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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 U.S. continue to grow and the number of legal proceedings against Chinese enterprises in the U.S. increases every year. Of them, proceedings related to intellectual property rights (IPR) issues, including violations of Section 337 of the *Tariff Act of 1930*, have the highest growth rate.

IPR cases involving Chinese companies that attracted much attention in recent years include: *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 involved Chinese companies, representing 27.8% of total number of complaints.

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

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, many tend to assume that their knowledge of the Chinese intellectual property system applies equally to the system in the U.S. Decision makers in many Chinese companies have difficulty seeing beyond the familiar Chinese system. Their understanding of IPR laws and how those laws can effect their business is based on their personal experience. Attorneys have a responsibility to help their Chinese clients understand the major differences in IPR laws in China and the U.S.

Cost of IPR Litigation and the Role of Attorneys

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

Furthermore, since the time required to deal with IPR cases in China is minimal, fees related to handling IPR cases in China tend to be much lower. By comparison, in the U.S., the legal system and litigation proceedings are very 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. Since an IPR dispute between two parties often involves very technical issues, competent and experienced lawyers specializing in IPR laws are required. The result is that IPR litigation in the U.S. can be far more expensive than it is in China.

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 quite similar, at least in theory. In either country, compensation should be equivalent to the benefits gained by the offending party from the infringement or the losses incurred by the claimant as a result of the infringement.

In practice, 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 by the claimant is difficult to determine, compensation is limited to three times the applicable license fees or RMB 500,000. In China, compensation rarely exceeds RMB 1,000,000. Hence, the impact on the offending party is limited. Perhaps this is the reason why many companies attach little importance to IPR issues in China.

The situation is far different in the U.S. Among all recorded IPR cases, a number have been settled for over USD 100,000,000. Cases resulting in compensation over USD 10,000,000 are not infrequent. Recently, eBay lost a patent infringement case and was ordered to pay the patent owner compensation of over USD 35,000,000, and Microsoft was ordered to pay USD 521,000,000 for infringing a patent held by the University of California. The dispute between Taiwan Semiconductor Manufacturing Co. and Semiconductor Manufacturing International Corporation was settled for USD 175,000,000.

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 complainant contests the ruling, it can request a retrial. If the defendant contests the ruling, 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 can be very high. The costs for most cases range between USD 1,000,000 and USD 4,000,000.

If the USITC rules that an IPR violation has taken place, it usually signs an exclusion order to keep the relevant products from entering the U.S. market. For most Chinese enterprises, this outcome is probably preferable to litigation which could cost several millions of dollars. However, for businesses with large-scale exports or strong business dealings in the U.S., losses could be far greater than the cost of litigation.

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

Fight or Settle?

This is an important question to be considered by the legal team faced with an IPR challenge. The majority of IPR suits and Section 337 cases involving Chinese enterprises relate to patents, and more than a half of all IPR cases end in settlement. The rate of settlement for Section 337 cases is similar. Settling allows companies to minimize legal expenses and provides a quick resolution. Before any settlement decision is made, attorneys should advise management of the chances of success and the impact the outcome could have on their business.

There are two common grounds for defending IPR violation claims: 1) invalidity or unenforceability of the intellectual property rights asserted by the plaintiff, and 2) that no infringement exists. Over 50% of patents in the U.S. are ruled invalid or unenforceable when a defendant mounts a vigorous defense. However, when companies choose to challenge the validity or enforceability of a patent, there are certain risks involved. 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.) 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 2 June 2 2004, the Administrative Magistrate ruled in favor of Energizer Holdings. The affected Chinese companies appealed to the USITC. In October 2004, the USITC overturned the ruling by the Administrative Magistrate and announced that Energizer's patent was invalid on the grounds that it had 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

In the U.S., legal fees are generally based on the time spent working on a case. Some clients choose their attorneys based solely on the hourly rates quoted by their law firms. But higher rates charged by experienced and well-established law firms do not necessarily result in higher fees. The reason is that experienced lawyers work with greater efficiency, and clients don't pay for the additional time required by inexperienced attorneys.

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

As attorneys spend much of their time dealing with documentation, good communication between clients and law firms is an important aspect of cost-control. Legal teams with Chinese language skills provide a higher quality of service to Chinese businesses dealing with IPR matters in the U.S. and require less time to resolve those matters.

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 find themselves on the receiving end of Section 337 investigations, they should not accept these challenges passively. They need to understand that there are great differences between IPR litigation in China and the U.S. and they must consider every option available to them. Unless a company is extraordinarily confident that the charges against it are without merit or that there are significant weaknesses in the suit being pursued, settlement should be considered. In any event, Chinese companies are in a much stronger position to defend themselves when they take advantage of the professional services offered by U.S. law firms experienced in IPR matters.