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China — Home And Away: The Next IP Powerhouse

Law360, New York (October 21, 2009) -- This article discusses various aspects of Chinese intellectual property policy and progress as a consequence of World Trade Organization-driven and, more recently, innovation-driven history of Chinese IP law.

The Evolution of IP In China

Although the first patent law in China took effect in 1985, its enforcement of patent laws in China was not emphasized until 2001 when China became a member of the WTO.

During the WTO-driven IP policy era, Chinese IP policies were often enacted reflexively, reacting to the international pressure directed at the inadequacy of China's protection of IP.

However, over the past several years, China's IP policy has become largely proactive, aimed at serving China's national interests via IP protection. China has strived to improve its IP stature by joining major international IP treaties, thereby aligning Chinese IP law with international standards.

The Chinese government has restructured its IP infrastructures and put in place IP policies that provide incentives to innovate. IP educational centers have been established in virtually all provinces to promote the awareness of IP.

Many local Chinese governments have designated certain days of the year as the "IP Week," during which various educational programs are offered to the general public.

Numerous international conferences, workshops and seminars on IP are held in China each year. The Chinese government frequently sends delegations to other countries to study their IP systems and legal standards relating to IP.

These efforts have reshaped IP landscape in China. Although initially passive, these significant IP-related changes have awakened to the realization that it too can benefit from IP protection.

The Chinese government issued IP Guidelines in 2008, aiming at utilizing IP to transform China from a manufacturing based economy to a knowledge based economy.

Instead of being reactive and ad hoc as in the past, China now strives to make its IP policies more proactive and based on strategic considerations relating to state interests.

New Amendments to Chinese IP law, scheduled to take effect Oct. 1, 2009, represents further harmonization of the Chinese IP system with the international environment. Cumulatively, these efforts have yielded impressive progress and are steadily transforming China into a player in the international IP stage.

The Newly IP Savvy Chinese Companies

Chinese companies are becoming more IP savvy. In the past, Chinese companies were often viewed as copiers. While this view is still prevalent, more Chinese companies are becoming innovators.

Although some technological advancements are geared to solving particular Chinese indigenous problems, many of the newer innovations are fundamental and made to compete in the world market.

A significant number of Chinese manufacturers have instituted procedures for designing around patented technologies of others to avoid infringement.

Often their design-around solutions are themselves the subject of newly filed patent applications intended to demarcate its own territory for potential offensive or defensive purposes.

The patenting activities by Chinese companies reflect the progress of IP in China. Various statistics, compiled both in China and abroad, show a sharp rise on patenting world wide by Chinese entities.

Reports from the Chinese patent office (SIPO), the United States Patent and Trademark Office and the World Intellectual Property Organization (WIPO) support the conclusion that innovation is the wave of the future in China.

There were 694,000 patent applications filed at SIPO, in 2007, making China, for the first time, the top country in the world in terms of annual filing of patent applications; far ahead of filings in either the U.S. (484,955) or Japan (443,150).

The majority (approximately 85 percent) of the SIPO applications are from Chinese domestic companies. In 2008, an impressive 828,300 patent applications were filed at

SIPO, an increase of about 20 percent increase. It is estimated that in 2009 (despite the economic downturn during which many foreign companies cut the number of filings in China), SIPO will receive 852,000 new patent applications.

Growth — With Room for More Growth

A January 2007 Newsletter from Thoms on Scientific reported that showed that in 2006, more than 90 percent of Chinese companies had no patent application experience and only 0.03 percent of Chinese companies own IP rights.

Given this enormous IP vacuum, the sharp rise in patenting activity is likely to continue as more and more Chinese companies come to understand that IP is key to competing in the market place.

According to the USPTO, the number of patent applications filed in the U.S. by Chinese nationals each year is rising sharply. From 2005 to 2008, the number of patent applications filed by Chinese nationals almost doubled.

In 1995, the number of applications from China was only 307. By 2008 it was 5,482, an increase by a factor of almost 15. During the same period, the number of filings from Japan rose from 39,872 to 82,396 — a factor of about two.

