

Extraterritorial
Application of Unfair
Trade Laws

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Intellectual property attorneys should counsel their clients to consider fair trade laws not only in the United States but also abroad when exercising their intellectual property rights.

Foreign Government Agencies May Restrict U.S. Companies from Exercising Their IP Rights in the United States

Intellectual property laws are aimed at allowing intellectual property owners to hold rights in their property for a certain period of time to the exclusion of all others. Exclusivity is the essential purpose of intellectual property rights.

Conversely, the essence of fair trade laws is to prevent monopolies and establish fair competition. The different purposes of these laws often give rise to conflicts.

The tension between these laws is demonstrated when fair trade laws are used to prevent intellectual property owners from exercising their intellectual property rights. This happens with increasing frequency. Countries around the world have established and strengthened rules, such as the “Antitrust Guidelines for the Licens-

ing of Intellectual Property” (prepared jointly by the U.S. Department of Justice and the Federal Trade Commission) or the “Treaty on the Functioning of the European Union” (Articles 101-102). These rules reflect the decisions of courts and administrative bodies that have held that the exercise of certain intellectual property rights can constitute unfair trade practices.

Moreover, given the global economy, regulators are now regularly exercising their authority to prohibit and punish con-



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duct that occurs outside their home borders. They do this based on the premise that anticompetitive conduct that occurs in one country now is felt by markets in many countries, and such conduct needs to be battled on an extraterritorial basis.

Korea is no exception to this trend. In Korea, there is a provision under the Fair Trade Act that allows its application to the exercise of intellectual property rights to prevent the exercise of those rights from restricting competition. The Korea Fair Trade Commission (KFTC) also has drafted internal review guidelines entitled “Review Guidelines on the Unfair Exercise of Intellectual Property Rights” (“Review Guidelines”). These guidelines specifically enable legal restrictions to be imposed to prevent the abuse of intellectual property rights. The KFTC and Korean courts have referred to the Fair Trade Act and Review Guidelines on several occasions to express the view that fair trade laws should prevail over intellectual property rights in certain circumstances. They have held that if intellectual property rights, including patent rights, undermine fair competition in the market, then those intellectual property rights violate the Fair Trade Act.

This viewpoint is amply illustrated by a recent high-profile case in Korea. On December 21, 2016, the KFTC ruled that Qualcomm committed unfair trade acts in relation to certain Standard Essential Patents (SEPs). It ordered Qualcomm to suspend the unfair acts and to pay a massive penalty (“Qualcomm decision”). The Qualcomm decision is seen as one of the milestone decisions made by the KFTC in relation to the unfair exercise of intellectual property rights because the penalty imposed reached KRW 1.03 trillion (USD \$910 million), an all-time high in Korea. Qualcomm is now appealing that case.

The Qualcomm decision has other important implications because the KFTC provided detailed explanations as to how it reached its decision on the various critical issues involved. These explanations included a description of how it defines relevant markets, its view of the types of decisions made by a business operator that can restrict competition by controlling the market, and how it analyzes particular facts to determine whether an unfair trade practice has occurred. Such explanations

will provide guidance to parties in future cases, not only in Korea but potentially in the United States and in other countries. Additionally, the Qualcomm decision will enable Korean, U.S., and other foreign companies that exercise intellectual property rights to better predict what actions might be considered violations of the Fair Trade Act, allowing companies to avoid those actions in the future.

Discussed below are Korea’s Fair Trade Act and Review Guidelines pertaining to the prevention of abuse of intellectual property rights, and how they were applied by the KFTC in the Qualcomm case.

Korea’s Fair Trade Act and Review Guidelines on the Abuse of Intellectual Property Rights and Their Application to Intellectual Property

Article 59 of the Fair Trade Act provides that the “Act shall not apply to any act that is deemed a justifiable exercise of a right under the Copyright Act, the Patent Act, the Utility Model Act, the Design Protection Act or the Trademark Act.” Although there is some debate over the meaning and scope of this provision, the majority of legal scholars and commentators interpret it literally to mean that the Fair Trade Act applies only to activities that would not constitute a justifiable exercise of these intellectual property rights and that would fail to meet the purposes of the various intellectual property acts.

