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Chinese Patent Litigation: Tips For US Companies

Law360, New York (June 19, 2009) -- Remember the days of low damages for IP infringement in China? They are soon to be over!

Not only is China one of the world's largest consumer markets, it may also become a world leader in patent litigation soon.

In addition, do you know that the courts in East China's Zhejiang Province have emerged as the "Eastern District of Texas" of China — the preferred venue where Chinese patent holders bring patent infringement lawsuits against non-Chinese companies?

This article provides practice tips for U.S. companies doing business in China through case studies of two recent patent litigations: one resulted in a US\$48.5 million judgment against Schneider Electric for infringing a Chinese patent owned by CHINT, a Zhejiang company, and the other resulted in a US\$7.4 million judgment against Samsung for infringing a Chinese patent owned by Holley Communications, also a Zhejiang company.

Case Study I: CHINT v. Schneider Electric

Generally, damage awards for patent infringement in China are less than US\$100,000. On Sept. 26, 2007, however, the Wenzhou Intermediate People's Court in Zhejiang Province ordered defendant Schneider to pay about US\$48.5 million to CHINT, a company based in Wenzhou, for infringing CHINT's Chinese patent directed to a miniature circuit breaker.

The Wenzhou Court calculated the damage award based on the profits Schneider made through infringement in China from Aug. 2, 2004, until July 31, 2006.

This is still the largest damage award for patent infringement in China! The case has been appealed and remains pending before the highest court in Zhejiang Province.

Schneider is one of the world's largest manufacturers of medium to low voltage electronic

equipment, while CHINT is a leader in China's electrical transmission and distribution industries and generated sales revenue over US\$2.7 billion in 2006.

Since 2004, Schneider has filed about 20 patent lawsuits against CHINT in several European countries, all of which CHINT aggressively defended.

Allegedly, the patent disputes between these two companies arose out of Schneider's failed attempts to acquire CHINT.

Needless to say, CHINT's lawsuit against Schneider came as a shock to Schneider. Because China does not publish court files or opinions, it is difficult to obtain and examine litigation files.

I was fortunate enough to have talked to two judges involved in this case regarding litigation proceedings.

A former trial judge in the Wenzhou Intermediate People's Court, who assisted in handling this case, told me that after CHINT sued Schneider in Wenzhou, Schneider tried to transfer the case to a different venue in another province.

After all, CHINT is based in Wenzhou and has considerable influence there. Schneider, however, did not succeed in transferring the case out of Wenzhou.

After Schneider appealed the trial court's judgment to the highest court in Zhejiang Province, I happened to visit Hangzhou, the capital of Zhejiang Province, and had dinner with a friend who was the justice handling this appeal.

I was told that he expected to issue his final decision in April 2008. He seemed confident, however, in his ability to render an unbiased decision, despite having political pressures from both sides.

Little did I know that the appeal would still remain pending a year later.

More interestingly, the same judge who was going to issue the final decision in April 2008 has since left the highest court of Zhejiang Province and joined a private law firm.

While I am not sure what exactly happened in the appeal, I am inclined to think that the long delay in the appeal would allow the parties to settle their differences before any formal decision.

On April 15, 2009, it was reported that Schneider agreed to pay CHINT \$23 million to settle their patent dispute worldwide.

Case Study II: Holley Communications v. Samsung Electronics

On Dec. 19, 2008, the Hangzhou Intermediate People's Court, also in Zhejiang Province, ordered Samsung to pay US\$7.4 million to Zhejiang-based Holley Communications ("Holleycomm") for infringing Holleycomm's patent directed to GSM/CDMA dual-mode handsets.

This is the largest damage award for patent infringement in China's mobile phone industry.

This ends the 20-month dispute, for now, as Samsung has indicated that it would appeal the decision after it receives the formal order.

The case started on April 9, 2007, when Holleycomm sued Samsung for patent infringement.

On May 8, 2007, Samsung requested China's State Intellectual Property Office (SIPO) to re-examine the validity of the patent. Under Chinese laws, the trial proceedings stayed pending SIPO's re-examination result.

On Dec. 14, 2007, SIPO declared that Holleycomm's patent was valid. The trial proceedings resumed, paving the way for the Dec. 19, 2008, decision.

Encouraged by this result, Holleycomm indicated that it would start suing other companies. "This means Samsung won't be the last to be prosecuted for the infringement of the dual-mode patent of Holleycomm," the company said.

This is still a developing story, as details of the case have not fully emerged.

It appears, however, that Holleycomm has fueled the nationalist sentiment by offering free licenses to wholly Chinese-owned companies, but seeking licensing fees from foreign entities.

Trends and Predictions

In light of the current sociopolitical environment in China, these two cases appear to be the tip of an iceberg, as many more similar decisions may follow.

On the one hand, the Chinese government has emphasized the importance of IP rights, and supported China's own R&D efforts for the past 10 years. And many Chinese companies have

learned to patent their innovations and technology.

