

China Judicial Reforms Are Creating Opportunities For Technology Transfer And Licensing¹

By Judge LUO Xia

Introduction

With the development of science and technology great distances in the past have been made unbelievably short. This is the achievement of the progress of human civilization. The historical experiences of both China and other countries have once again proved that culture needs exchanging, the legal theory and practice need exchanging also. Through exchange we can learn from each other and come to know each other better. Through exchange we can give full play to human wisdom and enjoy the common fruits of civilization.

IP has become more and more important in domestic and international competition. In 2015, the Courts accepted a total of 149,238 IP-related cases, including first and second instance cases, and retrial cases, and concluded 142,077 cases. The respective increases were 11.49 percent and 11.76 percent compared to 2014. The local courts accepted 109,386 and concluded 101,324 civil IP cases of first instance in 2015, and the year-on-year increases were 14.51 percent and 7.22 percent, respectively. Among the accepted cases, 11,607 were patent cases, an increase of 20.3 percent over 2014; 24,168 were trademark cases, a 13.14 percent increase; 66,690 were copyright cases, a 12.1 percent increase; 1,480 cases were related to technology contracts, a 38.19 percent increase; 2,181 cases were unfair competition cases (including 156 monopoly cases), a 53.38 percent increase; and 3,093 cases involving other IP disputes, a 22.45 percent increase. Among the concluded cases, 1,327 were civil IP cases involving foreign parties, a 22.67 percent decrease from last year; another 387 cases involved Hong Kong, Macau or Taiwan parties, a 9.15 percent decrease.² See Figure 1.

China has become a major market for foreign enterprises to develop IP

1. This article is the presentation Judge LUO Xia delivered at the LESI Annual Conference in Beijing on May 16, 2017.

2. The figure comes from "IP Protection by Chinese Courts in 2015," *IP White Paper*.

3. Cao Yin, "Foreign IP Disputes on the Increase," *China Daily*, April 26, 2016.

innovation. With more frequent economic and trade exchanges, foreign related IP cases are a key area for IP tribunals in courts, especially administrative ones. Patent and trade mark cases are the largest. The number of civil and administrative IP disputes involving foreign litigants rose from 2,840 in 2013 to 5,675 in 2015.³

Courts in China handled a total of 12,158 IP disputes in 2013-2015, including both civil cases and administrative appeals. New and tough cases are increasing. Some typical cases involve clarify the legal boundaries or to fill gaps in the law. For example, how to draw a line for lawful warning letter sent by IP right holder, and how to determine the nature of the Swiss-type claim in patent administrative cases.

Judicial Reform in China

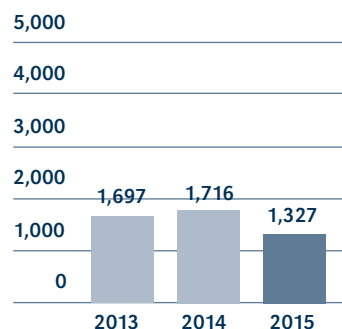
A strong IP protection and enforcement system in China is not just a desire of foreign companies doing business in China, but also a need of many domestic Chinese companies. To build such a system, China has

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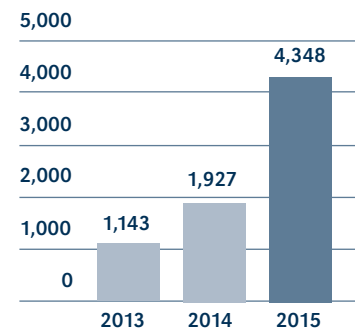
Figure 1. Battling Over Intellectual Property

Chinese courts handled 12,158 IP disputes, including civil and administrative ones, between 2013 and 2015.

Intellectual property civil disputes involving foreign litigants.



Intellectual property administrative disputes involving foreign litigants.



Source: Supreme People's Court

CHINA DAILY

an extensive judicial system for IP litigations. First of all, distribution of jurisdiction is an essential aspect involving rational allocation of adjudication resources, improving adjudication quality and efficiency, and serving the increasing need for judicial protection of IP. By the end of 2014, 87 intermediate courts have jurisdiction over patent cases, 46 intermediate courts have jurisdiction over new plant varieties cases, 46 intermediate courts have jurisdiction over integrated circuit layout design cases, and 45 intermediate courts have jurisdiction over cases involving the recognition of well-known trademarks. In addition, 164 district courts have jurisdiction over general IP cases, and 6 district courts have jurisdiction over the cases involving utility models and industrial designs. The IP tribunal of Supreme People's Court of China ("SPC") has concentrated on patent and technology-related civil cases in 2015, and has actively explored and exercised its cross regional jurisdiction over IP cases of first instance.