But in practice, Article 59 provides no concrete standards that can be applied in real cases where decisions need to be made as to whether the Fair Trade Act allows the exercise of a certain intellectual property rights. Unfortunately, the article does not define or in any way elaborate on what would be a “justifiable exercise of a right” that is not subject to the Fair Trade Act. This effectively has left it to the courts to try to fill this gap.

The Korean Supreme Court attempted to do that—at least in the context of patents. It ruled that “an act that is not deemed a justifiable exercise of a patent right” means an action taken that is substantially contrary to the purposes and essence of the patent regulations, even if the action may seem to be a prima facie proper exercise of patent rights. The court added that the decision must be made by considering the purposes

of the Patent Act, the influence of the exercise of those patent rights on fair and free competition, as well as the content of the patent rights being exercised (Supreme Court Decision 2012Du24498, Sentenced on February 27, 2014).

This decision lacks any concrete standards for determining whether the exercise

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of certain intellectual property rights might run afoul of the Fair Trade Act. Nonetheless, the decision is important because it is the first time the Supreme Court confirmed that purposes of the Patent Act (to provide justifiable compensation for innovative technologies) and the Fair Trade Act (to seek fair and free competition) both must be considered in each applicable case.

The Review Guidelines

The Review Guidelines, which are internal guidelines used by the KFTC, were established on August 30, 2000, and have been amended four times since their initial release. The Review Guidelines provide some indication of how the KFTC will decide cases because that organization applies these guidelines when deciding whether the exercise of an intellectual property right violates the Fair Trade Act. Some of the main points of the guidelines are described below.



Application to Foreign Business Operators

The Review Guidelines have an extra-territoriality component. They can be applied to the actions of foreign business operators, even if those actions took place overseas, if such actions have an impact on the Korean market. The application of these guidelines is considered valid by the KFTC,

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provision adopts the same reasoning as in the Fair Trade Act, which does not limit its target to Korean companies or companies doing business in Korea. The KFTC included such provisions in its guidelines to indicate the organization's intent that it will thoroughly examine cases involving foreign companies to identify unfair acts, given the global nature of intellectual property rights.

General Review Standards

The Review Guidelines contain general review standards that are applied to all cases to determine illegality. In their definition of the relevant markets under such standards, the Review Guidelines recently were updated to include a technology market and an innovation market, adding to the commercial market that historically had been considered for the application of fair trade laws. The technology market refers to a market where intellectual property rights-related technology is or may be traded in the form of a license. The innovation market is a market related to research and development that is influenced by the exercise of intellectual property rights or related to new technology that creates or may create a conflict with intellectual property rights (Review Guidelines II.3.A). Adding new markets to the guidelines significantly expanded the scope of the relevant markets for the enforcement of fair trade cases in the context of certain involved intellectual property rights.

The Review Guidelines also address restrictions on competition. The guidelines provide that when the effect of a restriction on competition is analyzed, the intellectual property rights involved should be examined to determine whether the relevant field or industry deems such rights as being essential and influential within that field or industry (Review Guidelines II.3.B). The guidelines also require consideration as to whether the rights promote the use and innovation of technology when one determines the application of the rights (Review Guidelines II.3.C). These provisions suggest that the KFTC thoroughly examines the content of the intellectual property rights involved and the nature of the relevant field or industry and then makes an assessment of the resulting restriction on competition, based on the identified details.

Specific Review Standards

The Review Guidelines also present specific review standards to be applied when deciding whether certain behavior is unfair in relation to the following issues: (1) acquisition of a patent right, (2) exercise of a patent right through litigation, (3) licensing, (4) patent pools & cross-licensing, (5) SEPs, (6) consultation in the course of disputes over patent rights, and (7) non-practicing entities. These specific standards are intended to relate to the nature of intellectual property rights by considering issues raised in recent actual cases.

Take, for example, a grant back situation. This arises when a patentee requires a licensee to assign back or grant back to the patentee an exclusive grant back license of the licensee's intellectual property—often subsequent patents obtained by the licensee for improvements related to the technology being licensed by the patentee. One of the issues decided in the Qualcomm Decision dealt with acquisition of patent rights—a topic addressed by the Review Guidelines. According to the guidelines, when a grant back clause is reviewed to determine how it might restrict competition, the following factors must be considered: exclusivity of the grant back; whether a licensor is authorized to use improved technology; the scope of the grant back and its relation to the patented technology to be licensed; duration of the grant back and its consideration; market power and position of relevant parties; and the grant back's influence on the promotion of research and development.

