

Webcast: Getting To Grips With China: A Business Imperative For The 21st Century

Date and Time: Friday, May 19, 2006 at 12:00 PM ET

Presented by the ACC IP Law Committee, the New Jersey (NJCCA) Chapter and the Greater New York (NYACC) Chapter and sponsored by Kilpatrick Stockton LLP, in conjunction with Lipper, Inc

ASSOCIATION OF CORPORATE COUNSEL

Moderator: Alex Montegue

May 19, 2006

(Alex Montegue): Good morning. I'm (Alex Montegue). I'm the general counselor of (Liprat), one of the sponsors here this morning. And on behalf of (Liprat) and the other sponsors, the Association of Corporal Council, the New York and New Jersey chapters and the law firm of Kilpatrick Stockton. I'd like to welcome you here this morning, and to thank you for coming.

I'm very excited by the size and diversity of this morning's turnout. The firms we represent range from high tech to low tech, from consumer brands to financial services companies, pharmaceuticals to electronics, and business information to publishing.

I believe that the diversity this morning is an indication of how timely this morning's program is, and how important China has become across all sectors of the economy.

Despite our varying backgrounds, we share a recognition and understanding that China will be essential to our professional and perhaps even personal lives.

Let's face it. China has arrived, and we need to know more. This program's goal is to impart the experience of our speakers so that we can all return to work more prepared to face the issues that China presents.

A few stories have caught my attention and exemplify the need to get to grips with China. First, Chinese President Hu Jintao's visit to the United States is an official confirmation that China is no longer the political foe that it may once have been regarded as – but an economic powerhouse.

The Chinese President's visit did not begin as most diplomatically as it's due in Washington D. C. , but rather in Washington State with meetings with Bill Gates and Boeing – signaling China's prime refocus as a global economic powerhouse, deeply reaching into all aspects of technology, manufacturing, and intellectual property.

Boeing was chosen because China will be the largest consumer of the Boeing Dreamliner – that's the next generation of Boeing plane that Boeing is counting on to, you know, make it's future and defeat the Airbus. And China is ordering 60 of the 345 planes, a deal worth \$7. 2 billion.

Boeing and the economy of the Pacific Northwest are banking on China and the success of the new airliner. In the speech President Hu Jintao declared, "Boeing is a household name in my country – underscoring the importance of developing and maintaining strong brands in China. ”

I'll just give you a different story as a contrast of this. In the 1970's when former President George Bush was the United States Informal Ambassador to China, he had difficulty obtaining an audience to even meet with the then Premier Zhou Enlai. The fact that it was through the intermediate of the Iranian Ambassador Prince Reza Shah Pahlavi that he eventually got the audience as truly a sign that times have indeed changed.

It should go without saying that China represents the largest developing market for your consumer goods, and the internet plays an essential role in its development. There are over 100 million Chinese internet users today, the second most on the planet. And by 2007 estimates show that China will surpass the U.S. in the number of users. Chinese will also surpass English as the most used language on the internet.

Technology companies such as Microsoft have long invested in China. And more recently companies like Google are pushing to the front of the line to serve Chinese internet users. Still for the most part we are trapped in our Western mentality.

I chuckled when reading the recent Da Vinci Code copyright decision. Justice Peter Smith of the English High Court was stupefied that the Da Vinci Code had sold 40 million copies. I could only think that once the Chinese market is fully realized, 40 million sales will be insignificant.

Indeed, a few days ago I saw a program explaining that one of the fastest growing segments of the Cisneros Television Group – a Latin American media giant – is the dubbing of Spanish soap operas into Chinese, and the distribution of these programs in China.

I hope our program today will provide this type of perspective to open our minds to the future of our profession. Our first speaker is going to be (Wayne Elowe). Wayne is a partner in Kilpatrick Stockton's Corporate Department, where he concentrates his practice on international business transactions in the areas of mergers and acquisitions, private equity investments, joint ventures, multi-national outsourcing projects, and strategic alliances involving various combinations of equity and debt investments.

He has represented multi-national corporations and financial investors in over 25 countries across Europe, Latin America, and Asia – including China.

(Wayne Elowe): Thank you Alex. Good morning everybody. Thank you for being here today. I wanted to give you an overview of the business environment that companies are dealing with when they're thinking about a China strategy as a backdrop to the discussion that's going to follow this morning.

Let's think about it – having a China strategy. If you're here, you either already have a China strategy and maybe you're into your second or third phase of putting that into place and in operation, or perhaps you're just getting started on it. But it's clear that having a China strategy is cutting across multiple industries, sizes of companies, and people just have to deal with this now as a reality of doing business.

It's very interesting. Recently, at a private equity conference of U.S. buyout funds investing in U.S. middle market companies, the only country that was brought up as a factor in the investment decisions between the buyout funds and head funds that were there was China. And had the difficulty of investing in middle market companies that do not have a China

strategy in place. So it's clear that this is coming all the way through the marketplace, and something we have to deal with.

Now the question though is where to start, and how do you start thinking about this. And what I wanted to do today was talk about some of the factors that are driving companies to have a China strategy, the solutions that they're trying to come up with, and then talk about a process of how to bring together the business considerations with a legal process for implementing and structuring, your trying a strategy, and the local relationships that you enter into in the country.

So first let's talk about what's driving the market for companies, and why are they even thinking about China. Let's look at a consumer product company – fairly broad category of businesses. What are they dealing with now out in the marketplace?

Talk about competition from private label products, unbranded products. You've got price pressures coming from the large retailers in the marketplace, knock-offs and counterfeit products that are coming into the market, maturing markets where the products are being sold, tend to regulatory factors, and of course there is the China factor generally of products coming in that are lower priced because of manufacturing advantages there.

So when we think about what kinds of solutions companies are trying to deal with, you know, one of the things is, "OK they're cutting costs but how are they doing that?" They may be looking at strategic sourcing relationships to bring in lower cost products and materials. They're working hard to manage their inventory and logistics of their supply chains.

Looking at increasing revenue through expansion into new markets – brand management, leveraging their technology through alliances or outsourcing strategies, new product design and innovation, and increasing their speed to market.

Now when you look at these kinds of strategies for dealing with the business pressures that are out there, what do these really translate into – and all of these are really applicable to the companies that are entering and to the China market.

We're talking about cutting cost through sourcing – strategic sourcing relationships. Developing partnerships with key suppliers of your parts materials, managing inventory, your logistic solutions, the rise of logistics providers to help you manage the whole supply chain.

In your increasing revenue you're talking about potential brand licensing, more strategic licensing relationships, franchising strategies, joint ventures or other kinds of alliances to expand into new markets.

Leveraging technology, of course we've seen the rise of outsourcing and other kinds of technology alliances. In product design and innovation, we've seen the growth of major corporations going out into the marketplace and making either equity investments or other kinds of alliances with early stage companies that can bring new products or technologies to market quicker than they can within their own R&D structures.

All of these are talking about collaborative relationships. You know, any of these – and the question really – as you start to think about implementing a China strategy – is where you're going to fall on the spectrum.

You know, what's traditionally been in place are contractual relationships, arms linked contracts at one of the spectrum all the way to the other end, which is the traditional equity joint venture model. And you've got all these other kinds of hybrid alliances in between.

And it's one thing to start thinking about is what kind of level of collaboration do you need to implement your strategy.

What I like to think about with these types of relationships is really, you know, they are in fact living relationships. They're very different than traditional M&A type transactions where you negotiate the price and the economics of the deal, and then you allocate the risk between the parties. And then once you're done it's up to the acquirer to figure out how to integrate the business.

These kinds of relationships on a collaborative level are really – you have to drill down into the operational aspects of the relationship, figure out what you're going to be doing on a day-to-day basis to make them work on an ongoing basis.

And you can see from this simple chart down below, in a sourcing context the potential number of legal relationships that you might have – you know, this is a situation where two companies may get together to pool their buying power to source different kinds of parts or materials.

And the provider down the bottom could be a Chinese entity or Chinese provider that they may be working with, or are multiple providers. And you can see from an intellectual property perspective as well where you may have to have licensing relationship or transfers of IP to enable those relationships to function.

So as we start talking about how to implement a strategy, you have to really be thinking about your overall strategy and the relationships that you're going to need to further the strategy. And the key is that the strategy should drive the relationships you enter into, but you have to look at individual relationships on an ongoing basis to make sure that they're in fact supporting the strategy that you have in place.

Now from a legal perspective, I think the key think is, with your business teams is to encourage them to get your legal team involved early on in the process so you can really be thinking on an operational level about the legal issues that come up.

Because everybody knows that as soon as you go outside of the U.S. or into other countries – and China is no exception to this – you've got issues of regulatory issues, timing considerations and multiple layers of legal issues that can come up and either sink or help your strategy going forward. And the key is to get to those early so that you can meet your timing requirements and execution requirements.

Now with that as a backdrop – if you're thinking about where to start when you're brought into the process of putting a China strategy in place – I like to work through these types of phases in the planning process. About defining your objectives, understanding your



operational requirements, looking at your options based on that for structure, and then let that drive the kind of vocal relationships that you'll get into with partners in China.

