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WHITE PAPER

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Chinese Supreme Court IP Tribunal Plugs Loophole in Patent Infringement Litigation

Similar to the laws in the United States and Europe, Chinese law allows those accused of patent infringement to commence actions for declaring non-infringement of patents to clear away the uncertainties. A key precondition for commencing a patent noninfringement declaratory judgment action ("DJ Action") is the patentee having claimed patent infringement. Chinese law leaves the means of such a claim undefined, and so Chinese courts have the discretion to rule whether an action constitutes a claim of patent infringement. Prior Chinese statute and case law did not clearly address the issue of whether a patentee's lodging of patent infringement claims with administrative agencies against a customer of the allegedly infringing device constitutes a claim of infringement against the manufacturer, enabling the manufacturer to commence a DJ Action.

In *VMI v. Safe-Run*, the Chinese Supreme Court Intellectual Property Tribunal made new law that an administrative complaint against the customer/end user constitutes a claim of patent infringement against the manufacturer, enabling the manufacturer to commence a DJ Action.

The new law plugs the loophole by handing the power of defense to the manufacturers, who are best placed to challenge the validity of the patents and defend the infringement actions.

VMI v. SAFE-RUN

The Chinese Supreme Court Intellectual Property Tribunal ("SPC Tribunal") recently issued a judgment ("Judgment") in a DJ Action, *VMI Holland B.V. v. Safe-Run Machinery (Suzhou) Co., Ltd.* (Chinese Supreme Court ("SPC"), 2019). The Judgment plugs the loophole that had allowed raids against customers or end users without allowing a defense by the relevant manufacturers. The case has also been selected by the SPC as a precedential case.

In the case, the Chinese company Safe-Run requested a local Chinese administrative agency to inspect and collect evidence from machines made by the Dutch company VMI that were being used by VMI's customer Cooper Tire in China, based on a claim of infringement of its Chinese utility model patent. Instead of filing a civil lawsuit before a court, Safe-Run lodged a complaint with the local agency for its expedited docket, which takes three to four months to complete patent infringement cases. Even though the products in question were made by VMI, Safe-Run did not join VMI in the action. Safe-Run asked for permanent injunction, on-site inspections, and evidence collection.

After learning of the filing of this action, VMI decided to make the fight official before a court and filed the DJ Action.

Safe Run challenged VMI's DJ Action. The SPC Tribunal issued the Judgment, although agreeing with the lower court in dismissing the case, disagreed with Safe Run. The Tribunal ruled that, although VMI was not a party in the administrative case, the administrative case also resulted in uncertainty and risks to VMI's business and constituted a claim of infringement against VMI, allowing VMI to commence the DJ Action.

ANALYSIS

Developments

Recently, there has been an increased number of patent infringement claims in China. Claimants who make such claims often refuse to resolve the disputes in legal proceedings. Similar to the laws in the United States and Europe, Chinese law allows those accused of patent infringement to commence DJ Actions to clear away the uncertainties and have the disputes adjudicated.

Law

The Chinese Patent Law and the Chinese Patent Law Implementing Regulation are silent on DJ Actions. DJ Actions are prescribed in the SPC's Judicial Interpretation (2009) (titled *Supreme Court Interpretation on Various Issues Relating to Applicable Law for Adjudication of Patent Rights Disputes*—"JI"), which has the force of law in China.

The JI sets forth the following preconditions for commencing DJ Actions:

1. The patentee claimed patent infringement;
2. The accused or an interested party requested the patentee to commence a patent infringement case; and
3. The patentee did not withdraw the patent infringement claim nor sue within the statutory time limit.

The JI leaves the means of claiming patent infringement under precondition (1) undefined. The courts therefore have the discretion to interpret whether an action meets precondition (1) based on the facts.

Prior Cases

Various prior trademark, trade secret, and patent cases in China set out various positions on whether the lodging of infringement complaints with administrative agencies against only customers constitutes claims of infringement, allowing the filing of DJ Actions by manufacturers.

