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Intellectual Asset Management
www.IAM-media.com
Issue 81 January/February 2017

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Defending a patent case in the brave new world of Chinese patent litigation

A huge market and a pro-patent owner system are fuelling an increase in patent litigation in China. Whether up against a local firm or a global non-practising entity, accused infringers need to be prepared for any scenario

By Erick Robinson

As any US patent litigator knows, the value of patents and the ease of enforcing them in the United States have dropped precipitously over the last few years. However, it was the US Supreme Court's 2006 decision in *eBay* which has had the greatest impact. This is ironic, given that the case was supposed merely to underline that injunctions should no longer be issued automatically based on a finding of patent infringement, but neither should they be denied simply on the basis that the plaintiff does not practise the patented invention. Over the last 10 years since *eBay*, the law has deteriorated to the point that it is now nearly impossible to enjoin a direct competitor.

Although damages in the United States have historically been the highest in the world, they have dropped considerably as the courts have enforced a *de facto* compulsory licensing scheme. In fact, many patent litigators – even the more seasoned among us – have largely forgotten the power of an injunction, or even the realistic threat of one.

Largely as a result of the United States' race to the bottom in terms of patent enforcement, Germany has emerged as a go-to patent jurisdiction, with virtually guaranteed injunctions, quick time to trial and no discovery resulting in a highly efficient system. However, the problem is that an injunction in Germany prevents sales in Germany alone. While it is an important market, it is a much smaller one than the United States or China. This is why many in the IP community were dismayed at the Brexit vote. Depending on how it played out, a Unified Patent Court in Europe might have combined the efficiency of German courts with the size of the European market. However, the future of both the European Union and the Unified Patent Court is now in a state of uncertainty.

Enter China. For years the laughing stock of all things IP related, the Middle Kingdom was ridiculed for the easy availability of counterfeit handbags, software and DVDs. However, over the last 15 years, and especially in the last two to three, China has put together an extremely effective patent enforcement system. Based largely on the German system and all of its advantages, but with selected portions from US law, China has now become a top forum for patent litigation.

Injunctions are now issued over 99% of the time to winning parties – although this is only half of the magic. Unlike most countries which enjoin making, using and selling in-country, as well as imports, Chinese law also bans infringing exports from leaving the country. So, for instance, if the accused device is Apple's iPhone, not only can sales of iPhones in China be enjoined, but also exports of the devices from China. Therefore, a patent owner can achieve an effective worldwide ban, since iPhones are manufactured in China.

All this would be for naught if the Chinese customs system were not effective. Luckily, China has had many years of experience in enforcing bans on trademark infringement and there is a well-developed system for blocking goods due for export at Customs. This is the magic (or horror) of Chinese patent litigation.

Patent litigation win rates in China are high, currently hovering around an average of 80%. Further, foreign plaintiffs fare better, statistically, than Chinese plaintiffs. While this is likely due in part to the fact that foreign plaintiffs take great care before filing in China, it still indicates that as long as a foreign party does its homework, it will get a fair shake in the Chinese courts. The time from filing to judgment and injunction is short, ranging from six to 14 months. Legal costs are also low – in many cases one-tenth the cost of US patent litigation – due to the lack of significant discovery.

As if all this were not enough, most validity challenges (through a collateral process at the Patent Re-examination Board, a division of the State IP Office (SIPO)) are not complete until after judgment (and injunction). Injunctions are generally stayed pending appeal – although it is possible to file for a preliminary injunction after winning a judgment. This requires a likelihood of winning and eminent harm – although given that the patentee has already won, the first prong is achieved. Given the pace of technology advancement in China, the second is generally provable as well.

In November 2014, China set up specialised IP courts in Beijing, Shanghai and Guangzhou, whose judges take pride in their skill and fairness. In addition, the government has issued an edict to advance innovation through patent enforcement. This has not been done altruistically, but rather because China now has a strong technology market to protect. Indeed, some of the most innovative companies in the world – including Alibaba, Xiaomi, Tencent, Huawei and Lenovo – are based in China. Although China has a civil law system, judges tend to seek out and respect prior decisions.

At every step of the road in patent litigation in China, the rules favour patent owners. For instance, forum shopping is available because filing is allowed anywhere that an accused product is sold. Also, pre-trial asset

freezing is available for bank accounts, inventory and documents, which provides teeth in negotiations. So Chinese patent litigation is indeed a formidable obstacle for accused patent infringers.