Let's think about defining objectives. On broad scope, what are you really going to be doing? What is the end game for your business in China? Is it going to be sourcing lower cost products just to bring them to the U.S. ? Are you going to be moving technology or other kinds of assets into the market to further the strategy? Is China a long-term market for your business? Do you want to ultimately expand there.

And there can be other objectives as well, but it's really to nail that down. And one thing we've seen companies do successfully is to break that into phases, because if this is a new effort on the part of your company, it's often times better to take it in phases, build on the success of Phase one, because you're going to be learning a lot about the market and your relationships that you're developing there. And then that may actually end up shaping Phase two, Phase three as you go forward. But ultimately it's going to depend on what the overall objective is.

The next stage – and this is really where it gets tough I think for most companies – is defining the operational requirements of the initiative. I can't stress the importance of this. It's where a lot of companies hit – you know, hit the brakes or have a really hard time moving forward in the process, because it requires multiple teams of people to really think about what is it you're going to be doing day to day in the market from a business perspective in order for your business to operate.

So again some examples, are you going to be sourcing parts? Are you going to be moving products out of country for export to the U.S. or other countries? Do you need to move raw materials or components into China, have them reassemble them back out – and then take them back out? Do you need to purchase materials from multiple sources in China and get them reassembled?

I mean these are just kinds of the operational questions in just a manufacturing context you might consider. And of course there would be a series of other questions in other types of businesses and industries.

Some other questions are going to be whether or not and what level of a local presence are you going to need in China as well. How soon will that have to happen?

This is another issue where if your business is on a cyclical basis where you need to have certain infrastructure in place and up and running to meet your other sales or other market demands for the business, you've got to put that into the planning process. Because again everything will take a certain amount of time to get it done, and it has to meet your schedule overall. Are you going to need local market employees?

So those are the kinds of things to drill down and try and get them nailed as early as possible. Because ultimately it's going to lead to this next phase, which is figuring out what kind of structure do you need from a macro level before you even get in country to meet your requirements.

Now I'm not a tax lawyer, so I'm not going to take you through chapter and verse of the tax code on any one of these issues. But what I wanted to do is give you a brief overview of some very rudimentary structures that people are using in China, and some key takeaways of the process so you can be thinking about that as you go back with your business folks.

This first structure is really kind of getting a big toe in the water into China. It's a very common way for companies to start to develop a presence in country by using a representative office. Representative office can have U.S. employees, it could have Chinese employees, you can use it as a way to develop relationships in the market, liaise with other partners in the market as well.

And it's a way to facilitate sourcing relationships or other kinds of business relationships in the country. And from a tax perspective it's a fairly neutral structure for a U.S. company to use because you're not having separate tax liability in the country other than some minimal operating taxes that they apply to representative offices.

This next structure is more of a later stage structure where, you know, you can - you're setting up a wholly-owned subsidiary in the country. And the use of a holding company provides a couple of opportunities for a U.S. company.

One is, oftentimes if you're going to have holdings in China, doing it for a holding company makes it easier to transfer ownership in those entities outside of China by transferring ownership of the holding company. Because you can do that in a much more quickly and simply than you can in China with the number of approval processes you have to go through.

Secondly, holding company offshore – if you have multiple international activities and sales – you can use that as a selling entity into other countries and capture profit outside of the United States, and use that revenue or profit to invest further in China or into other countries where you might be expanding.

From an intellectual properties perspective, another strategy is to move intellectual property offshore into a low tax jurisdiction as well, especially if that IP is expected to increase in value over time. And again it's a tax deferral strategy from a U.S. perspective.

And this next structure is a just a common structure that you might see in a joint venture situation as well. And again you'd have the same kind of a potential offshore holding company opportunity as well for the same reasons that we had in the prior slide.

But the key thing to keep in mind as you go through this process is what you're trying to mesh is U.S. tax regime with what I call the international tax regime and the Chinese tax regime. And from an international perspective it's really – to the extent you have multiple international activity.

You have to consider your China venture as part of all of that because you may be able to either leverage other international activities and generate other tax efficiencies with your other international activities based on what you're doing in China as well.

And so it's rationalizing those three areas together so that you get the most efficient tax result. And that's about as far as I'm going to go on tax issues today. I think your tax practitioner is going to take you through the chapter and verse on that.

Now assuming we've defined our strategy, you defined your operational issues, you've thought about some potential tax structures. Now what do you need to do in country to set up either a local presence or your relationships there? You can have contractual alliances. That still is a very common way to work with local partners.

Again representative offices – basically a marketing and sales function for a ((inaudible)) company in China – you can have a wholly foreign owned enterprise which people typically call a (whoofy), which is a wholly owned subsidiary in China. And of course you can have joint venture opportunities with local partners as well.

One thing to keep in mind as you're thinking about these things is there are also additional regulations in China that can impact the structures you adopt. You know, one example would be in the insurance industry where the Chinese Insurance Regulatory Commission and the certain regulations define what kinds of businesses can get into the insurance industry in China, and how you can structurally enter the market.

So that's another area to check as well, based on the business or industry that you're in. Let's look at a rep office real quickly just to give you a sense of what kinds of activities they can do. It's really, the bottom line is it's non-income producing activities. But you can hire employees, your local employees can conduct marketing, or other developer relationships of local manufacturers or business partners in country, is not permitted to execute contracts.

And I think that's one area for U.S. companies getting into China where your thinking about, "Well, we want to set up an infrastructure in China, we'd like people to operate

there and have some autonomy, because that's the whole reason of getting people over to operate. " So that decision about whether or not to use a rep office can turn on that feature.

If you'll still be able to run things through the home office than a rep office through the home office, then a rep office can work for you. But if you really want people to have a level of autonomy and be able to sign up contracts, the rep office would not be suitable for that activity. And these take generally 60 to 90 days to set up, depending on how quickly you need to move.

The (whoofy) is again you can think about that like any other kind of a wholly owned subsidiary you may have. They can generate profits, they can hire employees, they can sign contracts, they can operate as a separate business, and from a liability perspective as well.

The interesting thing in trying to – as part of the WTO commitments and the opening up of the markets, they have opened up other areas of activities for (whoofies), for foreign companies to engage in. One is trading and distribution rights.

Over the past year – year, year and a half – they have allowed U.S. and foreign investors to engage in trading rights in China, which traditionally if you were importing or exporting product in and out of China you had to work with the Chinese Trading Company.

But now you can set that up yourself, you can operate it yourself, and you can enter into distribution activities from either wholesale and a retail has opened up as well but has some

more limitations on it but allows you to get your product in and out of the country and be able to operate that yourself if you want to put that infrastructure in place.

The key thing to think about with a (whoofy) though is, from the approval process standpoint they still define the types of business activities you can engage in. For example, if you want to be a manufacturing company, that has to be part of your approval process and is part of your business license going forward.

So it's unlike a U.S. company where you say in the articles of incorporation you're going to engage in any kind of a lawful business and then you're off and running and do whatever you want to do going forward. You have to be more specific than that.

So the key is to try to think about what you want to do, and build as much flexibility as you can into that process and into that business license, but still realize that there's going to be some limitations.

Now one of the basic questions you get into is if you're not setting up your own entity or you have your own entity and then you need to have a local relationship, it's – basic question comes down to, “Do you pursue a joint venture with a local partner, or do you look at contractual alliances with a local party? ”

And some of the things that we typically want to talk to clients about to bring the legal and business together is – you know, one of the things is the business model. What are you trying to do?

We had one large manufacturer wanted to get into China, had a long standing relationship with a local supplier, and they said, “Well we want to do a joint venture with that party. ” I said, “Great. You know who they are, you’ve worked with them, you’ve got a level of confidence. What’s the business model and what kind of profits are you going to be generating? ”

And they said, “Well we don’t want any profits in the joint venture company. We want that to be a sourcing model and a cost saver. ” And I said, Well, it’s not going to be a great deal for your joint venture partner, because they’re going to want the value of their equity to go up, and they’re going to have some exit expectations out of that venture at some point. And that may not be the suitable vehicle for doing that relationship.

And they said, “Oh well maybe you’re right. Maybe that’s more of a contractual relationship where we can pay them for the services that we need, but we don’t actually have to have an equity venture with them. ” So think about the business model and really whether or not it makes sense.

Other issues is bringing together technologies, product lines, distribution channels, all of those can be motivating factors for joint ventures. But I think if you’re new to China, and you haven’t got established relationships that you can trust and know them, you know, contractual relationships are a heck of a lot easier to get in and out of than a joint venture.

So if you can do it through that and get the value out of that relationship without doing the equity joint venture I would typically steer you in that direction. But again there are valid reasons for doing a joint venture and companies had success with that.



Some other factors here, you know, looking at your joint venture partner and evaluating them to go forward, and also your risk sharing, you can mitigate some of your risk – and getting into the market. And I think, you know, I'm going to move quickly through some of these, and we can certainly get you a copy of this PowerPoint if you'd like to have a hard copy going forward.

This just quickly is an actual example of a large multi-national manufacturing company setting up a structure in China. And the only purpose from an IP perspective is to be thinking about, "Where do you layer in your IP rights and transfers and licenses in this kind of a structure?"

