

A Look At Chinese Courts' New Approach To IP Damages

By **Fei Deng, Yi Cheng and Hong Qiao** (February 11, 2022, 5:07 PM EST)

U.S. companies doing business in China are well-served by staying abreast of changes in the Chinese litigation landscape.

In the area of intellectual property infringement litigation, Chinese courts increasingly have been eschewing statutory damages and instead awarding nonstatutory damages, for example, for unjust enrichment, which in turn has created a trend toward larger awards.

For example, in February 2021, in *Jiaxing Zhonghua Chemical Co. Ltd. v. Wanglong Group Co. Ltd.*, the Supreme People's Court awarded RMB 156 million — approximately \$25 million — to a Chinese vanillin maker for stealing another Chinese company's technical secrets; this was the highest damage award in the history of trade secret litigation in China.[1]

This article discusses trends and analyzes recent judgments issued by Chinese courts in which plaintiffs received sizable nonstatutory damages awards.

Given that not all judgments involve U.S. companies and may not have drawn much attention from the U.S. media, understanding the methodologies, analyses and types of evidence accepted by Chinese courts in these judgments can help U.S. companies better position themselves to address IP infringement litigation in China.

After all, seeking compensation for past infringement should be an important and integral part of U.S. companies' IP strategies, as long as the level of potential compensation justifies the costs involved in presenting a more complex litigation case than would be required merely to obtain an injunction.

Legislative Developments Facilitating Evidence-Based Damage Calculations

Since 2019, China has implemented a series of legislative revisions that have raised the ceiling for damage awards, including increasing the upper bound for statutory damages to RMB 5 million — approximately \$800,000 — expanding the application of punitive damages from trademark to all types of intellectual property rights and increasing the multiplier for punitive damages from up to three to up to five.



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Chinese courts also recently rolled out various measures that facilitate the calculation of nonstatutory damages, including provisions that enhance evidence discovery.

Along with the legislative developments, we have observed a shifting trend away from the traditional default reliance on statutory damage awards, which tend to be relatively small, and toward nonstatutory damage awards, which with enough evidentiary support can result in figures that substantially exceed the legislatively set upper bound on statutory damages.

According to an empirical study, 94.4% of patent infringement cases adjudicated by Chinese courts between 2014 and 2018 were awarded statutory damages, albeit with an average amount less than one-tenth of that of those awarded nonstatutory damages.[2]

Although complete data for cases adjudicated since 2019 is not yet available, based on our collection of published IP infringement judgments, there has been an increasing number of nonstatutory large damage awards issued by Chinese courts. The number of judgments with adjudicated damage awards equal to or above RMB 10 million, approximately \$1.6 million, twice the amount of the upper bound of statutory damage, increased from around five to 10 per year between 2015-2018, to at least 15 to 20 per year from 2019-2021.[3]

How Chinese Courts Calculated Damages in Recent High Damage Award IP Infringement Cases and What Future Litigants Can Learn From Them

Based on analysis of the 56 judgments in 47 cases we have collected in which the Chinese courts awarded damages equal to or above RMB 10 million — approximately \$1.6 million — during 2019 to 2021, we discuss the trends in how Chinese courts calculate damages and provide advice on what future litigants can do to better prepare their IP rights infringement damage arguments in China.[4]

Frequent Reliance on Infringer's Unjust Enrichment and Flexible Choice of Methodology

In the U.S., there are differences among types of IP in the way damages are calculated. For example, unjust enrichment may be sought in copyright infringement cases, but not in patent infringement cases.

In China, however, relevant laws and regulations stipulate that compensatory damages for infringement of all types of IP rights including patents may be calculated based on (1) the right holder's actual loss, (2) the infringer's unjust enrichment from the infringing activities, or (3) a reasonable multiplier of existing royalties, and if none of the above can be calculated, (4) statutory damages of up to RMB 5 million.

Both our own study and past research[5] show that the most frequently adopted nonstatutory methods are, in decreasing order, the infringer's unjust enrichment, a reasonable multiplier of existing royalties, and the right holder's actual loss. Adoption of the lost profits is likely hindered by the difficulties in establishing causality and constructing the "but-for" world used to calculate lost profits.