The Review Guidelines also address SEPs, an issue that was discussed in the Qualcomm Decision. The guidelines deem the following actions to be inappropriate exercises of a patent right: (1) unfair conduct during the standard-setting negotiation process, which results in the inclusion of the technology into the standard; (2) failing to disclose material patent-related information in order to increase the likelihood of the patent being included in the standard or to avoid prior negotiations on licensing terms; (3) failing to license on FRAND terms; (4) unfairly refusing to license SEPs; (5) discriminating in the licensing terms of SEPs or charging unreasonable licensing fees; or (6) in relation to licensing of SEPs, unfairly restricting the exercise of a patent right held by a licensee or requiring

a licensee to license its non-SEPs in return for receiving a license for the SEPs.

The foregoing guidelines became much more specific through several rounds of amendments over the years. Since 2009, the KFTC has taken into account decisions on landmark fair trade cases regarding the unfair exercise of intellectual property rights and amended the Review Guidelines accordingly. Because the amended guidelines have reflected recent controversial issues raised in actual cases of intellectual property rights disputes and decisions of the KFTC and courts, they are intended to provide very detailed and updated guidelines.

For example, the KFTC overhauled the Review Guidelines in 2010 after a 2009 court decision on Qualcomm's SEPs. The revision included a requirement to extend the application of the guidelines to foreign business operators, as well as establishing other requirements on SEPs, patent pools, cross-licenses and the acquisition of patent rights through M&As, among others. In 2013, the KFTC amended the guidelines again to reflect the results of its investigation into other industries, such as pharmaceuticals, IT, machinery and chemistry, as well as from the results of a collusion case involving GSK and Dong-A Pharmaceutical. The 2014 amendment of the guidelines was also influenced by the results of a dispute over patent and design rights between Samsung Electronics and Apple. The 2016 amendment considered case decisions involving Dolby's alleged abuse of its superior bargaining position in its dealings with the licensing of digital audio coding technology, AC-3, and a business combination between MS and Nokia.

As can be seen from the foregoing, the Review Guidelines contain very specific standards updated from time to time, as well as general review standards applied to all cases. The Review Guidelines, therefore, provide a useful and detailed reference for companies embroiled in disputes over intellectual property rights. They can be used as a road map on how to try to avoid negative consequences stemming from KFTC investigations.

Review of the Qualcomm Case

The KFTC began its investigation into a potential unfair competition action against

Qualcomm in August 2014. It did this after the KFTC obtained information from press reports and people involved in the industry, alleging that Qualcomm restricted competition in the relevant markets by unfairly leveraging Qualcomm's SEPs (related to mobile communication) and its market power in the modem chip sets market. More than two years of investigation followed. The KFTC investigated not only Qualcomm but also sought extensive and detailed related information from Korean companies such as Samsung and LG, and foreign companies such as Apple, Intel, NVIDIA, MEDIATEK and HUAWEI.

As a result of its investigation, the KFTC issued its decision ordering Qualcomm to pay a fine amounting to KRW 1.03 trillion (USD \$910 million) and it ordered remedial and corrective action. The remedial and corrective action included orders that Qualcomm: (1) cease impeding the business activities of modem chipset manufacturers and cell phone manufacturers by demanding unfair terms in its patent license agreements; (2) engage in good faith negotiations with modem chipset manufacturers and cell phone manufacturers; (3) cease obstructing the business activities of cell phone manufacturers by signing patent license agreements with them in return for the provision and use of modem chipsets; and (4) revise or delete all unfair license provisions at the licensees' request.

The KFTC made the foregoing decision based on the Commission's view that Qualcomm engaged in unfair trade practices by leveraging its market power in the relevant markets, which resulted in restrictions on competition. Below is a summary of the KFTC's decision on the various issues in the Qualcomm case, which provides guidance on how Korea's unfair competition law may be applied to alleged anti-competitive and unfair exercises of intellectual property rights in Korea.

Relevant Markets

The KFTC categorizes the mobile communications industry into a variety of different markets. These are composed of a patent license market, a parts market that includes modem chipsets, a cell phone market, and a mobile communications service market. Under the KFTC's categorization, Qualcomm is a business operator

conducting its business in a patent license market and a modem chipset market.

