopoly enforcement authorities ("AMEAs") under the Anti-monopoly Law. The NDRC agreed to the rectification plan proposed by Qualcomm. In future licensing practices, Qualcomm is consequently expected to (1) provide patent lists and not charge for expired patents; (2) negotiate with licensees in good faith and provide fair consideration in case of cross-licensing; (3) grant Chinese SEP-licenses separately from its other patents instead of bundling;

1. NDRC *Administrative Sanction Decision, No. 1* (2015), available at [http://jjs.ndrc.gov.cn/fjgld/201503/120150302\\_666170.html](http://jjs.ndrc.gov.cn/fjgld/201503/120150302_666170.html).

(4) not condition the sale of chips upon the buyer's signing a patent license agreement with unreasonable terms; and (5) allow chip buyers to challenge unreasonable terms in patent license agreements.

### Legal Context

#### Three Anti-monopoly Enforcement Authorities

Article 3 of the Anti-monopoly Law defines three types of "monopolistic" conduct: Monopoly agreements reached between undertakings, abuse of market dominance, and concentration of undertakings that may have the effect of eliminating or restricting competition. The Anti-Monopoly Committee ("AMC") set up by the State Council is in charge of organizing, coordinating, and supervising antitrust-related activities (Article 9). In addition, three AMEAs designated by the State Council are currently responsible for different aspects of Anti-monopoly Law enforcement in China (Article 10): the Anti-Monopoly Bureau of the Ministry of Commerce ("MOFCOM") is in charge of approving transactions involving the merger control provisions; the State Administration for Industry and Commerce ("SAIC")<sup>2</sup> is in charge of investigations of undertakings' non price-related monopolistic agreements and abuses of dominance; and the Bureau of Price Supervision and Anti-Monopoly of the NDRC is responsible for the investigation of price-related cartels, resale price maintenance ("RPM"), and price-related abuses of dominant market positions.

#### Abuse of a Dominant Position under Anti-monopoly Law

The Anti-monopoly Law makes it clear that there is no per se illegal rule regarding the exercise of IP rights ("IPRs"): "this law is not applicable to conduct by undertakings to implement their Intellectual Property Rights in according with relevant IP laws and administrative regulations; however, this law is applicable to

2. The SAIC issued Provisions on Prohibiting the Abuse of Intellectual Property Rights to Preclude or Restrict Competition on July 4, 2015, effective on August 1, 2015. However, an evaluation of these provisions is beyond the scope of this case report.

the conduct of undertakings to eliminate or restrict market competition by abusing their Intellectual Property Rights" (Article 55).

The "relevant market" under the Anti-monopoly Law refers to "the commodity scope or territorial area within which the undertakings compete against each other during a time period for relevant commodities or services" (Article 12). A dominant undertaking is defined as "an undertaking(s) having the ability to control the price, quantity or other trading conditions of products in relevant market, or to block or affect the entry by other undertakings into the relevant market" (Article 17(2)). A non-exhaustive list of seven categories of "abuse of a dominant position" is set forth under the Anti-monopoly Law, which includes "(i) selling products at unfairly high prices or buying products at unfairly low prices; ... (v) tying in products or imposing unreasonable conditions for trading without legitimate reasons; ..." (Article 17(1)).

In finding a dominant position, the following open-ended factors shall be taken into consideration: "(i) the market share in relevant market, and the competition situation of the relevant market; (ii) the ability to control the sales markets or the raw material purchasing markets; (iii) the financial status and technical conditions of the undertaking; (iv) the extent of reliance on the undertaking during transactions by other undertakings; (v) the degree of difficulty for other undertakings to enter the relevant market; (vi) other factors relevant to find a dominant market position" (Article 18). In addition, a dominant position can be presumed in the following situations unless it can be proved otherwise: "(i) the relevant market share of one undertaking accounts for 1/2 or above; ..." (Article 19).

### Facts

The facts of the case have already been mentioned in the case report 4.4 by Assistant Professor Li Jing and Professor Lin Xiuqin and will not be repeated here.

### Reasoning

The decision consisted of (1) a determination of the relevant market and dominance, (2) the abusive conduct by Qualcomm, and (3) the antitrust remedies. In the following section this case report will only summarize the first and third issues, as the second was already dealt with in case report 4.4.

## Relevant Market and Dominance

### *Wireless communication SEP package licensing market*

A clear definition of the "relevant market" is vital to the determination of abusive conduct and the scope of remedies in antitrust cases.<sup>3</sup> There are two kinds of relevant markets, namely relevant product markets and relevant geographic markets. How to define the relevant market of the package licensing of SEPs was a thorny issue for the NDRC. The NDRC reasoned that each SEP licensing could be a relevant product market and in this case since all SEPs were combined in package and licensed as such the relevant product market would be the collection of all the individual product markets; the geographical market in this case would be the collection of all the national or regional markets of individual SEPs as the grant of license of patents and the use and protection of patents are territorial.