Chinese law allows for the adoption of more than one method in a given case.

For example, in the September 2021 *New Balance Inc. v. Putian Shengfengsheng Shoes* decision in the Jiangsu High People's Court, a trademark infringement case brought by New Balance against a few Chinese firms manufacturing or selling athletic shoes marked "new bairin," the court accepted both sets of the plaintiff's damage calculations arriving at similar amounts.

One was based on the plaintiff's own loss and the other based on the infringer's unjust enrichment, and the court awarded the full claimed damage amount of RMB 18 million — approximately \$2.9 million.[6]

However, when different methods arrive at drastically different amounts, the plaintiff may face an upward battle to convince the court to adopt the higher amount, especially if the higher amount is based on an estimated actual loss.

In the aforementioned Jiaxing Zhonghua v. Wanglong trade secret case involving the making of vanillin, the plaintiff's economic expert calculated the actual loss based on price erosion, which resulted in more than five times the amount calculated based on the infringer's unjust enrichment.[7]

Although the court acknowledged there was indeed a price erosion due to the infringement, it did not adopt the plaintiff's price erosion calculation due to "limitations of the data and method used" and instead calculated the final damages award based on the infringer's unjust enrichment.

U.S. companies and their legal advisors should be aware of Chinese courts' frequent reliance on the infringer's unjust enrichment as a measure of damages, while at the same time recognizing that other methodologies are available. Litigants should present their results using multiple methodologies, as much as they can when appropriate, to strengthen their litigation position.

Based on our experience and supported by what we have observed from the judgments, Chinese courts are more likely to accept a damage claim if the amount is supported by multiple methodologies. Therefore, putting forward calculations based on multiple methodologies can be helpful in increasing the litigant's chance of getting the claimed amount awarded.

Enhanced Discovery and Flexible Utilization of Alternative Data and Evidence

Although still not to the level of U.S. discovery, Chinese courts have in recent years implemented various procedural rules enhancing evidence discovery, allowing courts to issue orders seeking evidence production and to adopt the rightsholder's proposed alternative data and evidence if the infringer refuses to submit its accounting records or sales data.

In practice, when the infringer refuses to submit financial information, Chinese courts have indeed adopted alternative data and evidence proposed by the rightsholder. For sales data, Chinese courts have accepted evidence collected through online sales platforms and third-party industry reports, information disclosed by the infringer publicly in venues such as its website, annual reports and IPO prospectus.

Chinese courts may even obtain data produced from a government department—for example, in the June 2021 Contemporary Amperex Technology Co. Ltd. v. Jiangsu Tafel New Energy Technology Inc. decision, at the plaintiff's request, the Fujian High Court requested and obtained data related to the defendant's sales from the Ministry of Industry and Information Technology.[8]

As for the profit measure, relevant regulations stipulate that the infringer's operating profit margin for the infringing products should be applied when determining the infringer's unjust enrichment, but if the infringer solely engaged in the business of infringement, sales profits can be applied. [9]

In practice, courts generally follow the above principle.

In addition, although the profit measure is supposed to be specific to the infringing products, in practice, the companywide profit margin of the infringer is often applied due to a lack of accurate product-specific profit margin data. And when the infringer refuses to submit relevant evidence to calculate its own profit margin, courts have adopted alternative data proposed by the rightsholder, such as the average profit margin of other firms in the industry,[10][11] or even that of the rightsholder.[12][13]

U.S. companies and their counsel should take full advantage of Chinese courts' enhanced discovery process and the courts' willingness to make adverse inferences when the other party refuses to submit its own data. China's highly digital economy makes it easier than ever to obtain relevant data and evidence on sales and profits from third-party sources, even when the counterparty does not produce data.

Also, U.S. companies and their counsel should not shy away from requesting that a Chinese court issue an order to obtain data from other government departments such as the relevant industry administrative departments and the tax authorities. History has shown that such requests may be granted, and it is not surprising that data obtained through such a channel can be deemed by Chinese courts to be more authoritative and thus more reliable than data obtained from other sources.