You know, you have a parent company, down to a holding company potentially offshore, or a parent company directly to the Chinese Trading Company, or to the Chinese partner. I mean there's multiple ways of doing this. But as you can see there's a lot of other things going on in here as well.

So the point really is your IP may be a driving factor in your structure, and then how you put the deal together, or it may be more of an ancillary factor. And you just need to consider and be aware that there's these other competing business issues that are going on as part of the structure and the relationships that are being put in place.

So just in closing, a couple of final thoughts – operational and strategic clarity are key to thinking about how you're going to get into China. Follow a top-down approach of

strategic operational clarity to develop your local relationships. But test your local relationships over time to make sure they're consistent with your strategy.

Now and finally I think from an operational perspective just remember that your Chinese relationships – or what you're doing there has to integrate effectively with what you're doing over here as well.

So with that I'd like to turn it over to Dick, who's going to take you through some on the ground business experience there as well.

Female: (Richard Boshier). (Richard Boshier) has 25 years experience with manufacturing joint ventures, strategic business alliances, intellectual property licensing, and export distribution agreements in the PRC with Maytag, Hoover, and Ball Corporations. He was a lead business negotiator for multi-million dollar ventures throughout Asia – including the PRC, Japan, Korea, and Thailand.

(Richard Boshier): Thank you Alex. Alex failed to mention that some of those ventures were not successful. But that's part of the learning experience. Like many of you in the audience, as in-house counsel for many years doing ventures like this you are – we are very concerned with some of the practical business issues.

Because even if the company is set up correctly – and you've heard outstanding advice on some of the options there. And even if you've properly registered your intellectual property and protected your intellectual property, the venture can still fail.

So there are many other business, cultural, social issues that have to be considered as well.

And as in-house counsel, you know, we look to bridge the gap between the marketing, sales, finance, and the legal issues to help put together a good solid joint venture or strategic business alliance that will last for many years.

I've had the good fortune to be the key, the lead business negotiator, not just the lawyer in most of these deals. And in addition to teaching classes on cross-cultural negotiation, and how not to embarrass yourself in international business deals, I had thought about doing 20 minutes on karaoke and drinking etiquette, but I was talked out of that.

I will tell you one interesting drinking story though because we all know that relationships are important in any deal not just in China. We were negotiating a deal in (Onway) Province for a large manufacturing facility in the Whitepits industry.

And over the course of months of negotiation, we were at one very large dinner with the distributors, potential distributors of the product. And it came time near the end of the dinner to goe-bay the toast, bottoms up, all of the tables of distributors.

There were 21 tables of distributors, and it was my job to go table to table – and 21 times. And so the CEO of the company we were doing business with, who spoke very little English, started calling me number one. That was his phrase for me; number one because of the drinking.

So when our CEO finally came over from Maytag to close the deal and got off the plane, and the CEO of the Chinese company shouted out number one when he saw both of us

standing next to each other, the CEO when up thinking that he was obviously referring to him.

Our Chinese friends had a very good laugh over that, and I think eventually our CEO understood. But he didn't completely agree, but he understood with what was going on.

So there is a relationship aspect and a business aspect that we have to – we have to deal with as well. So today I'd like to raise some business slash legal issues and let our outside council comment on some of the solutions.

I'll raise more questions then give you answers, but hopefully get you thinking a little bit about some of the issues you need to deal with. And when I use the term joint venture I mean it in the broadest sense – could be a strategic business alliance, or it could be, you know, a more formal bricks and motor kind of joint venture.

One of the things we found out very early is you really need to decide where you're going to manage your venture from. We tried – we tried managing a venture from Newton, Iowa in (Onway) Province, and it didn't work.

So you have some serious financial considerations and business consideration as to who you're going to put on ground once the venture has started. Is it just going to be a sales marketing person; is it going to be the key financial person; is it going to be a team of people?

And that can get extremely expensive, patch wise and otherwise to put expats over in a venture. We find out in many cases they all want to live in Shanghai; they want the kids to go to school in Shanghai, very expensive no matter where the venture is.

So that's a critical business consideration particularly for managing a manufacturing joint venture. Who it is, the cost, and how you're going to manage it; very difficult to do it from the states.

You also have to take into serious consideration what's your financial goals of the venture are. If you evaluate a Chinese venture in terms of your normal return on investment that you might be using to assess a U.S. joint venture, it may be very difficult.

If you're used to double digit profits here, you may not be able to get double digit profits at the beginning of a joint venture. Or you may find tremendous pressure to role those profits back into the Chinese venture rather than to repatriate them back home.

And that's a very different way of thinking of the investment. In fact, we had to come up with all, and entirely new set of investment criteria for international ventures. We just couldn't use the formulas on return on investment we were using for U.S. ventures. That's the second issue.

You also have to consider length of time. Ball Corporation has now six can plants in the PRC. When they first started they weren't so certain it was going to be successful. And part of the problem was this return on investment for repatriation issue.

They were feeling pressure from the local partner to reinvest the money rather than to bring it back, even though they could bring it back. And so what Ball did was they started writing off, on their financial records, writing off the venture from the first year.

It's now 20 years later. They got six plants. It's been successful, and nearly the whole venture is written off on their books little by little rather than to take a big financial hit if it hadn't succeeded. That's something you don't normally think about.

So you need to consider why you're entering into this venture. We entered into ventures frankly because we knew that the Chinese partner was going to show up back in the U.S. manufacturing at some point. And we simply wanted to get to know their business a little better; make some profits in the meantime.

But it was more a defensive move to enter into a venture with them. We'll distribute your products, you distribute our products and there's a mutual benefit to us, but it was a very defensive venture; again, non-traditional type of return on investment.

Strategic goals, offensive defensive; same bad different dreams, you hear that a lot. And I think the important thing to take away from that concept is that you don't have to have identical financial and business goals to have a successful joint venture.

But you want to make certain that the goals aren't completely inconsistent so that, you know, at one point in time your Chinese partner's going to want to come the U.S. , and you don't want him here or you want to enter into your own manufacturing venture without them in China, and they don't want you there.

So you have to, you don't have to have completely consistent goals, but you can't have something that you know is going to be a train wreck down the road; culture clash, very, very important.

It's important between U.S. companies when you merge or acquire a U.S. company; Maytag and Hoover totally different companies – totally different internal structures; one a matrix organization, the other non-matrix; very difficult to blend those two cultures together.

The companies in the PRC are quite different as well. Not in terms – not just in terms of level of compensation of their executives and their employees, but in terms of their profit motive, the business objectives, the short-term versus long-term goals, quite a different clash of cultures. And so just like you would look at those considerations. In the U.S. venture, you'd have to take the time to look at them in a venture in China as well.

Due diligence, let me come back to due diligence because that's a significant issue that comes up on another slide. What I will say though about that now in terms of IP is the time to think about protecting your intellectual property, particularly with respect to the trademarks.

Maytag and Hoover trademarks were more important than other intellectual property. We found out that was a very complicated subject that you'll hear about from other speakers.

Do you register your trademark phonetically as how it sounds in English? Do you register it in Mandarin? Do you register it as variations of the term in either? And once the word is out that you're coming, and in many cases if you got a very well-known name even before the word is out you're coming, you find out it has already been registered.

We were absolutely amazed at the variations of Maytag and Hoover that had already been registered, and that we had to deal with in the marketplace when we got there. People were very, very creative in registering variations of those names.

Now you may ultimately be able to stop that, and our other speakers may address that issue, but you also have to spend the time and the money to do it, which is different than you, different issue than you have here in the states.

So even if you got solutions, you have to commit perhaps to spend more time and money to get what where you want to, to stop the competition.

OK. Let's talk about some other branding issues and initial IP consideration. And again, I'll just raise questions here. I do know a few of the answers, but I'm going to leave that to our outside council here to give you more specifics on this.

Co-branding is quite important, and this happens everywhere. One example actually not in China but in India, a local company entered into a joint venture with Lufthansa, and they called the airline company ModiLuft.



Well Lufthansa didn't protect their name adequately. And when that new mark – that hyphenated mark came up as a trade name, trademark, and the venture broke up; the Indian partner ended up with rights to the name.

That's happened to manufacturing companies repeatedly. You go there with your brand, your name, and you end up coming up with a hyphenated name, a composite name of the companies.

You create a new, you create new intellectual property. Not just what you brought into the venture. So you have to be thinking in advance what's your co-branding strategy is going to be.

Are you going to sell it under the U.S. name? Are you going to sell it under the local name, which may be more well known, or a combination of the two that you have to deal with?

Territorial expansion, you know, this is not just a legal issue. We found out frequently that some of the ventures failed because our Chinese partner wanted to take the product and expand to different markets in the Pacific Rim. We didn't.

We didn't want to spend the marketing money and the time to expand to Thailand, Vietnam – all over the Pacific Rim. They did, so it becomes a manufacturing business issue that you have to think about.

Not just what you're going to do within China, but what you're going to do with re-exports and distributions outside of China, and whether or not you're in the same bed with different dreams or not and going in different directions.

It's a business dispute you can avoid by thinking about it in advance. Ownership of jointly developed intellectual property again sounds like it should be fairly simple. And I'll let others talk about the details.