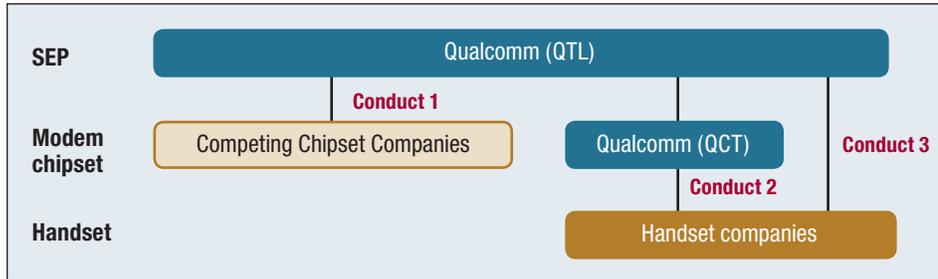
In relation to a patent license market, the KFTC determined that Qualcomm commands significant market power, holding the largest number of SEPs across 2G (CDMA), 3G (WCDMA) and 4G (LTE). The KFTC expressed the belief that even the possession of one SEP could lead to the power of an absolute monopoly in the market.

Similarly, the KFTC determined that Qualcomm commands significant market power in all modem chipset markets involving CDMA, WCDMA and LTE. Although Qualcomm's market share varies depending on the technology (*e.g.*, a high market share in CDMA and WCDMA markets and a lower market share in the LTE market), the KFTC calculated the company's market power mainly because of the backward compatibility of modem chipsets. Backward compatibility is a property of a system, product, or technology that allows for interoperability with an older legacy system or with input designed for such a system, especially in telecommunications and computing. In other words, when cell phones are manufactured, they must be equipped with CDMA-LTE multi-chip sets that work both on LTE and CDMA through backward compatibility because there are still users of legacy cell phones based on CDMA technology. Accordingly, Qualcomm, having a dominant position in the CDMA modem chipset market, also has a dominant market position in the entire modem chipset market, including LTE. The KFTC's decision is in accord with its Review Guidelines. The guidelines recently had added a technology market and an innovation market in the relevant markets categories, expanding the existing commercial markets for review of intellectual property rights matters.

Violations of the Law

The KFTC found that Qualcomm created a business model where the company separately manages QTL (a business operator that monopolizes an SEP license market) and QCT (a business operator that monopolizes the market for modem chipset manufacturing), and then combines them organically to conduct unfair business practices. See Figure 1.

Figure 1



The KFTC found a number of actions undertaken through this business model to be illegal. It categorized Qualcomm’s illegal activities as follows: conduct 1 (refusing to give SEP licenses to competing chipset companies); conduct 2 (forcing handset companies to sign unfair license agreements with QTL and to perform the terms of those unfair agreements to enable them to receive chipsets from Qualcomm, in circumvention of FRAND terms); and conduct 3 (forcing handset companies to sign unfair, comprehensive license agreements). Details of these activities are further explained below.

Conduct 1: Refusing to Give SEP Licenses to Competing Chipset Companies

Qualcomm was able to have its mobile communication technology designated as SEPs in part by declaring to ITU and ETSI that Qualcomm would observe FRAND terms. Based on that declaration, the KFTC would require Qualcomm to engage in good faith negotiations to sign license agreements if so requested by chipset manufacturers.

The KFTC’s investigation, however, indicated that Qualcomm did not do that. The KFTC concluded that Qualcomm rejected signing agreements or signed incomplete agreements, imposing restrictions on the scope of license rights being granted. The company engaged in that conduct, despite competing chipset manufacturers’ requests for complete SEP license agreements.

In relation to the foregoing, the Review Guidelines provide that if an SEP holder unfairly circumvents the FRAND terms when giving a license, or it unfairly rejects granting a license in order to consolidate the holder’s monopoly or drive competing business operators out of the market, then it constitutes an act of unfair competition that falls well beyond the fair exercise of a patent right. QTL’s refusal to grant

licenses to competing chipset manufacturers that requested licenses ran afoul of this guideline.