On the other hand, the Chinese industries, especially electronics industries, have been fed up with foreign patent holders' aggressive (and sometimes insensitive) stance in enforcing their patent rights against Chinese companies in China and globally.

Therefore, it was only a matter of time before Chinese companies and courts would find ways to counter the perceived imbalance in IP enforcement. And these two cases illustrated the trend.

Zhejiang Province's emergence as the "Eastern District of Texas" of China does not come as a surprise.

Zhejiang Province is one of the main commercial centers in China, and unlike other highly developed provinces in China, Zhejiang Province does not have many large state-owned companies in China.

Instead, it houses any successful medium and small private companies.

As a result, courts in Zhejiang Province have less political risks when the judges issue high damage awards against foreign entities in favor of private businesses.

In addition, although Zhejiang companies export products all over the world, they are not large enough to suffer major repercussions outside China.

The trend, however, is not against U.S. companies in the long run. As the courts continue to issue high damage awards, sooner or later, they will have to rule in favor of plaintiffs who happen to be U.S. companies.

Therefore, these two cases will continue to push China forward to become a world leader in patent litigation.

Practice Tips for U.S. Companies

Because China is one of the world's largest consumer markets, U.S. companies doing business in China will continue to profit from its large consumer base.

In light of this new patent litigation landscape in China, however, how should U.S. companies prepare for patent litigation in China? There is no simple answer, and U.S. companies must develop a holistic approach to patent litigation in China.

This article provides four practice tips below. Note, however, that there is no “one size fits all” approach, and companies will need to customize solutions most suited for their individual needs.

First, be aware of cultural differences. Both Schneider and Samsung misjudged Chinese companies’ reactions.

Schneider’s strategy of using lawsuits to force CHINT into acquisition backfired. Probably blinded by a sense of arrogance and self-entitlement, and more likely because of a misjudgment in cultural differences, Schneider has not chosen other means that would be much more effective.

CHINT is a privately held family enterprise, and its CEO is very wealthy. Therefore, he likely values his reputation more than money itself.

He would lose his “face” and social status if he were to be forced into acquisition. On the contrary, he capitalized this opportunity to become a national hero in his “fight” against the perceived foreign “aggression.”

CHINT’s PR efforts were commendable, but Schneider could play along with this PR scene after its first several lawsuits in Europe did not help it gain any business leverage.

At that point, Schneider should find a way to allow CHINT’s CEO, who is a business person at his core, to save his face while still inking a business deal.

Similarly, Samsung was shocked to see the large judgment. In hindsight, Samsung grossly underestimated Hollycomm’s strength.

In the beginning, however, Samsung retained one of the largest national law firms in China, and overlooked the fact that the strongest law firms in Zhejiang province are not national law firms.

Some Zhejiang firms have excellent knowledge of local practice and local political/business environment — an intangible asset that could help Samsung better evaluate the case.

Therefore, understanding cultural differences does not mean the differences at an international level, but also at an intra-China level.

Second, create win-win situations. The Chinese culture promotes win-win situations and avoids conflicts.

The fact that Schneider's appeal has not been decided shows that the court is creating a window for Schneider and CHINT to settle their differences.

Granted, however, it is difficult for Schneider or Samsung to salvage a win-win situation after such negative media coverage.

For other companies, however, there are a plenty of opportunities during litigation to create and capitalize win-win situations. Remember, saving "face" is the most important thing in China.

Third, execute a short-term plan. As patents and patent lawsuits become more and more important in China, U.S. companies doing business in China must have and execute a short-term plan to deal with potential patent litigation in China.

To avoid becoming the next Schneider or Samsung, one effective way is to have your own Chinese patents.

To balance the "perceived" favor for Chinese patent holders in Chinese courts, U.S. companies could countersue Chinese companies for patent infringement, using their own Chinese patents.

It is one thing if a court issues a large judgment against a non-Chinese infringer. It is quite another if the same court issues a small judgment against a Chinese infringer at the same time.

This way, U.S. companies would create a level playing field.

Accordingly, in the short term, U.S. companies must identify their Chinese patents that can be used for defensive purposes. If U.S. companies do not have such patents, they should consider purchasing patents from other entities.

Fourth, develop a long-term strategy. U.S. companies must also develop a long-term patent strategy for the Chinese market in order to enjoy continued business success.

The strategy is not only limited to R&D efforts and applying for Chinese patents. It should take into account U.S. companies' global patent and business strategy and understand the inter-relation between the Chinese market and other markets.

U.S. companies must first identify the long-term business goals in China and globally, then develop a long-term patent strategy accordingly.

For example, Schneider attempted to leverage its European patents for business advantages in China by suing CHINT in Europe.

It lacked the strong European patents that could defeat CHINT in Europe. If Schneider had a better global strategy, however, it might have succeeded.

The old saying is "when in Rome do as the Romans do." Likewise, when U.S. companies conduct business in China, they must follow Chinese culture and rules.

The changing landscape in China's patent litigation can benefit both Chinese and U.S. companies. To capitalize on potential opportunities, U.S. companies must be prepared!

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