We own what we bring in; you own what you bring in, and what we develop together is jointly ours. But you run into that same business issue.

Well if one of the partners who jointly owns the intellectual property wants to market and distribute in areas we don't want to, and that would include the cost of protecting that intellectual property if it's challenged in those other markets, we end up with a business issue that we can't resolve.

The legal issue maybe is taken care of. The business issue creates a schism that is sometimes very, very difficult to deal with. Let me go back a step here. I said – I entitled this Back to the Future Part 1.

I think there are many misconceptions in a manufacturing joint venture – some good some bad. When went to build a refrigeration plant in addition to a washing machine plant in the PRC, we were very, very surprised that the washing machine company that we had a joint venture with had more refrigeration engineers than we did.

So we grossly underestimated, you know, the amount of engineering talent that is – that's available in the PRC. Now I'm hearing some stories that I'm sure other speakers will comment on that there may even be a shortage of some engineers' in particular high-end engineering categories within the PRC because development is proceeding so fast within the country.

You have to consider whether or not you can expand your business and the services and people are available to do that. The Six Sigma quality is another manufacturing issue. Companies overseas can certainly make outstanding products.

But the reaction of the customer, to returns, quality, is quite different than it is in the U.S. versus in China. So you have to consider quality issues. Employment; we deal with, I think we're going to hold the questions if you don't mind. Is that – (Alex) is that the preference. We'll hold them? Excuse me, we'll get back to you.

We sometimes, we, once we got trapped with a financial structure as an example. We had, we acquired a company that had seven different business units. So our financial advisor said, "Fine, we'll have the seven different business units set up as different businesses. They'll be owned by seven Dutch companies. The seven Dutch companies will be owned by seven Canadian companies, and then it'll go through a U.S. subsidiary. "

OK, well financially accounting wise that all was wonderful. The problem was from a business prospective when we wanted to get rid of one of the companies, it was a nightmare.

We had to sort of undo all the financial planning for the business considerations. We thought we could close a non-productive business. Not easy to do, not easy to do in places in Europe either. You may have to take that non-productive business and find work for those other employers within the other portions of your business.

Now I think the last part to talk about here to bring this to a conclusion here is back to the relationship. I won't get into the enforcement mechanisms, but I will tell you based on our experience that things are wonderful at the beginning of the venture.

Everyone gets along well. The local authorities cooperate; could not be better. It's a little more interesting as the venture proceeds. For example, totally unrelated to IP, we found out that once we started our manufacturing joint venture, the local authorities allowed competition, local competition to sell at or below cost; similar products.

So it was more of an antitrust issue not an intellectual property issue. And we found that we were literally being – our margins were being driven next to nothing because the local authorities who were so friendly at the beginning of the venture now wouldn't step in to stop competitors from what we consider as unfair business practices.

Not just intellectual property, trademark infringement, but unfair business practices or anticompetitive practices. So you have to keep in mind – this sounds obvious but maybe not so obvious when you're close to concluding that nice venture of yours, that the local companies and the local authorities, you know, are friendly in the beginning.

Those relationships are hard to maintain in the long-term. And you have to – you have to be aware of a strategy, a business strategy, in terms of how you're going to react if the local competition starts doing things that they wouldn't be allowed to do back here in the states; totally aside from intellectual property.

You also have to consider what your exist strategy is. And I know this is a very difficult one. The business people don't want to talk about exist strategies across the table. The outside lawyers agree. I mean I'll say it's critical to talk about exist strategies – it is critical to talk about exist strategies.

In my experience the key is how do you talk about exist strategies? You have to figure out some positive way to approach that topic. Almost maybe with – do things in reverse by saying, "Well at some point if you would like to do something different. "

You know, you need to have a strategy as to how you're going to move into a different business or a competing business. As opposed to – at some point we're going to want to get out of this deal. It's really a tactical way that you have to address the issue. It's critical, but it's something that you have, you absolutely have to address. The changing laws and policies from a manufacturing perspective we found very confusing.

There are a lot of laws in China that everyone seems to know or about to be issued. But they actually aren't published yet, but people seem to know there coming out and their going to be there; and that's sort of an unusual thing to have to deal with.

Not to mention the length of the title for the laws. There's a unique way of naming laws.

In the PRC, they'll have a three sentence title, the longest title you'll ever see. It's a little hard to judge from a business perspective where the law is going so that you can plan your business; that you absolutely need the help of outside counsel in terms of getting a good read on how the law in the business side is going to be changing.

Just in conclusion, a couple of conclusions. You absolutely can't ignore the Chinese market. If you don't want to put in the time and money for a bricks and mortar operation, you at least ought to consider strategic business license. I'm very pro China. I think the opportunities are wonderful there.

But you can't rush into the market. You just can't. You have to do your due diligence. You have to take the time to develop relationships. You have to recognize that while IP protection is improving, it is still risky. There are risks and costs outside the ordinary risks and costs that you're used to.

And then two final conclusions there, use of chopsticks, very important. My wife is Japanese American, and our family is Korean, Chinese, Japanese, American – it's a, your typical Hawaiian family. We got more diversity than the UN in our family.

And it was the first thing they taught me – don't put your chopsticks straight up in the rice. You know, sign of disrespect and death and so forth. And we also always designate someone to do the toasting. If you toast every single day, they'll carry you out of every single negotiation.

So those portions of the relationship are quite important. Again, I'm very pro China. I think it's a tremendous market. It's challenging, it's different. And in many cases for manufacturing operations as well as high-tech operations, financial services operations, the way in my opinion to go about it is to develop those relationships through a strategic business alliance first.

Get to know and understand the market. Recognize that you are going to have to put some people on ground going forward and carefully consider what your business strategy is going into the Chinese market. Thank you very much.

Female: Dr. Lulin Gao. Dr. Gao worked for many years in public office in the state of intellectual property protection in China and has been very active in the intellectual property and information technology areas.

During the course of his career, he held the positions of Commissioner of the Chinese Patent Office and the founding Commissioner of State Intellectual Property Office China. He was a senior advisor to the World Intellectual Property Organization in Geneva for roughly two years.

Dr. Gao was currently the president of all China Patent Attorneys Association, vice chairman of the China Internet Society, and a member of the Steering Committee of the China Internet Network Information Center.

Lulin Gao: This one is a foreign application, and this one through (Crete), Portugal and Madrid agreement. The top ten foreign countries application or trademark; you see U.S. runs the first followed by Japan, Germany, and France.

In terms of patents, we also have a big increase of ten applications. In China, we have three kinds of patents. Invention patents as U. S as utility patent; then we have patents for utility model; then patents for industrial design.

So previously we always have fixed figure for ((inaudible)) model, but from the emphasis on three, emphasis on four. Patent invention ((inaudible)) the utility model had an application. In a year to selling five first time for China; this year we sold four patents for invention application – the most important patent at this time.

Before always with the model as such position. Here again, invention patent from grow to last year we got approximately 80,000. In terms of application patents abroad through the PCT route, China start very raw from 1999 to now. Higher but still small figure if you compare with the United States.

But around the tenth means award. I think for China it's not enough. We should apply more patent though the PCT route. This is ten, top ten IPC subclasses for applications of ((inaudible)) invention in China. The white one is year 2003 and the gold one year 2004.

And do you see pharmaceutical. A 61K remains a first in terms of patent application. But others – it's for acknowledge competitive (ice) translations in major communication



information for it, selection for which they and a strong force all belong to the IT information technology and information communication technology ITC.

They grow most fast, faster than ((inaudible)) And all fixed important subclass belongs with ITC. Here I give you top five country finding patents. You see, for the first ten years of the patent system, U.S. runs the first in terms of applications in China; was then bypassed by Japan.

So now you see the figures from the emphasis on one and the emphasis on five. The gap between U.S. and Japan widens. It means Japan applies patents now more than the U.S. And the extent is faster.

Another ((inaudible)) is up. Germany always wanted to (stir), but from the year 2003 bypassed by South Korea and also has yet to widen. So now Japan, U.S. , Berlin, Germany our most important country, applied for patents in China.

Here I give you ten foreign companies – top ten. Here this lists six companies from Japan. Just like the United States I see also; Japanese company from the ten top maybe six or seven even came from the ten; and the two from Korea; one from Europe ((inaudible)), from U.S. only I fear.

So I think if U. S will expand exports to China. I think the application for patent will be growing anyway. OK this is growing patent rounds in China. Chinese patent office right now we say ((inaudible)) stating ((inaudible)) office.

Increase examiner very fast. And now every year they recruit new examiners – more than 300; so three, four, one thing also increase. And yet for some things, which also is interesting ((inaudible)). So we have yet to sell five more than eight. ((Inaudible)) figure is for foreign countries.

OK this is very brief background what IPC circulation now in China. So my second half is several issues on acquisitions and enforcement of trademarks rights in China. China twice revised trademark law. From this table you can see the year to sell 1983; the first trademark law includes only the trademark.

But the year 1993 does service mark. Then the year to sell one last revision; the last three by nation trademark was service mark. ((Inaudible)). Eligible applicants previously only legal ((inaudible)) from here to sub one, you can have one for its natural person in a ((inaudible)) pattern trademark. And growing ownership also can provide trademark.