Second, China has established IP specialized courts in Beijing, Shanghai, and Guangzhou by the end of 2014 as part of the judicial reform. As of December 31, 2015, the three IP specialized courts have handled a total of 15,772 civil and administrative IP cases. They are also adding some reforms on judicial procedures for complicated patent cases, such as using technical experts in hearings and decision-making processes. Three courts undertake the mission of the pathfinder and pioneer. The system has seen some initial success and is off to a good start. Before 2001, the decisions made by the re-examination boards were final. Now all disputes concerning the validity of IP rights, a litigant can file a case to court to determine whether or not to grant IP rights, or concerned with maintaining or canceling the rights cases. The court which deals with the civil case (damages) still has the power to review all issues relating to the case, no matter whether an infringement has been determined by the administration or not, therefore, the courts play a vital role and hold the power of final decision-making.

Third, China has established the unique "three-in-one" adjudication system, it combines adjudication of civil, administrative and criminal cases to unify adjudicating standards, optimize allocation of judicial resources, and improve trial quality. As of November 2015, the pilot reform of "three-in-one" adjudication has been carried out in 6 high courts, 95 intermediate courts, and 104 district courts in China.

Fourth, Courts actively explore effective approaches to professional and technical fact-finding for IP cases. The SPC (Supreme People's Court) has issued "Provisional Regulations on Several Issues Concerning Technical Investigation Officers of Intellectual Property

Courts Participating in Litigation Activities" in 2015. Such regulations promote the establishment of technical fact-finding systems within courts for IP cases, especially complicated patent cases. The investigation officers of the courts can play special and important roles in technical fact-findings and assist judges to make fair decisions. Technical fact-finding systems such as expert assessor, expert testimony, expert consultation, and technical investigation officers improve the scientific and neutrality of the court judgments.

Finally, the SPC strives for the openness and transparency to protect and enhance the credibility of the judicial protection of IP. Early in 2006, the SPC established Chinese IP right Judgments and Decisions website and started to publish the SPC's decisions on this website. Further, the SPC has established the Chinese courts' website (China Judgements Online) for publishing decisions of various courts. By the end of 2015, 154,532 IP decisions of various courts were published.

During the IP rights Protection Week in April 2016, the SPC released ten "Major Cases" and 50 "Typical Cases," which should assist lower courts in their decision-making processes. Under the Chinese legal system, the court has no power of law making; the doctrine of precedent does not exist in China. However, under the Constitution, the SPC is authorized to interpret laws when it is needed. The judicial interpretations, such as opinions, circulars and advice of the SPC, have a special position in the legal framework for IP protection. Once the judicial interpretation is adopted and announced by the judicial committee of the SPC. It shall take binding effect and must be observed by all the people's courts in China. Although the absence of the doctrine of precedent, precedent decisions in China are used as references for later cases in many occasions. The court at a lower level will generally follow or respect opinions or decisions made by its superior courts, especially those "Major Cases" and "Typical Cases" released by the SPC in China.

Case Study

There is one case study to show how the SPC made its decision in one of the top ten civil and administrative disputes in 2015. The disputes between Shuanghuan Co. Ltd. and Honda involve objections to jurisdiction, relevant patent infringement claims, and administrative procedures for invalidation of the design patent at issue. The first-instance trial lasted up to 12 years. The key is how to determine whether sending of infringement warnings is proper conduct or an unfair competition act.

Honda sent a warning letter to Shuanghuan for infringement on its vehicle design patent and filed a patent infringement lawsuit in the court of Beijing in 2003. Shuanghuan then filed a lawsuit for declaration of non-infringement in the court of Hebei province.

During the court hearing the infringement dispute and the non-infringement declaration dispute, Shuanghuan proposed a request for invalidation of the design patent to the PRB (Patent Re-examination Board) of the SIPO (State Intellectual Property Office), and the PRB declared the patent at issue invalid. After the Beijing High People's Court upheld the administrative judgment and the PRB decision, Shuanghuan made a claim for compensation of damages in the instituted action for declaration of non-infringement due to the warning letter sent by Honda spread harmful opinions that damaged the management right and reputation thereof. Honda filed a Request for Retrial with the SPC. After retrial the SPC revoked the judgments and the invalidation decision. Honda proceeded with the patent infringement case, claiming an increased amount of the monetary damages. Shuanghuan further increased the amount of damages to RMB 36,574 on the grounds of unfair competition against Honda.