In *Shengfang LLC v. Changrong LLC*, ((2016) SuMinShen No.2949), Shengfang filed two consecutive cases with the local administrative agency (Administration for Industry and Commerce—"AIC") against Changrong on the grounds of trade secret misappropriation. Shengfang frustrated the proceedings, causing the adjudication of the cases to stall for years, and Changrong's business was adversely impacted. Eventually, Changrong filed a declaratory judgment action. The Jiangsu High Court held that the facts complied with precondition (1) for declaratory judgment actions. This was a trade secret misappropriation case, but it should have reference value for patent cases.

In *Yunusi v. Nongzi Group*, ((2013) MinShen No.237), Yunusi commenced a case with the local AIC against Nongzi for trademark infringement. When the local AIC was about to issue its decision, Nongzi filed a declaratory judgment action. The

SPC held that precondition (1) for a DJ Action was met. The SPC also held that Nongzi registered and used the relevant trademark before Yunusi, and the relevant consumers had associated the trademark with Nongzi. Therefore, Nongzi was entitled to commence the DJ Action. This was a trademark case, but it should have reference value for patent cases.

In *Zhenghao Pharma v. Fangsheng Pharma*, ((2014) XiangGaoFaMin No.51), the patentee sent a complaint of patent infringement to the Chinese drug administrative agency. The agency did not have the power to adjudicate the patent dispute. The letter was subsequently forwarded to the generic manufacturer (Fangsheng). The court held that the complaint constituted a patent infringement claim directly against Fangsheng, and hence precondition (1) for a DJ Action was met, and Fangsheng was entitled to commence a DJ Action.

In *Shenzhen Baili v. Apple (Shanghai)* ((2017) JingXingZhong No.2606), the patentee commenced a case with the local administrative agency (Beijing Intellectual Property Office—"IP Office") against local retailors of Apple products. The regional distributor Apple (Shanghai) moved to join the case, which the Beijing IP Office agreed. The Beijing IP Office subsequently issued a decision against Apple (Shanghai) and the retailors, finding infringement. Apple (Shanghai) applied for judicial review with the Beijing Intellectual Property Court, requesting to vacate the decision, and to declare that its sales of the products did not infringe the patent ("DJ Claim"). The Court ruled in favor of Apple (Shanghai) on both claims. On appeal, the Beijing High Court reversed in part, ruling that the DJ Claim did not meet the preconditions of DJ Actions and thus should be quashed, because "there was no evidence showing that the patentee conveyed a claim of infringement to either the distributor Apple (Shanghai) or the retailors."

The facts of the *Shenzhen Baili* case are distinguishable from *VMI v. Safe-Run*.

- Apple (Shanghai) never argued or submitted evidence to prove that the administrative case against the local retailors amounted to a claim of infringement against Apple (Shanghai) that would have entitled it to file a DJ Action.

- Apple (Shanghai)'s DJ Claim was not a separate civil DJ Action but was a claim added to a judicial review of an administrative case. The Beijing High Court merely ruled that the DJ Claim should be excluded from the judicial review. The court did not preempt Apple (Shanghai) from filing a separate DJ Action.

- Unlike VMI, Apple (Shanghai) joined the administrative case and hence had "the opportunity to defend its interests."

- Apple (Shanghai) was a regional distributor and not the manufacturer. A manufacturer generally has greater knowledge of the accused product and of the technology, and is better placed to defend against infringement claims. Therefore, the *Shenzhen Baili* case did not address the issue of whether a patent administrative complaint against a customer constitutes a claim of infringement against the manufacturer.

In *Kelaien Co. v. Jinkai Co.*, ((2018) SuMinZhong No.43) Kelaien manufactured and disseminated certain chemicals in China. The patentee Jinkai sent a letter to one of Kelaien's customers (i.e., Boyun), alleging patent infringement. Kelaien requested Jinkai to sue so that the court would adjudicate the issue, and subsequently lodged a DJ Action with the Guangzhou Intellectual Property Court. Thereafter, Kelaien and Boyun jointly filed a DJ Action in Jiangsu. The Jiangsu High Court held that, Kelaien's Guangzhou DJ Action barred it from filing another DJ Action in Jiangsu. In other words, the court seemed to have accepted Kelaien's Guangzhou DJ Action including that it having complied with the preconditions of DJ Actions.