Implications of a strong Chinese enforcement system

While China has developed its strong patent system to help boost domestic innovation, what are the implications for defendants? Non-practising entities (NPEs), patent assertion entities and patent trolls are already in China and beginning to file cases which are likely to target foreign companies, as the low-hanging fruit. However, Chinese operating companies are also beginning to enforce their patents against foreign operating companies, such as Huawei against Samsung. In addition, failed Chinese companies whose only remaining assets are patents are filing against foreign operating companies, as seen in the recent enforcement action filed by Baili against Apple. More recently, foreign operating companies are even filing against Chinese operating companies, such as Qualcomm against Meizu.

Each of these scenarios presents different but significant threats. This article examines some of those threats and provides some helpful hints for dealing with them.

Bottom line

If your company has been targeted for patent infringement in China, I have some bad news: all (or at least most) of the rules are stacked against you. This is quite different from the current status of patent litigation in the United States. When Michael Jordan was at the peak of his basketball career, many announcers would claim, "You can't stop him; you can only hope to contain him" – meaning that the opposing team could not expect to prevent him from scoring, but could only hope to slow him down. Defending a patent case in China is a lot like playing basketball against Jordan. That said, there are ways to slow down or contain your opponent. Some of these should be common sense, while others require a little lateral thinking.

One of the biggest challenges for defendants is the pace of patent litigation. In Chinese patent litigation, while the plaintiff can be fully prepared, the defendant is at a disadvantage in terms of time. Depending on the case's complexity, the venue and how many cases the court has pending, parties can expect to come to trial six to 14 months after filing. Because the patentee should be fully ready for trial in every respect upon filing, the defendant will constantly be playing catch-up. If you are familiar with cases at the International Trade Commission (ITC), you have a sense of what you are up against.

"Depending on the case's complexity, the venue and how many cases the court has pending, parties can expect to come to trial six to 14 months after filing. Because the patentee should be fully ready for trial in every respect upon filing, the defendant will constantly be playing catch-up"

Traditional defences

As in the United States and elsewhere, non-infringement is a defence to a patent case in China. The requirements for proving non-infringement are similar to those in other jurisdictions, with the caveat that the arbiter of both fact and law is a judge. In addition, the doctrine of patent exhaustion is alive and well in China.

In the past, some courts used panels of multiple judges, but currently the courts are so busy that most cases are heard by a single judge – often someone with no technical background. However, this is changing with the introduction of IP courts. In addition, judges in highly technical cases can enlist the assistance of court-employed technical advisers. So in many ways the hearing or trial in a Chinese patent case is like a bench trial elsewhere.

Prior art and other invalidity actions are not part of the court action. Validity challenges are heard by SIPO – this process is discussed later in this article.

Crucially, although prior use is a defence which can be used to defeat infringement allegations in litigation, the prior use defence states that identical products

Go local... and American

It is essential for any defendant in patent litigation in China to obtain excellent counsel, but this is particularly important for foreign defendants. Foreign litigants generally do not know the rules and customs and must have good Chinese counsel. Good counsel in this case means several things. First, they must know civil litigation and patent law well. Second, they must be good at advocacy – especially given the fast pace and lack of discovery. Beyond this, counsel should be well connected to both the trial court and appellate courts. They must also be skilled and experienced in dealing with the Patent Re-examination Board, where any validity challenge will take place.

However, no matter how great the Chinese firm and attorneys in these aspects, there is also a need for western counsel. First, western patent litigators have much more experience regarding large-scale complex patent litigation. A friend told me recently that Americans do not do a lot of things better than the rest of the world these days, but they still do patent litigation better. There is a lot of truth in this. The largest patent disputes in the world over the last generation have mainly been fought in the United States. The ability to use graphics and other tools of persuasion are well developed and tested in US courts. Chinese counsel are just as intelligent (in many cases more so) than their western counterparts. However, they do not have the same level of experience or advocacy skills in taking very difficult technology arguments and making these understandable for non-technical judges.