Conduct 2: Forcing Handset Companies to Sign Unfair License Agreements in Return for Receiving Chipsets

An SEP holder is obliged to grant a license based on fair, reasonable, and nondiscriminatory conditions (FRAND terms). This is because the holder obtained its predominant market position on the premise that the holder would comply with FRAND terms. If an SEP holder fails to comply with such terms, it is likely that SEPs would become exclusively owned and abused by a small number of right holders. This, in turn, would undermine the functions and fairness of the standardization procedures. In light of the foregoing principles, the KFTC created guidelines on SEPs and FRAND terms and it employs them in deciding whether an unfair act has been committed.

Under the KFTC’s guidelines, Qualcomm was determined to have engaged in unfair acts. The KFTC found that Qualcomm established a business policy that banned providing modem chipsets to handset companies that did not have Qualcomm’s SEP licenses and it followed that policy in its dealings with handset companies that wished to obtain Qualcomm modem chipsets. As a result, handset companies intending to use Qualcomm’s modem chipsets had to sign a license agreement with Qualcomm that the KFTC found contained terms unfavorable to the handset companies.

Conduct 3: Forcing Handset Companies to Sign Unfair, Comprehensive License Agreements

The KFTC found that handset companies were given no choice other than to

sign a license agreement with Qualcomm in order to obtain modem chipsets, however unfair the terms were. According to the KFTC, Qualcomm took advantage of the situation and unnecessarily required the licensees to obtain a comprehensive license on the entire spectrum of patents owned by Qualcomm, regardless of whether the licensee wanted all of them. In doing so, the company did not give handset companies the opportunity to evaluate and select certain of Qualcomm’s patents. Additionally, Qualcomm demanded that the handset companies provide a royalty-free cross-grant license on the patents held by the handset companies, without giving them reasonable payment for their patent licenses.

The KFTC held that Qualcomm’s conduct violated FRAND terms, which promised that an SEP license would be granted on fair and reasonable terms. It also was in conflict with the Review Guidelines that banned unfairly avoiding or circumventing the granting of licenses on FRAND terms, all with an aim to consolidate one’s monopoly or exclude competitors.

Effect of Restrictions on Competition

According to the Review Guidelines, there are multiple items to be considered regarding the effect of restrictions on competition: changes of prices in relevant markets; diversity of products; hindrance to innovation; foreclosure effects; and rising costs on the part of competitors. These guidelines alone, however, are not sufficient to make decisions that reflect accurately the unique aspects of intellectual property rights because these factors also are considered when addressing regular non-IP fair trade cases.

To solve this problem of the guidelines not being uniquely suited to evaluating intellectual property cases, the KFTC discussed in its decision the details of a number of other intellectual property cases that were recognized to have involved significant restrictions on competition: 1) where a business operator that exercised its intellectual property rights has strong market power; 2) where an intellectual property right is recognized as important technology such as an essential factor for production; 3) where business operators holding related intellectual property rights are in

competing relationships with each other; and 4) where other business operators have become less likely to enter the market. The Review Guidelines also provide that if the exercise of intellectual property rights promotes use and innovation of technology in relevant markets, currently and in the future, then this also should be considered in analyzing the effect of restrictions on competition.

As seen above, the KFTC comprehensively considers various types of impacts that intellectual property rights have when it determines whether there has been a restriction on competition. However, it is very hard to predict what decision the KFTC might actually make in a given case because the guidelines themselves are rather abstract and difficult to apply. But again, the Qualcomm Decision provides some information on how the detailed fair trade regulations of Korea were applied in that case and the focus of the KFTC in deciding that there had been a restriction on competition.

Effect of Restrictions on Competition in Modem Chipset Market

In the Qualcomm case, one of the first things that caught the attention of the KFTC was that handset companies granted Qualcomm a royalty-free cross-grant license in return for providing modem chipsets, and this measure protected its chipset clients as well as the company itself under a “patent umbrella.” In other words, handset companies purchasing modem chipsets from Qualcomm do not have to pay a royalty to other patent holders that provide a cross license to Qualcomm. But other handset companies purchasing the chipsets from Qualcomm’s competitors must pay an additional royalty. The KFTC found that this constituted a restriction on competition because competitors of Qualcomm were not practically able to compete with Qualcomm in terms of the function or price of their chipsets alone.

The KFTC also concluded that Qualcomm’s conduct affected deals between competing chipset manufacturers and handset companies. Competing chipset companies were not able to expand their client bases because they might have been exposed to patent infringement allega-

tions if they sold their chipsets to handset companies without a cross-grant license agreement with Qualcomm. Moreover, Qualcomm was found to have affected the market further by preventing handset companies that signed license agreements with Qualcomm from purchasing chipsets from Qualcomm’s competitors.

