A question of strategy

There is more to dispute resolution in China than meets the eye. By making strategic choices, foreign businesses can maximise their chances of winning anti-monopoly and IP disputes

Foreign businesses and their legal advisers often discuss how to weigh different dispute resolution methods such as mediation, arbitration and litigation to better protect their interests in China. They seem to have little understanding of other important options such as administrative review and administrative litigation, let alone considering carefully how these options could be used strategically to handle anti-monopoly and intellectual property issues.

Anti-monopoly disputes

The implications of this issue for anti-monopoly disputes are significant, as reflected in Article 53 of the 2007 *PRC Anti-monopoly Law* (中华人民共和国反垄断法) (AML). The provision stipulates, among other things, that if a business operator is dissatisfied with a decision made by agencies in charge of investigating monopolistic acts such as "monopoly agreements reached between business operators" and "abuse of dominant market position by business operators", the business operator "may apply for administrative review or lodge an administrative lawsuit according to law [author's note: this means administrative litigation]". After the AML was enacted, it became clear that the industry and commerce authorities in China are responsible for investigating these two types of monopolistic acts (see, for example, *Provisions for the Prohibition by Administrations for Industry and Commerce of Acts of Monopolistic Agreements* (工商行政管理机关禁止垄断协议行为的规定) and *Provisions for the Prohibition by Administrations for Industry and Commerce of Acts of Abuse of Dominant Market Position* (工商行政管理机关禁止滥用市场支配地位行为的规定)).

Consider a hypothetical situation. A local administration of industry and commerce in Shanghai determines that a business operator in the city has abused its dominant market position. Pursuant to Article 47 of the AML, it orders the business operator to stop such violations, confiscates its illegal gains, and imposes a fine of up to 10% of the total sales volume made in the previous year. The business operator wants to challenge this decision. What can it do?

Pfizer won its patent dispute in China largely thanks to an understanding of judicial dynamics

According to Article 53 of the AML, the business operator has two choices. It may choose to take the case to a Shanghai court with the jurisdiction to review the decision made by the local administration of industry and commerce. When the court handles the case, it is required by the *PRC Administrative Litigation Law* of 1989 (中华人民共和国行政诉讼法) to examine the legality of the agency's decision and then, depending on the legality of the decision, rule to uphold or revoke the decision. Alternatively, the business operator may apply for administrative review. This means that the operator may ask the authority ranked, in accordance with China's administrative system, at the level immediately above the local administration of industry and commerce to review the agency's decision (see the *PRC Administrative Review Law* of 1999 (中华人民共和国行政复议法)).

How can the business operator make a strategic choice between administrative litigation and administrative review to optimise its interests? In general, administrative review is preferred for two reasons. First, unlike the Administrative Litigation Law, the Administrative Review Law authorises the offices in charge of administrative review to review not only the legality of a decision made by an agency but also the appropriateness of that decision. This broader scope of review could be very helpful to the party that challenges the agency's decision. For instance, a certain legal provision authorises an agency to make Decision X, Decision Y or Decision Z under certain circumstances. The agency makes Decision X, but the affected party believes that Decision Z is more appropriate. If the party challenges the decision through administrative litigation, the court cannot rule in favour of the party because Decision X, however inappropriate it may be, is legal and cannot be revoked. But if the party challenges the agency's decision through administrative review, the administrative review office can rule that Decision X is inappropriate and urge the agency to make Decision Z instead.

Judges are outside the administrative system and have been struggling to command more respect from government officials

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The different scope of review in the administrative litigation and administrative review processes reflects the political reality in China considered, and the compromises made thereby, when the laws on these processes were enacted. Overall, administrative agencies in China are more receptive to being corrected by administrative authorities ranked above them than being formally held to be wrong by judges, who are outside the administrative system and have been struggling to command more respect from government officials.

The second reason for choosing administrative review instead of administrative litigation is rooted in an understanding of the mentality of government officials. In general, government officials dislike being sued and identified as defendants in administrative cases, as the very mention of the word "defendants" reminds them of those in criminal cases with whom they do not want to have any association. Nor, as explained above, do these officials want to be challenged by judges, whose status in China's political system is still below that of officials at the corresponding level. In light of these considerations, why would a business operator risk making the local industry and commerce authority lose face? After all, the same authority will likely be in a position to decide whether the operator's business licence should be renewed or whether the operator's applications for launching other business projects should be approved.

The Hung Cheong case

In practice, businesses choosing administrative litigation may encounter additional challenges, as best illustrated by the seven-year *Hung Cheong* case, where a Thai-Chinese developer based in Bangkok was eventually ousted by his Chinese partners in the 1990s. In this case, the developer agreed to contribute capital to develop a 65-storey office building in Shenzhen, while his Chinese partners agreed to offer their rights to use the land on which the building would be built. Subsequently, the Thai-Chinese developer invited a Hong Kong developer to jointly contribute capital to the project. The Hong Kong developer contributed the agreed amount but the Thai-Chinese developer failed, claiming that his agreement with the Hong Kong developer was invalid. Arbitration was then conducted and the agreement in dispute was determined to be valid. The Thai-Chinese developer ignored the arbitration ruling and disappeared, leaving the project in limbo.