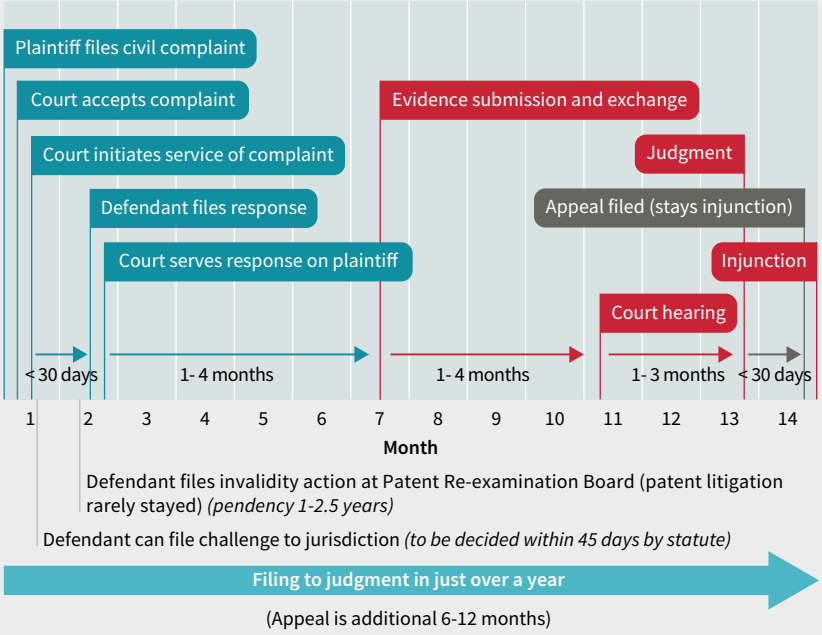
Equally important, the level of service of most Chinese firms is not the same as for western firms. Western businesses are accustomed to receiving email responses within five minutes, not 10 days. Further, even if you receive an answer in a reasonable time, you are likely to receive only a response to the specific question asked. Western businesspeople are used to having their lawyers not just answer the question asked, but also figure out the questions that should have been asked and then answer them, as well as dealing with all possible contingencies.

The answer is to hire both good Chinese counsel and western managing counsel. The end result is a better outcome, as well as the ability to speak English and pay a single bill.

Characteristics of Chinese patent litigation

- High win rate (75%- 95%).
- Foreign plaintiffs win more than Chinese plaintiffs (but must do their homework).
- Virtually guaranteed injunctions (99%).
- Short time from filing to trial/judgment (6-14 months).
- Sparse discovery.
- Validity challenges are often not complete until after judgment (and injunction).
- Dominant Chinese market for sales (largest worldwide for many electronics) and manufacturing (largest worldwide).
- Specialised IP courts and judges who take pride in their skill and fairness (no discrimination against NPEs).
- Although a civil law system, judges seek out and respect prior decisions.
- Government has demanded that the courts be fair and create a strong enforcement system.
- Forum shopping available.
- Pre-trial asset freeze available – freezing bank accounts, inventory a useful negotiating tactic.
- System for blocking goods due for export at Customs is well developed.

FIGURE 1. Chinese patent litigation timeline



manufactured before the patent application date will not be regarded as infringing where:

- necessary preparations for their use have already been made; and
- they will continue to be manufactured and used only within the original scope.

This does not invalidate the patent, but is rather designed to defeat infringement.

Slow things down

If you are accused of infringing a patent, the first thing to do is to try to slow things down. There are several ways to achieve this. First, before filing a response to a complaint, a defendant should file a challenge to the jurisdiction. While this tactic rarely succeeds – as a patentee may file anywhere that the infringing item is sold or used (ie, anywhere that a product can be delivered) – it can put the litigation on hold for one or two months. It may also be possible to appeal this decision to a higher court, although care should be taken not to annoy the court with frivolous actions. Challenging the jurisdiction is a prime method of postponing a case at its infancy before any evidence is exchanged and allowing a defendant to close the plaintiff's head start. Unlike in US litigation, there is no procedure to grant a defendant additional time to respond to a complaint.

Another way to slow the pace of the litigation is to seek mediation throughout the process. Mediation is one of the most encouraged and accepted alternative dispute resolution methods in China. The process is voluntary and non-binding, although any agreement reached can be contractually enforced. Further, the outcome (or statement) of mediation, after it has been approved by the court, can be enforced in the same manner as a court judgment. SIPO's Administration Department of Patent Affairs can also hold mediations – although, as it is part of SIPO and essentially a government body, it is not entirely neutral.