While the absolute number of the U.S. patent filings from China is still much lower, the rate of change in filings from China's is significantly higher. Given that most Chinese companies are still not yet engaged in patenting, this figure is likely to grow in the coming years.

In terms of international filing via Patent Cooperation Treaty (PCT), China also made noticeable progress. In 2008, China became the sixth largest user of PCT. In the same year, Huawei Technologies Co., a Shenzhen based Chinese telecommunications company, became the top user of PCT, filing 1,737 PCT applications.

In comparison, in that same year such well established giants as Panasonic Corporation filed 1,729 PCT applications and Koninklijke Philips Electronics filed 1,551 PCT applications. Another Shenzhen based Chinese telecommunication company, ZTE Corporation, was also one of the top 50 PCT users in 2008.

In 2007, WIPO reported that since 1998 there had been a 488 percent increase in applications from Chinese domestic entities and, during the period from 2000 to 2006 China's share of worldwide patent fillings rose from 1.8 percent to 7.3 percent. During the same period, the total number of patent applications filed worldwide by the Chinese entities increased by 32.1 percent.

Licensing

When China opened its door to foreign investors companies from all over the world entered China to establish joint ventures or subsidiaries. Technologies were transferred and licensing agreements were put in place, sometimes with terms designed to stunt the development of domestic Chinese industries.

In the early years, many Chinese companies, lacking experience and having no IP rights to use in negotiating better terms, entered into agreements that would inhibit them from owning improvements on licensed technology.

Today, Chinese companies are becoming a more potent and sophisticated force in reshaping the global IP landscape according to their own political, economical, and social interests.

IP Enforcement in China

Historically, Chinese have been targets for patent infringement suits, both in China and abroad. Today, the number of patent infringement suits in China, mostly brought by Chinese companies, is rising sharply.

In 2006, there were more patent cases filed in China than in any other country. Ninety-eight percent of these cases involved only Chinese companies. In the 2 percent involving a plaintiff from abroad, the foreign entities received favorable verdict 90 percent of the time.

In 2007, there were more than 4,000 patent infringement suits brought in China; 4 percent by a foreign company. A study of reported decisions of the IP cases in China suggests that when an IP owner appears before a Chinese court, irrespective of whether the plaintiff is Chinese or foreign, it has a 75 percent chance of receiving a favorable decision.

A widely watched IP case in China involving Pfizer's Viagra patent is considered to be a test of the willingness of the Chinese courts to conduct themselves in accordance with international standards.

In this case, facing allegations of patent infringement, more than a dozen Chinese pharmaceutical companies, challenged the validity of Pfizer's Viagra patent. In 2004, the Chinese Patent Reexamination Board ("CPRB") invalidated the Viagra patent.

Pfizer appealed to the Beijing No. 1 Intermediate People's Court, which issued a ruling in 2006 that reversed CPRB's decision and upheld Pfizer's patent. This case evidences the continuing development of the Chinese patent system.

The proceedings demonstrate significant progress in China to handle disputes according to rule of law. Although the initial decision of the CPRB was negatively viewed by IP watchers outside China, the reversal of the CPRB's decision was well received as a step forward by the Chinese courts.

Even though IP owners may have good prospects to prevail in IP litigation in China, criticism remains about the effectiveness of IP enforcement. Even when the plaintiff prevails, damage awards are usually too low to deter infringement.

This is especially true when the losing infringer simply registers as a different company making the same infringing product, forcing the patent owner to continuously incur legal expenditures to enforce its rights. The amendments to the Chinese Patent Law addresses a number of these issues.

Although actual damages are theoretically available, in many cases only statutory damages are awarded. The amendment doubles the statutory damage amount from RMB 500,000 to RMB 1,000,000 (about \$145,000) (an amount still unlikely to deter infringement).

In addition, the amendments will require an adjudicated infringer to pay the plaintiff's attorney fees. Although this reduces the financial burden on a patent owner to bring suits against repeat offenders, IP owners will still bear the burden of valuable executive time, energy, and diversion of attention.

To further deter repeat offenders, the amendments provide for criminal sanctions. The effectiveness of the amendments remains to be seen.

Chinese Companies as Litigants in the U.S.