So the figure of trademark administration dramatically increased. Priority, you see, the first trademark law that we had, we still not member of ((inaudible)). So there is no priority. But the year of 1993 when we raised our trademark law, we provide priority according to the patent.

Then as far as the well-known trademark is concerned the year of 1993 to some extent. The year ((inaudible)) we provide particular for protecting for the well-known body; also protecting of registered map according to the latest version of trademark law.

To some extent we protect the mark, which is not for just in China but used. Here I give you very brief comparison between China and U.S. One is civil law and another is common law. Here a better of protection. In China only a registration, but also some use can be checked into consideration.

For U. S based, only upon use; as I was saying, when patents were used while use in commerce. In China when you file a trademark, you have no use. You just file. You just ((inaudible)) your trademark.

Then follow the requirements that you should use it. If you don't use it for three years, then anybody can cancel through the trademark office, your trademark. OK. You have the slides. There is more detail about. Then I have to tell you that China is a member states not only as Madrid protocol as United States. But China is also member states of Madrid agreement.

So we all our member states of Madrid agreement or Madrid protocol can enjoy their rights, their benefit in China. Quite ((inaudible)) to ground trademark as all countries. This is distinctiveness.

In China, generic terms, descriptive terms, signs electing distinctiveness can not be rehearsed or will be rejected. Here I give you some example. Slim Fast – this is a drop in class five.

It was grounded in U.S. , but finally rejected by the trademark office and applicant raises issue with person ((inaudible)) again rejected because of electing distinctness. Another

example is, was finally rejected by the Beijing high court. Then another is Chrysler designed mark. They make the front part of the car as a trademark, so trademark office says this is a lack in distinctiveness. So don't know ((inaudible)). But for some signs if you use it and acquire some reputation, you still can be just as a trademark.

For example, MTV. According to the previous conception, this is a less distinctiveness. But it used very successfully for finally they got this trademark in China. Also, here I give you the Coca-Cola bottle. So most of this two bottles was rejected by the trademark office. In September ((inaudible)).

Then the applicant raised issue with the trademark review and occupation bureau. This one was approached by this bureau for ((inaudible)). But this one, rejected. Then this one, went more rejected by the court. OK.

So here I give you well known marks recognized by administrative authority. In China we have several ((inaudible)) status as well known marks, firstly, for SAIC, State Administration for Industry and Commerce. During the process a position infringement made by administrative organ locally.

You say, no, no, no. This is my well-known mark. Then finally will be considered by the trademark office. So in total they are ((inaudible)) a year for some 156 well-known marks. Among them, 30 are care from abroad, US trademarks 13. Let me give you an example.

Barbie toys, this is a well known mark in China, also developed for saving also coupon and many other companies ((inaudible)) trademark. For this one, for example France,

Netherlands. This one is well known mark recognized by court during the infringement cases. ((Inaudible)), DuPont, ((inaudible)), Honeywell, Safeguard of the P&G, ((inaudible)).

For the first time in year 2001 trademark law we include the issue. You are ((inaudible)) trademark cannot be in conflict with prior rights, mostly copyright or industrial design, something like that. Here we have one example. This is copyright order, United Feature Syndicate, Incorporation.

But someone buy the trademark, not the title design mark. Then it was rejected by the, this was applied by the ((inaudible)) company in ((inaudible)) Province, China because it's in conflict of the copyright order. It's rejected.

This one also the copyright, the picture was ((inaudible)) one applicant using it as a trademark. Again, rejected. So now I have some time to say about the patent law for the pharmaceuticals and chemicals. In year 1992, when firstly we provide patent law. We provide patent protection for pharmaceuticals.

And the term of patent protection was extended to 20 years from 15. And exclusive rights for 1992, 1992 revision go back from the process and imports. Then again ((inaudible)) offering for the sale, for years last revision.

In terms of opposition procedure, presently we have pre grant opposition. Then we have post grant opposition and finally we no opposition. After granting you can use only one possible procedure in validation or in U.S. terms, re-examination. No opposition at all.

Here I give you ten points. Tangible subject matter. ((inaudible)) conferred terms of protection. Process patent ((inaudible)). If you compare with TRIPS agreement, I would say, all in principle in full conformity with TRIPS agreement.

I would like to emphasize that even in 1992 when we revised our present law after long negotiation with the US, and we reached ((inaudible)) then China revised our present law. This revised present law is already in conformity with TRIPS Agreement. Nine years earlier in advance, if you compare with obligation, provided by the TRIPS Agreement, China reached the standard nine years earlier.

Here I give you a very brief compile of present law between U.S. and China. Regarding the status of patent product protection, U.S. very wide. You say any invention made by the man under the sun are patentable. But then China, not so wide. We still cannot, we don't provide a patent of protection for DMP, also for plant and animals patents right now.

Then term extension for dropped patents, for the time being, China, we don't provide. Please remember, China provides the dropped patent protection since 1993. So first dropped patent will be expired the year 2013. So still we have some time to discuss the issue around the exchanging of the drop when you have a long time for clinical trial.

It takes a long time the FDA process, and many, many others I will say it later. OK? Here I give you some concrete proposal. First one I recommend US company use PCT route more. Why? Because according to the PCT, every member states should recognize or you know, application in English has legal effect.

If you apply patent in China while ((audible)) and according to the Chinese patent law, China only takes the Chinese version as official legal patent. This is most important thing. Then another, my advice is that when you take the ((inaudible)), compare U.S. and China, so you should be very careful publication in the United States before filing patent.

Some times could lead to losing ((inaudible)) in China. You should be very careful. Then because U.S. has first to invent, China and other countries, you first to file. So you should take very careful attitude to your initial patent document. , especially, we have different system.

You have a patent inventors then assigned to the entrepreneur. In China, we have no such process. So when you apply patent in China based on U.S. , you should fulfill all this assignment. If you don't satisfy this requirement it may be cause some trouble. We have already some of these applications, and also China patent law, a law, one invention, two applications.

One for you did the modal another for invention. It's a law by the law. But I don't recommend you use this possibility, because there could be big conflict in the time they come. Then I also recommend that when you're filing patent in China you should have right to extend to Hong Kong.

Because Hong Kong becomes more and more important, especially many enterprises listed in Hong Kong. So you need to protect also in Hong Kong. If you have patent in China we

can help you to extend to Hong Kong territory and again, in US and China we have some different appeals process.

So let me give you, you see reexamination in your case, appeal. Invalidation in your case is re-examination affirmed by the court. Very high ((Inaudible)) So my recommendation is that you must pay especial, special attention when you case goes to the Patent Examination Board, because high percentage affirmed by the first ((inaudible)) court. If you fail, then it's very difficult for you, very small percentage you can win.

Then also another recommendation is that if you have subsidiary or are in the center in China and you apply patent firstly in China, then you come back to the United States or Europe or Japan, my recommendation is that if you have software related patent, or computer implemented invention, you should drop the claims in conformity with the requirement of Chinese patent law.

But if for the pure software and many others, China didn't grant, for example, BMP but you still can claim. Because if you claim in China first application, it will be, no matter, Chinese patent office will reject this because they don't provide. It could be served as a basis of priority for application in U.S. , in Japan, in other countries.

OK. This part I will fully escape because I was told there will be panel to discuss enforcement of patent rights in China. So I escape all this part. Now you have some slides in my presentation. Thank you.



Many people are interested in enforcement. I already said it. I escaped this part but I gave you some cases which firstly, Intel against ((inaudible)). This case will damage more than 100,000,000 ((inaudible)). This case stuck out world wide, on a world wide basis.

Then another one Cisco and ((inaudible)). It was in California also ((inaudible)). The third is ((inaudible)) company, the number one foundry for semi-conductors. CSMC against SMIC which is located in Shanghai, very big semi-conductor foundry factory.

It was set up by SMIC will take every year ((inaudible)). They will pay five years in \$150 million and it was six years ((inaudible)). I total they will pay \$165 million U.S. dollars ((inaudible)).

In other words, another one is ((inaudible)) with one ((inaudible)) for ((inaudible)) Chinese character ((inaudible)). ((inaudible)) also ((inaudible)). For trademarks, we have one ((inaudible)) status is that one company. They have famous wine brands called Great War and several other companies they use also similar trademark.

Then damage more than 10 million Chinese Yen. OK, I come to the last part of my presentation, several citations for further improvement of IP systems. First I suggest that if you look at the court system in China, we have four different levels, different courts ((inaudible)), high court ((inaudible)). The intermediate court 400 and elementary ((inaudible)).

((Inaudible)) always started from ((inaudible)) and high court ((inaudible)). So now we can see, theoretically you can have one different opinion ((inaudible)) on the same case, so

inconsistent decision ((inaudible)). This is one. Then if you have infringement cases, first instance go to the appeal. Of the defendants ((inaudible)) about validity ((inaudible)). Then it goes to the CRB, Patent Examination Board. That is the legal ((inaudible)).