The first reason for a defendant to seek mediation is that the parties might come to a compromise they can live with. Second, the defendant will get more information from the patentee about the case and about what it wants (this is nearly always money). Finally, the courts in China seek resolution of litigation via mediation even more aggressively than US judges. Part of the reason for this is the sheer size of their dockets. Over 11,000 patent cases were filed in China in 2015, most of them concentrated in the major cities. Courts want the parties to be reasonable and will generally force them to go through mediation. As a defendant, you should ask the court for time to mediate at every opportunity. It will slow the pace of the litigation, albeit only a little. But any extra time can be put to good use.

Finally, if the patent litigation concerns a utility model or design patent and the defendant files an invalidation request within the prescribed period, the court will usually stay the case pending the validity challenge. Although this is rare, in certain cases the court may also stay the litigation in a case involving invention patents (known as utility patents in the United States). Either way, there is no downside for seeking the stay. Also, invalidation proceedings may serve to reduce the scope of protection for the patent concerned.

The statute of limitations can also prove useful. Infringement proceedings in China must be brought within two years of the date on which a patentee knew or should have known of the infringement. After the limitation period has expired, the claimant can still initiate litigation. However, the claim will not be enforced by the court.

The only exception is where the infringement is still continuing at the time that the case is filed. In such circumstances, the court will order the defendant to cease infringing the patent during the period of its validity and the amount of damage suffered as a result of the infringement will be calculated over a period of two years, counting back from the date that the claim was filed.

Proving when the patentee knew or should have known of the infringement, especially without the benefit of any discovery, is usually quite difficult. However, it may be worth a try and, in the worst-case scenario, may at least slow down the litigation.

Fight back

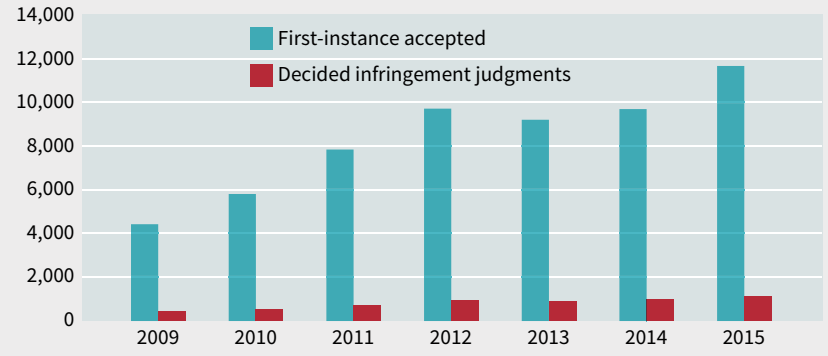
For cases in which the plaintiff is an operating company, the defendant can fire back with a countersuit. Generally, even if requested, such a suit will not be joined as part of the plaintiff's lawsuit or heard at the same time. Given this, it can make sense to file the defendant's patent case against the original plaintiff in a different, more favourable jurisdiction.

For cases filed by either operating companies or NPEs, it may be worth filing an unfair competition lawsuit if the facts allow. If a plaintiff – before, during or after litigation – makes misleading remarks which are likely to unduly influence the defendant's clients or commences infringement proceedings knowing that its patent is invalid, the defendant should consider that filing such an action in a favourable venue can put pressure on the other side to withdraw its patent claims or settle for a lesser sum.

Further, if the Chinese antitrust authorities can be convinced that a party is taking advantage of its patented monopoly power, the government may launch an antitrust investigation. Specifically, if the enforcement of a patent is believed to be eliminating or restricting competition, the patent holder may risk violating the Anti-monopoly Law 2007. In addition to the possibility of staying any litigation, such an investigation is bad news for foreign companies. My former employer, Qualcomm, has been said to have escaped its antitrust investigation lightly – it had to pay a $975 million fine and significantly limit the patent licensing royalties it received from Chinese companies. NPEs are particularly vulnerable to both unfair competition and antitrust allegations because they do not practise the asserted patents. Although the current climate for NPEs in China is good and overt efforts to label such entities as 'trolls' are not gaining traction, attempts to malign NPEs as anti-competitive may succeed in the future, especially if the NPE fails to make friendly gestures (eg, setting up scholarships at Chinese universities for science, technology, engineering and mathematics students; creating and funding incubators in China for innovation; or even simply donating a small percentage of any profits from litigation in China to universities, technology incubators or promising students). A smart and patient NPE can pre-empt the anti-competitive arguments, but not every NPE is smart or patient.