Preliminary Attempt on Value-Based Apportionment

In China, for any type of IP rights except for standard-essential patents, injunctions are issued by default once infringement is established — there is no Chinese equivalent to the rule derived from the 2006 U.S. Supreme Court *eBay Inc. v. MercExchange LLC* decision. While apportionment is legislatively required, it has traditionally been roughly estimated based on qualitative evidence rather than on a rigorous quantitative analysis.

Among the 47 cases for which we collected information, there are 14 cases in which an apportionment percentage was specifically determined by the court, ranging from 5% to 51%, with an average of 29.5%.[14] Adopted methods for apportionment include:

Qualitative Analysis

There are 10 cases in which the court calibrated the apportionment value based on qualitative analyses, without specifying how quantitatively such a value was calculated.

For example, in the May 2020 *ActionSoft Science and Technology Development Co. Inc. v. Sinnet Technology Co. Ltd. and Amazon Connect Technology Services (Beijing) Co., Ltd.* decision, the Beijing High Court determined that the majority of the defendant's profits could be attributed to defendant's technology, service and sales efforts.

And only 5% of the profits was attributable to the infringed "AWS" trademark, considering the infringer's use of other noninfringed trademarks and based on a qualitative evaluation of factors such as the duration and scale of infringement.[15]

Numerical Share

There are three cases in which the court estimated the apportionment value based on the numerical share of certain measures.

For example, in the October 2020 Hangzhou NetEase Thunderfire Technology v. Guangzhou Sifeng Information Technology Co. Ltd. decision, while the first instance court did not apply any apportionment percentage, the Guangzhou IP Court determined an apportionment value of 13% as the contribution of the infringed copyright to the infringer's profits, calculated as the number of game elements — such as characters, tasks and graphic settings — infringed divided by the total number of game elements in the infringer's game.[16]

Economic Analysis of Value Contribution of Infringed IP rights

There is only one case in which the court estimated the apportionment based on economic analysis of the value contribution of the infringed IP rights.

In the December 2021 Aux Air Conditioning Co. Ltd. v. Zhuhai Gree Electric Appliances Co. Ltd. decision, the Ningbo Intermediate Court determined 20% to be the appropriate apportionment to the patent in suit.

This was based on consideration of various factors, including a hedonic regression analysis put forward by the plaintiffs' economic expert resulting in 29.26% as the value contribution of the patent in suit to the infringed products, a survey of previous judgments' adopted apportionment values ranging from 28.7% to 81.97% with an average of 56.79%, and a comparison of the quality and value of the patent in suit with patents in these previous judgments.[17]

As observed above, while Chinese courts have started to grapple with apportionment to the product feature covered by the infringed right, it is less common to find an assessment of noninfringing alternatives. The incremental value of the infringed right is the extra value it provides in the infringing product compared to what could have been achieved by the defendant in the but-for world in which it used the next best noninfringing alternative.

Rigorous analysis to determine the incremental value of the infringed right over noninfringing alternatives is still lacking, even though this type of analysis is encouraged by Chinese courts.[18] This is not surprising, given that correctly done apportionment requires a complex analysis — even in the U.S., there had been a long history of relying on the 25% rule of thumb before the U.S. Court of Appeals for the Federal Circuit rejected it in the 2011 Uniloc USA Inc. v. Microsoft Corp. decision.

Companies involved in U.S. IP litigation have experience making arguments for and against noninfringing alternatives, including experience with the art and skill of designing and integrating technical and economic analyses in a rigorous and convincing way. Such companies and their legal advisors can leverage this experience to their advantage when involved in IP litigation in China.

Advancement in Punitive Damages

Similar to the U.S. practice but perhaps with a wider application to all types of IP rights across the country, in China, IP rightsholders may seek punitive damages in addition to compensatory damages for intentional and serious infringement.

