Developing a patent and trade secret strategy for China

Patent Protection

China has three types of patents: invention patents, utility model patents, and design patents. For a hardware invention, all three should be considered; this is because each will help to protect your product in different ways.

Invention patents cover products that provide solutions to technological problems – they are more 'inventive' than utility model patents, which essentially provide protection for technological 'upgrades'. Companies developing software inventions should consider filing for protection under an invention patent. The Chinese patentability standards for software inventions are similar to those in Europe. Thus, a software invention that is patentable in Europe should generally be patentable in China, although the patents should also be registered *separately* in China. An invention patent lasts twenty years and should be used to protect inventions with a relatively long life. The duration of a utility model patent is only ten years. Since the 'novelty threshold' for utility model patents is lower than that for invention patents, utility model patents are suitable for incremental inventions and technologies with a shorter life span.

Since Chinese companies can freely access patent information in Europe and the USA, it is advised that companies register their invention and utility model patents in China before their inventions are released anywhere in the world. If your invention or utility model is disclosed to the public before it has been patented (i.e. it is no longer 'novel'), it is no longer possible to apply for a patent.

Design patents protect the 'look' – or cosmetic appeal – of a product. In the EU, designs are automatically protected for three years. This is different in China, where if you do not register your design patent before you disclose it to the public in any way (anywhere in the world), it can no longer be protected by a design patent.

Trade Secret Protection

Trade secrets include confidential business information that may provide your company with a competitive advantage over others. Unbeknown to many, trade secrets can be extremely valuable intellectual property. However, since they are not registrable rights, protection strategies adopted by EU SMEs should be considered carefully.

Trade secrets can include a myriad of technologies, including source codes (to the extent that they cannot be reverse engineered). Trade secrets can also include operational information, such as processes and methods; or other information, such as marketing strategies and customer lists, so long as they meet all of the below requirements.

A **trade secret** is defined as:

1. Technical and business information that is unknown to the public;
2. Information that has economic value and practical utility; and
3. Information that the trade secret owner has palpably protected – the owner should have undertaken (demonstrable) measures to ensure its confidentiality.

Although trade secrets can be protected by a confidentiality agreement – as in Europe – it is also recommended that recipients of confidential information should sign an acknowledgement prior to receiving such information. If it later becomes necessary to file a misappropriation action, a trade secret owner must provide appropriate evidence to show that the trade secret meets the above requirements (*see definition*), in addition to proving there has been misappropriation of the trade secret by a wrongdoer or a third party.

In the case of trade secrets, prevention is the best strategy. Although companies that take enforcement actions can, and have, received positive outcomes from Chinese courts.

FRAND: Interface of standards and patents

While in the past it was viable to obtain patents according to industry standards, recent developments in the law on Standard Essential Patents ("SEPs") have changed this. A standard essential patent is a patent that claims that an invention must comply with a technical standard.

Standards for different industries are set by regional organisations, such as The European Telecommunications Standards Institute (ETSI), which amongst other standards covers wireless communications. Due to inter-operability requirements on this technology, certain ETSI standards are adopted in China.

ETSI generally does not determine whether a particular patent is essential to a standard. Rather, it provides a mechanism by which the patent owner themselves can make a declaration of essentiality, coupled with *a commitment to license any SEPs on Fair, Reasonable, And Non-Discriminatory ("FRAND") terms and conditions.* Therefore, where a European patent is declared by the patent owner as essential to an ETSI standard, the Chinese patent corresponding to the European patent is also considered essential in China. Thus FRAND terms and conditions will also apply.

If a patentee engages in standard-setting or agrees that a patent should be incorporated into a national, industrial or local standard, this permits others to exploit the patent for implementation purposes. Those using the patented technology to implement the standard may be charged royalties by the patentee for use of the patent, but are not deemed to be committing an infringement.

Enforcement

China is the most litigious country for IP disputes in the world in absolute terms. 87,419 IP suits were filed in Chinese courts in 2012. However, out of these only about 1,400 foreign companies participated, which means that less than 2% of Chinese IP disputes involved foreign parties.

The reluctance by foreign companies to enforce their IPR rights in China is largely due to the perception that China does not protect IPR and that foreign companies won't get fair treatment. However, such reluctance is misplaced: evidence suggests that case outcomes are not affected by litigants' nationalities or, in short, the Chinese IPR system has reached a point at which foreign companies can get justice through a number of channels.

