

July 14, 2006

## HOW SHOULD CHINESE COMPANIES DEAL WITH INTELLECTUAL PROPERTY RIGHTS INFRINGEMENT CHARGES IN THE UNITED STATES?

With the rapid expansion of the Chinese economy, an increasing number of Chinese companies are focusing on the international market. Chinese exports to the United States (U.S.) continue to grow and the number of legal proceedings against Chinese enterprises in the U.S. increases every year. Legal proceedings, related to intellectual property rights (IPR) issues including Section 337 violations, have the highest growth rate. IPR litigation involving Chinese companies that attracted much attention in recent years includes: *Cisco Systems, Inc. v. Huawei Tech., Co., Taiwan Semiconductor Manufacturing Co. v. Semiconductor Manufacturing International Corporation* and *SigmaTel Inc. v. Actions Semiconductor Co., Ltd.* Among some three hundred cases investigated for Section 337 violations conducted before 1993, only one involved a Chinese business. Since 2002, the number of Section 337 investigations by the U.S. against Chinese companies have increased dramatically, representing over a quarter of the total number of Section 337 cases initiated over the past three years. The United States International Trade Commission (USITC) received a total of eighteen "337" complaints from January to May 2006. Five of these complaints involve Chinese companies, representing 27.8% of total complaints.

Dealing with IPR issues in the U.S. is a challenge for every legal professional representing Chinese companies.

### Differences in IPR Litigation Between China and the U.S.

Attorneys for Chinese clients have a sound knowledge of the legal system in China. However, they tend to assume that their knowledge of the Chinese intellectual property system applies equally to U.S. IPR litigation. Decision makers in many Chinese companies have difficulty seeing beyond the familiar Chinese system. Their understanding of intellectual property rights laws and the effect on their business is based on their personal Chinese experience. Attorneys have the responsibility of making their Chinese clients understand the major differences in intellectual property rights laws in China and the U.S.:

#### *Cost of IPR litigation and the Role of Attorneys*

Due to the relatively simple legal proceedings in China, clients tend not to invest much time or effort in IPR issues. Lawyers do play an important but limited role because of the nature of the Chinese legal system. Consequently under the Chinese system, many clients downplay the importance of employing experienced IPR lawyers.

Furthermore, as the amount of time required to deal with IPR cases in China is minimal, fees related to handling IPR cases in China tend to be lower and less attractive. In comparison the U.S. legal system and litigation proceedings are very mature and complex. The sheer volume of documents exchanged between two parties may amount to tens of thousands of pages. In a patent lawsuit, court hearings can last for several weeks. As an IPR dispute between two parties often involves very technical issues, competent and experienced lawyers specializing in intellectual property rights laws are required. All these factors contribute to the high cost of handling IPR issues in the U.S.

### *Compensation in IPR Lawsuits*

Aside from the fact that punitive damages exist in the U.S. system but not in the Chinese system, the compensation principles regarding IPR infringement cases in the two countries are for the most part the same. Compensation should be equivalent to the benefits gained by the party from infringement or the loss incurred to the claimant as a result of the act of infringement.

In practice, the amount of compensation is often at the discretion of the judge. The Supreme People's Court of China limits the discretion of judges by judicial interpretation: when the benefits obtained by the offender or the loss incurred to the claimant is difficult to determine, compensation is limited to three times the indicative license fee or RMB500,000. Among the IPR cases recorded in China, rarely has compensation exceed RMB1,000,000. Also, the impact of the decision on the guilty party is limited. Perhaps this is the reason why many companies attach little importance to IPR issues in China. Management may even ignore the suit and leave it to the legal team to handle.

The situation is different in the U.S. Among all recorded intellectual property rights cases, a number of cases have settled for over US\$100,000,000. Cases resulting in compensation over US\$10,000,000 are not infrequent. Recently, Ebay lost a patent infringement case and was ordered to pay the patent owner compensation of over US\$20,000,000. Ebay contested the ruling and the case is now being heard by the Court of Appeals. The dispute between Taiwan Semiconductor Manufacturing Co. and Semiconductor Manufacturing International Corporation was settled for US\$750,000,000 to be paid over six years. Losing in an IPR infringement suit may result in the bankruptcy of many small-to-medium enterprises and can hurt even the largest businesses.

### *Section 337 Investigations*

Section 337 investigations in the U.S. follow a certain path: upon receiving a complaint, the USITC decides if certain imports to the U.S. infringe the intellectual property rights of the complainants and if pre-legal proceedings should be initiated to ban the relevant products. The cases are first judged and ruled on by the Administrative Magistrate of the USITC. If the concerned party contests the ruling, it can request a retrial by the USITC. If the defendant contests the ruling by the USITC, it can appeal the decision.

The litigation proceedings of Section 337 resemble those of the courts in many aspects. Accordingly, the cost of a Section 337 investigation is also very high. The cost for most cases range between US\$1,000,000 and US\$4,000,000.

