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PATENT AND TRADEMARK LAW

Expert Analysis

Reevaluating Corporate IP Strategies in Light of the U.S.-China Trade War

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The trade war between the United States and China has had far-reaching effects on international trade and the global economy. The dispute is slowly developing into a battle of attrition, without any immediate resolution on the horizon despite ongoing trade talks. As businesses change the way they operate in response to this unpredictable trade environment, corporate counsel should consider the risks and potential impacts on corporate IP strategy.

Background

The trade dispute is the culmination of long-standing tensions between the United States and China. For decades, the United States has maintained a trade deficit with China, and that deficit has increased dramatically in recent years—from less than $100 million in the late 1990s, the excess of U.S. imports from China over exports to China topped $419 billion in 2018. See "The People's Republic of China: U.S.-China Trade Facts," Office of the United States Trade Representative (retrieved Sept. 17, 2019). This trade imbalance has resulted in the wide availability of inexpensive imported goods for the American public, but at the expense of manufacturing jobs in the United States.

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In times of economic turbulence and, particularly, during economic downturns, companies often turn to enforcement of IP rights to provide new revenue streams and seize market share.

In addition to the widening trade deficit, another driver of the trade war has been China's history of intellectual property misappropriation. While the United States alleges illicit activities including theft by Chinese agents, e.g., by breaking into U.S. corporate offices, and bribing U.S. corporate employees, to obtain high-value trade secrets, the allegations of misappropriation extend to subtler activities. Foreign companies doing business in China have complained of China's use of administrative measures, such as foreign ownership restrictions, licensing requirements, and product approvals, as mechanisms used to coerce foreign companies to transfer technology and IP to Chinese companies. Although foreign ownership requirements have been relaxed in some sectors, in others foreign businesses are still required to form joint ventures with Chinese firms in order to do business in China. These joint ventures often require some level of technology transfer, after which the Chinese partner has sometimes

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used the transferred technology to thereafter compete with the foreign company.

This battle between the world's two largest economies has resulted in increased uncertainty in the global business environment. Many companies are delaying new investments in capital equipment, research and development, and IP procurement. In light of the unpredictability of global economic conditions, trade negotiations between Washington and Beijing, and the upcoming 2020 U.S. presidential election, there is no telling how long the uncertainty will last. The tariffs will continue to have meaningful impacts on many companies—including how and where they source materials, how and where they manufacture, and how their products are sold. In the midst of this unpredictability, and in light of the way that businesses are changing in response to the trade war, there are a number of things that companies based outside of China can do to reconsider their corporate IP strategies.

Consider (or reconsider) IP risks associated with moving business operations. In response to the tariffs, many companies are shifting the regions in which they do business—where they manufacture, how they source materials, and where they sell products or provide services. Given these changes, new and different IP risks will emerge.

For example, many companies that previously manufactured in China have been forced, due to the heavy tariffs, to consider moving their manufacturing out of China and into other countries that also offer low-cost manufacturing—including India, Vietnam, Thailand, Indonesia, the Philippines, Malaysia, Pakistan, Sri Lanka, and Myanmar. See "Countries Seen to Have the Lowest Manufacturing Costs," U.S. News & World Report (Feb. 14, 2019). Some companies are otherwise moving manufacturing back to higher-cost domestic locations in Japan, Europe, and the United States, either as stop-gap measures, or for the longer term.

> If the trade war continues to have a damping effect on the world economy, this may be another factor that influences an increase in IP litigation and licensing activity—both in China and in the United States.

While there are business and profitability ramifications for these types of changes, they also can bring new or heightened risks of infringement of competitor IP holdings in the new jurisdictions. And, importantly, many of these jurisdictions are ones in which IP strategy is oftentimes not a key focus for major corporations. In some instances, a manufacturer may not have previously conducted IP clearance studies in these jurisdictions (or may have conducted less thorough clearance studies), for example, because they may have never seriously considered manufacturing in those jurisdictions.

