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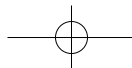


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Corporate America's slow boat to China

Japanese companies were forced to rebalance their patent portfolios after finding themselves on the wrong end of IP lawsuits in the US during the 1980s. US companies must apply for more patent rights in China if they want to avoid having to learn the same lesson, says **Alan Kasper** of Sughrue Mion PLLC

For decades, a fundamental principle of US international trade policy has been to encourage, if not insist upon, the recognition and protection of IP rights. The more immediate and newsworthy initiatives have targeted enforcement against counterfeiting and piracy, while others are focused long-term on the establishment or modification of fundamental legal principles and cultural philosophies through legislation. In both cases, the US has achieved success by maintaining that the adequate protection of IP by a foreign country is an important consideration in determining whether that country should be accorded Most Favored Nation status as a trading partner.

Patent protection

For the US, no country raises greater concern than China with respect to the protection of IP rights. The issue has been on the agenda since the two countries established diplomatic relations in the 1970s. The two countries signed an "Agreement on Trade Relations," which provided that "[e]ach Party shall seek, under its laws and with due regard to international practice, to ensure to legal or natural persons of the other Party protection of patents and trademarks equivalent to the patent and trademark protection correspondingly accorded by the other Party." During the decade that followed, the US urged China to establish an infrastructure and adopt modern principles to protect all forms of IP, including patents, copyrights and trademarks. In 1980, the government established the Patent Office of the People's Republic of China (CPO, the predecessor of the State Intellectual Property Office, SIPO). In 1984, the PRC adopted its first Patent Law.

Notwithstanding these basic advances, the US continued to maintain pressure on China over its

provision of adequate IP protection because substantial and unabated violations of fundamental property rights continued. In 1989, the US Trade Representative (USTR) reported that the absence of intellectual property protection cost US exporters \$100's of millions of dollars in lost sales during 1987. In 1992, after threats of sanctions by the US Trade Representative (USTR), China agreed to sign a Memorandum of Understanding on the protection of IP with the US, which resulted in further amendments to China's patent law. The 1992 amendments included several important reforms: they extended the term of certain types of patents to 20 years; expanded the technological fields of patent protection to include pharmaceutical products, foods, beverages, flavorings, and substances obtained via a chemical process; and narrowed the grounds under which a compulsory license may be granted. When China became a member of the WTO in 2001, thereby agreeing to abide by TRIPs, the US insisted that China's accession be on "commercially meaningful terms". This resulted in China joining the WTO as a developed country, rather than as a developing country, which meant that China had to comply immediately with TRIPs. In 2001, China amended its Patent Law again, in an effort to harmonize with international standards and treaties.

Today, China has a fully-functioning patent office (SIPO) with examiners that are adequately trained to implement effectively the necessary procedures to receive, process and examine patent applications, and grant patents with minimal backlog.

SIPO statistics

SIPO's latest annual report says that the Office received 353,807 patent applications for three types of patents in 2004: invention; industrial design; and

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utility model patents. The number of applications filed in each category is fairly evenly divided. The report further states that most of the Chinese origin (domestic) applications were for utility model and industrial designs and that domestic origin applications for invention patents amounted to only 23.6% of the total. By contrast, 86% of the foreign origin applications in 2004 were for patents for inventions

subsidiaries of LG are among the top ten domestic filers in China.

Based on the figures for 2004, Japan is outpacing the US in patent filings by a rate of roughly 2:1. In 2005, the number of US patent applications in China reached 20,395, an annual increase of 30%. Japan advanced by 19% with 36,221 filings. This rate of growth by Japanese entities is expected to continue for

"The Chinese judiciary is expected to attain the sophistication and experience needed to handle complex patent claim interpretation issues with consistency and fairness"

and the number equaled those of domestic entities. This discrepancy between domestic and foreign origin filing is notable because protection for industrial designs is limited, and the utility model patent has a far more restricted scope than that of an invention patent. This is because it is not subject to examination before issuance and requires only a search prior to enforcement. It also indicates a clear difference in philosophy and a reluctance on the part of domestic entities to invest in long-term rights that offer a significantly broader scope of protection.

Several factors may be at work. First, cash-strapped domestic entities may opt for the lower cost protections that are easily available and do not involve the higher fees required for a substantive examination. Second, the innovations of domestic entities may not merit long term protection, as they may be improvement or design-type, rather than fundamental advances or break-through developments. Third, there may not yet be a business culture that views broad conceptual definitions of IP rights as valuable, or believes that the judicial infrastructure and philosophy is mature enough to ensure meaningful protection for inventions that are defined by the words of a claim and not by illustrations.