If not OK, then it goes to Beijing for Superior Court, because most ((inaudible)). If you are not satisfied it can go to appeals to the Beijing High Court. Then you have two trials possible, the Infringement Court ((Inaudible)) the case and wait for the results. ((Inaudible)) to this, I think, not so rational.

So my suggestion is that (AUDIO GAP). So improving ((inaudible)) for impending consistency of appeal decision serves a ((Inaudible)) for infringement and validity issues by establishing a unique IP Appeal Court such as CAFC, which occurred in 1982 in the United States

In China we need ((inaudible)) unique consolidate appeal IP Court. Then we to improve ((inaudible)) by increasing conformity and evidence collecting procedure. In addition to that in this year we raised the issue for further amendment of Chinese Patent Law. We are thinking about our expanding the scope protection for software related inventions and of BMP.

Also the biotechnology and we also need to improve the procedure of preliminary injunction. I finished my presentation by saying a very brief conclusion. That the above analysis shows that Chinese trademark and the patent system are in full conformity with TRIPS Agreement.

It is possible for foreign companies to successfully obtain and enforce UR trademark and the patent rights in China. When you acquire and enforce your patent and trademark rights in China, you should pay special attention to the differences of the patent and trademark laws between the United States and China.

In your ACC ((inaudible)) there is an article written by one American attorney, me and one former Chinese judge, our enforcement of patent in China. I finished my presentation.

Thank you. Thank you very much.

Operator: Our next speaker is Jamie Segal. Jamie is a Senior Intellectual Property Council for Sony Corporation in the US. Prior to joining the company more than eight years ago, Jamie was an IT litigation attorney at the law firms of Kenya and Kenya ((inaudible)).

Jamie has been very active on projects in China including as a member of the AVS ADHAWK IPR Experts group and the representative for Sony on the AVS Patent Pool Administration Executive Committee. Please welcome Jamie.

Jamie Segal: Thank you. Let me first preface my comments by saying that my comments are mine alone and are not comments of Sony and please don't take them as such. I want to talk, I'm going to talk a little bit about philosophical issue that we have dealing with IP in China.

And then I'm going to talk about some real world experiences and tell you why there's some hope about enforcing your IP. Patents are, in my opinion, the great market equalizer. They allow companies that don't have research and development to partake in developments and

technology simply by paying for it instead of having to hire a staff and invest in research and development.

But the one thing about research and development is that it costs a lot of money to do. There are, most companies in the world don't have big investments in research and development. But those of us that do need to be able to recoup that investment.

Typically in the consumer electronics industry, for those of you that are in to electronic devices, when devices first come out they're very highly priced, a lot of margin built in to those products. And typically and historically prices would start to come down over time allowing the companies that innovated that technology to recoup their investment in research and development before products become commodity devices.

Everything's changed with the development and the advancement of markets in China. In particular, because pricing pressures have come on faster than anybody can account for. So where you have new devices coming out, we have now shortened the period of maximizing your margins on products to virtually nothing, where pricing pressures coming in immediately enforcing the margins to go to slim for none.

Most notably in the past couple years, you had a company called APAX, which APAX itself wasn't a Chinese company but APAX was selling Chinese goods. APAX had the best model of all. It sold goods but it never paid for them. And by selling goods that they didn't pay for, they were able to force, they were actually able to go from zero percent of the television market in the United States to almost 20 percent in the span of a year, which is huge. , obviously having a huge impact on this business.

But importantly they highlighted their pricing pressures that the industry is basing and it's not just the consumer electronics industry. So patent licensing, through patent licensing, it allows companies to recoup their investments from competitors and colleagues in the industry.

Without the licensing fees, non innovators, companies without research and development get an unfair advantage because they can come in without any investment, buy a device, reverse engineer it for virtually next to nothing and come out with products and sell them for little or no margin because they have no built in cost to recoup.

Point number two on patent licensing, which is, as I said, that patent licensing allows manufactures to participate. So especially for upstart companies and what I hear a lot is that from China and particularly doing business in China is that we should just compete on selling products. We shouldn't license our ideas for money.

This idea that you would recoup and license and ask for money for your technology is fine and understandably so because the whole concept of intellectual property is relatively new in China. So the idea that someone would want money for his theory or idea of intellectual property is a new ground for China.

But as a practical matter it's just not reality to expect us to be able to simply compete on manufacturing products because we do have this built in research and development cost that has to be recouped.

So the whole process for high technology company and any companies that depend on patented technology and large research and development programs is, there has to be an education process in China, which, as in any new country that comes in to the industrialized major economy.

It happened in Japan. It happened in Korea. Now it's happening in China. There has to be an education process to respect, to build in a respect of intellectual property and why it's important.

And even up to the retailer level, if Best Buy were to sell the same black and white television set that was available 50 years ago and that's all they sold, they would have a hard time getting in any new customers. So new technology and research and development is very important for manufactures. It's very important for retailers. It's very important for consumers.

Enough of my philosophical discussion. Let's talk about some real world experiences in China. AVS standard is a comparable to the I triple E. It's a standard body of national and China and they are trying to adopt a standard that covers audio, video, digital rights, management or QRM, and systems.

Essentially they're trying to duplicate what we already have in place with MPEG two video or MPEG four video, which are standards adopted by the motion pictures experts group, which is an internationally recognized standards group and audio Codex, which normally AAC or there's also MPEG3, which are audio standards and they're trying to develop their own nationalized standards.

But to do that they recognize that there's intellectual property out there that they have to design around and that they have to either acknowledge. Ideally they wanted just to avoid all intellectual property so that they don't have to pay for it and as part of that stated goal, or to start out, they had inadequate IPR policy.

Their policy was initially if you sign up for the AVS standard and participate, you basically have to give up all your rights to your intellectual property. That is necessary for the standard and that was just inadequate based on international practices.

The second problem was what they wanted they wanted for that intellectual property. They stated intent that they would collect no more than one ((inaudible)) which is approximately 12 cents for all patents essential to the entire standard, that's audio, video, digital rights, management and systems.

To put this in perspective, MPEG2 video, which is licensed in a patent pool with hundreds of patents of 26 licensors at this point, and that MPEG2 was the video Codex on DVDs. The royalty on that is \$2. 50 per device. , which is a reduction from the original \$4 per device.

And current Codex that are out now, MPEG4 have royalties in the area of 10 to 15 cents, but that's just for video. The audio has another royalty. The digital rights management has another royalty, systems, another royalty. And they stated the organizers of AVS stated that the royalties would be no more than 12 cents.

This caused a lot of concern to those of us in the international intellectual property world.

So, you had to overcome this lack of knowledge of how these patents can be licensed, and the IPR policy. And we did that by working with a number of other high tech companies including IBM, Sun, Microsoft, Broadcom, ((inaudible)), Samsung, and we created this IPR ADHAWK expert group which rewrote the IPR policy for ABS.

And we rewrote it. It's not ideal. But it certainly goes a long way towards conforming or closing conforming with internationally standards, where now if a party actively contributes an idea to the standard that's adopted they have to agree to license their IP to those contributions.

So other words, you can't ask the standards group to adopt your technology and then say I'm going to withhold my intellectual property and block the standard. So that's generally a good rule to follow and we were actually very successful. We had to provide proposals as the experts group, which were then adopted by the AVS standard's body.

And we were operating in an environment understanding that there was a philosophical barrier to overcome here to have the industry acknowledge international IP. But we bridged a gap and we found an exclusion that would be acceptable to everyone.

The next step was that we had to create a patent pool that's going to license the intellectual property. Typically now, at least in the electronics industry, you have companies like MPEG LA or VIA Licensing, which is a subsidiary of Dolby that act as independent administrators of patent pools.



So they make the patent calls, ask everybody with patents are essential to technology, to submit and they're basically a one stop shop. You want to go get virtually all or most of the intellectual property that's essential to a technology, you go them.

For MPEG2 you go to MPEG LA. For some of the audio Codex, you go to VIA and you can sign up for a license and we had to do the same thing at ABS. Only there's nobody in China that's ever had any experience with patent pools because at least to date there's been a steadfast refusal to even take licenses and run the patent pools, which is why you can see DVD players for \$25 or \$20 when the royalties on the devices alone would be in excess of that if they were being paid.

So we, at Sony we decided to become active participants in the creation of a patent pool, because the only way you can enact change is to, or influence change is to be a participant, and that work is continuing.

We've been successful so far at getting the organizers of ABS to acknowledge that 12 cents is not a realistic royalty for the entire standard and we've gotten a compromise that we could probably live with the 12 cents just for video, which would be consistent with international rates on comparable products.

And that was no small accomplishment ((inaudible)) involved in that development, which is why we have wait requirements for people on our Chinese negotiations ((inaudible)). And it's really, it's a battle of patience. One of the first things I learned working for a Japanese company is that patience is a great virtue especially in age. It takes time.

And you have to have patience and it requires a lot of trips over to China and you develop your relationship. I think the term is (Wong Gee), to develop relationships. And it just takes time and we have to build a trust between people on both sides of the equation. And ultimately, like I said, Japan went through this. Korea went through this. China's going through this albeit at a much faster rate than any other country.