The SPC issued the Judgement No. Minsanzhongzi 8/2014 on July 23, 2015, holding that the vehicle design of Shuanghuan does not fall within the scope of the design patent of Honda at issue, i.e., Shuanghuan does not infringe Honda's design patent. Thus, the SPC upheld the first-instance judgment of HeBei High People's Court, Shuanghua should not bear the infringement liability. In response to the declaratory judgement case that Shuanghuan filed against Honda, the SPC issued the Judgment No. Minsanzhongzi 7/2014 on December 8, 2015, and took a prudent step alteration of the cause of action as declaration of non-infringement and a damage dispute, then reconfirming that the vehicles manufactured and sold by Shuanghuan do not infringe the design patent of Honda at issue, and the decision of damage that Honda is liable for Shuanghuan's economic losses of RMB16 millions.

Specifically, the SPC divided two stages of Honda sending of the warning letter in the Judgment No. Minsanzhongzi 7/2014. In the first stage, Honda sending of the warning letter to the manufacturer Shuanghuan is a reasonable right-safeguarding act based on fact findings, explicit targets and stable right. The SPC pointed out that Honda's sending a warning letter is a reasonable enforcement action only at the first stage. But in the second stage, the SPC considered the fact that the warning letter was sent out after Shuanghuan had negotiated with Honda and intended to seek judicial remedies for a declaratory action of non-infringement and after Shuanghuan filed a request for Invalidation of Honda's design patent. Honda expanded the scope of the warning letter and sent it to dozens of Shuanghuan's distributors in China, but the warning letter merely recites the design patent at issue, without disclosing the specific grounds for infringement, necessary infringement comparison, or other facts that may help the distributors make rea-

sonable and objective judgments on whether or not they should cease the warned acts. The SPC held that Honda's sending a warning letter is unfair competition act in the second stage.

In making the Judgment of No. Minsanzhongzi 7/2014, the SPC faced an issue: In what circumstances shall the IP right holder who sends a warning letter be liable to pay compensations to the party who suffered from the warning letter due to unfair competition? Based on the fact that the right holder had bad faith and knows that the IP right is invalidated and no infringement conduct in the fact. OR the right holder's act of exercising his right of warning is illegal and no matter whether an infringement occurs.

The SPC focused on the "act" instead of the "consequence." One of major reasons, the SPC pointed out that because the judgment on whether the alleged act infringes the patent involves the specialization and complexity of technical fact-finding, after the grant of patent, there always remains a likelihood of invalidation within the effective patent term. It is impossible for the patentee alone to decide whether the patent may be eventually declared invalid. In general, an administrative litigation follows the declaration of invalidation. For instance, the patent has gone through the processes of declaration of invalidation, upholding of first-instance and second-instance administrative judgments, revocation of the invalidation decision after retrial and restoration of patent right in this case; therefore, we should not require a right holder to be quite certain about the extent of infringement constituted by his warning act, otherwise, the normal effect of the infringement warning system may be trammled and the original intent of such a system may be undermined.

Furthermore, the SPC considered the conduct of the right holder is justified shall be evaluated on the basis of whether the conduct violate the fair competition order, instead of whether the warning act constitutes infringement. Where the patentee is justified and not at fault for sending an infringement warning, even if the warned act does not constitute infringement. Specifically, the patentee's act can be justified and the patentee is not liable for sending a warning letter of patent infringement, even if the warned act does not constitute patent infringement; and in this circumstance, the patentee's act does not pertain to an unfair competition act involving abuse of right; therefore, the patentee does not need to compensate for the loss suffered from the warning letter.

The SPC pointed out the infringement warning system as a self-rescuing act is a double-edged sword. The infringement warning system provides a self-rescuing opportunity for IP right holders for parties to resolving disputes via active communication and negotiations, and should not be premised on the infringement judge-

ment to be made by the court. Such a system reduces enforcement costs, increase efficiency of dispute resolution, and save judicial resources. The patentee's sending of an infringement warning to safeguard the rights and interests thereof is a lawful self-rescuing act and not premised on the infringement judgment made by the court. The IP right holder sends an infringement warning with an aim of informing the warned party of the potential infringement upon other's rights, in hope of ceasing infringement by itself or resolving disputes through active communication and negotiations with the right holder, by doing this, the advantage is to increase the efficiency of dispute resolution and save judicial resources, thereby enhancing economic benefits; moreover, according to Article 70 of the Patent Law in China that provides:

Where any person, for the purpose of production and business operation, uses, offers to sell or sells a patent-infringing product without knowing that such product is produced and sold without permission of the patentee, he shall not be liable for compensation provided that the legitimate source of the product can be proved.