The KFTC found that the above-mentioned restrictions on competition resulted in nine out of eleven global modem chipset manufacturers being forced out of business as of 2008. Although the market has expanded to more than twice its original size since 2008, none of the companies entering the market grew large enough to rival Qualcomm. As such, the KFTC concluded that Qualcomm enjoyed a soaring market share, recording 4,670 on the HHI index (a measure of market concentration) in 2014, a significant rise from 2,224 in 2008.

Effect of Restrictions on Competition in the SEP License Market for Mobile Communications

The KFTC stated that Qualcomm coerced handset companies into signing patent license agreements using modem chipsets as a bargaining chip, even though the company was granted a predominant position in the market based on the promise of FRAND terms. Handset companies, therefore, were not able to refuse unfair license terms proposed by Qualcomm. If they had refused, the companies would have received no chipsets and would have had to suspend their entire business operations. As a result, they accepted unnecessary non-SEPs under the license agreement and paid a royalty as requested by Qualcomm, while not fully understanding the value of Qualcomm’s SEPs. Moreover, they provided cross-grant licenses to Qualcomm free of charge according to the KFTC.

In reaching its conclusion, the KFTC also considered legal decisions of government entities outside of Korea. In the 2013 Google-Motorola case, the U.S. FTC decided that filing a request for an injunction based on patent infringement against a willing licensee was an act of unfair competition. The European Commission reached a similar decision in the 2014 Motorola-Samsung Electronics case. Given the U.S. FTC and European Commission cases, the KFTC concluded that Qualcomm restricted

competition in the SEP license market by forcing unfair license terms on handset companies, and that was an abuse of its market power.

Distortion of Competition for Innovations in R&D

The KFTC also found that Qualcomm’s unfair actions seriously undermined incen-

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tives for modem chipset manufacturers and handset companies to invest in R&D, thereby further restricting competition. According to the KFTC, as Qualcomm forced handset companies to provide royalty-free cross-grant licenses to the company, handset companies realized that however hard they might try to obtain SEPs through active R&D investment, they would end up providing licenses to Qualcomm—all free of charge. It was only natural that they lost motivation to invest in R&D and thus, their R&D activities were crippled.

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Qualcomm also was found to have imposed a patent fee by unilaterally applying standards that were favorable only to Qualcomm, while ignoring the actual content and value of the patents. This ultimately undermined motivation of all the modem chipset and handset companies to develop technology. In the KFTC's opinion, many handset manufacturing companies were affected by Qualcomm's unfair actions because cellphones are the result of comprehensive technical integration involving various companies, including handset companies, modem chipset companies, software development companies, and application companies.

In determining whether restrictions on competition have occurred in the innovation market, the Review Guidelines require consideration of how the exercise of intellectual property rights impact on improvements of products or development of technology. In light of this, the commission's finding that Qualcomm's actions had undermined motivation in relevant companies and potentially damaged competitiveness in chipset and handset markets appears to be consistent with the content and purposes of the Review Guidelines. The KFTC's review also is noteworthy in that it fully considered and reflected the nature and features of intellectual property rights as applied to a specific case.

What the Future Holds

It is highly likely that companies engaged in international commerce will see continued vigilance by government institutions that regulate fair trade and that these types of extraterritorial investigations and enforcement actions will increase. The KFTC already has announced plans for increased investigations. Qualcomm's appeal of the KFTC's decision will be closely watched. A reversal in the courts may dampen the KFTC's enthusiasm for these types of extraterritorial enforcement actions. But if the decision is upheld, it will likely act as a catalyst for even more of these actions, not only in Korea but in other parts of the world where regulators will be emboldened to flex their extraterritorial muscles against foreign companies.

Intellectual property attorneys should counsel their clients to consider fair trade laws not only in the United States but also abroad when exercising their intellectual property rights. They should not be lulled into a false sense of security that compliance with their own country's laws alone will insulate them from scrutiny and regulatory consequences. Any company that operates globally should be proactive in learning about the fair trade laws in its important markets around the world so that it can comply with those laws and hopefully avoid unpleasant surprises from foreign government fair trade regulators. 