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On February 10, 2015, the National Development and Reform Commission ("NDRC") of China issued its Administrative Penalty Decision (the "Decision") pursuant to Article 47 of the China Anti-Monopoly Law ("AML"), based on its investigation of possible abuses of dominance by Qualcomm Incorporated ("Qualcomm"). Though not the first abuse of dominance investigation conducted by one of the Anti-Monopoly Enforcement Authorities ("AMEAs"), the NDRC's Decision marks the first instance in which an AMEA has found a violation of the abuse of dominance provisions of Chapter 3 of the AML.[2]

The investigation, which began sixteen months earlier, in November, 2013, focused on "suspected abuses of dominance," in violation of Chapter III of the AML, in two markets defined by NDRC as: (1) the licensing market for standard essential patents ("SEPs")[3] for CDMA, WCDMA, and LTE wireless communications (the "SEP licensing market"); and (2) the market for sales of baseband chips[4] for CDMA, WCDMA, and LTE wireless communications (the "baseband chip market").

In defining the SEP licensing market, the NDRC found that, because Qualcomm had entered into "package licensing" (i.e., offered portfolio licenses) of its SEPs, the relevant product market for SEPs in the case should be defined as "a collection of every independent licensing market of SEPs held by Qualcomm." Because patent licensing, exploitation, and protection have an "attribute of territoriality," the NDRC concluded that the relevant geographic market was "a collection of countries or regions where Qualcomm has SEPs."

The NDRC defined three separate baseband chip markets: the markets for CMSA, WCDMA, and LTE chips, respectively. Because chipmakers sell the chips throughout the world and compete globally, and smartphone manufacturers buy the chips worldwide, the agency found that the geographic market for each of these chip markets was global.

NDRC next considered whether Qualcomm held a dominant position in these defined relevant markets. Article 19(1) of the AML provides that a company can be presumed to have a dominant market position if its market share accounts for more than 50 percent of the relevant

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[2] Instead the other decisions of the NDRC and SAIC to date found violations of the provisions governing so-called "monopoly agreements" in chapter 2 of the AML, primarily price-fixing agreements between competitors and resale price maintenance arrangements between manufacturers and distributors.

[3] A standard-essential patent is a patent that claims an invention that must be used to implement a technical standard.

[4] Baseband chips, or baseband radio processors, are an integrated circuit that manages all the radio functions of wireless communications devices, the relevant types of which in this matter were 3G and 4G smartphones.

market. The NDRC found that Qualcomm held a 100 percent market share in every licensing market where it owned SEPs and that there was no competition in that SEP licensing market.[5] Accordingly, the NDRC presumed that Qualcomm was in a dominant position in the SEP licensing market.

The NDRC then considered various relevant factors set forth in Article 18 of the AML to determine whether a company had a dominant position. On the basis of certain of those factors, the agency found that Qualcomm had a dominant market position in the SEP licensing market, based on the following findings:

1. Qualcomm controlled this market because manufacturers could not produce 3G and 4G smartphones without risking Qualcomm's initiating patent infringement lawsuits or seeking injunctions;
2. Smartphones manufacturers are highly reliant on Qualcomm's SEP portfolio, because each 3G and 4G SEP is indispensable and irreplaceable for such manufacturers; and
3. Entry into the market is difficult because, once a patent is incorporated into a standard, competing technologies are excluded from such standards, and switching to an alternative standard involves unbearable costs.

Article 19 of the AML permits companies to prove that they are not dominant, but the Decision expressly found that Qualcomm did not provide evidence sufficient to prove that it was not in a dominant position in the SEP licensing market. On these grounds, the NDRC concluded that Qualcomm was dominant in this market.

The NDRC then moved to consideration of whether Qualcomm was dominant in the CDMA, WCDMA, and LTE baseband chip markets. Based on an industry report, the NDRC concluded that Qualcomm's market shares in these markets each exceeded 50 percent, giving rise to a presumption of dominance under Article 19.

Moving to the factors for the assessment of dominance in Article 18, the agency found that: (1) Qualcomm had a relatively high ability to control this market, because, *inter alia*, Qualcomm's products are much more competitive than competing products; (2) major smartphone manufacturers are highly dependent on Qualcomm's chips, because they have limited options from a small number of suppliers and because Qualcomm excels in the middle-level and high-end baseband chip technologies, product functions, and brand, thus leading many device makers to select Qualcomm chips to gain more competitive advantages for their products; and (3) the R&D investment requirements to participate in this technology-intensive market makes entry difficult. On these grounds, and because Qualcomm did not provide evidence proving that it was not dominant, the NDRC concluded that Qualcomm was dominant in all three baseband chip markets (CDMA, WCDMA, and LTE).

