China Insights

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In This Issue...

Cleveland:

2300 BP Tower
200 Public Square
Cleveland, OH 44114-2378
Phone: 216.363.4500
Fax: 216.363.4588

Columbus:

88 East Broad Street
Suite 900
Columbus, OH 43215-3506
Phone: 614.223.9300
Fax: 614.223.9330

www.bfca.com

Benesch Pacific, LLC

Foreign Representative Office
15/F One Corporate Avenue
222 HuBin Road, LuWan District
Shanghai, PRC 200021
Phone: 86 21 6122 1098
Fax: 86 21 6122 2418

Fast Track for IP Enforcement

Section 337 of the Tariff Act of 1930 is a unique provision in U.S. trade law empowering the U.S. International Trade Commission ("ITC") to investigate complaints brought by private parties concerning unfair practices in import trade. The statute authorizes the ITC to exclude products from entry into the U.S. based on a variety of "unfair acts" and "unfair methods of competition" committed in connection with importation; however, almost all Section 337 investigations are based on alleged infringement of registered U.S. intellectual property rights. In recent years, some of the world's most prominent companies, such as Chiron, Fujitsu, Genentech, John Deere, Intel, Microsoft, Motorola, Pfizer, Samsung, Texas Instruments, and 3M, have filed complaints with the ITC based on such allegations. Although patent cases predominate, an increasing number of gray market (trademark) cases have been filed recently concerning products as diverse as agricultural tractors and cigarettes.

Section 337's powerful remedies have much to do with the increasing use of the forum. Although the ITC has no authority to award damages, the remedies the ITC does have available for violations of the statute are unique and effective. Unlike U.S. District Court, the ITC's injunction powers are not limited to products of companies named in the complaint; the ITC may issue "general exclusion orders" covering all products of a certain type, regardless of whether the manufacturer or importers were named as parties. The ITC can also exclude secondary or "downstream" products incorporating the infringing article (such as a fax machine incorporating a computing chip). Finally, unlike in U.S. District Court, the ITC's orders are by law sent directly to U.S. Customs and Border Protection, which is charged with enforcing them at all U.S. ports of entry. In addition to its powers of exclusion, the ITC can issue orders to cease and desist the sale of any infringing goods already entered into the United States.

Chinese imports increasingly have become targets of Section 337 complaints. From 2001 to 2005, Chinese companies were "respondents" (defendants) in 22 investigations. In 2003 alone, four separate investigations were instituted in which Chinese companies were the principal or only respondents. In all but one of those cases the requested relief was granted. Thus, Chinese industry has a vested interest in understanding the scope of Section 337 and the powerful remedies available under it. Perhaps more surprisingly, there is no exemption for U.S. citizens. Therefore, U.S. companies that manufacture (or partially manufacture or assemble) outside the U.S. and then import products back into the U.S. can be, and have been, sued under this law.

The Proceeding. A section 337 case begins when a party files a complaint with the secretary of the ITC. The elements of the claim are (1) an infringement of a U.S. intellectual property right (2) by imported goods and (3) the existence of a domestic industry relating to the articles protected by the right. All legal and equitable defenses are available to defend a claim, but counterclaims are removed to federal court and not allowed to delay or affect the ITC proceeding.

Following the ITC's vote to investigate, an administrative law judge ("ALJ") is assigned to the case and follows discovery rules similar to those in federal court. The ALJ also rules on motions, conducts a trial-like hearing, and issues a written decision on the merits. The ITC's Office of Unfair Import Investigations represents the public interest as an active party in the investigation. The ALJ's decision is reviewed by the ITC and, if appealed, the U.S. Court of Appeals for the Federal Circuit.

Types of Relief and Time Limits. Both temporary and permanent relief are available. By law, the ITC must complete its investigation in temporary relief proceedings within 90 days (150 days in more complicated cases). In permanent relief proceedings, the ITC sets a target date for completion, usually within 12 to 14 months of filing.

If the ITC finds in favor of the complainant, it issues a temporary or permanent exclusion order, either limited or general, barring the goods from entry into the U.S. A limited order excludes infringing articles manufactured by or

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on behalf of any named parties. Limited orders also may be written to cover downstream products containing the infringing articles or upstream components of the infringing articles. General orders cover all products of a certain type, regardless of origin, *i.e.*, they can reach beyond the named parties to an entire product type (*e.g.*, all neodymium-iron-boron-magnets). Imports violating an exclusion order may be seized by U.S. Customs.