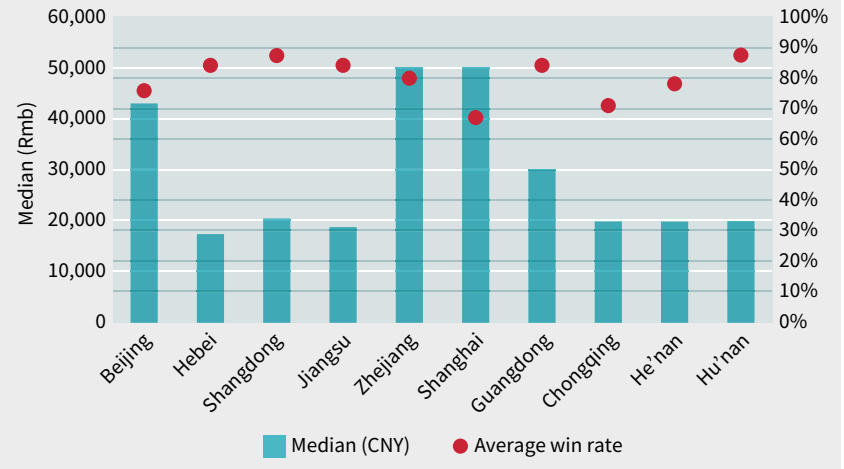
In some cases, it may make sense for the defendant in a Chinese patent case to file a retaliatory patent case in another country. At present, no country can provide the broad leverage that China does, but this can vary depending on the circumstances of the Chinese patentee. For instance, if it has an interest in moving into particular markets, then it may make sense for the defendant in the Chinese case to file a patent case in the jurisdictions that correspond to those markets. If the original plaintiff is a Chinese entity which sells products, or plans to sell products, in the United States,

FIGURE 2. First-instance patent litigation filings in China, 2009-2015



Source: CIELA

FIGURE 3. Win rate and median damages by jurisdiction



Declaratory judgment options

Like US law, Chinese law allows a party that has been threatened with an infringement action to file a pre-emptive lawsuit to prove non-infringement. This procedure is rarely used in China, largely because of the prerequisite actions that are generally required before filing such a declaratory judgment action.

No specific act or regulation has set clear rules for non-infringement declarations. However, the Supreme People's Court has issued guidelines and judicial interpretations on this subject. These provide that the following conditions should generally be met before bringing proceedings to obtain a declaration:

- A warning letter should be sent to the alleged infringer by the patent owner.
- A letter should be sent to the patent owner by the alleged infringer, in which the alleged infringer denies the infringement and urges the patent owner to exercise the right to sue.
- The patent owner should not withdraw the warning or institute a lawsuit within one month of receiving this letter (or within two months of the date on which the alleged infringer posts its reply letter to the patent owner).

Unlike under US law, this effectively gives a patentee time to file a litigation after sending a warning letter. This area of law is likely to evolve over the next few years; but for now, a declaratory judgment action is difficult to use by an accused infringer without a tactical mistake by the patent owner.

then filing before the ITC may be an effective strategy. Similarly, if the entity sells a large number of accused devices in Germany, then it may be useful to file in a German court.

Unfortunately, this is not possible for NPE plaintiffs. Also, the litigation timeline in many jurisdictions is significantly longer than that in China, diminishing any potential leverage for settlement. Still, the world is becoming a smaller place with interrelated markets and a worldwide litigation play should always be considered.

Validity challenges

In the Chinese system, the trial court for the patent infringement has no power to evaluate and judge the validity of the patent directly. Validity is ascertained through a separate collateral procedure before the Patent Re-examination Board. Depending on the complexity of the technology, the board issues its decision in between six and 24 months, with cases involving complex electronics and smartphones tending to be on the longer side of this range. If the parties are dissatisfied with the decision, either may, within three months of receipt of notification of the decision, initiate litigation against the board before the Beijing IP Court. After that, either party may further appeal to the Beijing Higher People's Court.

