

NDRC issues decision in landmark case against Qualcomm and imposes record fine of RMB 6.088 billion

Following around 1.5 years of investigation and lengthy remedy-discussions, China's National Development and Reform Commission ("**NDRC**") has issued a decision against US semiconductor giant Qualcomm, imposing a record-penalty of RMB 6.088 billion (USD 975 million) and a set of remedies around the companies' patent licencing fees.

Following the fines in the baby-formula sector in 2013 (USD 110 million) and in the automotive industry in 2014 (USD 201 million), the Qualcomm case marks a new record for the highest individual fine in China. The fine corresponds to 8% of Qualcomm's China revenue in 2013, which is at the upper end to the fines of 4 to 8% of previous-year revenue imposed on ten Japanese auto parts and bearing makers for price fixing in autumn 2014 ([further reading](#)). This penalty is also several times higher than NDRC's total fines for all the alleged infringements of the Chinese Anti-Monopoly Law ("**AML**") imposed in 2014, which topped RMB 1.8 billion (USD 300 million).

Further, Qualcomm has agreed to a comprehensive set of remedies applying to the Chinese market. It is understood that, as a novel feature, some remedies are not part of NDRC's decision but have been given orally as a means of avoiding possible follow-on litigation. Qualcomm agreed to stop bundling practices in relation to its standard essential patents ("**SEPs**") and non-SEPs, which was considered as unjustifiable by the NDRC. Further, the company will abandon a free cross-licensing¹ clause and lower certain royalty rates by approx. 35%.

The Qualcomm-case in a nutshell

Following complaints from some competitors and industry associations, most notably Mobile China Alliance, which represents China's powerful mobile phone industry, and the Internet Society of China in early November 2013, NDRC carried out simultaneous dawn raids at Qualcomm's offices in Beijing and Shanghai. It was reported that NDRC had assigned up to 80 officials to the case, which marks a record in the regulator's investigations and highlights

¹ A free cross-licensing clause requires the licensee to license its own relevant patents to the licensor for free.

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the substantial resources NDRC can mobilize, especially when compared to the antitrust-division of the Chinese Ministry of Commerce (“**MOFCOM**”), which is in charge of merger control and only employs around 30 officials. In addition, NDRC teamed up with some external advisors in order to comb through the substantial volume of data collected. Throughout the investigation, NDRC cooperated closely with the Ministry of Industry and Information Technology (“**MIIT**”), China’s powerful telecom and internet regulator. It is understood that several meetings took place involving NDRC, MIIT and Qualcomm.

In its press release, NDRC generally concludes that Qualcomm holds a dominant position in the markets of SEPs licensing in relation to CDMA, WCDMA and LTE wireless communication and the baseband chip market. It is not clear whether the regulator applies the same logic of the Guangdong High Court rulings in the “Huawei v InterDigital”-case, defining each individual SEP as an independent technology market and each chip designed for a particular function as an independent relevant product market.

Key aspects investigated by NDRC include excessive pricing, licensing fees for expired patents, patent bundling, restrictive sales and cross-licensing clauses. The case particularly focused on whether patent licensing fees can legitimately be set according to the price of the whole cell phone, what is understood to be a common practice in China, instead of the price of the technology being licensed, such as micro-processors, while the Guangdong High Court already suggested in the “Huawei v InterDigital”-SEPs royalty-ruling dated back to October 2013 that, royalty charged for SEPs licensing shall not exceed a certain percentage of the product profit. In its commitment Qualcomm has committed to base the licensing fees on a certain percentage of the wholesale price of the phone.

Under the Commitments, Qualcomm is obliged to remove unreasonable conditions in the licensing agreement for selling baseband chips to Chinese customers, and is prohibited from requiring Chinese customers to enter into a unchallengeable licensing agreement as the prerequisite for supplying baseband chips to such customers. That said, Qualcomm will still be entitled to refuse to supply chips using its patents, if the other party is not willing to enter into a license agreement. Also, customers, i.e., Chinese cell phone manufacturers, will continue to be required to report their sales of licensed devices to Qualcomm in order to determine the royalties to be paid.

NDRC’s attempt to build an “iron-clad case”

The Qualcomm-case marks a shift from the authority’s previous short and sharp strikes, where investigations were typically a matter of a few months. For cases in industries which are considered vital for the Chinese economy, NDRC appears to be willing to mobilise substantial resources and conduct a thorough assessment. It is understood that the regulator has interviewed dozens of Chinese cell phone and telecom companies as well as several chip producers in order to gather data over Qualcomm’s business practices. Information sourced included purchase contracts with Qualcomm and related

information. According to market intelligence several companies made very extensive submissions of several hundred pages to NDRC. Further, at least seven meetings took place, involving senior officials of NDRC and Qualcomm's top management including the company's president.

Despite its efforts to increase transparency, NDRC has – so far – not published the full decision but only a reasoned press release. It remains to be seen whether a decision, containing useful background information, in particular in relation to the legal basis and framework for the determination of the fine will be published at a later stage.