Complainants have increasingly been seeking, and the ITC has been granting, general exclusion orders. One case ("*Magnets*") involved a specialized type of magnet imported from China and used in a variety of consumer electronic products such as computer disk drives and headphones. Other cases involved what may be considered lower-value products such as hand tools, cigarettes, bathroom faucets, and disposable cameras. The ITC finds general exclusion orders appropriate in these cases because they involve products that are "cheap, fungible, and susceptible to easy fabrication by entities that can begin infringing with low entry costs and may disappear before their products can be subjected to appropriate trade oversight[.]" Nevertheless, the ITC has issued general exclusion orders in some cases involving more expensive items.

Several general exclusion order cases have involved Chinese respondents. For example, in the *Magnets* case, the ITC found that there was sufficient evidence that other companies not named as respondents might attempt to enter the U.S. market with infringing articles, including evidence that the origin of the magnets was difficult to trace, that no Chinese manufacturer was licensed under the patent, and that the manufacturers tended to use many export companies. Chinese companies were also the subject of investigation in other cases which resulted in general exclusion orders.

The ITC also may issue cease-and-desist orders against all ongoing U.S. activities of named respondents that are "reasonably related" to the importation of infringing goods and can impose civil penalties. The ITC can impose civil penalties (collectable in U.S. District Court, if necessary) representing the greater of $100,000 for each violation day or twice the value of the imported articles entered or sold on each day.

Defending Against Section 337 Actions. Chinese companies historically have not defended themselves in Section 337 investigations. (The recent *Batteries* case is an exception.) This strategy can be dangerous, not just to the named respondents, but for an entire industry that might be affected by an ITC order. Section 337 authorizes the ITC to issue general exclusion orders when respondents fail to appear, and the ITC has found no policy grounds against issuing such orders. In one case, all the Chinese respondents failed to appear and contest the case and were found in default. The ITC then issued a general exclusion order against all infringing compact tools, regardless of source.

Contrary to some perceptions, respondents are not at as great a disadvantage as they may think. The ALJ who make the initial decisions are required to follow trial-type procedures. Moreover, ITC ALJs are not political appointees and therefore do not have the political and other biases that the ITC Commissioners may have when approaching, for example, dumping or countervailing duty cases (which are also decided at the ITC, but under far different procedures). Further, respondents have many weapons available to defend themselves. Section 337 specifically provides for all legal and equitable defenses available under U.S. law. Therefore, in most cases, the best defense strategy usually will be to pursue the typical defenses to the alleged intellectual property infringement (non-infringement, invalidity, unenforceability).

However, the real key to a successful defense is speed. Any company facing a Section 337 lawsuit must retain attorneys and expert witnesses as rapidly as possible and promptly begin coordinating document and witness searches. Because Section 337 cases proceed very quickly, getting a quick start on the issues in this way can sometimes be the difference between winning and losing.

Bryan A. Schwartz, a partner in Benesch's Intellectual Property Practice Group, has significant experience in Section 337 and other ITC matters, and can be contacted at 216.363.4420 or bschwartz@bfca.com.

A Primer on Alternative Dispute Resolution in China

It is better to die of starvation than to become a thief; it is better to be vexed to death than to bring a lawsuit. — Ancient Chinese Proverb

As international business between China and the U.S. continues to grow, commercial disputes will inevitably increase. U.S. and Chinese firms have much different comfort levels on the various ways to resolve disputes. For example, many U.S. firms expect litigation and view it as part of doing business. In contrast, mediation has a two thousand year history in China and is the preferred method for Chinese firms to resolve civil disputes. More recently, arbitration, with the establishment of the Chinese International Economic Arbitration Commission ("CIETAC"), has emerged as another viable method for resolving international commercial and investment disputes. Prior to signing a China-related contract, a U.S. firm should weigh the costs and benefits of litigating an international dispute in the Chinese court system with those of alternative dispute resolution, including mediation and arbitration.