In the U.S., there is also a rise in patent infringement suits involving Chinese entities. This includes both suits brought against a Chinese entity and suits brought by a Chinese entity to enforce its own IP rights. Chinese companies have gradually become more assertive in the US courts, both in defending themselves and in asserting their own IP rights.

As recently as five years ago, in nearly all patent infringement suits involving Chinese entities, the Chinese entity was the defendant. Due to the high cost of U.S. litigation, a significant number of Chinese companies did not answer the complaints but simply gave up the U.S. market.

Even some that were initially willing to litigate, quickly settled because of their unwillingness to go before a U. S. judge or jury. But this is changing.

In October 2007, the Financial Times reported that a growing number of Chinese companies are aggressively defending themselves in infringement cases in the U.S.

The Chinese are learning not only the rules and strategic considerations for engaging in the US market, but also the rules and strategies for engaging in IP litigation. In the past few years, the Chinese have started to assert themselves and test the limits of IP rights asserted against them.

These efforts have led to favorable verdicts in U. S. courts. In 2007, after a three year legal battle, the U.S. District Court for New Mexico ruled that products made by Chinese defendant China General Protecht Group Inc. did not infringe a patent asserted by Leviton Manufacturing Company.

Before entering the U.S. market, Protecht had obtained a freedom to operate study on its products. Based on its belief that its products did not infringe, Protecht was determined to defend the lawsuit.

During the three years of litigation, Protecht suffered losses in both reputation in the U.S. market and revenue due to loss of orders.

During the pendency of the case, Protecht made product improvements and applied for and obtained patents in China and the U.S. Following its victory, Protecht entered into cooperation agreements with major U.S. retailers including Wal-Mart and Home Depot.

In another case, in 2008, multiple Chinese manufacturers of environmentally friendly mercury free alkaline batteries won a multiyear legal battle fought before the U.S. International Trade Commission, the Court of Appeals for the Federal Circuit and in a companion case in Germany.

Chinese companies are becoming more sophisticated in taking advantage of the US patent system to protect their interests. Reports indicate that Chinese companies started to leverage their IP to compete domestically internationally.

China's biggest maker of personal computers, Lenovo Ltd., has sued companies in the US based on patents it acquired when it bought IBM's PC division in 2005.

In 2006, a China-based company Netac Technology Co., a flash memory chip manufacturer, filed a lawsuit in District Court in Texas against a New Jersey based U.S. company, PNY Technologies.

In a matter still ongoing, Changzhou Asian Endergonic Electronic Technology Co., a China based company, recently sued a dozen US retailers, including Wal-Mart and Best Buy, over dashboard mounts for GDS devices.

These lawsuits brought by Chinese companies further indicates the increasing maturation of Chinese companies in IP, both domestically and internationally. As part of that process, it is increasingly likely that the Chinese will bring more lawsuits in the US and worldwide to enforce their patents.

Conclusion

In the post WTO period, China has changed from a passive and reactive IP player to a proactive player. China has started to organize itself in order to play its IP cards, like

other developed countries, in a way that will best serve its national interests, but based on international standards.

In today's global economy, the keys to success in many industries are price competition and IP. Most Chinese companies are already fiercely price-competitive.

Now the Chinese have come to realize that IP is essential to transform their current manufacturing based economy into a knowledge based economy. Having glimpsed its economic future, China will likely rapidly and strategically advance its progress in IP.

In the next decade or so, we anticipate that China will continue to emerge as a critical world player in IP. It is widely approximated that it took Japan about 50 years to get where it is today in terms of IP, Korea about 30 years, and Taiwan about 25 years. China likely will move faster for several reasons.

First, the experience of its Asian neighbors is well documented and can be used to benefit the Chinese.

Second, China is a top-down society where the government can rapidly effect change. Given that the Chinese government seems determined to emphasize IP, many observers believe the Chinese will be well supported in strategically developing their IP assets.

Third, the pressure on the Chinese in terms of leveling the domestic IP playing field will continue to influence China to act.

Finally, despite its impressive economic and technological progress, China still strives to attract foreign investment and technology. Such investors routinely demand effective IP protection.

--By Dr. Qian Huang (pictured) and Paul Devinsky, McDermott Will & Emery LLP

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