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Section 337: What Every Chinese Co. Should Know

Law360, New York (October 31, 2008) -- The United States International Trade Commission (ITC) is authorized to conduct investigations and provide relief for holders of a valid and enforceable U.S. patent against the importation or sale of imported articles that infringe patent.[1]

These actions are referred to as Section 337 investigations, and provide an alternative venue to the Federal courts for companies seeking redress for patent infringement. Of particular note, the ITC is becoming an increasingly popular venue for patent enforcement against Chinese companies.

According to the head of China's Bureau of Fair Trade for Imports and Exports, Chinese companies have been the largest group to be targeted by Section 337 investigations for the last five years in a row.[2]

As another example, twelve Chinese products were the subject of ITC investigations in the first eight months of 2007.[3]

The fact that more and more Chinese companies have become the targets of Section 337 investigations is not surprising. China has clearly become one of the world's leading manufactures of goods and a substantial number of these products are sold in the United States.

Thus, it is of particular importance for Chinese companies (and likely members of the Chinese government) to understand the basics of a Section 337 investigation.

Accordingly, this article is intended to provide a basic primer on Section 337 investigations, as well as some practical advice, for Chinese companies and counsel representing those companies.

Overview Of A Section 337 Investigation

A Section 337 investigation proceeds through several different stages. The first stage is instituting the investigation. Unlike in a district court, where a patentee can start a case merely by filing a complaint, a Section 337 investigation is not automatically instituted by the ITC just because a complaint is filed.

Rather, the ITC must decide within thirty days of the filing of a complaint whether to institute an investigation based on the complaint's allegations. An ITC Staff Attorney is typically involved in reviewing the filed complaint and providing comments to the ITC relating to the sufficiency of the complaint.

This participation by ITC Staff Attorneys is one of the more unusual aspects of a Section 337 investigation. Unlike the typical two sided system in district courts (i.e. plaintiff and defendant), there is a third participant in these ITC proceedings: the Staff Attorney, whose primary function is to protect the public interest by ensuring that all issues are fully explored and that a complete factual and legal record is developed.

Thus, the Staff Attorney fully participates in discovery and may present and question witnesses at the hearing.

If the ITC does decide to initiate an investigation, then the next phase of the case will be discovery, which typically lasts from five to eight months. After all discovery has been completed, an Administrative Law Judge (ALJ) will hold a hearing. Arguments and evidence will be presented within a short period of time.

After the hearing, the ALJ will issue an initial determination on the merits, usually within two to four months. The ITC will then either adopt the ALJ's initial determination as the Commission's final determination, reverse the ALJ's initial determination, or modify the decision.

If the ITC reverses the ALJ's initial determination, then it will issue a new determination as the final determination.

After the Commission has issued its final determination, there follows a sixty-day period of Presidential review. If, after sixty days, a final determination has not been modified or vetoed by the President, it is enforced by the United States Customs Service.

The losing party can appeal the final determination to the United States Court of Appeals for the Federal Circuit⁴.

Practical Issues Faced By Chinese Companies And Related Rules/Procedures

There are a number of rules and procedures governing an ITC investigation and, while there are many parallels to the rules and procedures found in district court proceedings, some are unique to the ITC.

Given the complexity of these rules and procedures, this section highlights some the ones that are particularly relevant to Chinese companies.

Responding A Section 337 Action

In contrast to the timing for district court actions, ITC investigations move remarkably fast. From the time that a complaint is served, a company accused of infringement (referred to as the “respondent”) has only twenty days to respond.[5]

Given this need for an immediate response, a foreign company is left with very little time to interview and select U.S. counsel. For this reason, it is often prudent for foreign companies to have interviewed and prescreened competent counsel in advance.

A respondent will be in default if it fails to respond or answer the complaint and it cannot provide a convincing explanation as to why it did not respond in time.[6] A defaulting party waives its right to appear, to be served with documents, and to contest the allegations at issue in the investigation.[7]

The facts alleged in the complaint will be presumed to be true with respect to the defaulting respondent.[8] In addition, the complainant may seek immediate relief against a respondent in default.[9]

Such relief may be a limited exclusion order that prohibits the importation of goods originating from the defaulting respondent, or even a general exclusion order that prohibits the importation of all infringing goods, regardless of source or owner.

