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Bloomberg Law Reports April 27, 2011

Global IP Law

China

Expanding Your IP Pie in China: Winning Strategies for Agile Foreign Companies

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Imagine a company that has the best available clean lithium battery, but unlike many of its competitors, its manufacturing process does not cause birth defects in pregnant women. “Have you considered your opportunity in China’s gigantic electric car market?” one of the authors recently asked the CEO. “If you can really deliver what you claim, China will place a premium on your technology.” “Of course, we know this,” he replied, “but a small company like ours cannot afford to put its intellectual property (IP) at risk in China.”

A great number of CEOs think in this way. And they have good reasons to be concerned, because innovation and creativity are blossoming in China, and the Chinese government is determined to establish China as a world class innovator. Yet, disengagement is a losing strategy. Agile foreign companies will find a way to level the playing field, and the smartest of them will build effective IP alliances with Chinese companies and outcompete their Chinese and foreign rivals.

The Challenge

To understand the ecology of IP protection in China, we must see the world as China’s leaders do, against a history of foreign manipulation and domination. Chinese policy makers have developed a sophisticated understanding that certain “strategic technologies” (zhanlue jishu, “战略技术”) function as “quasi-public” goods. These technologies are viewed not only as strategic in a military sense, but also as engines of innovation, job creation, and economic growth, which will bring huge benefits to all levels of society. Chinese practice recalls Japan’s industrial policies during 1955-1990 which actively promoted strategic sectors, each “triggering” the takeoff of the next: from automobiles to semiconductors, computers, and robotics. In fact, U.S. government policies for “critical technologies” and the Obama Administration’s present targeting of green and other important sectors derive from the U.S. government’s response during the Carter Administration to the Japanese challenge to the U.S. electronics industry.

The most immediate challenge to foreign intellectual property is China’s indigenous innovation (zizhu chuangxin, 自主创新) program, which under *The National Medium and Long Term Plan for the Development of Science and Technology (2006–2020)* (国家中长期科学和技术发展规划 纲要 (2006–2020年)), seeks to reduce the percentage of reliance on foreign IP ownership to 30 percent. China’s indigenous innovation policies are buttressed by a framework of other rules and regulations, the most significant of which is Article 27 of the *Regulation of the People’s Republic of China on Administration of Technology Import and Export*¹, which stipulates that during the term of validity of a technology import contract, the rights in the improvements to the technology shall belong to the party making the improvements. Another problem is recent interpretations of the Anti-Monopoly Law², which deem an alleged refusal by a foreign company to license valuable IP as a potential “abuse of rights.” Until only very recently there have also been many administrative and judicial barriers which have placed foreign IP owners at a competitive disadvantage. These include the costs and unpredictability of securing broad patent protection, harassment by “junk patents” filed by Chinese litigants, and the weakness of judicial remedies, in particular the low level of compensatory awards for infringement, and the difficulty of obtaining preliminary or permanent injunctions against infringers.

Leveling the Playing Field

Yet some progress is being made. Resourceful companies have combined legal, negotiating, and inventive strategies to level the playing field.

Administrative and Judicial Trends.

Foreign companies can now secure broad patent coverage on equal terms with domestic Chinese companies. In one case, a Japanese company whose product involves financial supply management obtained its strongest patent in China, broader than the patents it obtained in Japan, Hong Kong, Taiwan, Singapore, or the United States. Damage awards are also increasing. In *Chint Group Corporation v. Schneider Electric Low Voltage (Tianjin) Co. Ltd.* (2007), a domestic Chinese company was awarded 334 million RMB in the first instance, which represents the highest compensation for infringement involving foreign interests to date. The parties later settled for 157 million RMB. Just like Chinese companies, foreign litigants can also obtain permanent injunctions. In *Andreas Stihlag & Co. KG v. Swool Power Machinery Co., Ltd.* (2008), the Hangzhou Intermediate People's Court held that Swool's products infringed Stihlag's invention patent, and ordered Swool immediately to cease production and to destroy all infringing products.

Several other cases provide additional evidence of a trend toward stronger legal protection of foreign IP rights in China.