The penalty and commitments imposed on Qualcomm are expected to have some implications for technology companies operating in China:

- > An “unfairly high licensing fee” may not only stem from the royalty amount itself but also as a combination of different factors, including licenses for expired patents or royalty-free cross-license requirements.
- > NDRC is likely to consider the bundling of SEPs and non-SEPs to constitute an abuse of a dominant position absent a plausible justification. While such an abuse may be justified in exceptional cases, the judgement of the Guangdong High Court in the “Huawei v InterDigital”-abuse of dominance-case has already shown that the relevant legal standard for such a justification is particularly high.
- > A considerable degree of uncertainty will exist in relation to the determination of royalties which are in line with competition law requirements.

It remains a typical feature that NDRC, in addition to imposing penalties, also shows a preference for suggesting companies to take corrective actions such as price cuts. Notably, in this case, it is understood that the remedy given by Qualcomm is not entirely written in the penalty decision but that some parts are oral commitments. This move is likely to be a means of avoiding possible follow-on litigation. In China, outcomes of an authority's investigation can be used as evidence in court. Including the remedy in the decision would likely have triggered an avalanche of private litigation, given that Qualcomm's licensees would have been able to use the decision as an evidence in litigation asking for compensation by Qualcomm.

Qualcomm has already agreed not to challenge NDRC's decision and not to pursue further legal proceedings to challenge the findings.

A new era for excessive pricing cases in China

In the first years of the enforcement of the AML, the antitrust regulators NDRC and the State Administration for Industry and Commerce (“SAIC”) focused on relatively straightforward cartel cases, often involving industry associations and vertical constraints (most notably resale price maintenance). Starting from 2013, abuse of dominance cases started to emerge, which pose many new questions. While investigations into alleged excessive pricing

become increasingly rare in Europe, the Qualcomm-case marks the fourth case which NDRC has investigated in the last two years:

- > The first case was the September 2013 **river-sand** probe conducted by the Guangdong Price Bureau, where two river-sand companies were fined two percent of their sales revenue in the previous year (approx. RMB 530,000; USD 86,000). The regulator set a maximum price for future sales of sand and ordered the companies to sell of their reserves of sand within six months. In its reasoning in this case, the authority held that the two companies, controlled by the same individual, held a 75% share of the local sand mining and processing market over the last two years. The companies were accused of hoarding large amounts of sand, leading to a sharp price rise by as much as 54.5% over two years. The regulator compared the price increase against the costs and found that the latter had only increased by around 20%.
- > The second case was the September 2013 investigation by NDRC's local branch in Qinghai of a local producer of **pasteurized-milk**. The authority found the company to have a monopoly in the relevant local market and that the company had increased the sales-price by 267% compared to the cost increase, which was held to constitute excessive pricing. Following only three weeks of investigation, the companies offered commitments to increase the weight of its packaged milk and hold off any price rise for four months, despite an increase in the cost of raw milk. The regulator subsequently terminated the investigation.
- > The third case was NDRC's investigation into the case of **InterDigital's** alleged abusive prices by charging unfairly high licensing fees for its SEP for wireless telecommunication technology as well as cross-licensing and bundling practices involving SEPs and non-SEPs. Following a settlement with Huawei in a parallel lawsuit, with regard to patent licensing fees and other items, InterDigital committed to refer to its agreements with Huawei when negotiating licensing fees and other conditions with Chinese companies. Subsequently, NDRC suspended the probe pursuant to Article 45 of the AML.

All abuse of dominance proceedings conducted by NDRC were largely based on Article 11 of the regulator's Anti-Price Monopoly Regulation, which states that, in excessive pricing cases, NDRC should look at factors such as whether an increase in price is noticeably higher than the cost increase.

It is expected that NDRC and SAIC will investigate more cases in the near future, possibly also as a means to guide the Chinese economy.

Outlook

The long-awaited decision in the Qualcomm-case clearly underpins that Chinese antitrust enforcement continues to intensify, both in depth and breath. NDRC increasingly starts to tackle some of the more powerful companies in the market, which suggests that the authority has strong backing from the central government. The Qualcomm-case also highlights that NDRC is willing to impose drastic fines. However, in the present case, the level of fines is heavily influenced by the fact that Qualcomm generates nearly 50% of its global turnover in China. While the wording in the AML would also allow NDRC to calculate a fine on the basis of the companies' global turnover, the regulator's approach has so far always been to refer to the Chinese turnover of the company under investigation.

Further, the authority appears to focus on sectors, which have been identified as being vital to the national economy, such as the technology sector. The Qualcomm-decision is likely to have a significant impact on the licensing business practices of multinational technology companies and will affect domestic manufacturing firms. It is expected that the cancelation of cross-licensing practices will benefit companies with large patent pools, such as e.g. Chinese manufacturers Huawei Technologies and ZTE, while other industry players may see rising costs for a lack of basic communication patents. Also this practice may lead to more patent infringement lawsuits, because it sets incentives for Chinese patent holders to go after companies using their patents without payment.

According to media reports Chinese companies Huawei, ZTE and Coolpad have already issued patent infringement warning letters to some companies and started demanding royalty negotiations. It remains to be seen whether the commitments will have an impact on patent licensing practices outside China. In any event the outcome of the Qualcomm case is likely to trigger a proliferation of patent infringement lawsuits and to generate pervasive uncertainty for tech companies.

Links: NDRC press release ([CN](#) / [EN](#)).

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