U.S. firms should consider dispute resolution when they begin to negotiate a contract. Like U.S. law, the Chinese Civil Procedure Law grants Chinese courts jurisdiction over all commercial litigation involving foreign elements, unless the parties agreed otherwise. Despite rapid improvements in the Chinese court system, commentators often cite the difficulty of enforcing court decisions as a major problem, potentially making any victory in court a hollow one. Even if a foreign party receives a ruling in its favor, the enforcement department of the judiciary ("zhixing ting") may lack proper training or may be reluctant to act out of concern of retaliation by the Chinese firm's employees, shareholders or creditors.

When a court's enforcement department attempts to enforce an award, it frequently relies on the cooperation of local police departments, government officials and banks. Obtaining cooperation from all necessary parties can be difficult when the ruling court is located in a different geographic region from where the enforcement is sought. In this case, the ruling court will need to rely on the cooperation of local courts. Some commentators suggest that local courts may refuse to cooperate with a different region's enforcement department, and they may even obstruct execution by secretly telling the affected party to shift its funds and property so they cannot be attached. The Supreme People's Court has publicly acknowledged this problem and has taken steps to mitigate court-to-court hostility. Perhaps, China's long standing recognition of the problems associated with litigation has led to its development of viable alternatives to litigation.

CIETAC was established in 1954 to provide a forum to resolve disputes arising out of contractual obligations between foreign and Chinese firms. Although other domestic arbitral institutions exist in China, including the Beijing and Shanghai Arbitration Commissions, most authorities consider CIETAC the preeminent arbitration forum for international disputes.

The inclusion of an arbitration clause in a contract offers several benefits, including the ability to choose the applicable law (unless the application of Chinese law is mandatory), the forum (including the U.S., China or another country)

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and the language to be used (including English, even though Chinese is the official language of CIETAC). In practice, Chinese firms usually insist on keeping arbitration proceedings in China; however, this point is becoming more negotiable.

Even with CIETAC arbitration, a Chinese firm retains important advantages. For a CIETAC award to be enforced against a Chinese firm, the foreign firm must still use the Chinese court system, as CIETAC has no independent enforcement powers. Unfortunately, despite laws that provide for the mandatory enforcement of CIETAC awards, Chinese courts frequently review the merits of CIETAC decisions before enforcing them.

U.S. firms should consider mediation to resolve disputes with their Chinese business partners. U.S. firms often mediate disputes to save money and reduce risk. Mediation ensures them an opportunity to circumvent the court system and its enforcement issues. More importantly, mediation could save time and the relationship. Chinese firms should be amenable to mediation because of "guanxi," which compels the fulfillment of expectations and obligations to save relations.

The popularity of mediation in China has led to the recent formation of the U.S.-China Business Mediation Center. Under the Center's rules, parties choose one or two neutral mediators who will focus on resolving the dispute, instead of focusing on legal issues.

An alternative dispute resolution provision in a contract could combine the benefits of mediation and arbitration. For example, the parties could agree to attempt non-binding mediation before submitting a dispute to binding arbitration. The clause could set specific time limits for mediation so that a timely resolution through subsequent binding arbitration can be achieved.

In conclusion, U.S. firms should anticipate the possibility of disputes in their Chinese business ventures. Keeping this in mind should be an important part of contract negotiations with Chinese firms. Well-drafted alternative dispute resolution procedures will give U.S. firms a better chance to reach a reasonable resolution outside of the Chinese judicial system to any disputes that may arise.

For more information on this subject, contact Joe Gross at jgross@bfca.com or 216.363.4163.

Revaluation of the China Yuan and its Aftermath

In our March/April 2005 issue, we focused on the possibility of a revaluation of the Chinese currency, the yuan. For many years, the Chinese government held the yuan at a fixed exchange rate of approximately 8.27 yuan to one U.S. dollar. Many constituencies outside of China, including manufacturers, labor groups, government officials, money managers and economists urged the Chinese government to allow the yuan to "float" freely against the world's currencies, allowing market forces to dictate the exchange rates. It was believed that by maintaining an artificially undervalued exchange rate, China was protecting the lower price of Chinese exports. These groups argued that a free-floating yuan would reduce trade deficits, improve access for foreign goods in China's growing markets, and ultimately impact everything from wage rates to environmental protection to job security in the United States and elsewhere. Indeed, the U.S. Senate considered a bill in April calling for a 27 percent tariff on all Chinese imports unless China revalued the yuan by at least 27 percent within one year. For years, China's government had resisted all economic and diplomatic efforts to effect this change, citing, among other things, its national sovereignty in determining how to value its currency.