If the patent is successfully invalidated, the plaintiff's patent litigation is destroyed (although there is no retroactivity once the civil court has acted and an injunction has been put in place; the injunction is lifted, but whatever harm occurred in the interim is not addressable). For an invention patent, the court will generally not stay the infringement case unless there is clear evidence showing that the patent is likely to be declared invalid, even if the defendant immediately files the patent invalidation request after being sued.

Another advantage of requesting that the Patent Re-examination Board invalidate a patent is the leverage that the invalidity proceeding gives to the alleged infringer, allowing it to force the plaintiff to drop the litigation or to reach a favourable settlement. Under Rule 71 of the Implementing Regulations of the Patent Law in China, a person that requests invalidation proceeding may withdraw the request as long as this takes place before the board's decision on validity. In such cases the invalidation proceeding is terminated. As a result, requesting invalidation of the patent at issue may give the alleged infringer some advantages at the negotiating table as the parties attempt to settle the litigation.

TABLE 1. Patent cases in Chinese courts – win rates and damages awards

	Win rate	Median (Rmb)
Beijing	76%	43,000
Hebei	84%	17,500
Shangdong	87%	20,574
Jiangsu	84%	19,000
Zhejiang	80%	50,000
Shanghai	67%	50,000
Guangdong	84%	30,000
Chongqing	71%	20,000
He'nan	78%	20,000
Hu'nan	87%	20,000

TABLE 2. Civil patent cases 2006-2014 (first instance)

	Total case number	Win rate	Average damages awarded (Rmb)
Foreign v Chinese	629	45%	180,800.9
Chinese v Chinese	6094	63%	93,672.7

Source: CIELA

Design-arounds

Although an injunction against the manufacture, sale and export of goods from China is perhaps the most powerful patent tool worldwide, the fact remains that such a ban applies only to infringing products and methods. If a defendant can create and implement a redesigned product or method, then any injunction will no longer apply. This can be difficult to do in the six to 14-month timeline of a patent lawsuit, but even a partial design-around can put significant pressure on the patent holder. The goal of the litigation is not the injunction *per se* – especially where the patentee is an NPE. The injunction is a tool to get a large settlement; no NPE is interested in putting anyone out of business, since it provides no remuneration. Further, exposing a party – especially an important or popular Chinese defendant – to disruption of its product line, even a short one, is risky from a political perspective.

What NPEs (and typical operating company plaintiffs) want is money via settlement. So if a defendant even appears to be able to shift to a redesigned, non-infringing product, this can increase the patentee's risk of getting nothing in return for its lawsuit other than changing the defendant's product or process. In many cases, this is a high-stakes game of chicken in which the loser is the party which gives in first. However, although plaintiffs risk going away empty-handed, the risk to defendants can be much greater. Unless a design-around is ready by the time an injunction is issued, even a few weeks' disruption to the defendant's manufacturing chain can lead to the destruction of its business. Even if a defendant can survive not producing the product in suit, if it is a public company, its stock price may tank. The risk game is just one of the many facets of patent litigation that favour the plaintiff in China.

Be transparent

This advice applies to both patentees and accused infringers: be transparent to the court and, possibly, the Chinese public and media. If the other side is being provably unreasonable, it may make sense to make a public offer (not a repeat of a settlement offer, but rather a first-time offer), which the offering party can live with. For instance, if the plaintiff is asking for a royalty that is 5% of the cost of a smartphone and all comparable licences (especially if they are to the patent in suit) are significantly lower (eg, less than 1%), then announce to the court in pleadings and in a hearing that you are willing to pay a fair royalty of 1%, but that anything more than that is unfair. This makes the patentee appear unreasonable and, in addition to opening up a cause of

Be a friend to China

The number one rule for any foreign company in China is to be a friend to China – a mantra repeated by various members of the Chinese government. It can mean different things in different situations, but any long-term success in China requires adherence to this recommendation.

Defendants should prepare to be a friend of China well before they are sued for patent infringement. Although being in such a favourable position may be useful in litigation, it will certainly help in virtually every other aspect of the business. Relationships in China are important for everyone, including businesses. Having good friendships with Chinese companies, agencies and government officials is crucial. This is not about encouraging any form of corruption, *quid pro quo* or other nefarious activity. Rather, it is simply common sense: make friends. They will be able to give you good advice and recommendations, and can vouch for you and your company at the necessary time. Foreign companies should develop strong ties to China and its people, businesses and government to show that they are not just in the country short term to obtain cash and then leave. Invest in China and its amazing resources. It is the right thing to do and will also likely serve you well in the long run. Plus, you will be well on your way to being a true friend of China.