Japan is by far the largest foreign user of the Chinese patent system. In 2004, Japanese inventors filed 30,444 patent applications in China, most of which were for invention patents. US industry similarly favors invention patents. Although it comes second place to Japan, there were only 16,187 applications from the US. Even though Korea is regarded as a developing nation, it still comes third, although by some distance, with 6,660 applications. However, it is notable that three Korean

the long term and may even accelerate as the Japanese government begins to implement policies encouraging companies to divert their filing resources from domestic applications to foreign applications. It is expected that this trend will not be limited to the popular medical, digital processing and digital

transmission fields, but will embrace a broad spectrum of technologies involving an increasing number of Japanese companies.

As to Korean interests, the growing numbers of filings in China in recent years and Samsung's rise to the top of the list of US patent owners for 2005 demonstrates a strategic commitment to protecting inventions in key geographical regions.

Offensive or defensive strategy?

Even though the invention patents obtained by Asian companies in China could be used solely for defensive purposes, they could also be used offensively, with a goal of extracting substantial royalty income and establishing strategic barriers to competition. Those members of US industry that have a present or future interest in China as a supplier and/or a market should be mindful of the increasing sophistication of Asian companies with respect to licensing and litigation.

For example, almost a half century ago, those Japanese companies that valued patents as a medium of defensive disclosure rather than a source of enforceable rights filed poorly drafted US patent applications with insufficient disclosures and inadequate claims, even as their share of the US market grew rapidly. In the 1980s, Japanese computer memory chip manufacturers were flooding the US with products, driving prices down and leaving US companies with mounting losses. As a result, key players such as Intel, Motorola and National Semiconductor, exited the DRAM market. By contrast, Texas Instruments (TI), another important US company in the market, used its patents aggressively to attack its foreign competitors.

According to the 2004 book *Make the Rules or Your Rivals Will*, by G Richard Shell of the Wharton School at the University of Pennsylvania, TI held the basic patents on both integrated circuit and microprocessor designs and decided to use these patents to its advantage in the market it had created. This represented a basic change in the way TI thought of patents. Shell reports that in 1985, “[p]atents were perceived as trading materials to get free use of someone else’s intellectual property. So people just cross-licensed it.” Companies did not use patents as weapons to defend the markets they created. TI decided to either litigate or charge a hefty license fee for other companies to enter the US memory chip market. In 1986, TI surprised its Japanese and other Asian competitors by filing a series of infringement suits against them and “the shock was huge. You could hear the gasps from Tokyo all the way to Dallas.”

The patent litigation campaign by TI against its Asian competitors was unprecedented. “[TI] sued nine companies simultaneously – Hitachi, NEC, Mitsubishi, Matsushita, Oki, Fujitsu, Toshiba, Sharp, and Samsung. And it filed cases against these defendants in two different forums: the Federal District Court in TI’s hometown of Dallas, Texas, and the International Trade Commission (ITC) in Washington, DC”

TI’s action in the ITC had the potential to block all Asian competitors from the US computer chip market, an unacceptable alternative for the respondent companies. Moreover, at that time, the culture of both the Korean and Japanese respondents favored conciliation, rather than litigation in foreign courts. As a result, faced with an overwhelming IP imbalance, all the respondents eventually settled on terms favorable to TI. “The nine deals yielded \$1 billion in royalty income [for TI] spread over the five-year term of the settlement agreements,” Shell says in his book.

Changing approach

However, even as the TI litigation was progressing, Japanese companies changed their approach to US patents

by dramatically increasing both the quantity and quality of the patents in their US patent portfolios and modifying their patent strategies to correct the IP imbalance. This change was illustrated clearly in Motorola’s suit in 1989 against Hitachi. Motorola sued the Japanese company for patent infringement. Hitachi responded to the suit by identifying in its portfolio a patent that was infringed by Motorola’s most impor-

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tant computer chip. The court ordered both companies to take their products off the market, a decision that could have hurt Motorola more than Hitachi. Hitachi’s success led it to use its patent portfolio more aggressively and Hitachi, which until 1984 paid out more in royalties than it received, recorded a net profit of \$110 million from royalties in 1994 through the efforts of a dedicated licensing department that markets licenses for its technology.