In short, prior cases did not clearly address the issue of whether a patentee's commencement of a case with an administrative agency claiming patent infringement against a customer constitutes a claim of infringement against the manufacturer. This enables the manufacturer to commence a DJ Action if the patentee does not commence an infringement action.

Judgment

With the lack of statutory pronouncement and case law on whether a patent infringement administrative case lodged against a customer constitutes a patent infringement claim against the manufacturer meeting precondition (1) for a DJ Action, the SPC Tribunal ruled on the issue in *VMI v. Safe-Run* by adopting a purposive approach. The SPC Tribunal held that Safe-Run's administrative case that was against only the customer/user was no less against VMI's products, which affected VMI's business, but VMI did not have the opportunity to defend against the complaint. VMI, as a non-party to the administrative

case, was therefore entitled to treat the administrative case as a claim of infringement meeting precondition (1) for DJ Action.

Policy Reasons

The manufacturer is the party most concerned when its technology and product stand accused of patent infringement. Unlike a customer or user, the manufacturer generally has greater knowledge of the technology, the industry, the prior art, the asserted patent's value, and the intention of the claimant. Therefore, the SPC Tribunal gives the manufacturer the right to commence a DJ Action to mitigate the adverse impact caused by the administrative case against its customer.

Administrative Enforcement

Under Chinese law, patent infringement claims may be handled by administrative agencies as well as courts (Article 60 of Chinese Patent Law). The Judgment did not deny but affirmed the administrative agency's power to adjudicate patent disputes. The Judgment, however, noted that the patentee's failure to join the manufacturer of the accused product to the administrative case gives the manufacturer the right to treat the administrative case as a claim of patent infringement meeting precondition (1) for DJ Action. The right is automatic and immediate. The SPC Tribunal did not give Safe-Run or the administrative agency the opportunity to join VMI to the case if Safe-Run did not join VMI at the time of commencing the administrative case against Cooper Tire. Nor did the SPC Tribunal place the burden on VMI to avail itself to join the administrative case. Rather, the SPC Tribunal automatically and immediately gave VMI, the nonparty, the right to request Safe-Run to submit the case to court for adjudication, and the clock was then ticking for commencing a DJ Action.

KEY TAKEAWAYS

The Judgment allowing the manufacturer to commence a DJ Action when a patent infringement case is lodged against only its customer is a big step forward for deterring harassment against customers. In its explanation of selected precedent cases, the SPC Tribunal explained that if the patentee filed an administrative case against any party in the supply chain (be it a user, a seller, or a manufacturer), the case constitutes an infringement claim to anyone in the supply chain that is not a party in the administrative case.

If there are patent infringement administrative cases against customers without joining the relevant manufacturers in the future, the Judgment permits staying such cases pending the outcome of later-filed DJ Actions or litigation between the manufacturers and the patentees. Such an approach drastically reduces waste of administrative and judicial resources, and directly hands the power of defense to the manufacturers who are best placed to challenge the validity of the patents and defend against the infringement actions.

For patentees, the new law incentivizes them to do due diligence and sue the manufacturers of the relevant products, rather than sue someone else in the supply chain.

For manufacturers, the Judgment provides them with an effective defense mechanism against raids. The manufacturers can now stem the tide for their customers, and can defend their legitimate rights even when the patentees try to take away their rights by not joining them in actions. With such a level playing field, the manufacturers would be encouraged to disseminate their technology and products, enter into indemnification agreements with customers, and introduce their advanced technologies into the Chinese market, without worrying about their customers being sued and raided without recourse.

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LAWYER CONTACTS

Chiang Ling Li
Hong Kong
+852.3189.7338
chianglingi@jonesday.com

Haifeng Huang
Hong Kong / Beijing
+852.3189.7253 / +86.10.5866.1216
hfhuang@jonesday.com

Anthony M. Insogna
San Diego
+1.858.314.1130
aminsogna@jonesday.com

William E. Devitt
Chicago
+1.312.269.4240
wdevitt@jonesday.com

Associates Luke Song, Albert Wang, and Jiahui Sheng assisted in the preparation of this White Paper.