As for the market dominance, the NDRC adopted a two-step approach of "rebuttable presumed dominance." First, based on the 100% market share of both the individual SEP licensing market and the package licensing market of SEPs that cover specific wireless communication standards, a dominant position of Qualcomm was presumed according to Article 19(1), Anti-monopoly Law. Secondly, the NDRC confirmed the assumed dominance by taking into account the factors listed in Article 18, Anti-monopoly Law, such as Qualcomm's ability to control the market, the degree of reliance by other manufacturers on the SEP package licensing, the difficulty for other undertakings to enter the relevant market as well as the fact that Qualcomm did not provide evidence to prove that it did not possess dominance in the SEP package licensing market.

### *Baseband chip market*

Similarly, the NDRC first defined Qualcomm's CDMA, WCDMA, and LTE baseband chip markets as three separate relevant product markets without meaningful demand and supply substitution. In presuming Qualcomm's dominance in these three chips markets under Article 19(1), Anti-monopoly Law, the NDRC identified Qualcomm's market shares by sales value, citing a strategy analysis' report, as 93.1%,

3. Rule 3 "Functions of Defining the Relevant Market" of the Guide for the Definition of Relevant Market issued by the AMC of the State Council, effective since May 24, 2009.

96%, and 53.9% (all more than 50%) in the CDMA, LTE, and WCDMA chips markets, respectively. After considering factors listed in Article 18, Anti-monopoly Law and the absence of persuasive justificatory evidence from Qualcomm, the NDRC established Qualcomm's dominance in these chip markets.

### Remedies

There are two major types of remedies for Qualcomm's abusive conduct in the wireless communication SEPs licensing market and the baseband chips market. The one imposed by the NDRC in its administrative sanction orders in accordance with Articles 47 and 49 Anti-monopoly Law, and the one contained in the rectification plan that Qualcomm has agreed to implement.

#### *Those that were imposed by the NDRC*

The NDRC imposed a cease-and-desist order in relation to abusive conduct. When granting licenses for wireless communication SEPs to device manufacturers within China, Qualcomm was ordered: (1) to provide patent lists to licensees during negotiation and not to charge for expired patents; (2) not to compel licensees to grant back their non-SEPs and to cross-license without fair recompense; (3) not to charge for SEPs royalties based on the net wholesale price of the entire device manufactured and sold within China while maintaining a higher rate; (4) not to bundle non-SEPs with SEPs without legitimate reason; (5) not to condition the sale of chips upon the acceptance of unfair clauses, such as charging for expired patents, royalty-free cross-licensing, no-challenge, and other unfair clauses. The cease-and-desist order shall be applied to Qualcomm's subsidiaries and other companies of which Qualcomm has actual control and the restrictions mentioned above will be passed on to the acquiring party (transferee) when the SEPs were acquired by him.

#### *Those that Qualcomm agreed to implement*

Qualcomm principally agreed to offer licenses to its current 3G and 4G essential Chinese patents separately from licenses to its other patents and to provide patent lists during the negotiation process. If Qualcomm seeks a cross license from a Chinese licensee as part of such offer, it will negotiate with the licensee in good faith and provide fair consideration for such rights. For licenses of Qualcomm's 3G and 4G essential Chinese patents for branded devices sold for use in China,

Qualcomm will charge royalties of 5% for 3G devices (including multi-mode 3G/4G devices) and 3.5% for 4G devices (including 3-mode LTE-TDD devices) that do not implement CDMA or WCDMA, in each case using a royalty base of 65% of the net selling price of the device. Qualcomm will give its existing licensees an opportunity to elect to take the new terms for sales of branded devices for use in China as of January 1, 2015. Qualcomm will not condition the sale of baseband chips on the chip customer's signing of a license agreement with terms that the NDRC found to be unreasonable or on the chip customer not to challenge unreasonable terms in its license agreement. However, this does not require Qualcomm to sell chips to any entity that is not a Qualcomm licensee, and does not apply to a chip customer that refuses to report its sales of licensed devices as required by its Patent License Agreement.<sup>4</sup>

### Legal Analysis

#### Overview

The NDRC was not active in Anti-monopoly Law enforcement until 2013, five years after its taking effect. Though the NDRC has gained experiences from several investigations of domestic and international companies since 2013,<sup>5</sup> it is no comparison to the more than 120 years antitrust enforcement experiences in the United States since the Sherman Act in 1890 or the almost 60 years antitrust experiences in the E.U. Nevertheless, the NDRC's decision against Qualcomm is a significant milestone for China. It is the first antitrust investigation relating to SEPs in China and one of the most high-profile SEP-related antitrust cases of international significance. The case illuminates the interaction between patent rights and the Anti-monopoly Law, that is, how patent misuse by a dominant business operator can amount to abuse of its market dominance and a violation of the Anti-monopoly Law.

4. Qualcomm Press Release on February 10, 2015, supra note 7.

5. The NDRC has become active in Anti-monopoly Law enforcement since 2013. For instance, in January 2013 it imposed a fine of RMB 353 million on six LCD panel manufacturers including Samsung and LG from Korea, and ChiMei, AU Optronics, Chunghwa Picture Tubes and HannStar from Taiwan, in the first antitrust case against international cartels in China. An even higher fine of RMB 670 million was imposed on six baby formula producers for fixing minimum resale prices in August 2013.