If the USITC rules that an IPR violation has taken place, it will usually sign an exclusion order to keep the relevant products from entering the U.S. market. This outcome for most Chinese enterprises is probably preferable to litigation which could cost them several millions of dollars. However, for some businesses with large-scale exports or strong business dealings in the U.S. market, they would suffer a loss far greater than a few million U.S. dollars.

Section 337 Rulings do not involve the issue of compensation. However, for intellectual property rights owners, Section 337 and intellectual property rights litigation are not mutually exclusive. Consider, for example, the dispute last year between SigmaTel Inc. and Actions Semiconductor Co. Ltd. SigmaTel Inc. in the U.S. accused Actions Semiconductor Co. Ltd. of infringing upon its U.S. patent. This claim not only resulted in a court action but also a Section 337 investigation.

### *Settlement and Appearance*

Fight or settle? This is an important question to be considered by the legal team when faced with an IPR challenge. Statistics indicate that more than a half of all IPR cases end in settlement. The rate of settlements for Section 337 cases is similar. Settling allows companies to avoid legal expenses and provides a quick resolution. Before any settlement decision is made, attorneys should advise management properly of their chances of success and the impact the outcome would have on their business. There are two common grounds for defending IPR violation claims: 1) invalidity or unenforceability of the intellectual property rights of the plaintiff, and 2) that no infringement exists.

The majority of IPR suits and Section 337 cases involving Chinese enterprises relate to patents. Among all intellectual property rights cases, the issue of patents is the most vague. Approximately 50-60% of patents in the U.S. are ruled invalid or unenforceable when a defendant has mounted a vigorous defence. However, when companies choose the invalidity or unenforceability of the patent defense, there are certain risks involved. It is difficult for companies to find a balance between the risk of losing a case and the cost of settlement. The following case is a good example:

In June 2003, dry cell battery manufacturing giant Energizer Holdings, Inc. of the U.S. requested Section 337 proceedings against twenty-seven foreign companies whose imports were said to be infringing upon its patent in the U.S. Among the twenty-seven companies named in the suit, nine were of Chinese origin. Reportedly, 80% of the alkaline batteries manufactured in China are exported to the U.S. A successful case by Energizer would mean that some companies would not survive.

Soon after the commencement of the proceedings, most of the companies being investigated chose to settle the disputes with the exception of the Chinese firms. On June 2, 2004, the Administrative Magistrate ruled initially in favor of Energizer Holdings. The affected Chinese companies appealed to the USITC. In October 2004, the USITC overturned the initial ruling by the Administrative Magistrate and announced that Energizer's patent was invalid on the grounds that it failed to clearly state the scope of the claims. Energizer then took the case to the Federal Circuit Court opposing the decision of the USITC. On 1 January 2006, the Federal Circuit Court ruled against the USITC and ordered a retrial. The outcome of the ruling was extensively reported by the Chinese media as a sweeping victory for the Chinese companies. The final outcome of the case is still pending.

### *Dealing With U.S. Law Firms*

Legal fees are generally determined by U.S. law firms on the basis of the time spent by attorneys on the case. Some clients choose their attorneys based solely on the fees and rates quoted by the law firms. But fees charged by experienced and well-established law firms are not necessarily higher than those charged by less experienced law firms. The reason is that experienced lawyers work with higher efficiency, and clients are not saddled with the additional hours required by inexperienced attorneys.

The cost of legal counsel is the most important factor for many Chinese clients. The client may request the law firm to generate an estimate for further negotiations. The client also has the option to assess their own situation during litigation with the option to decide if settling would be more advantageous. Facts uncovered in the course of legal proceedings may change the assessment made at the early stage and a different strategy adopted.

As attorneys spend much time dealing with documentation, good communication between clients and law firms is one aspect of cost-control. Legal teams with Chinese language skills are an important factor in improving the quality of service and reducing fees.

### **Conclusion**

Chinese businesses continue to face more and more intellectual property rights challenges in the U.S. This trend will only continue to increase. When Chinese companies become targets of IPR lawsuits or on the receiving end of Section 337 investigations, they should not accept the challenge passively. Chinese companies need to understand that there is a vast chasm between IPR litigation in China and the U.S. and must take into account every option available to them. Unless the client is extraordinarily confident that the case is without merit or that there are significant weaknesses in the suit being pursued, settlement should be a serious option. Chinese companies would be in a much stronger position to defend themselves if they take advantage of the professional services of leading U.S. law firms.

**By Jason Ma, Foreign Registered Lawyer (PRC)**

Heller Ehrman LLP 2006, All Rights Reserved.

<http://www.hellerehrman.com>

*This bulletin is a publication of Heller Ehrman LLP. This bulletin should not be construed as legal advice or opinions, since legal advice and opinions are only given to clients in response to inquiries involving specific facts.*