

KIRKLAND ALERT

February 2015

China Continues its Aggressive Anti-Monopoly Law Enforcement With a Record-Breaking \$975 Million Fine Against Qualcomm

Earlier this week, China's antitrust regulators started off 2015 with a continuation of last year's aggressive enforcement of the Anti-Monopoly Law ("AML") by levying an almost \$1 billion fine against Qualcomm, about 8 percent of the company's 2013 China revenue — equaling the highest percentage penalty previously dispensed under the AML, but short of the 10 percent maximum allowable. The penalty ends the NDRC's first "abuse of dominance" investigation.¹ The fine is greater than the total amount of 2014 NDRC AML fines and is five times the combined \$202 million fines against the 12 Japanese auto parts and bearings manufacturing companies in 2014. In its announcement, the NDRC said that Qualcomm's behavior "restricted competition in the market, curbed technology innovation and harmed the interests of consumers."² The Qualcomm settlement is the latest in large, high-profile antitrust fines against foreign companies and further demonstrates that Chinese regulators are prepared to continue to aggressively enforce the AML against foreign companies.

Qualcomm stock actually rose on the announcement after speculation regarding its position in China ended. Furthermore, declining chip prices could actually lead to increased sales in China, which already accounts for half of Qualcomm's revenue.³

AML Enforcement Overview

Three Chinese agencies and their regional offices enforce the AML — the Ministry of Commerce ("MOFCOM"), the National Development Reform Commission ("NDRC") and the State Administration for Industry and Commerce ("SAIC"). The jurisdictional breakdown is as follows: MOFCOM focuses on reviewing merger control cases, the NDRC enforces price-related AML violations, and the SAIC is responsible for non-price-related AML violations. Under the AML, when companies are found to have reached and acted under a monopoly agreement, authorities are supposed to halt the conduct, disgorge illegal gains and impose fines between one to 10 percent of the previous year's sales revenue. When imposing a fine, the relevant agency takes multiple factors into account including the nature, degree and duration of the illegal conduct. The NDRC rules also provide that immunity may be provided for companies that are the first to self-report monopolistic behavior and provide "important evidence." It also has discretion to reduce penalties for subsequent reports.

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Over the past two years, Chinese antitrust regulators have been enforcing the AML across industries, including notably against automobile and infant nutrition companies. *China Daily* cited an unverified statement of an NDRC official in August 2014 that more than 1,000 Chinese and foreign companies in the auto industry alone had been involved in antitrust investigations.⁴

Qualcomm Decision

The NDRC's investigation of Qualcomm began in November 2013 and continued for 14 months before concluding on February 10, 2015. The investigation was initially triggered by complaints from industrial organizations. During this time there was significant interaction between Qualcomm and the NDRC, which reported that it carried out dawn raids at Qualcomm's Beijing and Shanghai offices with teams of more than 80 investigators.⁵ Qualcomm's CEO, Derek Aberle, made seven visits to the NDRC to discuss the pending investigation.⁶ A substantial amount of the NDRC's evidence was collected from a dozen other domestic and foreign mobile and chip manufacturers.⁷

The NDRC found that Qualcomm abused its market dominance by: 1) charging "unfairly" high royalties for patent licenses, 2) bundling SEP and non-SEP licenses for wireless communication to SEP licenses without justification, and 3) attaching the unfair conditions to the sale of baseband chips.⁸ The NDRC imposed a fine amounting to eight percent of Qualcomm's revenue in China in 2014. Notably, however, Qualcomm was spared a clawback of any of its China revenue, which totaled \$13.2 billion in the company's 2014 fiscal year. In addition to the ¥6.088 billion (\$975 million) fine, the NDRC ordered Qualcomm to cease its monopolistic misconduct and has approved Qualcomm's remediation plan. In its proposed remediation plan, Qualcomm has agreed to (1) charge royalties based on 65 percent of the net selling price of mobile devices, instead of 100 percent; (2) disclose a list of its patents to Chinese licensees and not charge royalties for expired patents; (3) cease requiring Chinese licensees to provide their own licenses to Qualcomm for free in exchange for purchasing Qualcomm licenses; (4) cease bundling non-SEP and SEP licenses for wireless communication without justification; and (5) cease imposing unreasonable conditions in its licensing agreements, including conditions designed to prevent Chinese licensees from challenging the terms of the licensing agreements.⁹ Qualcomm will give its existing licensees an opportunity to elect new terms of sales for branded devices for use in China as of January 1, 2015. It also agreed that for handsets sold in China, it will charge a licensing rate that is similar to the royalty rates charged elsewhere in the world.

The Qualcomm case is notable in showing that Chinese regulators took action ahead of their U.S. and EU counterparts in tackling complex antitrust investigations in contrast to, for example, the auto components matters, in which it appeared that the Chinese authorities followed enforcement actions that had already taken place in other jurisdictions, such as the U.S. and EU. While it is unclear if the events are directly related, following the NDRC Qualcomm investigation, in the fall of 2014, U.S. and EU enforcement agencies also launched their own Qual-

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comm investigations related to the company's licensing strategies and potential abuse of market position. The Korean antitrust agency is also considering an investigation into whether Qualcomm has abused its dominant market position.