Trademark Law: *Yamaha Motor Co. Ltd. v. Zhejiang Huatian Industry Co. Ltd. & Anor.* (2007)³. The plaintiff owned three registered trademarks—雅马哈, YAMAHA and FUTURE—in China. In 2000, the legal representative and controlling shareholder of Zhejiang Huatian Industry Co., Ltd., registered “Japan Yamaha Corporation” in Japan. In 2001, Japan Yamaha Corporation licensed Zhejiang Huatian Industry Co., Ltd. and Taizhou Jiaji Motorcycle Sales Co. Ltd. to use the enterprise name of “Japan Yamaha Corporation” and its Chinese equivalent. Prior to this license agreement, Zhejiang Huatian Industry Co., Ltd. had already begun to produce motorcycles and engines on a large scale, which were obviously marked with “Japan Yamaha Corporation” and “FUTURE.” The infringing motorcycles were then sold to the market by the other three defendants.

In January 2001, the plaintiff brought a lawsuit in Japan to prohibit the use of “Japan Yamaha Corporation” by Japan Yamaha Corporation and eventually won the lawsuit. In 2002, the plaintiff filed the lawsuit with the Jiangsu High People's Court on the ground of trademark infringement. In 2005, the Jiangsu High People's Court in the first instance ruled in favor of the plaintiff. Afterwards, the defendants appealed to the Chinese Supreme People's Court. The Supreme People's Court upheld the first instance ruling in 2007. The four defendants' collective infringement was established. The Supreme People's Court ordered defendants to compensate plaintiff for their collective unlawful gains, assessing the producer and vendors as a whole, instead of calculating the revenues of each defendant individually. The award of 8,300,440.43 RMB is the highest ruling delivered by a Chinese court to date in a trademark infringement case involving foreign interests in China.

Copyright Law: In *Porsche Automobile Holding SE v. Beijing TechArt Automobile Sales & Service Co., Ltd.* (2008), the plaintiff was the owner of the copyright in the Beijing Porsche Center's architecture, which the plaintiff claimed was being infringed by the defendant. The plaintiff filed a lawsuit to Beijing No. 2 Intermediate People's Court on the ground of copyright infringement and won. The defendant appealed to the Beijing High People's Court and the Beijing High People's Court upheld the first instance judgment.

Defendant's designs were deemed to be fundamentally identical to plaintiff's, despite some minor differences. For this reason the Court ordered defendant not only to compensate the plaintiff for its losses, but also to reconstruct its center in order to render it different and distinct from that operated by the plaintiff.

Artful Negotiation

Negotiating over IP in China is often contentious, with an “agreement” merely setting the next stage. The key is to unmask the “real” decision makers and devise imaginative solutions to their concerns in order to gain leverage. A company will be able to adapt rapidly under changing conditions by taking risks and managing time and resources wisely. As in Japan, Chinese negotiators display a recurrent and distinctive pattern of “moves” that are largely “culturally hard wired” (unconscious), which have the singular effect of creating chaos in the mind of an inexperienced foreign negotiator. “Not-knowing”—(in Japanese, “mushin”⁴) where the mind becomes a blank slate temporarily in order to set aside all assumptions and expectations—will place a foreign negotiator in a position of creative advantage. If the negotiator can maintain an attitude of tranquil humility and openness to learning, he or she will detect the critical signs and signals of an infringement early on and respond proactively.

Invention Methodology

Foreign companies can now use powerful invention methodologies such as Directed Evolution and I-Triz to create an invention roadmap, and use this advanced intelligence to circumvent or leapfrog blocking patents and to construct patent fences. The Russian science of Directed Evolution and I-Triz was initiated in 1946 by Genrich Altshuller, and as refined by a U.S. company, Ideation International, is currently taught in universities in 26 countries. It is an inventive asset of BP Amaco, Samsung, Hitachi, Boeing, Johnson & Johnson, GM, and many other international companies.

IP Value Management

Since IP portfolios can be systematically enhanced, virtually on demand, two new avenues are open for discussion. Often an impasse is reached at the threshold when a Chinese party is seeking to license foreign technology. Many foreigners, especially smaller companies, are reluctant to rely solely on a Non Disclosure Agreement because of the costs and uncertainties of enforcing their contractual rights in China. In such cases, one option is for foreign parties to request an IP surety bond, which will compensate all parties, foreign and Chinese, for IP conversion or infringement. The mechanics are straightforward. The licensee establishes an escrow account in Hong Kong, the United States, or some other mutually acceptable jurisdiction. Under the contractual terms of the bond a three party, quasi-arbital panel, is appointed. The members include the Chinese party's attorney/advisors, the foreign company's attorney/advisors, and a third neutral, trusted, and knowledgeable person. The team oversees the performance of the bond. If a dispute arises over an alleged infringement, the team reviews the situation and reaches a final determination on whether the facts justify a triggering of the obligations under the bond. If so, the arbitral panel instructs the escrow agent to pay the bond to the licensor.