But those countries may now present interesting, or even necessary, options for manufacturing or supply, and a fast-moving business unit can make these risks very real, very suddenly. IP strategy often follows business strategy, and as business units come under great pressure to maintain profitability despite the tariffs, business leads are acting quickly to shift supply chains, manufacturing, and sales channels. In-house legal functions, including those managing IP legal risks, should work closely with those business units now more than ever to help monitor and guide those business units, and soften IP risks in these new jurisdictions. Once a company has committed resources to a new region, it may be costly (or impossible) to move those operations a second time.

Consider maintaining and building IP protection in new jurisdictions. On the flip side, it is just as important for companies to have an overarching strategy to protect their own IP, particularly in jurisdictions in which they (or their competitors) plan to do business. As corporate manufacturing and supply chains move out of China and into new regions, so may manufacturing and supply for competitors. Strong IP holdings in these new jurisdictions can provide helpful leverage against competitors in the event of an IP dispute, and can also help to gain advantages in business. Again, many of these other low-cost manufacturing countries are ones in which IP is oftentimes not a focus, or even a consideration, for corporate IP strategy. In light of the current trade environment, those decisions may now be worth revisiting.

Continue to seek robust IP protection in China. Although many IP considerations at this time will be focused on the impact of moving manufacturing and supply chains out of China and into new regions, over the long run China will remain a critical cog in the world economy. Accordingly, even if a company must move business out of China entirely—for the time being, or permanently—it may be a good idea to continue to pursue and maintain IP rights in China.

China has often been referred to as "the world's largest patent factory." While patent application filings in the United States have increased each year, to over 600,000 per year in recent years, that figure for China exceeds one million. More patent applications are filed each year in China than in the United States and Europe combined. See "WIPO World Intellectual Property Indicators 2018," at 24 (retrieved Sept. 17, 2019).

To the extent the trade war spurs China to continue to develop and strengthen IP protection domestically—a likely result anyway, as the Chinese economy continues its shift away from manufacturing and towards an information-based and consumer-driven economy like that of the United States—IP protection in China will likely become increasingly valuable. Companies not investing heavily in protecting and registering their IP rights in China should reconsider that approach. If foreign companies fail to register their IP in China, competitors, distributors, and partners may do so, barring manufacture and sale of products locally. If nothing else, neglecting IP protection in China may lead to costly business disadvantages over time.

Carefully consider the impact of the trade war in connection with IP disputes. One of the critiques in the past of the IP system in China has centered around the limited enforcement capabilities, limited discovery, and limited damages that have been awarded for IP infringement. But that is changing. Chinese patent litigation is on the rise. See Ryan Davis, "What You Need to Know About Patent Litigation in China" (Aug. 9, 2018). Furthermore, the amount of damages awarded for patent infringement in China since 2015 has almost tripled (albeit only to over $200,000, still paltry relative to damages awards in the United States), with a few awards eclipsing $5 million and even $10 million. In addition, over 90 percent of the time successful patent litigants in China are granted an injunction. See "Chambers and Partners: Patent Litigation 2019, Trends and Developments" (March 8, 2019).

The current environment may promote a further increase in patent litigation. In the midst of the trade war, companies based outside the United States may feel emboldened to pursue IP infringement claims against U.S. companies in China. Similarly, U.S.-based companies may likewise be incentivized, in the current climate, to bring U.S. patent litigation against Chinese competitors.

Moreover, in times of economic turbulence and, particularly, during economic downturns, companies often turn to enforcement of IP rights to provide new revenue streams and seize market share. If the trade war continues to have a damping effect on the world economy, this may be another factor that influences an increase in IP litigation and licensing activity—both in China and in the United States.

Ultimately, no one can predict how long the trade war will last, or whether it is simply a taste of the new normal. It therefore makes sense to consider the impacts on all aspects of business—including IP strategy—and adjust accordingly.