The Qualcomm decision also demonstrates that Chinese regulators are now prepared to impose significant fines on companies, similar to what they would face in other jurisdictions. Unofficial reports indicate that this single fine against Qualcomm is as much three times greater than combined 2014 fines. Notably, several penalty decisions from investigations last year are still pending, including those against foreign auto manufacturers (as discussed further below). The decision also shows that beyond imposing penalties, Chinese regulators are taking an aggressive role in the name of "fair" competition in regulating operations of foreign companies, in this case, through their pricing and licensing behavior.

Recent AML Enforcement Cases

The Qualcomm penalty is the latest in a series of antitrust enforcement actions, which are summarized below:

- In August 2013, the NDRC imposed a combined fine of ¥669 million (~\$110 million) on six dairy companies including Mead Johnson Nutrition Co. for fixing infant formula prices. The NDRC alleged that the companies used various improper tactics, including reaching agreements, implementing price controls and cutting off or limiting supply in order to penalize distributors who offered prices below set limits. After the NDRC initiated its investigation in early July 2013, formula makers including Danone and Frisco immediately announced plans to reduce prices.
- In the summer of 2014, a number of foreign auto manufacturers including Mercedes-Benz, Audi China, BMW, Toyota and General Motors were under NDRC antitrust scrutiny. Mercedes was found guilty of manipulating after-sales service prices in China, though the penalty amount has yet to be publicized.¹⁰ The other manufacturers are said to be cooperating with the Chinese authorities.
- In September 2014, the NDRC fined 12 Japanese auto components and bearings manufacturing companies a record \$201 million for price manipulation as a result of the NDRC's finding that the companies had entered into monopoly agreements with the expressed purpose of restricting competition. The findings also demonstrated the NDRC's implementation of its AML leniency policy because some of these companies were exempted from fines for self-reporting. In addition to the penalties, the companies involved announced changes, including correcting sales policies and conduct so as to be in accordance with Chinese law, conducting antitrust training, ensuring staff compliance and taking efforts to remediate price-fixing effects.
- In addition to the NDRC's high-profile enforcement actions, the SAIC has also been actively investigating non-price-related antitrust violations. Last year, the

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SAIC disclosed that it had nine antitrust investigations in 2014, covering industries including software, tobacco, telecommunications, insurance, travel and utilities. Microsoft has also been under SAIC investigation for antitrust violations related to software compatibility, bundling and document authentication because it allegedly failed to fully disclose relevant information related to the Windows operating system and Office software, “which had caused problems with compatibility, bundling and document authentication.” The SAIC has yet to disclose specific details about the subject of its probe.

Conclusion

The Qualcomm settlement reflects the latest development in the Chinese government’s recent crackdown on anti-competitive behavior. Given the success of the enforcement activity, it seems likely that the stricter environment will continue for the foreseeable future, and it will likely make sense for multinational companies to examine their antitrust compliance readiness and to prepare for potential discussions with Chinese authorities regarding the propriety of recent business tactics.

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- ¹ <http://globalcompetitionreview.com/news/article/37959/qualcomm-ends-china-probe-near-billion-dollar-fine/>
 - ² <http://www.bloomberg.com/news/articles/2015-02-09/china-fines-qualcomm-975-million-sets-patent-licensing-rates>
 - ³ <http://www.engadget.com/2015/02/10/qualcomm-china-fines/>
 - ⁴ Lan Lan and Li Jiaobao, *More Than 1,000 Auto Companies are Probed*, CHINA DAILY, Aug. 13, 2014, available at <http://bit.ly/1pmaMJQ>.
 - ⁵ *The NDRC Confirmed Qualcomm’s Monopolistic Behavior*, THE SECURITIES TIMES, July. 24, 2014, available at <http://www.stcn.com/2014/0724/11588217.shtml>
 - ⁶ *Transcript of Press Briefing and Statements from Director General Xu on Antitrust Enforcement*, NDRC, Sept. 15, 2014, available at http://www.sdpc.gov.cn/fzgggz/jgdyfld/jjszhdt/201409/t20140915_625603.html
 - ⁷ *The NDRC Ordered Rectification of and Imposed a RMB 6 billion Fine on Qualcomm’s Monopolistic Behavior*, NDRC, Feb. 10, 2015, available at http://www.sdpc.gov.cn/xwzx/xwfb/201502/t20150210_663822.html.
 - ⁸ See *supra* note 3.
 - ⁹ See *supra* note 3.
 - ¹⁰ Brenda Goh, *China Finds Mercedes-Benz Guilty of Price-Fixing: Xinhua*, REUTERS, Aug. 18, 2014, available at <http://reut.rs/1p4aDjc>.

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