IP insurance is a second option to be combined with the surety bond to cover the costs of IP enforcement. IP insurance is currently available in the United States and the United Kingdom, and is currently being assessed in China and Hong Kong. Although neither the surety bond nor IP insurance is customary in China at present, both options will likely become standard fare, as IP portfolios are increasingly viewed as tradable currencies.

Social Enterprises

Because key technologies in China are conceived as quasi-public goods, foreign companies might consider licensing some uses of their technology to "social enterprises" (gongyi qiye, 公益企业). A social enterprise is a for-profit company which distributes virtually all its earnings to an important public cause, such as the eradication of poverty, provision of health care, or the delivery of clean and affordable water and energy. Companies that conduct themselves this way in China will build precious good will and valuable relationships.

Expanding Your IP Pie

The secret of competitive leverage in China lies in effective collaboration between foreign and Chinese companies and through networks of public/private alliances. The following is a roadmap.

- **Build Mega-Patents and Innovation Centers:** Since the Chinese government has mandated a national innovation initiative, foreign companies should aim for continuous innovation with their Chinese colleagues. It makes no sense for foreign or Chinese parties in a collaborative IP venture to cite their own inventions as prior art against the other. The best strategy is to build the strongest possible patent(s), against Chinese and other foreign competitors. Such mega-patents are permitted under Chinese law. If one party believes it has contributed more creatively, these concerns can be effectively addressed by a contract, rather than weakening the common intellectual property asset.
- **Alliance Charters and Strategic Alliance Mediation:** IP deals almost always engender significant differences. The key is to build a container to hold these differences. By the time a company sues or arbitrates with its ally, trust is shattered, and the passion of the enterprise is lost. One established procedure used outside of China is to write an Alliance Charter, a non-binding memorandum, which covers the really important issues which a legal contract cannot cover, e.g. the parties' feelings about the basic equities of the deal, their expectations, protocols of communication, and a contingency plan for emergencies. Another procedure is strategic alliance mediation, a form of third party facilitation with the goal of transmuting the creative energy of differences into opportunities. The best practice is to appoint a knowledgeable Chinese/foreign mediation team at the outset with expertise in alliances, IP, and the industry.
- **Coupling IP Creation to China's IPO Markets—**Every ambitious entrepreneur in China today wants to take his company public, and by one estimate there will be over 10,000 IPOs on various Chinese stock exchanges over the next 20 years. "Going Public, Chinese Style" will soon be understood as the most powerful way for a foreign company to expand its market presence and build its brand in China, by forging closer relationships with customers, the financial community, commercial allies, and the regulatory authorities. By building IP value through mega-patents and other strategies and then injecting this IP into a public company, in consideration for shares, foreign companies have a fresh way to realize substantial near and long term gains in China, with the Chinese and U.S. governments applauding on the sidelines.

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¹ See <http://tradeinservices.mofcom.gov.cn/en/local/2007-11-13/9733.shtml> (last visited April 26, 2011).

² See http://www.china.org.cn/government/laws/2009-02/10/content_17254169.htm (last visited April 26, 2011).

³ *Yamaha Motor Co., Ltd. v. Zhejiang Huatian Industry Co., Ltd. & Taizhou Jiaji Motorcycle Sales Co. Ltd. & Taizhou Huatian Motorcycle Sales Co., Ltd. & Nanjing Lianrun Auto Sales Co., Ltd., 2007.*

⁴ For a detailed explanation of the Chinese and Japanese negotiation “codes,” see Julian Gresser, *Piloting Through Chaos—Wise Leadership/Effective Negotiation for the 21st Century* (1996).

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Trademark Law

Patent Law

Copyright Law

Industry Topics:

Manufacturing

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Print ISSN: 1947-1599

Online ISSN: 2153-4802