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Commercially Essential Patents Recognised as Essential Facility in China

On 23 April 2021, the Ningbo Intermediate Court handed down the long-awaited decision in *Ningbo Ketian Magnet Co., Ltd. v. Hitachi Metals, Ltd.* Hitachi Metals holds a significant portfolio of rare earth magnet patents and was accused of abusing its dominant position by refusing to license its patents to a local Chinese company. In a case involving novel antitrust and IP issues, the court agreed with the plaintiff and found that Hitachi Metals' patents were commercially essential and therefore constituted an "essential facility" within the meaning of antitrust law. The court went on to hold that Hitachi Metals' refusal to license without objective justification was anti-competitive and ordered damages of RMB4.9 million (approximately USD756,800). Significantly, the court in effect required Hitachi Metals to license its patents to the plaintiff.

Background

China is the world's top producer of sintered neodymium-iron-boron (NdFeB) magnets, a type of rare earth magnets, which are widely used in the electric vehicle, wind power and high tech industries. Hitachi Metals owns more than 600 patents relating to sintered NdFeB magnets globally (including in China) and, according to its statement in July 2013, it had at the time licensed patents to only eight Chinese companies on a worldwide basis excluding Japan.

The plaintiff, Ningbo Ketian, along with six other Ningbo-based companies, formed an alliance, and sought to license sintered NdFeB magnet patents from Hitachi Metals in March 2014.[1] The parties signed a NDA in April 2014 and held a two-day meeting in San Francisco in late May. Shortly after, Hitachi Metals sent an issues list requesting the alliance to respond to 144 technical questions and to provide product samples of sintered NdFeB magnets.

The alliance replied that it would respond in full to these questions but only if Hitachi Metals was ready to grant them the required licence. After Hitachi Metals indicated that it was not ready to license its patents to these companies, the alliance, after some further communication, terminated the NDA in October 2014.

Two months later in December 2014, Ningbo Ketian, a member of the alliance, filed a complaint against Hitachi Metals with the local court, the Ningbo Intermediate Court, alleging that Hitachi Metals had abused its dominant position on two grounds: (i) Hitachi Metals "refused to deal" (ie by refusing to license its patents); and (ii) Hitachi Metals had attempted to "bundle" essential patents with non-essential patents in its portfolio. Ningbo Ketian requested that the court order Hitachi Metals to cease its abusive conduct and sought damages of RMB7 million (approximately USD1.1 million) for loss caused by Hitachi Metals' antitrust infringement.

Hitachi Metals' dominance

In order to determine if a company is dominant in any market, a "relevant market" in which the conduct will be assessed must first be defined. The Ningbo court defined the relevant market as follows:

1. **Product scope of the market**. After conducting a substitutability analysis, the court followed the plaintiff's technical expert opinion and found that sintered NdFeB magnets cannot be substituted by other magnets in terms of price and performance. Accordingly, the court concluded that the upstream product market was the market for licensing sintered NdFeB magnet patents and that the downstream market was for producing sintered NdFeB magnets.
2. **Geographic scope of the market**. For both the upstream licensing and downstream tangible product markets, the geographic scope of the market was determined as worldwide.
3. **Temporal market**.[2] As Hitachi Metals confirmed during the proceedings that it had not granted any license to any companies other than the eight authorised Chinese licensees that were announced in July 2013, the court concluded that the duration of the relevant market was from July 2013 to the time when the debate at the first-instance hearing was completed.

1_Although the decision was not explicit on whether the plaintiff sought a China only licence or a worldwide licence, the plaintiff alleged that due to Hitachi Metals' refusal to license, it had been confined within the China market and could not export its products. We assume that the licence sought was worldwide in scope.

2_ In a slightly atypical manner, the court also defined the relevant market from a temporal perspective.

The court went on to hold that Hitachi Metals was dominant in the relevant market during that entire period. The court reasoned that "due to the proprietary nature of patent rights", Hitachi Metals held the *entire* licensing market in respect of its commercially essential patents and that absent comparable patent portfolios, no counterparty could restrict Hitachi Metals' power over price and licensing terms. According to the court, Hitachi Metals had a significant impact on the downstream market through its licensing arrangements with selected magnet producers. In particular, the court noted the fact that the majority of the main customers for sintered NdFeB magnets consider it necessary for magnet producers to be licensed by Hitachi Metals.

Essential facility

In its abuse of dominance analysis, the court invoked the doctrine of essential facility as "an analytical tool". The court stated that generally the following five elements must be present to establish an essential facility:

1. the facility is indispensable for other firms to participate in competition;
2. the monopolist firm controls the facility;
3. competitors cannot duplicate the facility using reasonable efforts;
4. the monopolist firm unreasonably denies the use of the facility by competitors; and
5. it would be feasible for the monopolist firm to provide the facility.

