# Handle with care

## IP rights in developing countries

**In summary**

– Many US and multinational companies are not filing patent and trademark applications in developing markets such as China as they believe China does not enforce IP rights. However, China is stepping up its IP enforcement systems and, along with other increasingly important markets such as India, is capitalizing on failures to file for patent protection in their country

– Using China as an example, this article explores selected issues that highlight the differences between US and foreign IP practices

**J. Benjamin Bai and Anthony M. Insogna of Jones Day warn US firms not to overlook China and India in their global IP strategies**

As more and more US pharmaceutical and chemical companies are moving or outsourcing their manufacturing and R&D overseas, particularly to India and China, a myriad of intellectual property ("IP") issues arise. While there are certain commonalities between US and foreign IP laws, the differences are significant and numerous. The unwary will be trapped. Indeed, certain US IP laws are not only distinct but are incongruous with most of the world. Thus, mistakes commonly occur when US or multinational companies simply apply US practices without modifications to their overseas patent filings.

### Global IP strategies

Generally speaking, IP rights, particularly patents and trademarks, are territorial. Simply put, a US patent cannot be enforced in China, and vice versa. There can be no patent infringement in China if one only seeks patent protection in the US, Europe, Canada and Japan for their most significant invention. Many US and multinational companies have made, or are still making, the mistake of not filing patent and trademark applications in China because they believe that China does not enforce IP rights. However, the fact is, developing countries, like China, are rapidly taking measures to improve their IP enforcement systems. They realize that a robust IP system is ultimately beneficial to their national economy and global competitiveness. Therefore, where to obtain IP protection requires forward-looking visions.

To adequately protect the fruits of R&D, it is essential to file patent applications overseas. It is, however, costly to file and maintain patents globally. Thus, for most companies or inventions, it is not cost effective to file and maintain patents in every country in the world. A balance should be struck between patent filings and their associated costs. Such balance is generally driven by business strategies. In other words, patent protection should be aligned with specified business objectives. As a general rule, patent filings should cover all the major markets. For important inventions, a broad net of overseas filings should be made in countries where there are potential licensing opportunities or where there are manufacturing capabilities. For less important inventions, US, Canadian, Japanese and European filings might be sufficient. China and India are not only becoming increasingly important, but Chinese and Indian companies are capitalizing on failures to file for patent protection in their countries.

### IP ownership

Most US practitioners take it for granted that transfer of IP assets between a parent company and its subsidiary can be done freely, subject to some tax consequences. However, in developing countries, such as China, administrative approval may be required for such transfer to be legally valid.

For example, in China, ABC, Inc., a Delaware company with its headquarters in New York, is considered as a foreign entity. On the other hand, ABC (China), Inc., a wholly foreign-owned enterprise of ABC, Inc.'s with its headquarters in Beijing, is considered as a Chinese entity. Any technology transfer, such as assignment of patents, between a foreign entity (e.g., ABC, Inc.) and a Chinese entity (i.e., ABC (China),

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Inc.) is subject to China's Regulations on Administration of Technology Import and Export, effective January 1, 2002 ("the Regulations"), which govern the import and export of technologies into and out of China, as well as technology transfers between a Chinese legal entity and foreign legal entity.

The Regulations classify technologies into three broad categories:

- **Prohibited technologies:** technologies that cannot be imported into or exported out of China;
- **Restricted technologies:** technologies the import and export of which must be approved by the relevant governmental authority in advance, and the relevant technology transfer agreement must be submitted to the relevant governmental authority; and
- **Permitted technologies:** technologies that can be imported into or exported out of China without prior governmental approval, but the parties need to register the technology transfer agreement with the relevant governmental authority.

Under Article 52 of the Chinese contract law, a contract is void if it fails to comply with relevant administrative regulations. A seemingly innocuous intra-company patent assignment between a US parent company and a Chinese subsidiary involving restricted technologies may be ineffective as a matter of law for failure to obtain prior administrative approval. With respect to permitted technologies, though the failure to register a technology transfer agreement does not affect the effectiveness of the agreement, failing to do so may have other adverse consequences, such as the inability of a Chinese licensee to make royalty payments in foreign currencies.