Enforcement cases concerning ICT technology in China can be very complex, given the consideration of individual IP rights and industry standards that is often required. Therefore, it is beneficial for an

ICT company that deals predominantly with incremental technology development to consider their rights and how they may conflict with certain competitive market laws.

ICT company case study

InterDigital, Inc. is a mid-sized US wireless research and development company. In July 2011, it filed a complaint with the United States International Trade Commission (USITC) against Nokia Corporation and Nokia Inc., Huawei Technologies Co., Ltd and its affiliates, and ZTE Corporation and its affiliate, alleging patent infringement of certain 3G wireless devices, such as WCDMA- and CDMA 2000-capable mobile phones, USB sticks, mobile hotspots and tablets and components of such devices.

Actions taken

In December 2011, Huawei filed two suits against InterDigital in the Shenzhen Intermediate People's Court in China. The first suit alleged that InterDigital had a dominant market position in China and the United States for the licensing of standard essential patents (SEPs) (inventions that must be used to comply with technical standards) owned by InterDigital, and abused its market power by engaging in unlawful practices, including differentiated pricing, tying, and refusal to deal. The second suit alleged that InterDigital failed to negotiate on *Fair, Reasonable, and Non-Discriminatory* (FRAND) terms with Huawei – a requirement of owners of SEPs. It asked the court to determine the FRAND rate for licensing essential Chinese patents to Huawei and also sought compensation for its costs associated with this matter.

Outcome

In February 2013, the Shenzhen Intermediate People's Court ruled that the royalties to be paid by Huawei for InterDigital's 2G, 3G, and 4G standard-essential patents should not exceed 0.019% of the actual sales price of each Huawei product. This appears to be the first time that any judicial authority has ruled on the appropriate royalty rate for a FRAND encumbered standard essential patents (SEP) – a patent that defines an invention that must be used to comply with a technical standard.

With respect to the first suit, the court held that InterDigital violated China's Anti-Monopoly Law by (1) making proposals for royalties from Huawei that the court believed were excessive; (2) tying the licensing of essential patents to the licensing of non-essential patents; (3) requesting as part of its licensing proposals that Huawei provide a grant-back of certain patent rights to InterDigital; and (4) commencing a United States International Trade Commission (USITC) action against Huawei while still in discussions with Huawei for a license. The court ordered InterDigital to cease the alleged excessive pricing and bundling of InterDigital's Chinese essential and non-essential patents, and to pay Huawei approximately USD 3.2 million in damages. The court dismissed Huawei's remaining allegations, including Huawei's claim that InterDigital improperly sought a worldwide license and improperly sought to bundle the licensing of essential patents on multiple generations of technologies.

With respect to the second suit, the court determined that, despite the fact that the FRAND requirement originated from the European Telecommunications Standards Institute's (ETSI) IPR policy, which refers to French law, InterDigital's license offers to Huawei should be evaluated under Chinese law. Under Chinese law, the court concluded that the offers did not comply with FRAND.

InterDigital is reported to have filed appeals to both decisions.

IP lessons and take-away messages

- FRAND is *not* an essential patent holder's friend.
- Enforcing SEPs is problematic in China: injunctions may not be possible; royalties are lower than normal.
- Antitrust enforcement further limits the value of SEPs.
- Enforcement of SEPs outside China may give rise to countersuits in China.
- Software inventions can be protected in China, as in Europe.
- Utility model patents can play an important role in your Chinese patent portfolio.
- Implementation patents are much more valuable than standard essential patents.
- Trade secret protection should be complimented by additional confidentiality measures that require signed acknowledgements.
- IP enforcement in China is improving, though cumbersome evidence rules make it difficult to enforce.

CHINA IPR SME HELPDESK

An initiative of the European Commission

*The **China IPR SME Helpdesk** supports small and medium sized enterprises (SMEs) from European Union (EU) member states to protect and enforce their Intellectual Property Rights (IPR) in or relating to China, Hong Kong, Macao and Taiwan, through the provision of **free information and services**. The Helpdesk provides jargon-free, first-line, confidential advice on intellectual property and related issues, along with training events, materials and online resources. Individual SMEs and SME intermediaries can submit their IPR queries via email (question@china-iprhelpdesk.eu) and gain access to a panel of experts, in order to receive **free and confidential first-line advice** within **3 working days**.*

The China IPR SME Helpdesk is an initiative by the European Union

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