In practice, after the patentee sends the warning letter, if the warned party does not stop infringement then the patentee may request the defendant to bear liabilities for damages due to its subjective maliciousness in a later infringement lawsuit. But the big disadvantage is the risk of unfair competition act.

Compare the warning letter with the court's pre-trial injunction, the alleged infringing act will not be certainly ceased by the warning notice, and it is up to the alleged parties to decide whether to settle patent infringement disputes on their own. So the SPC looked into the content of the warning letter. The content of the infringement warning plays an extremely vital role in making a reasonable judgment and deciding to take resulting commercial risks. Court may determine patentee's act of sending out a warning letter without subjective malice is reasonable and lawful patent enforcement action and the warned party can reasonably determine and consider the potential risks associated with it. If a warning letter is sent with subjective malice for disturbing the normal business of the competitors and winning customers and opportunities, such an act is not allowed.

The SPC further states that the IP right holder needs to base its warning on ascertained and specific infringing facts. The information involved in the warning shall be detailed and sufficient, such as disclosing the protection scope of the patent and the particulars suspected of infringement, and briefly summarizing the features of the alleged product and comparing the same with the patent, so as to clarify that the alleged product falls within the protection scope of the patent at issue. Other information necessary for determination and cessation of infringement shall also be disclosed in a sufficient manner.

To determine if the infringement warning is a lawful patent-safeguarding act instead of an unfair competition act is based on the content of the infringement warning letter, the SPC stressed that the right holder must send the infringement warning based on ascertained specific infringing facts after taking sufficient account of and proving the specific alleged infringing facts; therefore, the warned party can decide whether to stop the alleged infringing act, reasonably determine corresponding commercial risks, and judge whether infringement occurs upon the warning letter to ensure a stable trade order. As long as the patentee's conduct is justified and sent the explicit content of the infringement warning, the warned party shall make a judgment on their own. The loss caused by the warned party's acts shall be considered as commercial risks and shall be borne by the warned party itself.

The hard part is how to judge the sufficiency and explicitness of the warning letter. The right holder is not always obliged to fulfill the same duty of care at the time of sending the warning letter, and things get different where diverse warned parties and disputes are involved. The IP right holder has higher duty of care to customers, users, and importers, than to manufacturers, when a warning letter is sent out; the reason is manufacturers are different from users or sellers in terms of information awareness and the stake when facing the infringement warning act. For instance, manufacturers as the source of infringement are the primary targets. The right holders sending the warning letter hope can cease infringement or settle down the dispute through negotiations. For sellers and importers of the product, they are very weak in judging whether the suspected infringement on patents occurs. They know little about the circumstances of infringement, and are strongly aware of the risk and readily apt to be affected by the infringement warning. They tend to choose to remove the alleged infringing products from shelves or even return them so as to stop the warned acts and refuse to trade the products of the manufacturers avoiding their potential consequences brought by the warning letter.

Finally, the SPC states that the warning letter shall not be abused or impair the legitimate rights and interests of competitors. Such measures are taken not purely for safeguarding patents, but also for frustrating competitors and winning trading partners or opportunities, because an infringement warning can stop or even pre-emptively prevent infringement, without seeking public remedies for a lodged infringement lawsuit. The act of warning the users and sellers may directly give rise to the impossibility of sales on the part of manufacturers.

Another thing is the cause of action in this dispute. The cause of action is the declaration of non-infringement in the first instance. Because damages and declaration of non-infringement are two different litigation

pledges, they shall be examined under different substantive laws. Infringement is judged in the light of relevant provisions of the Patent Law, whereas damages are examined in the light of relevant provision of the Anti-unfair Competition Law as the impairment consequences resulting from unfair competition acts. SPC based on the ascertained facts, in view of the first instant court that has actually conducted trials concerning declaration of non-infringement and damages and has guaranteed the right of both parties concerned in the procedure, as the first instant process has taken 12 years, if the case is remanded for the procedural flaw, it is not conducive to effectively settle the dispute in a timely manner. Based on above factors, the SPC took a prudent step alteration of the cause of action as declaration of non-infringement and a damage dispute in the second instance.

Conclusion

Chinese IP system has been in continuous reform, providing more opportunities for technology transfer and licensing for domestic companies and foreign companies doing business in China. The Chinese economy has become an important part of the world economy. China has also become an important member of the international trade. China cannot develop in isolation from the rest of the world, nor can the world enjoy prosperity and stability without China. China will, as it always does, endeavor to build, together with other countries, a harmonious world of enduring peace and common prosperity. ■

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