On July 21, 2005, the Chinese government announced that it would finally allow the yuan to be revalued and "unpegged" from a fixed rate against the U.S. dollar. Initially, the yuan was to float within a very restricted specified range of approximately 0.3 percent from the previous day's closing price. The price would be set by the People's Bank of China, against a basket of foreign currencies, instead of just against the U.S. dollar. A modest 2% increase was immediately allowed, with the possibility of daily revaluations.

Reaction to China's move was immediate and cautiously optimistic. While most acknowledged that this tight range and small rate change was, itself, artificial, it was recognized that this constituted a long-anticipated first step. The real question was whether it was to be the first step, or the only step, on the road to a changed monetary policy in China. U.S. Treasury Secretary John Snow welcomed the move, as did Federal Reserve chairman Alan Greenspan, hailing it as a "good first step." Even Senator Charles Schumer, a strong voice for reform (and one of the sponsors of the proposed 27 percent tariff), praised the move, tempering his enthusiasm by pointing out that "[i]f there are not larger steps in the future, we will not have accomplished very much."

Since that initial move to bring the yuan into step with the world's currencies, there has been much back and forth discussion but very little action. In early August, the Governor of the People's Bank of China disclosed the composition of the basket of currencies which forms the basis for valuing the yuan. While the U.S. dollar still plays a significant role, so do the euro, the Japanese yen and the South Korea won. This was followed by an amorphous statement by a Chinese official that China would further develop and perfect the yuan exchange system "with a firm heart." Throughout August, September and October, there were many additional calls by the United States and other trading partners of China for further yuan revaluations, with reaction from the Chinese remaining fairly consistent. "The exchange rate [will] continue to be set by the managed floating regime rather than by official revaluation," as announced by an assistant to the governor of the People's Bank of China.

There have been more recent comments outside China to perhaps force the issue a little. Treasury Secretary Snow recently stated that he planned to suggest to the International Monetary Fund that it take the lead in moving China toward further monetary reform. Senator Schumer has stated that unless more change is forthcoming, he might reintroduce legislation imposing a tariff on Chinese goods.

Whatever happens in the area of monetary policy will affect the U.S. and global economies. If the yuan remains stable and is not allowed to appreciate against foreign currencies, Chinese goods should remain relatively inexpensive compared to similar non-Chinese goods. Moreover, the demand for non-Chinese goods within China would continue to be negatively impacted by the relatively high value of the U.S. dollar and other currencies. Naturally, it is assumed that with more active changes in the value of the yuan, including another upward revaluation, the opposite will occur, but companies should approach this analysis with caution. As the yuan increases against foreign currencies, goods manufactured by U.S. companies in China will become more costly, and goods manufactured in the U.S. which require parts from China will also increase in price. As recently as early November, the People's Bank of China confirmed that it was focusing on yuan reform, and that it would "gradually push forward reform of the exchange rate mechanism, establish a market-oriented, managed floating exchange rate system and maintain the basic stability of the yuan at a reasonable and balanced level."

So, as with most global economic issues, it will be important to monitor changes within China's monetary system in order to effectively plan both domestic and foreign business strategies.

For more information, contact Doug Haas at dhaas@bfca.com or 216.363.4602.

Benesch Attorneys at Work in China

During the last two weeks of October, six Benesch attorneys were at work in China on a wide variety of matters in furtherance of the firm's commitment to assisting clients in the PRC or wherever their businesses take them. On October 16, Allan Goldner, Yanping Wang and Peter Shelton of Benesch's China Group commenced a two-week trip that began in Beijing and ended in Shanghai. Goldner, Wang and Shelton were accompanied throughout their travels by Joanna Liao, Manager of Benesch Pacific's Representative Office in China. Benesch's Managing Partner, Jim Hill, joined the China Group for the last week of their work in China and, at about the same time, corporate partners Ira Kaplan and Larry Bell arrived in Shanghai to represent Benesch at the TerraLex annual meeting.