Since 2019, there has been a series of important legislative developments in China pertaining to punitive damages, including expanding the application of punitive damages beyond trademark to trade secrets, since April 23, 2019, and patent and copyright, since June 1, 2021, and increasing the multiplier for

punitive damages from up to three to up to five.

Along with the legislative developments, the number of trademark infringement cases awarding punitive damages leaped from two annually between 2017 and 2019, to eight in 2020.[19] Chinese courts have also started to award punitive damages in other types of IP rights infringement cases — for example, in the November 2020 Guangzhou Tinci Materials Technology v. Anhui Newman Fine Chemicals Co. Ltd. decision, the Supreme People's Court first awarded punitive damages for trade secret misappropriation, and with the highest multiplier of five.[20]

Relevant laws and regulations stipulate that the base for punitive damages cannot be statutory damages, and since traditionally statutory damages were awarded in most cases, it is not surprising the total number of cases applying punitive damages was limited.

However, this trend is expected to change with the increasing application of nonstatutory damages. Seeking punitive damages is a worthwhile strategy for any company seeking monetary remedies for infringement of their IP rights in China, since the potential benefit is high — as much as five times the compensatory damages, and the additional cost is minimal, mainly to prove that the infringement was intentional and serious.

Conclusion

Equipped with enhanced discovery processes and the ability to award larger punitive damages, Chinese courts have adopted a variety of methodologies based on flexible use of data and evidence, including economic analyses, resulting in an increasing size and number of nonstatutory damages awards.

U.S. companies enforcing IP rights in China should take advantage of these recent changes in China's IP litigation landscape and strategize accordingly whether bringing or being the subject of litigation in China.

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[1] Jiaying Zhonghua Chemical v. Wanglong, Dispute Over Technical Secrets Infringement, Second Instance Civil Judgement by Sup. People's Ct., Feb. 19, 2021, (2020) Zui Gao Fa Zhi Min Zhong No. 1667.

[2] Renjun Bian, "Standards, Difficulties, and Redesigning of Rules of Patent Infringement Damages," Intellectual Property, Vol. 3, 2021, pp. 34-53.

[3] We have collected these high damage IP infringement judgements through the IP House database (<https://www.iphouse.cn/report/index.html>), and also from various other public websites through keyword search. Not all judgements may have been made publicly available, therefore these counts may be an underestimate of the actual number.

[4] When counting the number of "judgements," judgements from different stages of the same case

(e.g., first instance judgement, second instance judgement) are separately counted, instead of dropped as duplicates; while when counting the number of "cases," such judgements are counted as belonging to one case.

[5] See Bian 2021, fn2.

[6] New Balance v. Putian Shengfengsheng Shoes et al., Dispute Over Trademark Infringement and Unfair Competition, First Instance Civil Judgement by Suzhou Interm. People's Ct., Feb. 7, 2020, (2018) Su 05 Min Chu No. 1017; Second Instance Civil Judgement by Jiangsu High People's Ct., Sept. 23, 2021, (2020) Su Min Zhong No. 561.

[7] Jiaxing Zhonghua Chemical v. Wanglong, Dispute Over Technical Secrets Infringement, First Instance Civil Judgement by Zhejiang High People's Ct., April 24, 2020, (2018) Zhe Min Chu No. 25; Second Instance Civil Judgement by Sup. People's Ct., Feb. 19, 2021, (2020) Zui Gao Fa Zhi Min Zhong No. 1667.

[8] CATL v. Tafel, Dispute Over Patent Infringement, First Instance Civil Judgement by Fujian High People's Ct., June 15, 2021, (2020) Min Chu No. 1.

[9] In Chinese accounting terms, sales profit equals revenue minus sales costs and value-added tax (VAT), and operating profit equals sales profits minus additional operating expenses, such as administrative expenses and marketing costs, thus is less than the sales profit.

[10] Wyeth v. Guangzhou Wyeth Baby Maternal & Baby Products et al., Dispute Over Trademark Infringement and Unfair Competition, First Instance Civil Judgement by Hangzhou Interm. People's Ct., Dec. 25, 2020, (2019) Zhe 01 Min Chu No. 412; Second Instance Civil Judgement by Zhejiang High Court, April 26, 2021, (2021) Zhe Min Zhong No. 294.