Today, the USPTO grants Japanese inventors more than 37,000 US patents each year. At a price of \$30,000 to \$50,000 for each patent, Japanese companies and inventors have invested over \$1 billion dollars a year to obtain US patents. This investment serves both defensive and offensive goals. Japanese companies today license their US patents globally and

Alan Kasper



Alan Kasper has been a partner at Sughrue Mion in Washington DC for almost 20 years. His practice focuses on both domestic and international IP law. He is the director of the firm’s international department and is on the Board of Directors of the American Intellectual Property Law Association. Before entering private practice, Alan Kasper was a patent examiner with the USPTO and then joined the Communications Satellite Corporation (COMSAT), where he served as the chief patent counsel for several years.

Alan Kasper represents clients in litigation, renders opinions on patentability, validity and infringement and provides counseling on matters involving licensing, proprietary rights protection, contracting and export control. He advises clients engaged in electrical, semiconductor, network, nanotechnology, software/computer-based and mechanical technologies and has had extensive experience with business method patents.

Alan Kasper received a JD degree from Georgetown University and a Bachelor of Science degree in electrical engineering from the State University of New York at Buffalo. He is a member of the DC Bar, the US Court of Appeals for the District of Columbia and the Federal Circuit and is registered to practice before the USPTO.

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use the US courts to enforce their patent rights against competitors from other nations, the US and even Japan.

In his book discussing Japanese companies' patent strategies, Hisamitsu Arai, the former vice-minister for international affairs at the Japanese Ministry of International Trade and Industry, wrote that 45% of companies file patents to block the development and sale of look-alike products, while 10% file because they expect advantages in cross-licensing deals. In some cases, companies have refused to license technology to

binding authority and are not regularly published in China. In order to comply with TRIPs, the Beijing High People's Court began in 2003 to make judicial decisions on IP cases available on the internet. As of February 2006, more than 860 court decisions related to patents have been posted.

Moreover, the judiciary in China includes exceptionally bright, young and enthusiastic judges, many of whom have received training in Japan and the US and, according to a noted Japanese jurist, may have been infused with a sense of judicial activism. Within the next

decade, the Chinese judiciary is expected to attain the sophistication and experience needed to handle complex patent claim interpretation issues with consistency and fairness, and without a concern for limiting damages awards or granting injunctions.

The true value of Chinese invention patents will be derived from their economic impact and the effectiveness of enforcement by the Chinese courts

businesses that do not have patented technology of their own to the cross-license, and 41% file because they want to prevent other companies from using the technologies, even though the companies did not plan to use the inventions themselves.

These same observations about Japan may be applied equally to Korean industry. They too are battle-hardened by litigation in the US due to historical IP imbalances. They have demonstrated a clear vision with respect to the acquisition of patent rights globally, and especially in China.

Long-term value

The true value of Chinese invention patents will be derived from their economic impact and the effectiveness of enforcement by the Chinese courts. At the least, China's importance as a market for goods and services cannot be ignored, given the fact that it has one of the highest economic growth rates in the world and a population of 1.3 billion. Equally important is its significance as a low-cost outsourcing centre for goods and services. James Maccoun, senior counsel at Hewlett Packard and experienced in IP matters in China, recently observed that "[f]or many types of products it is economical to manufacture the product only in China. For these types of products the Chinese patent may function as a 'world patent' because the Chinese patent may be used to stop world-wide economical manufacture of such products having the patented invention."

As to the effectiveness of judicial enforcement, China has acted to increase the transparency in legal proceedings, even though court decisions generally do not have

It might be difficult to predict how quickly or slowly the problems with patent enforcement in China will be resolved. However, concerns regarding the effectiveness of the legal system in China should not result in companies failing to obtain strong invention patent portfolios in China.

Historical lessons

American industry may wish to take a lesson from history and be mindful of the adverse impact that an IP imbalance in any important market may have with respect to the ability to purchase components and sell products. Recent statistics suggest that US companies are too intently focused on the immediate issues of counterfeiting and piracy, based on trade mark and copyright concerns, and have not maintained a proper perspective with respect to obtaining the invention patent rights that will surely govern freedom of business and legal actions in the future. If corporate America remains on the slow boat to China with respect to invention patent rights, they are likely to confront additional barriers and extraordinary costs as they implement their plans to expand into China.

The views expressed are solely those of the author and do not reflect the views of Sughrue Mion PLLC or its clients. The author recognizes with gratitude the invaluable effort by Weiwei Stiltner in providing research support for this paper.