What makes the interaction more complicated is the combination of patents with technology standards. By definition, an SEP is a patent “essential for the implementation of a standard.” As a result, the SEP proprietor is even more powerful in patent licensing. To avoid monopolistic conduct, SEP proprietors are required by standard-setting organization (“SSO”) to give a commitment to grant license on fair, reasonable, and non-discriminatory (“FRAND”) terms to anyone who is willing to use the SEP. However, case law in China has just started to deal with the definitions, legal nature of the FRAND commitment, and its usefulness in effectively restricting and preventing abuses by SEP owners.<sup>6</sup>

### The Issue of Paying for Expired Patents

The NDRC ordered that Qualcomm must provide patents list and may not charge for expired patents. This is in line with the Korea Fair Trade Commission (“KFTC”) decision which explicitly prohibited Qualcomm from “acting in an unfair manner that would enable it to receive patent royalties for its technology even after the concerned patent expires or becomes invalid.”<sup>7</sup> However, the licensing agreement is about licensing out a package of numerous SEPs which is in constant flux with older patents expiring and newer patents joining. In addition, the calculation of royalty is not based on the number of SEPs that are being actually used by the licensee. Rather, the royalty is a lump sum in the form of a fixed percentage of the sales price. Against this background, paying for expired patents does not seem to be a real issue. No wonder the rectification plan did not address the issue of how to avoid paying royalty for expired patents.

### The Royalty Base Issue

The NDRC demanded that Qualcomm not charge for SEPs royalties based on the net wholesale price of the entire device manufactured and sold within China while maintaining a higher royalty rate at the same time. However, this demand is very

6. For instance, see *Huawei v. InterDigital* decided in 2013 by Guangdong High People's Court, Yue Gao Fa Min San Zhong Zi No. 305. For details of this case, please refer to the case report by Professor Jyh-An Lee, “The Determination of FRAND Rate for SEPs — *Huawei v. InterDigital*.” (pp.194–203).

7. *KFTC Decision No. 2009-281* on July 23, 2009. For more details of this case, please refer to the case report by Professor Byungil Kim, “Anti-competitive Patent licensing Practice—Qualcomm's Abuse of Market Dominance”, (pp. 84–193)

unclear and therefore difficult to enforce. First of all, the NDRC never defined what it meant by “higher royalty rate.” According to the rectification plan, the NDRC agreed that Qualcomm will charge royalties of 5% for 3G devices and 3.5% for 4G devices that do not implement CDMA or WCDMA, in each case using a royalty base of 65% of the net selling price of the device. Does it mean royalties of 5% for 3G devices and 3.5% for 4G devices would not be “higher royalty rate”? May Qualcomm therefore still use the net selling price of the device as royalty base so long as only 65% of the price applies? And why? Secondly, as some have argued, Qualcomm's calculation base has not been fundamentally changed.<sup>8</sup> Further, more and more SSOs and jurisprudence are turning away from the price of the entire device and adopting the “smallest saleable component”<sup>9</sup> as the royalty base. For the present case, this means the calculation of SEP royalties by Qualcomm should be based on the chip. The NDRC's decision is not in line with this international trend.

### Commercial/Industrial Significance

#### For Qualcomm

It is not a coincidence that Qualcomm has come under the scrutiny of a number of antitrust enforcement authorities in Asia. One reason is that Qualcomm's revenues have been mainly generated from Asian countries. According to Qualcomm's 2014 Annual Report, during the 2013 fiscal year, 49%, 20%, and 11% of Qualcomm's revenues were from customers and licensees based in China, South Korea, and Taiwan, respectively, as compared to 42%, 22%, and 14% during the 2012 fiscal year, and 32%, 19%, and 17% during the 2011 fiscal year.<sup>10</sup> From China (including Hong Kong) alone, Qualcomm collected USD 13.2 billion in 2014

8. Huang, Wei and Ye, Bingbing. 2015. Qualcomm case review (in Chinese), JingZhengFaWeiWang. Retrieved February 12, 2015. from [http://mp.weixin.qq.com/s?\\_\\_biz=MzA5NjcxNDgyNg==&mid=202708571&idx=1&sn=20b566f76e328f6ea4c6badb75f9eda#wechat\\_redirect](http://mp.weixin.qq.com/s?__biz=MzA5NjcxNDgyNg==&mid=202708571&idx=1&sn=20b566f76e328f6ea4c6badb75f9eda#wechat_redirect).

9. For instance, on September 30, 2014, the Institute of Electrical and Electronics Engineers (“IEEE”), one of the important international SSOs, proposed various changes to its recommended IPR Policy, mostly involving SEPs licensing practices. The U.S. Department of Justice (DoJ) approved IEEE's new IPR policy on February 2, 2015, according to which the new SEP royalty base for IEEE Standards should be the “smallest saleable compliant implementation.” IEEE's new IPR Policy was announced by IEEE on February 8, 2015, available at <http://www.justice.gov/sites/default/files/atr/legacy/2015/02/17/311483.pdf>.

10. *Qualcomm Annual Report 2014*, p.14 and 40, available at <http://investor.qualcomm.com/annuals-proxies.cfm>.