The China Group team began their travels with several days of meetings in and around Beijing with prospective clients, colleagues at several Chinese law firms, and investment bankers and other business advisors. As was the case with previous trips taken by members of the China Group, a considerable amount of time was devoted during the October trip to furthering the firm's relationships with other service providers who have been, and will continue to be, valuable resources for our clients. During the week, the three Benesch lawyers and Ms. Liao also traveled by train to Tianjin (southeast of Beijing) to meet with a Cleveland-based client that is building a manufacturing facility to produce highly-engineered plastic components for the electronics industry.

Also during their first week, Goldner and Wang traveled to Qingdao (about an hour flight southeast of the Chinese capital) where they spent a day and a half conducting legal due diligence and negotiating on behalf of another client that is acquiring a majority interest in a foundry that produces components for the appliance industry. Goldner, Wang, Shelton and Liao then spent two days in Dalian (an hour north of Qingdao by plane), where they met with representatives of the Dalian Economic and Technological Development Area, a leading national level economic development zone, as well as with members of a leading Chinese law firm.

From Dalian, the China Group members traveled to Shanghai, where they were joined by Hill, who traveled with Goldner, Wang, Shelton and Liao for two days of client meetings and plant tours in Kunshan, Suzhou and Changzhou (all situated along the industrial corridor that connects Shanghai and Nanjing to its northwest). Later in the week Goldner and Wang made a long, all-day round trip to Guanzhou (about two hours by plane) for meetings and negotiations on behalf of a Cleveland-based client. Also during the week, the Benesch lawyers had client meetings in Benesch Pacific's Shanghai offices, and numerous meetings with Shanghai-based private equity firms, lawyers, investment bankers and consulting firms.

How We Work With Clients

We help U.S. companies: (1) establish China-related strategic alliances and joint ventures for manufacturing and distribution; (2) establish wholly owned manufacturing or other business operations in China; (3) acquire the shares or assets of China-based companies; (4) deal with governmental and operationally-related legal issues in China; (5) source components or products from China, and deal with related logistics issues; and (6) develop U.S.-based solutions to competition from China.

We help clients structure, negotiate and document China-related transactions, and provide counsel with respect to capital structure, operating control, governance, due diligence and other issues.

In the area of intellectual property, we are experienced in working with our China-based colleagues and governmental officials to maximize the protection of our clients' valuable patents, trademarks, know-how, trade secrets and other intellectual property rights.

Our established network of highly competent, experienced and reliable U.S. and China-based service providers enable us to help produce complete China business/legal solutions. Together we provide U.S., China and other international legal, tax, governmental relations, import/export, construction, operational and other solutions for our clients in a cost effective manner.

Events

For additional information, contact Megan Thomas at 216.363.4174 or mthomas@bfca.com.

November 17, 2005 – Allan Goldner delivered a presentation entitled "Legality vs. Relationship - Each Necessary, Neither Sufficient" at the 5th Annual International Trade and Foreign-Trade Zone Workshop, sponsored by the Northeast Ohio Trade & Economic Consortium.

December 1, 2005 – Maximizing Opportunities and Minimizing Risks in Transportation and Logistics: *How the Law Can Help*
Join us for a fast-paced afternoon of timely, relevant topics for any business involved in transportation and logistics. Break-out panels will include "Developments in China Logistics."

December 6, 2005 – China Presentation and Reception with representatives of the Suzhou National New and Hi-Tech Industrial Development Zone. Benesch's China Group and East-West Development Inc. will jointly host this informative session at Benesch's Cleveland office.

FOR MORE INFORMATION OR TO DISCUSS ANY ASPECT OF YOUR CHINA STRATEGY, CONTACT ANY MEMBER OF OUR CHINA GROUP:

ALLAN GOLDNER, *Co-Chair*
216.363.4623
agoldner@bfca.com

PETER K. SHELTON, *Co-Chair*
216.363.4169
pshelton@bfca.com

STEVEN M. AUVIL
216.363.4686
sauvil@bfca.com

JOSEPH N. GROSS
216.363.4163
jgross@bfca.com

DOUGLAS E. HAAS
216.363.4602
dhaas@bfca.com

GREGORY S. KOLOCOURIS
216.363.4453
gkolocouris@bfca.com

ROBERT A. MARCHANT
216.363.4489
rmarchant@bfca.com

MEGAN L. MEHALKO
216.363.4487
mmehalko@bfca.com

BRYAN A. SCHWARTZ
216.363.4420
bschwartz@bfca.com

YANPING WANG
216.363.4664
ywang@bfca.com