Obviously, in any litigation in China, a foreign defendant should overtly point out its contributions to China and its economy, beyond just employing workers. However, in addition, foreign defendants should attempt to target the patentee as not being a friend to China. This can be done by pointing out any lack of commitment to China on the patentee's part in terms of time, money and strategy. This is obviously problematic when the plaintiff is a Chinese entity. However, where the plaintiff is foreign, a deep dive should be made into its history. Does it pay Chinese taxes? Does it employ Chinese people? Does it provide higher-order strategy or other assistance regarding technology or innovation? Is it new to China? Is it giving back? What is China's return on investment on allowing the plaintiff to operate in the country and use its courts?

Also, think long term. Explain to the court – and perhaps the Chinese media through a PR campaign – how, if the plaintiff is allowed to achieve a monopoly, this will be bad for China, Chinese companies and the Chinese people. This is fair game and should be repeated to the court and media as often as possible.

Additionally, foreign defendants should build and use all of their relationships to put pressure on the plaintiff. This is easier when the plaintiff is an operating company. For instance, if an injunction will adversely affect Chinese government-owned entities, enlist the assistance of those entities. Also enlist the support of major private companies which would bear any loss based on the plaintiff's success.

However, be aware that the plaintiff may try to do the same. For example, if the defendant is a supplier to Company A and the market includes several alternative suppliers, the plaintiff might try to cause a rift in the business relationship between Company A and the defendant and leverage the possibility of Company A finding a new supplier. Creativity and common sense control the ability to create leverage on behalf of both the plaintiff and defendant.

action for unfair competition or an antitrust allegation, directs the court's ire towards the other side.

However, bear in mind that this also works for patentees. Consider, for example, a scenario in which the parties have been in licensing discussions for an extended period and the patentee has previously successfully licensed the patent to a number of parties, which have paid 5% or more. However, the defendant in the litigation has consistently said that it will pay no more than 1%. Making a public offer to the defendant of between 2% and 4% would likely steer the court's favour to the patent owner as being fair and the accused infringer as being unreasonable.

Administrative actions versus civil litigation

Article 60 of the Patent Law provides that if a patent dispute arises, a party may bring either a civil case or an administrative case. In China, patentees can initiate administrative actions against an infringer through SIPO. Generally, the SIPO office closest to the infringer's premises has jurisdiction.

The chief advantages of administrative actions compared to civil litigation are that:

- they cost less;
- they are quicker; and
- the administrative agency may act on less evidence than a court would and sometimes accepts evidence that would be inadmissible in court.

However, the chief disadvantages of administrative proceedings are that:

- monetary damages are not allowed;
- the relevant administrative agencies have discretion over whether to take on a case and are generally unwilling to do so if the case requires anything other than a straightforward interpretation of the law; and
- the result can be appealed to a people's court, so the case often ends up in court in any event.

Although the odds are stacked against a defendant in Chinese patent litigation, there are steps that can be taken to maximise the chance of success. You may not beat Jordan, but you will not lose by 50 points either. *iam*

Erick Robinson is chief patent counsel, Asia-Pacific at Rouse, Beijing, China

Disclaimers

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Action plan

China offers strong remedies to patent plaintiffs, but an effective defence is possible. Pointers for this include the following:

- Slow things down – unlike in the United States, the defendant cannot be granted additional time to respond to a complaint. However, a variety of tactics can be used to extend proceedings and create time for you to negotiate.
- Challenge validity – litigation will not be stayed pending the Patent Re-examination Board's decision, but you can use the validity challenge as a bargaining chip.
- Fight back in China – given the favourable situation for plaintiffs, it is one of the best ways to put pressure on your opponent.
- Consider the antitrust route – China's competition regulators are a force to be reckoned with and non-practising entities are particularly vulnerable to this tactic.
- Be a friend to China – this overriding imperative means that you should seek to show how an injunction for your opponent might cause harm to Chinese companies or consumers.