So the goal in AVS participation is that more so than the money involved in the pool. As the first pool in China, this is what everybody's going to look at. So as far as my personal involvement, I'm most concerned with developing best practices and that's where I spend most of my time. I want this pool to be done right.

Ultimately whether it's 10 cents or 12 cents or 15 cents, that's not as important as making sure that next time we do it, the next time, the next time, we have a good modal to follow. So we spend a lot of time doing that.

I apologize for the slides, a bit of something here. Anyway, my next topic, which isn't in here but I'll be happy to supplement the slide if they get redistributed. We've actually been successful in enforcing our IP. Sony actually has cases number one, two and three in China as the first ex parte injunction ever issued by a Chinese court.

We have a large portfolio patent on our batteries. If any of you have Sony devices, you can buy knock-off batteries and most of those knock-off batteries are all infringing our patents because in order to put a battery in our device, you have to have a various notches and tubes and interfaces to the device, and we have patents on all those.

So the problem with batteries is also that there's a safety issue. Batteries have a nasty habit of exploding. And when a consumer has a Sony camcorder and their battery explodes even though it's a Chinese battery, guess who they call?

They don't call the Chinese battery company. They call Sony. So we had a interest both from an intellectual property enforcement standpoint and also from a safety standpoint to go after battery manufactures. And we did that in 2004 probably about the time of the development of the more advanced development of the laws in China.

We filed seven patent actions against seven manufactures and almost immediately we were able to receive ex parte injunctions against those seven manufactures. And to solve the disappearing company act that we heard about earlier, as part of the injunction, we were able to seize all their manufacturing molds.

As a practical matter, it's a slight inconvenience for the infringers because they'll just go make more molds. But as symbolically, it was a very big development for us to be able to go in and seize their products with the help of local authorities and get these injunctions.

Since we've gotten, we've been successful in all seven of our cases of infringement. We were able to recoup, I think the cost of the flights from Japan to China as our whopping damages award was I think equivalent of \$60,000. But for us it was more of an injunction. You certainly should not get in to any litigation in China with the hopes of recovering even your legal expenses.

And right now we're facing a couple of appeals for the companies that appealed. And one of the companies filed an anti-trust counter claim against us separately charging us with anti-trust violations for making a requirement that the battery has ((inaudible)) the device, trying to keep out knock off batteries.

That case is still pending. Another fall out, which you need to keep in mind, is that we've also faced some invalidation proceedings on those patents after the fact, even after we won. Some of those patents or a couple of the patents have been rejected at least initially and those cases are ongoing and it has to run off the courses from the re-examination board all the way up to the court system.

And I'm sure in the end we'll still have, at least, some of our portfolio in existence. So that's really all I have. I just want to give everybody some hope that if you do intellectual property you can actually enforce it but it's going to cost you a lot more than you're ever going to hope to recover. But that still has some hope of changing too. Thank you.

Operator: Christopher Woods. Chris Woods is a partner in the Intellectual Property Practice Group in the firm's New York office. He has worked and practiced in Europe, Asia and the U.S. , focusing his practice on international intellectual property disputes from cross boundary litigation to mediation, the acquisition of IP right, both as stand alone transactions and as part of more complex corporate acquisitions to creation, marketing and protection of global brands often requiring knowledge of cultural and economic issues as well as the likely legal issues and extensive counseling and strategic advice are a broad range of world wide IP issues.

He has extensive experience in the Asian market, particularly in China, having represented U.S. clients over the past 15 years in the most dynamic of markets. Chris has worked with clients who are new to China as well as corporations who have been in China for many years but are seeking advice and help on novel or complex issues both IP related and general.

Christopher Woods: Final speaker. You'll be pleased to know that you've reached the late show and unfortunately for you I am not David Letterman. But I do have a top 10 list, which is the top 10 most commonly encountered problems or concerns or issues that companies have when they first go in to China.

And this is, we're only going to take 20 minutes to do this. So each of the top 10 are going to be quite brief summaries of what those issues are. But I hope what that will do is prompt you to think of some questions that we can deal within the panel session after this. This is a map of the world and it looks fairly obvious.

I mean clearly the U.S. is geographically distant from China, but one of the underlying issues that causes a number of problems as companies go forward into China is failing to recognize that, as well as the geographical differences, there are substantial cultural differences.

And although those differences have diminished somewhat over the past few years, there are still substantial differences in the way that we do business here as opposed to how the Chinese do business. So issue number ten in our top ten list is the wrong mindset, and whilst that could probably just as equally apply to the Chinese party coming to the negotiating table.

It's undoubtedly true of many mid-size U.S. corporations going into China for the first time, that they arrive at the negotiating table with the wrong mindset. And it first manifests itself in the documentation that everybody wants to use from our side.

People are very comfortable with, even in the most straight-forward of licensing arrangements, we're very comfortable with a 25 page document or even better a 30 page document that has number of annexes to it. We love that. ((inaudible)), and the Chinese have a very different approach to doing business and making an agreement. If they could, it would even be reduced to a handshake because it's an agreement between party.

Now I'm not suggesting that when you go into China you do it on a handshake. But I think, or perhaps you should. But what I'm suggesting is that the documentation is going to be appropriate for different types of transactions, it will be quite different to the documentation that you have used to the equivalent transaction here and you should bear that in mind.

And the second way that it manifests itself in those early days is a belief that national rights, IP rights particularly, that are created in the U.S., rather it be patent rights or trademark rights, somehow we close that issue by the USPTO magically become valid in China. Or even rights that the company has that were issued in Hong Kong have somehow become valid in China.

And in both cases, that's not correct and often you see documentation that is in draft form or is even fully executed where the rights that are actually being licensed into China or are

being used by the joint venture are U.S. rights. They have no validity there. And when that comes to light, the 12th hour, 11th hour it's extremely difficult to overcome.

Now, I think somebody outside referred to the issue of copyright and we can talk about that in the Q&A. Copyright is a different beast because copyright, if it arises in the U.S. then, because of international conventions it also will move into China. But leaving that aside for the moment, the real issue, which relates to the wrong mindset is a belief within a company that the U.S. rights are going to be relevant to the Chinese transaction.

So I think the underlying issue number ten is, is a set of assumptions that should be left outside ((inaudible)) and the underlying assumption is that what works here works there and very often it doesn't. And where it often particularly doesn't work, is in branding. And here on this slide we have a common object or actually a computer,. It's an early iMac. It's the first iMac at that. The first Mac. ((inaudible)) a hamburger and a cup of coffee.

You see number nine is all about how to brand these products in China and I think it was Dick, somebody touched on that issue earlier on. And obviously a U.S. corporation going into China to sell products to the 1.4 billion people who live there is going to want to use that entrusted trademarks from the market here.

But the problem that you have is that there are significant linguistic challenges in doing that. Of the 1.4 billion people who live in China, a vast majority, that's the write or read English are no more capable of pronouncing a reading in the English language trademark than we would a Chinese language trademark.

So, the three-legged horse, how about sort of launching China without a Chinese language trademark tends to run into the difficulty of the local market adopting a trademark for that product, which is very rarely the trademark or image that the company would have chosen for it.

Quaker Oats, when that was launched in China it didn't have a Chinese language trademark and it is now universally. I'll show you the product, so you remember what it looks like. But you'll recognize the Quaker on the packet. Our product, this product is known generally as the old man brand in China.

Now, obviously the Quaker Oat Company would most unlikely would have chosen to label it the old man brand. It doesn't really give the kind of image that the company had in mind. Nor, indeed, I suspect that Ralph Lauren intend for the Polo brand to be known as something of a lame pony. The three-legged horse that the picture, what the logo looks like, it does look a bit like a three-legged horse and that is what it's known as.

So, when you come to devise a trademark, a Chinese language trademark, you have a number of issues to deal with in order to get the right characters to mean what you want them to mean. Now if you're lucky, you'll be Apple, and of course, I doubt whether there are any languages where the word Apple does not directly translate and as it was in Chinese, it means Apple.

If you are Starbucks, then obviously you have a more significant problem because Starbucks is not capable of being directly translated. So what they did there was they took a star, the first part of the, there are stars in the mark and a star in the word.



They took the Chinese character for star and then they took a few characters which sounds approximately like ((inaudible)) and when you do that, when you take characters that sound like something, you obviously need to make sure that they don't sound like something bad, which we'll comment on in a minute.

And in this case, I'm talking about translators. It's quite difficult sometimes to get people to agree what a particular character means. But one translation of this would be hope and overcome, that's the other two characters, which are perfectly innocent words.

When Coca-Cola and before Coca-Cola formerly launched in China, there were, you could buy Coca-Cola and a number of vendors picked the Chinese language trademark for it. And the most common of those marks, before Coca-Cola itself picked the market it wanted, was one that translated back as – well, one translation was white the wax tadpole, which it's possibly what Coca-Cola had in mind, but probably not.

So when they did formerly launch, they picked characters which are as close as they could get to the sound of Coca-Cola. So those are characters, those sounds are actually practical to avoid some other unpleasant meanings and then, again as some, the side of the can shows what the characters are.

And again, there's some debate as to exactly what it means, but it's something like tastes good, be happy, which is not bad. And then finally McDonald's had a big issue in trying to decide what to do with the name McDonalds because it doesn't translate as anything in particular.