[5] The identical presumption is set forth in article 19(1) in the NDRC Anti-Price Monopoly Rules that were put into effect as of Feb. 1, 2011. For an English translation of same, *see* H. STEPHEN HARRIS, JR. ET AL., ANTI-MONOPOLY LAW AND PRACTICE IN CHINA, Annex at 450 (2011).

Having defined the relevant markets, and having found Qualcomm to be dominant in all of them, NDRC next set forth its specific findings of Qualcomm's conduct that NDRC found to constitute abuses of dominance in violation of the AML. Specifically, the NDRC found that:

1. Qualcomm violated Article 17, paragraph 1, subparagraph 1 of the AML[6] by charging unfairly high royalties for its SEPs, because: (1) Qualcomm included some expired CDMA SEPs in its licensing agreements and failed to prove that the expired SEPs equaled the value of patents that were newly added to the portfolio during the term of the license; (2) Qualcomm failed to provide patent lists to licensees, and set a constant long-term royalty rate, thus including expired patents in the licensed portfolio with licensees having no opportunity to avoid paying for expired patents through fair negotiations; (3) Qualcomm required some licensees to grant back their patents on a royalty-free basis, and asked some to waive their litigation rights over their patents against Qualcomm and Qualcomm's customers; and (4) the portfolio licensed by Qualcomm included non-SEPs for wireless communications, in addition to SEPs, resulting in charging excessive and unfairly high royalties to any licensees that were "forced" to accept the packaged patent licenses, the royalty rates of which were based on the wholesale net selling prices of smartphones.
2. Qualcomm violated Article 17, paragraph 1, subparagraph 5 of the AML[7] by bundling the sale of non-SEPs with SEPs, without reasonable justification, without offering licensees a choice to acquire licenses for only SEPs.
3. Qualcomm violated Article 1, paragraph 1, subparagraph 5 of the AML[8] by conditioning the sale of baseband chips on the purchasers' agreement to sign a license agreement with unreasonable provisions, such as charging for expired patents, royalty-free grant-back licensees, the bundled sale of SEPs and non-SEPs, and the purchasers' agreement not to challenge the agreement, as well as by Qualcomm's practice of stopping its supply of baseband chips to licensees that initiated litigation against Qualcomm.

Based on these three findings of AML violations, the NDRC set out its Administrative Penalty Decision pursuant to Articles 47 and 49 of the AML[9] and proceeded to order Qualcomm to cease its illegal abuses of dominance. Specifically, the NDRC ordered that Qualcomm take, or refrain from taking, the following actions:

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[6] This provision states that "Undertakings with dominant market positions are prohibited from engaging in any of the following conducts that abuse their dominant market positions: (1) Selling products at unfairly high prices or buying products at unfairly low prices."

[7] This provision reads: "Undertakings with dominant market positions are prohibited from engaging in any of the following conducts that abuse their dominant market positions: (5) Without valid justification, tying in products or imposing other unreasonable trading conditions."

[8] *Id.*

[9] Article 47 reads as follows: "Where undertakings abuse their dominant market positions in violation of the relevant positions of this law, the AMEA shall order the undertakings concerned to cease and desist such acts, confiscate the illegal gains, and impose a fine of more than 1% but less than 10% of the total turnover of the undertaking in the previous year." Article 49 states: "Where determination of the amount of fines pursuant to Article 46, Article 47 and Article 48, the AMEA should consider factors such as the nature, seriousness and duration of the illegal act."

1. Provide patent lists to parties seeking licenses to its SEPs for manufacturers of smartphones in China, and not charge for expired patents;
2. Not require royalty-free grant-back licenses of the licensees' non-SEPs against the will of manufacturers of smartphones in China;
3. Not force licensees to grant back patents without reasonable consideration;
4. Not use a royalty base of the entire wholesale net selling price of the device while also adopting a relatively high royalty rate, for smartphones sold for use within China;[10]
5. Refrain from bundling the sale of non-SEPs with SEPs in licenses to smartphone manufacturers in China, without reasonable causes; and
6. Refrain from imposing unfair conditions on the sale of baseband chips to smartphone manufacturers in China—such as requiring potential licensees to pay for expired patents, agree to royalty-free grant-back licenses, bundling SEPs with non-SEPs without reasonable causes, or conditioning the supply of chips on a licensee's agreement that it would not challenge the license agreement.