[11] raumplus Besitz-und Entwicklungs-Gmb H & Co.KG et al. v. Delu Home et al., Dispute Over Trademark Infringement and Unfair Competition, First Instance Civil Judgement by Suzhou Interm. People's Ct., Oct. 26, 2021, (2020) Su 05 Min Chu No. 271.

[12] Zhonghua Chemical v. Wanglong, Dispute Over Technical Secrets Infringement, First Instance Civil Judgement by Zhejiang High People's Ct., April 24, 2020, (2018) Zhe Min Chu No. 25; Second Instance Civil Judgement by Sup. People's Ct., Feb. 19, 2021, (2020) Zui Gao Fa Zhi Min Zhong No. 1667.

[13] Zhejiang NHU Co. Ltd. v. Fujian Fukang Pharmaceutical Co., Ltd. et al., Dispute Over Technical Secrets Infringement, First Instance Civil Judgement by Zhejiang Shaoxing Interm. People's Ct., Jan. 18, 2017, (2014) Zhe Shao Zhi Chu Zi No. 500; Second Instance Civil Judgement by Zhejiang High People's Ct., May 21, 2018, (2017) Zhe Min Zhong No. 123; Retrial Civil Judgement by Jiangsu High People's Ct., Mar. 31, 2021, (2020) Su Min Zai No. 12.

[14] Among the 47 cases for which we collected information, there are three cases for which we obtained the summaries of courts' decisions from news and commentary articles but were not able to find any information regarding apportionment. For the other 30 cases, no quantitative calculation of apportionment was performed by the courts—in some cases the implied apportionment rates were 100%, in other cases the implied apportionment rates were less than 100% judging from the gap between the amount before any apportionment was applied (e.g., calculated directly from the infringer's profit) and the amount of the final damage award. The numerical values listed here are on a per-right basis (e.g., per patent).

[15] Beijing ActionSoft Science and Technology Development v. Beijing Sinnet Technology and Amazon Connect Technology Services (China), Dispute Over Trademark Infringement, First Instance Civil Judgement by Beijing High People's Ct., May 6, 2020, (2018) Jing Min Chu No. 127.

[16] Hangzhou NetEase Thunderfire Technology v. Guangzhou Sifeng Information Technology (formerly as Guangzhou Yuelang Network Technology), Dispute Over Copyright Infringement and Unfair Competition, First Instance Civil Judgement by Guangzhou Tianhe District People's Ct., June 30, 2017, (2016) Yue 0106 Min Chu No. 5333; Second Instance Civil Judgement by Guangzhou IP Ct., Oct. 16, 2020, (2017) Yue 73 Min Zhong No. 1094.

[17] Aux Air Conditioning v. Zhuhai Gree Electric Appliances and Others, Dispute Over Patent Infringement, First Instance Civil Judgement by Ningbo Interim People's Ct., Dec. 2, 2021, (2019) Zhe 02 Min Chu No. 165, 183. There are two case numbers, each one alleging a different infringing product, both based on the same patent. These two cases are currently on appeal.

[18] See Li Zhu, "An Economic Analysis for Apportionment Rule in calculating Patent Damages," Modern Law Science, Sept. 2017, Vol. 39 No. 5 pp. 54-62.

[19] Beijing Haidian District People's Court, "Research on the Application of Punitive Damages to Intellectual Property Rights Infringement," Dec. 2021.

[20] Guangzhou Tinci Materials Technology et al. v. Anhui Newman Fine Chemicals et al., Dispute Over Misappropriation of Technical Secrets, First Instance Civil Judgement by Guangzhou IP Ct., July 19, 2019, (2017) Yue 73 Min Chu No. 2163; Second Instance Civil Judgement by Sup. People's Ct., Nov. 24, 2020, (2019) Zui Gao Fa Zhi Min Zhong No. 562.