And they took the route of trying to find three characters that, say them fast enough, sound a bit like McDonald's in fact sounds more like McDonald's ((inaudible)) and which has a meaning which kind of, kind of sounds that ((inaudible)) of McDonald's.

But the difficulty with branding really is part of the entire difficulty that we have in China as Westerners going there, which is a communications issue. And that really applies at all levels. It applies at the factory level in trying to explain exactly what it is you want.

It applies at a management level from the Chinese company to a U.S. company and it particularly applies at the council level, in-house council in the U.S. dealing with outside council in China, or indeed they offer a number in a Chinese corporation.

The Chinese language does not translate easily into English. It doesn't translate as directly as say, German to English would. And really there's a high degree of imprecision that comes into the equation when people are trying to do that. And Chinese laws are, in any event, different in a ((inaudible)) and ambiguous way. There may be some purpose for that.

But, so anyone translating them and then trying to give advice as to what they mean, it's a difficult process. And so you'll often find that one lawyer will give you one interpretation of what the law says, or what the advice would be in relation to it, which is quite different to another one, or appears to be.

But actually when you examine what it is they're saying and then you think about the context in which they're saying it, the advice is often exactly the same thing.

But if you do what you want to do as an English reader, and take it as being a very precise document, you'll run into significant difficulties.

You have to step back and accept that there is some interpretation going on here and I think that, and it's really a question of expectations. When you look at a document that has been translated or gone through a process, you have to not see what you expect to see, but try and think about what the writer is saying in that particular context. That was issue number eight.

Issue number seven relates to the way that China has so dramatically come off of the global economy, has so rapidly advanced. Now that's a picture when you go to Shanghai or any of the big Chinese cities, you cannot really comprehend how extraordinarily modern they are and how sophisticated ((inaudible)) is in China.

And issue number seven is really one that you still hear from mid-size companies in the U.S. when they're sort of talking about issues that they face and what they need to be doing. My company has nothing to do with China. And really there are very few companies that could realistically say that in the U.S. today.

Because even if they don't make anything in China, even if they don't outsource any services to China and even if they don't sell anything in China, the chances are that their competitors are doing just that or are about to do that.

And so to maintain a competitive edge you simply cannot ignore what's going on in the industry. And even if that industry is not involved in any of those things, if you make something that's worth making, then somebody in China is copying that.

And in the old days, the old days, maybe ten years or less than that counterfeits that were made in China tended to be made either for the domestic market or for the regional market and they didn't tend to come to the U.S. Now, there is a very well developed infrastructure so that counterfeits, enormous counterfeit ((inaudible)) do come to the U.S. market.

And if even if your company didn't have a ((inaudible)) of counterfeits, the Lenovo factor is one that is impossible to ignore. Lenovo is, of course, is a Chinese personal computer manufacturer that a decade and a half ago, nobody had ever heard of because it didn't exist.

And then a year, maybe just over a year ago, it rose up and acquired the personal computer division of IBM an almost unthinkable thing and it represents the way the world is going, where Chinese corporations are growing and they're not just there.

They are coming here. They are part of the commercial fabric that we have here in the U.S. And if you think that the Lenovo thing was just a one off and it's not likely to be repeated, you only have to look at, it's sort of almost the opposite of Dr. Gale's slides. If you look at what Chinese companies are doing in the U.S. over, if you went back before 2000, the number was quite low.

By 2005, it was a progression and suddenly an enormous leap in the number of trademarks being filed by Chinese companies here. They're not doing that for ((inaudible)), because they're doing business here.

And if you look at patents, it's even more significant because finding a patent ((inaudible)), finding a patent is obviously part of an innovative process. And we have a first case this year of a Chinese company suing a U.S. company in the U.S. on a patent., and that is the first of what will become undoubtedly a trend.

This is a minefield, issue number six. There is still a belief amongst a number of corporations here that are obtaining IP rights in China is a minefield. It isn't a minefield and there isn't, there is a sense of this corruption in the process in some Asian jurisdictions it's true.

It is not true in China and although there is a sense that time and cost is much greater China, that is not correct and even if, well, the cost is not significantly greater the time periods probably are. But, as Dr. Gale was saying, primarily the rights you get in China arise by, not by use of our being the first to invent but by filing those rights.

So you have to do it to get those rights. And one needs in China to be very aware of the reality that obtaining IP rights is not a particularly onerous task. A post cousin of that is the restricted nature of the Chinese market and we did talk about that through Dr. Gale and I think that people here may well want to press a little bit more on that, particularly if you work for a pharmaceutical company.

Because I think that although there is patent protection for pharmaceuticals now in China, I think the way that the courts are looking at infringement, and the way that the Patent Examination Board is willing to find invalidity, as is the case of Pfizer in Viagra, there may well be a sense that global protection is still at work.

And we've talked about the reinforcement on that side of it. And I think that in large part it is due to a lack of control within the court system and within the (IRC). But there is no lack of control in China is in respect of the Internet and that brings us to issue number four, which is of great concern to mid-size U.S. companies going into China because obviously they need to use the internet as a sales tool.

They need to use it as a communications tool with the Chinese partner and there is a great fear because they internet is restricted in China, access is restricted, Web sites are restricted, search terms are restricted and there is a lack of privacy in that whole Internet traffic goes through the great firewall of China is monitored and users of Google and Yahoo and others have had their records handed over to the government.

So, for mid-size companies about to do business in China, there is a significant concern as to how these things impact on their business there and here, and also how those affect their Chinese partner and how the Chinese partner is able to do business in an open way.

Issue number three is the Chinese partner that ((inaudible)) Chinese partner and the U.S. companies concern. Again we're talking about a mid-size company that 's not used to doing business in China. How do you trust your partner? How do you know that the partner that you've identified a business interest., how do you know that that partner is trustworthy?

And they ask that question in a way that they would never ask it of the U.S. partner because there are ways in the U.S. of analyzing whether this partner is a company that you want to do business with. Due diligence here is a straightforward process. In China, you have to do business in a different way.

You have to get to know the principals in the entity. You have to socialize with them. You have to do all the things we've been talking about. That's how you get to trust your partner, by spending time with them beforehand, by spending time with them during the lifetime of the joint venture or whatever it might be.

And again, you need to make a reality check of the life, through the life of that joint venture because things change and the issue that ((inaudible)) will bring up issue number two, which is the counterfeiting problem. A large part of it is actually or a part of it is due to companies not maintaining a reality check on what their partner is doing in China.

Just very quickly, as you can see, China is by far and away the leader in the production of counterfeit goods which have been seized by U.S. customs. The other don't even get onto the same chart. And the reason why it's issue number two is that clearly it is a massive problem.

It is a problem in respect of ordinary straightforward copies, but it's also a problem in respect of what we refer to as genuine fakes, which is where a U.S. company or a foreign company has a joint venture in China to revamp a manufacturer. Let's say automotive to

their parts and the joint venture partner is making those spare parts for shipment back to the U.S. and then it runs what is often known as the night shift.

It makes another huge quantity of the same product. So it's exactly the same as the genuine product. It has the same production line, it has the same packaging. That comes to the U.S. It is then sold at much less than the normal retail price, less than half, thereby undermining the whole market in the U.S.

But it was the purpose of going into the joint venture to make them in China in the first place. And that is because U.S. companies tend and foreign companies in general, they set up the joint venture. They are very excited by it and then everybody goes back to America and forgets about it.

You need to have a program of anti-counterfeiting in general. It is very difficult to set it up. It is expensive. But unless you have that program, whether it relates to copies or genuine fakes, if you make things in China they will be copied and they will come here.

And finally, this is a Chinese ((inaudible)). Issue number one will probably be a surprise to many people and wouldn't have been issue number one, three or four or five years ago. It relates to how you enforce the contractual provisions that you have with the joint venture partner. A few years ago, a lot of low grade technology was being sent to China in the joint venture.

People didn't really, if that broke down it wasn't a great consequence. A lot of American companies were involved in ventures, which were not bet-the-farm ventures and so again, if



it broke down, it didn't really matter whether you could enforce the provisions of the agreements with the Chinese partner. Now that's not true. It's cutting edge technology going to China and it is often bet-the-farm venture that if it doesn't succeed, the U.S. company is in significant difficulty.

So, obviously the venture is built on connections and trust. But a lot of the times it's going to break down and the dispute resolution clause that you write is an extremely important one and we might have a little talk in the Q&A session about what right now is perceived to be one of the better ways of getting around that.

Because litigating in the U.S., litigating in China, arbitrating in the U.S., arbitrating in China are all fraught with difficulty and you need to come up with something that is likely to enable you to get back the assets and the rights and cash out of the venture.

Am I OK? OK. That's the end of that. But I do just want to say one thing. The Kilpatrick Stockton Intellectual Property Desk Reference has in it an article on counterfeiting on the ((inaudible)) I wrote, but also one that somebody else wrote as well.

I think ((inaudible)) there's a lot of, I'm sort of promoting my book. There's a lot of very useful IP articles in this reference. If you'd like a copy of it, you can leave your business card with Monica and we'll send one to you. That's it. Thank you.

END