## Where to file first

Under Chinese patent law, inventions made in China must be first filed with the Chinese Patent Office before any foreign filing. There is no statutory definition of "invention made in China." It clearly covers inventions wholly made in China, *i.e.*, where all the inventors are resident in China at the time of the invention. It arguably encompasses inventions partially made in China, *i.e.*, where at least one inventor is resident in China at the time of the invention.

This file-first-in-China requirement conflicts with longstanding "normal" practices of US and multinational companies of filing patent applications first with the US Patent and Trademark Office. While there is no statutory requirement that inventions made in the US be filed in the US first, US patent law does require that a foreign filing license be obtained prior to foreign filing.

Therefore, to comply with both Chinese and US laws, a US company should consider filing patent applications for inventions made in China with the Chinese Patent Office as PCT applications in English. Before such filings, US and multinational companies should consider which entity is the appropriate assignee and should consider seeking a foreign filing license from the US Patent and Trademark Office.

Currently, Chinese patent law does not prescribe any penalty for failing to comply with the file-first-in-China rule. Thus, foreign companies are not complying with this law. It is conceivable that in the foreseeable future Chinese courts may invalidate the corresponding Chinese patent if the patentee failed to file in China first.

## Inventor remuneration

Under US laws, an employer can obligate employees to assign their inventions made within the scope of employment to the employer with no additional compensation. However, many foreign countries, by statute, require that an employer pay reasonable remuneration for the transfer, exploitation, or license of an employee's invention, for example Japan, Germany, China, and Taiwan.

Under Article 35 of the Japanese patent law, employee inventors are entitled to "reasonable remuneration" from their employers for transfers of patent rights, either by assignment or exclusive license. Until 2004, little attention was given to Article 35 – inventors in Japan simply accepted modest fixed or variable payments on terms set unilaterally by their employers, or received nothing at all. On January 30, 2004, a Tokyo district court ordered Nichia Corporation to pay approximately $180 million to an inventor of the blue light emitting diode he invented while employed there. It was reported that the parties eventually reached settlement a year later for about $5.4 million.

China has a similar provision in its patent law which requires reasonable remuneration to inventors. With respect to "reasonable remuneration", Chapter 6, Rules 74 to 77, of the Implementation Regulations of Chinese Patent Law provides some compensation guidelines. The guidelines are mandatory for state-run (*i.e.*, government-owned) enterprises; but private businesses may adopt the standard voluntarily. According to the guidelines, inventors are compensated at each of the following three stages:

(1) **Issuance of Patent:** Within three months after the patent is issued, the employer should pay the inventors at least about $250 for each invention patent, or about $60 for each utility model patent;

(2) **Exploitation of Patented Invention:** During the term of the patent and for every year the patented invention is practiced by the employer, the employer should pay the inventor(s) at least 2% of the after-tax profits generated by the invention. The compensation can be made by a lump sum payment or paid annually; and

(3) **Licensing of the Patent:** The employer should pay the inventor(s) at least 10% of the after-tax profits generated by licensing the patent.

While private companies in China are not subject to such compensation guidelines, US companies should consider adopting such compensation schemes or develop reasonable remuneration standards for inventors in China. In addition, US companies should consider taking the following steps:

- Work closely with employees to agree upon a remuneration standard.
- Make the final remuneration standard available to employees.
- Give an employee inventor an opportunity to speak when determining remuneration.
- To prepare for a possible dispute at a later date, preserve documents evidencing the steps taken to ensure that the overall process was reasonable, including having inventors to acknowledge in writing the reasonableness of the remuneration.

## Conclusion

As illustrated above, foreign IP laws differ significantly from certain US practices. Therefore, best practices in the US may not best practices overseas; and sometimes US practices do not even comply with foreign laws.