The NDRC then proceeded to impose a fine of 8 percent of Qualcomm's annual revenue within the territory of China for 2013.

Shortly after release of the Decision, Qualcomm announced that it would not pursue further legal proceedings contesting the NDRC's findings, and agreed to implement a rectification plan to modify certain of its business practices in China that Qualcomm stated satisfied the requirements of the NDRC order, and had been accepted by NDRC.[11] The key terms of that rectification plan include the following:

1. Qualcomm will offer licenses to Chinese-issued SEPs separately from licenses to its other patents and will provide patent lists during the negotiating process;
2. Qualcomm will negotiate cross-licenses with Chinese licensees in good faith and provide fair compensation for such rights;
3. Qualcomm will charge royalties for 3G and 4G Chinese SEPs for branded smartphones sold for use in China based on a royalty base of 65 percent of the net selling price of the smartphone and royalty rates of 5 percent for 3G devices and 3.5 percent for 4G phones;
4. Qualcomm will provide existing licensees an opportunity to take the new terms for sales of branded devices for use in China as of January 1, 2015; and

[10] The Decision does not define what would constitute a lawful royalty base or royalty rate. It thus stops short of imposing on Qualcomm a "compulsory license" with any specific rates or terms.

[11] *See* Qualcomm Press Release, *available at*: http://files.shareholder.com/downloads/QCOM/3864235320x0x808060/382E59E5-B9AA-4D59-ABFF-BDFB9AB8F1E9/Qualcomm_and_China_NDRC_Resolution_final.pdf

5. Qualcomm will not condition the sale of baseband chips on the chip customer signing a license agreement with terms that the NDRC finds to be unreasonable, or on the customer agreeing not to challenge unreasonable terms in the license agreement.[12]

The specific details of the changes to Qualcomm's business practices that will take place in light of the Decision are therefore set out as voluntary commitments put forward by the company in its rectification plan, and were not ordered by the NDRC beyond the more general language in the Decision, as described above. The NDRC praised Qualcomm for cooperating in the investigation and for "proactively" proposing a "package of corrective measures," and went on to acknowledge that the "[c]orrective measures proposed by Qualcomm have met the NDRC's requirements."[13]

This landmark case provides much needed guidance on the approach the NDRC[14] will take to analyzing complex issues at the intersection of antitrust and intellectual property law. However, in part because the Decision itself is drawn in broad terms, while the detailed obligations of the company are set out in a voluntary rectification plan that was acknowledged by the NDRC to meet its requirements, the Decision leaves open many questions about the NDRC's views of the scope of its own jurisdiction. For example, the precise limitation of the geographic scope of the remedies to smartphones made in China for use in China, and the limitation of the SEPs affecting only Chinese patents, are not set out in the Decision itself.

Also, the broad language in the Decision itself presents the troubling prospect of insoluble conflicts of law conundrums that could arise if antitrust authorities of multiple jurisdictions purport to impose inconsistent worldwide licensing obligations on patent holders without regard to, or in defiance of, the axiomatic "territorial nature" of IP rights.[15]

This is but one of the knotty issues facing us in the brave new world of numerous active antitrust regimes around the world that appear to have adopted differing views of the proper role of competition law in regulating IP licensing conduct. In light of these and other unknowns, and the worldwide nature of patent licensing in many sectors, the NDRC *Qualcomm* Decision may entail more questions than answers regarding future AML enforcement in matters affecting intellectual property rights.

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[12] The Qualcomm rectification plan makes clear, however, that this commitment does not include a commitment that Qualcomm 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 the license agreement.

[13] *China's NDRC fines Qualcomm 6.088 billion yuan, imposes remedies* (English version), MLEX (February 10, 2015).

[14] NDRC decisions do not bind the other two AMEAs, the State Administration for Industry and Commerce (SAIC) and the Ministry of Commerce (MOFCOM), thus raising the prospect that the three agencies may apply the AML to IP rights in different ways. The SAIC recently issued its Rules on the Prohibition of Abusive Use of Intellectual Property Rights to Exclude or Restrict Competition, which, in turn, are not binding on the NDRC or MOFCOM.

[15] *See* generally A. Peukert, *Territoriality and Extraterritoriality in Intellectual Property Law*, in BEYOND TERRITORIALITY: TRANSNATIONAL LEGAL AUTHORITY IN AN AGE OF GLOBALIZATION (G. Handl & J. Zekol, eds. 2011).