In many early ITC investigations naming Chinese companies as respondents, those companies often chose not to respond and defend themselves during the investigations because of the high cost of litigation; and therefore they fell into default. As a result, they lost the case, and their products were then prohibited from being imported into the U.S.

In recent years, however, Chinese companies have come to understand the grave consequence of losing access to the entire U.S. market, and have started fighting back in ITC cases.

For example, Energizer Holdings Inc., a U.S. company, filed a complaint in the ITC in 2003 against nine Chinese battery manufacturers, alleging that the Chinese made batteries infringe its patent and asking the ITC to ban importation of such products.[10]

These nine Chinese manufacturers responded to the complaint, litigated, and eventually won the case.[11]

In some cases, a company may file a Section 337 complaint to gain business leverage against its competitors.

The company may choose to settle the suit with a respondent any time during the litigation, and this may be particularly true if it sees that the respondent is seriously defending its positions.

As an example, the ITC instituted Section 337 investigations in 2003 against seven lighter makers, including four Chinese ones, for infringing a U.S. patent owned by a lighter manufacturer Zippo.[12]

Of the four Chinese companies, only one responded to the complaint. Later, that responding Chinese company settled with Zippo and became the only Chinese lighter maker that was exempted from a general exclusion order and therefore the only Chinese lighter maker that can now export its product to the U.S.[13]

Thus, by responding, the company not only retained its access to the U.S. market, but also gained the U.S. market share of the non-responding Chinese companies.

Discovery

The discovery process in the United States is notoriously difficult and time consuming by international standards and those difficulties are intensified by the rapid pace of an ITC investigation.

Discovery in a Section 337 investigation starts right after the investigation is instituted and proceeds in much the same way as in a U.S. District Court case, but at an accelerated pace.

Responses to interrogatories and document requests are typically due within ten calendar days.[14] The entire discovery process, including all third-party and expert depositions, is typically completed within seven months.[15]

Since the complainant is in a position to prepare its discovery in advance of initiating the investigation, a foreign respondent can often find itself in a disadvantaged position due to this accelerated discovery process and its unfamiliarity with discovery in the United States.

Discovery is probably the most expensive and time-consuming process in a Section 337 investigation. It involves extensive work in reviewing documents, communications between the client and litigation counsel, responding to discovery requests, and preparing witnesses for deposition.

Various tools are available to parties for discovery, and among them, requests for production of documents and things and depositions have been causing particular problems for Chinese companies.

A request for production of documents and things is a basic discovery tool in all litigation in the United States. It serves the function of providing a party with the opportunity to

discover relevant information for a case that may eventually be decided before or at trial.

However, due to a lack of equivalent court procedures in China, many Chinese companies are often unfamiliar with this document production process.

Like the Federal Rules of Civil Procedure, ITC rules afford a fairly liberal approach and a broad scope regarding document requests. Under these rules, all documents that are relevant to the claim or defense of any party must be produced unless privileged.[16]

Failure to produce relevant documents may lead to sanctions against a party, including an inference that the evidence that was not produced would have been adverse to that party.[17]

Of particular importance, document destruction should be absolutely avoided if the document could be considered relevant to the litigation. Quite frequently, destroyed documents may be referenced in other documents that are produced in discovery or identified in depositions.

When such documents cannot be located, serious sanctions against the producing party may follow, which may well be a deciding factor for the entire case.

To prevent this from happening, a Chinese company should issue a litigation hold[18] right after being served with an investigation notice, requiring that relevant documents be retained and to suspend the company's document destruction policies for those documents that may be relevant to investigation.

In addition, procedures should be put in place to ensure that this litigation hold is enforced throughout the investigation.

Depositions are another important discovery tool for litigating a typical Section 337 investigation. As of today, Chinese authorities do not recognize the authority or ability of foreign persons, such as U.S. attorneys, to take depositions in China, even in a U.S. consular office.[19]

Taking depositions in China is impossible even if a Chinese company in a Section 337 investigation is willing to cooperate. However, a solution to this problem is to find a different country or jurisdiction where it is possible to take voluntary depositions. For example, taking depositions in Hong Kong is an option, and this will help limit travel expenses for Chinese witnesses.