The court followed the plaintiff's technical expert opinion and noted that two types of Hitachi Metals' patents were "indispensable". The first type is those sintered NdFeB magnet patents that cannot be designed around when producing sintered NdFeB magnets, with the second type being all patents, of which the cumulative design-around costs were so high that they could have forced a firm out of the market.

As the relevant patents were indispensable for manufacturers of sintered NdFeB magnets to compete and cannot be reasonably substituted, the court found that Hitachi Metals' patents constituted an essential facility. In finding so, the court also took into account Hitachi Metals' own marketing statement that its patents were "essential" for manufacturing sintered NdFeB magnets.

Refusal to license was anticompetitive

The court relied on Article 7 of the amended Rules on Prohibition of IPR Abuse issued by the PRC antitrust authority in October 2020. Article 7, in the relevant part, provides that: "where a dominant firm's intellectual property constitutes an essential facility for certain manufacturing and business activities, the dominant firm shall not refuse to license other firms such intellectual property on reasonable terms without reasonable justification."

Notably, the court stressed that "when intellectual property becomes an essential facility to enter into the downstream product market, refusal to license [such intellectual property] may substantially restrict or eliminate downstream competition and thereby harm consumers or public interests."

The court ruled that Hitachi Metals had in effect refused to license its patents, noting the following:

1. although the plaintiff had indicated its willingness to license the relevant patents, Hitachi Metals had failed to respond in a timely manner and did not provide the plaintiff with an actual offer;
2. as an attempt to gain technical information from the plaintiff, Hitachi Metals took advantage of its dominance and requested that the plaintiff unconditionally respond to its 144 technical questions in the licensing negotiation;
3. in indicating its refusal, Hitachi Metals cited the fact that the plaintiff initiated patent invalidation proceedings against its patents (which, according to the court, constituted a "no challenge" requirement and was in itself anti-competitive); and
4. Hitachi Metals had not provided any objective justification for its refusal or any proof that its refusal had a positive impact on innovation and efficiency.

As a result, the court held that Hitachi Metals' refusal to license its patents to the plaintiff was anticompetitive.

No standing to sue for bundling

In addition to refusal to deal, another ground of abuse raised by the plaintiff was that Hitachi Metals had attempted to bundle essential and non-essential patents in its portfolio. The plaintiff stressed that a significant amount of Hitachi Metals' patents were based on processes and techniques known in the industry and that those filings were aimed to unwarrantedly extend its patent protection and to create entry barriers.

The court, however, declined to assess the existence of abusive bundling conduct alleged by the plaintiff on the ground that Hitachi Metals had not provided the plaintiff with a patent list. Noting that the past licensing practices could not be relied on in the instant matter, the court held that the plaintiff had no standing in relation to its bundling claim.

Implications and takeaways

Hitachi Metals is the first case after *Huawei v. InterDigital* where a Chinese court found that an IP owner's licensing practice could constitute an abuse of dominance. After seven years of litigation and with both parties filing evidence including technical and economic expert opinions, the court's analysis of Hitachi Metals' dominance and practice appeared to be relatively comprehensive. The decision involves issues that are both technically and legally complex and the following aspects are particularly noteworthy:

1. The *Hitachi Metals* decision affirmed that Article 7 of the Rules on Prohibition of IPR Abuse as amended in 2020 can be invoked in cases where the licensed subject matter is commercially or technically essential, even if it is not a standard-essential patent (SEP). This position is quite unique in the world.
2. In the SEP context, SEP owners and implementers have benefited from the case law concerning the way the parties should conduct their negotiations to be FRAND-compliant. However, in the *Hitachi*

Metals case, the court did not go into detail regarding the parties' negotiations. It would be helpful to understand how substantively the parties should engage in the licensing negotiation before a court may conclude that an owner of commercially essential patents – albeit not SEPs and subject to FRAND commitments – has in effect "refused to deal" under antitrust law.

3. The court indicated that although a few of Hitachi Metals' patents in the portfolio were invalidated, its licensing practice could not be said to harm competition through the bundling of invalid patents with valid patents. The court distinguished that practice from a situation where a patent owner purposively included unwanted patents in package licenses.

At the time of writing, Hitachi Metals reportedly has appealed the first-instance decision to the IP Tribunal of the Supreme People's Court. It would be interesting to see how these issues would be disposed on appeal.

Furthermore, and notably, Hitachi Metals did not sue the plaintiff for patent infringement. As Chinese companies continue to move up the value chain, their access to intellectual property from upstream foreign players through licensing will become increasingly critical and could be in itself susceptible to potential disputes. The *Hitachi Metals* case provides a pathway for Chinese companies where such disputes concern the crown jewels of an industry and require effective countermeasures before the home court.

Finally, as shown in the latest SEP disputes, Chinese courts have become increasingly flexible in fashioning remedies. It would be interesting to see whether a licensee in a similar future dispute could seek an interim remedy of an interim mandatory licence pending the outcome of the dispute.

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