

# Alerts & Publications

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## Chinese Court Releases Guidelines for SEP-Related Disputes

May 23, 2018

The High People's Court of Guangdong issued guidelines for hearing standard essential patent (SEP) disputes (the "*SEP Guidelines*"—available here in Chinese) on April 26, 2018. The High People's Court of Guangdong is one of China's most important forums for IP disputes and acts as the appellate court of the IP tribunal of Shenzhen, home to China's most successful technology companies. The SEP Guidelines are primarily concerned with SEP disputes in the telecommunications sector but are also of relevance for SEP disputes in other sectors of the economy.

The SEP Guidelines follow on the heels of the recent European Commission communication *Setting out the EU approach to Standard Essential Patents* (released November 2017). Both sets of guidelines take the position that a balance should be struck between the rights of SEP holders, SEP licensees, and the general public. The SEP Guidelines go further in offering specific directions for key SEP-related concepts, including: (1) guideposts on how to comply with fair, reasonable, and non-discriminatory (FRAND) terms; (2) when courts may grant injunctive relief to enforce SEPs; (3) factors courts should take into account when determining FRAND royalty rates, and (4) whether and when conduct relating to SEPs may violate China's Anti-Monopoly Law (AML). While arguably offering more detail than can be found in comparable statements issued in other jurisdictions, the SEP Guidelines are also notable for the discretion they leave to courts hearing individual disputes.

Most significantly, the SEP Guidelines provide that:

- The rights of patent holders, patent licensees/implementers, and the

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- public must be balanced
- Courts in China may exercise extraterritorial jurisdiction when a SEP dispute is brought in China relating to licenses with international reach
- FRAND requires good faith negotiations from both parties, but not specific outcomes
- Injunctions for SEPs are not favored and are appropriate only if the infringing party has acted in bad faith
- Courts may set FRAND royalties when bilateral negotiations breakdown and should use a “top-down” approach that takes into account comparable licenses, license information from patent pools, and the *ex ante* market value of the SEPs
- A breach of FRAND does not, of itself, violate the AML absent adverse effects on competition.

We examine below in further detail the key points in the SEP Guidelines.

### Framework for Injunctive Relief

When faced with a request for injunctive relief in relation to a SEP, the SEP Guidelines provide that relief should only be granted if there is “*subjective fault*” (also termed “obvious fault”) on the part of the SEP implementer in the negotiations with the SEP holder. An examination of subjective fault looks at: (1) the overall nature of negotiations between the parties; (2) the timing, method, and content of the negotiations; (3) the reasons the parties failed to reach an agreement; and (4) other relevant factors (SEP Guidelines, points 10–11). It remains to be seen how subjective fault will be assessed in practice, but the concept appears similar to a “bad faith” standard in US and other laws.

The following scenarios can be envisaged based on the SEP Guidelines:

#	SEP holder	SEP implementer	Result
(1)	No FRAND commitment offered	No subjective fault	No injunctive relief granted
(2)	FRAND commitment offered	Subjective fault	Injunctive relief may be granted
(3)	FRAND commitment offered	No subjective fault	No injunctive relief when the SEP implementer submits a “ <i>reasonable guarantee</i> .” This would presumably be satisfied if the patent implementer commits to paying a “reasonable royalty” in the view of the court
(4)	Subjective fault	Subjective fault	The availability of injunctive relief will depend on a number of

	<p>factors, including:</p> <ul style="list-style-type: none"> <li>▪ The relative fault of each party</li> <li>▪ Whether each party has tried to remedy the fault on its part</li> <li>▪ The impact of each party's fault on the negotiations and whether the fault of any party led to the failure of negotiations</li> </ul> <p>The above factors appear to leave the courts an important margin of discretion when deciding whether or not to grant an injunction</p>
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The SEP Guidelines not only offer guidance on what subjective fault is but also what SEP holders and implementers can do to avoid being found subjectively (or obviously) at fault (see Practical Guidance for SEP Holders and Implementers below).

### Determining a FRAND-Compliant Royalty Rate

Typically, a FRAND-compliant royalty rate is determined through bi-lateral negotiations. But where these negotiations break down, the burden of setting a FRAND-rate may fall to the courts. The SEP Guidelines provide guidance for the courts (and indirectly private parties) in this context (SEP Guidelines, point 18). Specifically, the SEP Guidelines refer to the following methods to which courts might resort:

- Reference might be made to comparable license agreements
- Establishing the market value of the SEP
- Reference might be made to comparable patent pools
- Other methods.

Notably, the “market value” benchmark appears to exclude value gained solely from the patent being included in a standard. In other words, market value is based on an *ex ante* valuation of the SEP that excludes network effects flowing from standardization. Moreover, when examining the market value of an SEP, courts are advised to calculate an overall FRAND royalty for all SEPs required to practice the standard and then to determine what proportion of that value is attributable to the particular set of SEPs at issue in the dispute (SEP Guidelines, point 23). This is similar to the “top-down approach” used by some US courts.

### The Long Reach of FRAND Determinations

One interesting statement in the SEP Guidelines is that, without a “reasonable objection,” the court may determine FRAND royalties for a

geographic scope stretching beyond China's borders, in particular if there is an industry practice of granting regional or worldwide licenses (SEP Guidelines, point 16). This is in contrast with the 2015 NDRC FRAND decision relating to Qualcomm, Inc., which was limited geographically to China, but reflects the approach taken by the Korea Fair Trade Commission in a more recent decision against Qualcomm. This may represent a significant move by Chinese courts to influence FRAND-policy globally and could give rise to considerable issues of international comity.

When is SEP conduct an abuse of market power?

The SEP Guidelines recommend applying the basic framework of the AML with respect to SEP related conduct. This includes defining a relevant market (including potentially a technology market) as well as evaluating the competitive effects of SEP-related conduct.

Interestingly, the SEP Guidelines provide that where a SEP holder departs from FRAND terms or seeks an injunction, this is not automatically an abuse of a dominant market position. Instead, the SEP Guidelines state the AML will apply only if the conduct has some adverse effects on competition. (SEP Guidelines, points 28–29).

Practical Guidance for SEP Holders and Implementers

Finally, the SEP Guidelines offer some practical guidance for SEP holders and implementers (SEP Guidelines, points 13–14). To avoid a claim that an SEP holder has breached FRAND and potentially the AML, SEP holders should:

- Enter into negotiations with parties seeking an SEP license in a timely manner
- Be as specific as possible about the scope of the patents during negotiations
- Provide the licensee with a list of exemplary patents, claim comparison tables, and other patent information to further negotiation
- Share specific licensing conditions and claims for royalties calculations
- Have a reasonable basis for demonstrating that its offers are FRAND compliant
- Respond to the other party within a reasonable time limit and not impede or interrupt negotiations without justifiable reasons
- Avoid obvious stonewalling tactics.

To avoid being considered at fault, SEP implementers should:

- Acknowledge any notice of infringement by the SEP holder and reply in a timely fashion expressing a willingness to negotiate or offer reasonable arguments for non-infringement
- Be open to signing a reasonable confidentiality agreement that will allow free and open negotiations
- Offer substantive replies to the list of exemplary patents, claim comparison tables, and other patent information provided by the SEP holder within a reasonable timeframe
- Reply within a reasonable timeframe upon receipt of licensing conditions

from SEP holder

- Avoid exploiting obviously unreasonable conditions, resulting in the failure to enter into a patent exploitation licensing contract
- Not delay or refuse to engage in licensing negotiations without justifiable reasons
- Avoid other obvious stonewalling tactics.

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