Under the ITC's discovery rules, an organization such as a corporation may be deposed by questioning its officers, directors, managing agents, employees, or other agents. This type of deposition requires that a party noticing the deposition specifies the subject matter on which questions will be asked.

The party then designates and provides at the deposition those officers, directors, managing agents, or employees who are most qualified to testify on its behalf as to those matters, to the extent such information is known or reasonably available to the company.

A Chinese company that is unfamiliar with these types of corporate depositions in the United States may be tempted to designate lower level employees as these corporate witnesses.

The company may reason, for example, that these employees have more time and more flexible schedules than a higher level executive. However, this would almost always be a mistake and a lost opportunity.

A corporate deposition provides the company with an opportunity to present itself and its case in the best position for opposing counsel, the staff attorney and, if the transcript is read at the hearing or a video tape of the deposition is played, the ALJ.

Accordingly, these witnesses ideally should be experienced, articulate, and well prepared. And if they have some English language skills such that, for example, they can conduct the deposition in English (perhaps with the assistance of a translator when needed), then this would be even better.

Conclusion

At least in the foreseeable future, manufacturing will play a central role in China's economy, and the technology used as part of that manufacturing will become much more sophisticated. Accordingly, intellectual property related issues will surface much more frequently. And, for those reasons, more Chinese companies will likely face ITC investigations.

Thus, Chinese companies, especially those which have entered or will be entering the U.S. market, must have a general strategy for dealing with intellectual property related issues in the United States that includes Section 337 investigations by the ITC.

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[1] See 19 U.S.C. Section 1337 (Section 337).

[2] Jiang Wei, Sorting Out Section 337, China Daily, October 8, 2007, at 9.

[3] Id.

[4] The United States Court of Appeals for the Federal Circuit is the United States Court of Appeals that hears appeals in patent cases.

[5] 19 C.F.R. 210.13.

[6] 19 C.F.R. 210.16.

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *In re Matter of Certain Zero-Mercury-Added Alkaline Batteries, Parts thereof, and Products Containing Same*, Inv. No. 337-TA-493 (2003)

[11] An ALJ initially determined that Energizer's U.S. patent was valid and enforceable and that the patent was infringed. The ITC, however, reversed the ALJ's initial determination and issued a final determination ruling that Energizer's U.S. patent was invalid and unenforceable, and that the accused products did not infringe. Energizer appealed the ITC's determination to the Federal Circuit. See *Energizer Holdings, Inc. v. International Trade Commission*, 435 F.3d 1366 (Fed. Cir. 2006). The Federal Circuit reversed the ITC's ruling that the claims of Energizer's patent were indefinite and remanded the case back to ITC. *Id.* The ITC then reinstated the investigation, but ultimately maintained its previous ruling that there was no violation of Section 337 on the basis that the asserted claims of the patent were invalid for indefiniteness. See Notice of Commission Decision to Terminate Remanded Investigation with a Finding of No Violation, *In re Matter of Certain Zero-Mercury-Added Alkaline Batteries, Parts thereof, and Products Containing Same*, Inv. No. 337-TA-493 (2007). Energizer then filed a second appeal to the Federal Circuit. On April 21, 2008, the Federal Circuit ruled on the appeal and upheld the ITC's determination.

[12] See Notice of Investigation, *In re Matter of Certain Lighters*, Inv. No. 337-TA-575.

[13] *Id.*

[14] See Part V., *Demystifying Section 337 Investigation at the ITC: Pre-hearing Preparation* by Kent R. Stevens, Tom M. Schaumberg, and Jeffery R. Heinze.

[15] *Id.*

[16] In a nutshell, a document is privileged if it is a communication between a client and its legal counsel, or a work product prepared by the legal counsel in anticipation of the litigation.

[17] See *supra* note 28.

[18] A “litigation hold” is a suspension of a company’s document retention/destruction policies for those documents that may be relevant to a lawsuit that has been actually filed, or even one that is “reasonably anticipated.” A “litigation hold” ensures that relevant data is not destroyed and that key employees are notified of document preservation requirements. Even informal procedures for managing print or electronic documents, such as recycling e-mail backup tapes, may need to change when a company is sued, or even threatened with suit.

[19] China Justice Assistance, at travel.state.gov/law/info/judicial/judicial_694.html