

ClientAlert

Antitrust

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China Imposes Record Fine of Approx. US\$975 Million (€863 Million) Under Its Anti-Monopoly Law

China's National Development and Reform Commission (NDRC) announced an RMB 6.088 billion (approximately US\$975 million and €863 million) fine against Qualcomm Inc. for alleged abuse of its market position in China in violation of China's Anti-Monopoly Law (AML). This is the largest fine ever imposed by Chinese competition authorities and exceeds all but the largest antitrust fines levied in Europe. It is nearly twice the largest ever fine in the United States against a single company.

For comparison's sake, in the 125-year history of the US's Sherman Act, the largest criminal fines against a single company are US\$500 million imposed on each of F. Hoffmann-La Roche, Ltd. (1999) and AU Optronics Corporation of Taiwan (2012). In Europe, the two largest competition fines against a single company are the aggregated €2.2 billion fine imposed on Microsoft Corporation (2004, 2006, 2008 and 2013) and the €1.06 billion fine on Intel Corporation (2009).

China's record Qualcomm enforcement action reflects a rapidly growing trend in China's use of its antitrust laws to scrutinize and regulate how firms use and license their intellectual property. In this case, the Qualcomm settlement resolves NDRC's 15-month investigation into Qualcomm's alleged abuse of its dominant position in a Chinese market for the licensing of standard-essential patents (SEPs), including those for CMA, WCDMA and LTE wireless communication technologies, and the Chinese baseband communications semiconductor market.¹ The primary charge focused on Qualcomm's conduct in allegedly demanding unreasonably high royalties from Chinese licensees. In addition to the large fine agreed to, Qualcomm committed to a number of business restrictions, including a reduction of its royalty fees for its patents.

In its penalty decision, the NDRC also emphasized that Qualcomm had cooperated and voluntarily offered a series of remedies, and that this cooperation was taken into account in setting the fine amount. The NDRC further indicated that it welcomes more investment from Qualcomm and encouraged Qualcomm to charge royalty fees for its patent protected technologies but at "reasonable" rates.²



Noah A. Brumfield
Partner, Silicon Valley and Washington, DC
+ 1 650 213 0395
+ 1 202 626 3698
nbrumfield@whitecase.com

Mark Gidley
Partner, Washington, DC
Chair, Global Competition Practice
+ 1 202 626 3609
mgidley@whitecase.com

Bijal V. Vakil
Partner, Silicon Valley
+ 1 650 213 0303
bvakil@whitecase.com

Z. Alex Zhang
Partner, Shanghai
+ 86 21 6132 5966
azhang@whitecase.com

Lucy Xu
Counsel, Shanghai
+ 86 21 6132 5909
lxu@whitecase.com

Yi Ying
Associate, Washington, DC and Shanghai
+ 1 202 729 2425
+ 86 21 6132 5900
yying@whitecase.com

¹ See NDRC's Official Statement: Order for rectification and a 6.088 billion yuan fine against Qualcomm for abuse of dominance (Chinese), February 10, 2015, available at http://zys.ndrc.gov.cn/xwfb/201502/t20150210_663821.html.

² *Id.*

Breakdown Analysis of NDRC's Penalty

The NDRC determined that Qualcomm dominates the Chinese SEP licensing market and the Chinese baseband semiconductor market for CDMA, WCDMA and LTE wireless technologies. The investigation centered on Qualcomm's patent licensing practices and the royalty rates it charges Chinese licensees. The NDRC's findings focused on both how Qualcomm determined the royalty amount and its alleged requirement that licensees pay a license fee for a portfolio of both SEPs and non-SEPs. The NDRC has stated that it found Qualcomm's licensing conduct amounted to an abuse of its dominant market position under the AML based on the following factors:

- Qualcomm allegedly charged unreasonable royalty fees, including those for expired patents, based on the net wholesale prices of mobile phones. Licensees in China are also required to grant back their relevant patents to Qualcomm for free;
- Qualcomm allegedly engaged in bundled sales of non-SEPs with SEPs without justifiable reasons; and
- Qualcomm allegedly implemented unreasonable conditions in its sales of baseband chips. Licensees in China are forced to agree to a waiver of any challenge of their licensing agreements with Qualcomm; otherwise, Qualcomm may suspend the supply of baseband chips.³

In addition to the monetary penalty, the NDRC listed several remedies offered by Qualcomm. To resolve NDRC's concerns, Qualcomm has agreed with the NDRC to implement a series of changes to its patent licensing business model in China, including:

- The royalty fees shall be calculated at 65 percent of the net wholesale prices of mobile phones to be sold in China;
- Qualcomm shall provide patent lists to its licensees in China and not charge licensees for expired patents;
- Qualcomm shall not request its licensees in China to grant back their patents to Qualcomm for free;
- Qualcomm shall offer licenses to its wireless communication related SEPs without bundling with other non-SEPs; and
- Regarding the sale of baseband chips, Qualcomm is not allowed to request its licensees in China to enter into licensing agreements with unreasonable conditions which constrain the licensees from challenging the agreements.⁴

Although the record monetary penalty reaches nearly US\$1 billion, the NDRC statement stressed that it was limiting the fine to eight percent of Qualcomm's 2013 annual revenue earned in China.⁵ The AML provides for fines up to ten percent of a company's annual revenue in China. The NDRC explained the two percent reduction was provided in consideration for the company's cooperation.

Qualcomm was also able to avoid potentially more significant changes to its licensing business model by means of its settlement with the NDRC. The possibility that the NDRC would impose broader restrictions on Qualcomm once led to speculation that the NDRC could order the company to charge royalty fees based on a certain percentage of the prices of chips instead of those of mobile phones. NDRC's follow-up comments suggest that the company's cooperation with the investigation contributed to NDRC's decision of imposing lesser restrictions on the company's business model.

Increasing Antitrust Scrutiny of Foreign Technology Firms

China's AML came into effect in 2008. Despite a lack of high-profile antitrust cases in the first five years, since 2013 China has subjected technology companies, especially those based outside of China, to increasing antitrust scrutiny.

In parallel with the investigation into Qualcomm, another US technology firm (InterDigital Inc.) was targeted by the NDRC and has been under investigation since the middle of 2013. The NDRC made a similar patent licensing-related claim in its investigation of InterDigital. The NDRC's investigation arose in connection with a dispute with a China-based competitor. In early 2014, the NDRC suspended its probe after InterDigital reached a settlement agreement with the competitor. More recently, in January 2015, the NDRC has reportedly initiated an investigation into another US technology firm.

In July 2014, China's State Administration of Industry and Commerce (SAIC), which is responsible for non-price-related antitrust violations, raided multiple offices of a multinational technology company based on the antitrust concerns related to compatibility, bundled sales and file verification issues for certain of its software products.

³ *Id.*

⁴ *Id.*

⁵ *Id.*

These trends have also been reflected in China's antitrust review of mergers. In 2014, China's Ministry of Commerce (MOFCOM), which enforces the AML in the context of merger filings, imposed remedies related to intellectual property on three out of a total of four conditionally approved deals. MOFCOM's approach is, to some extent, consistent with its peer agencies, the NDRC and the SAIC. All three antitrust enforcers have recently been prioritizing their limited resources to antitrust investigations or merger filings involving technology firms and pharmaceutical companies for which patents are a critical asset.

Why the NDRC Instead of the SAIC

Unlike NDRC's role in overseeing price-related antitrust matters, the SAIC regulates non-price-related antitrust issues, most of which are abuse of dominance cases. The NDRC took the lead in this investigation because part of its abuse of dominance claim is price-related (i.e., the allegation that Qualcomm charged unreasonably high royalty fees).

The difference in the two Chinese government agencies can sometimes make a huge difference to investigated companies. When comparing the levels of authority and enforcement activity between the NDRC and the SAIC, the former has been more centralized and proactive in pursuing its various investigations, while the latter agency usually delegates its investigation authority to local branches that have more experience in dealing with the investigated companies on a routine basis.

Conclusion

The NDRC enforcement action raises important considerations for companies engaged in licensing negotiations, particularly if the underlying intellectual property involves SEPs and Chinese licensees. The NDRC settlement here includes both a very significant fine and regulatory limits on licensing practices that are likely to have implications for companies' global licensing practices.

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White & Case LLP, Shanghai Office
39th Floor, CITIC Square
1168 West Nanjing Road
Shanghai 200041
China
+ 86 21 6132 5900

White & Case LLP, Beijing Office
19th Floor, Tower 1 of China Central Place
81 Jianguo Lu, Chaoyang District
Beijing 100025
China
+ 86 10 5912 9600

White & Case LLP
3000 El Camino Real
5 Palo Alto Square, 9th Floor
Palo Alto, California
94306
United States
+ 1 650 213 0300

White & Case LLP
701 Thirteenth Street, NW
Washington, DC
20005-3807
United States
+ 1 202 626 3600