Desperate to continue the project, the Hong Kong developer and the Chinese partners sought assistance from the authorities in Shenzhen, which decided to first dissolve the original joint venture established by the Thai-Chinese and the Chinese partners. Those Shenzhen authorities proceeded to register the new joint venture formed by the Hong Kong developer and the Chinese partners. Infuriated by this arrangement, the Thai-Chinese developer sued, challenging through administrative litigation the legality of the acts taken by the Shenzhen authorities. The Guangdong Higher People's Court was the court of first instance and held that the Shenzhen authorities' acts should be revoked because they were not carried out in accordance with legal procedures. The case was subsequently appealed to the Supreme People's Court, which upheld the Guangdong Higher People's Court's decision in July 1998.

This final judgment made by the highest court in China was, however, not enforced until the Thai and Chinese national governments intervened to handle the dispute diplomatically. In September 1999, arbitration was conducted, in which the Chinese partners exercised their rights stated in their agreement with the Thai-Chinese developer to ask to end their collaboration with him. This request was allowed in July 2000 and the Shenzhen authorities finally dissolved the original joint venture in accordance with legal procedures.

Additional considerations for IP disputes

The above analysis seems to suggest that administrative litigation should be avoided. But is this necessarily true in the context of handling patent invalidation proceedings? An important case that should be examined is the *Viagra* case. Pfizer received a patent on Viagra from China's authorities. Pfizer's competitors in China, however, asked the Patent Re-examination Board to review the validity of the patent. In 2004, the Board invalidated Pfizer's patent. According to law, Pfizer could take the case to the Beijing No 1 Intermediate Court to challenge the Board's decision through administrative litigation. If Pfizer or the Board was dissatisfied with the court's judgment, either party could appeal to the Beijing High Court. Should Pfizer sue the Board? In fact, should foreign businesses in Pfizer's position bring a lawsuit against the Board?

In every court in China, any "major and complicated" case is ultimately decided by the adjudication committee instead of the judges presiding over the case

The chance of Pfizer winning was, actually, quite low. Since 2003, the author has been conducting quantitative analysis of patent invalidation cases made available by the Beijing courts (which have the sole jurisdiction to handle these cases). Of the 650 first instance cases published and analysed so far, approximately 76% are cases in which the Beijing No 1 Intermediate Court upheld the Board's decisions. Of the 570 appeal cases published and analysed, approximately 80% are cases in which the Beijing High Court upheld Beijing No 1 Intermediate Court's rulings (see *Patent Invalidation Disputes in China: Some Trends and Strategies*, presented at the 12th Annual Silicon Valley Advanced Patent Law, December 9 2011).

Defying all the odds against it, Pfizer sued the Board and won in the Beijing No 1 Intermediate Court and the Beijing High Court. The secret of Pfizer's success largely lies in a good understanding of judicial dynamics in China and a strategic use of the media. In every court in China, any "major and complicated" case is ultimately decided by the adjudication committee of the court, instead of the judges presiding over the case. The adjudication committee, which consists of leaders of the court such as the president, the vice-presidents, and the chief judges of each tribunal, is subject to the supervision of the Chinese Communist Party's legal and political committee at the corresponding level. Intriguingly, if the foreign businesses involved in major and complicated cases handle the situations well, such a mechanism that lacks judicial independence by Western standards might become a driving force for achieving outcomes that favour foreign businesses.

To this end, foreign businesses need to understand what major and complicated cases are. Unfortunately, there is no clear definition of this term. But based on the author's interviews with judges and other legal experts, they are generally cases of which the final judgments will likely have significant impact on society. An example is a case that will capture a lot of attention from the media inside and outside of China, primarily because a party to the case is a multinational company that knows how to strategically use the media. For this reason, the adjudication committee involved must handle the case carefully and, sometimes, the legal and political committee at the corresponding level may step in to give specific instructions to the adjudication committee.

When China's Patent Re-examination Board invalidated Pfizer's Viagra patent, the media around the world reported the story, resulting in widespread concerns from foreign businesses, especially those who were holders of Chinese patents. A series of questions were raised. Would China's courts ultimately revoke the Board's decision? How would the outcome of the case affect the business community's interest in investing in China and, more importantly, foreign innovators' interest in sharing their technology know-how in China? Increased concerns about intellectual property rights protection in China would not bode well for China's plan to turn the country into a more innovative country. All of these considerations were likely taken into account and the case was, therefore, likely considered to be a major and complicated case. As a result, the adjudication committees of the Beijing No 1 Intermediate Court and the Beijing High Court, as well as the corresponding legal and political committees were likely involved in the final decision-making process to ensure that the judgments would be in favour of Pfizer and that a positive signal could be sent to the business community and foreign innovators. With this in mind, one should, therefore, not be surprised that the Beijing No 1 Intermediate Court revoked the Board's decision and, subsequently, the Beijing High Court upheld the lower court's ruling.

Lessons for foreign businesses

The above comparison of administrative review and administrative litigation, as well as discussion of how these options could be used strategically to handle anti-monopoly and intellectual property issues lead to important lessons for foreign businesses and their legal advisers. They should bear in mind that although there are still limitations in the Chinese legal system, favourable outcomes can be achieved if, when they handle their specific cases, they carefully analyse what their cases are about and who they are in the eyes of Chinese leaders. This analysis, together with a deep understanding of the judicial, legal, political and social cultures in China, will help them optimise their gains in China. As always, those who are better prepared win.

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