Interview with Christopher Stephens, Managing Partner – Asia Offices, Orrick, Herrington & Sutcliffe LLP – Hong Kong

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This interview was conducted with Christopher Stephens, managing partner of Orrick, Herrington & Sutcliffe's Asia offices with supporting responses from Xiang Wang, lead partner of the firm's IP pracitce as well as Patricia Thayer, life sciences specialist in IP litigation and counseling. Could you provide a brief introduction to Orrick, Herrington & Sutcliffe LLP's well established history here in China?

Christopher: Orrick as a firm has about 1,100 lawyers in 21 offices between North America, Europe and Asia. Our principal presence in Asia is in Tokyo, Hong Kong, Beijing, Shanghai and Taipei. We also run regional practices covering Korea and Vietnam out of our Hong Kong office. Our representation in the China market was launched in 2005 as a result of the demise of Coudert Brothers, a global law firm that had been in Hong Kong since 1972 and in mainland china since 1979. Coudert's China group, with its three offices, moved to Orrick. Orrick has since expended significantly, adding 70 lawyers to the China team, including a market-leading IP practice. We had always done 'soft' IP with technology transfer and trademark licensing as it was common among foreign law firms in China. Orrick has always had a global leading practice in IP law and since this is obviously important to the Chinese market we aggressively built out this practice here. While it took over a year, we were able to bring Xiang Wang and his team to Orrick in Beijing in 2006 and

have expanded that team since then. Our IP China-focused IP team includes a wide range of lawyers in the United States and in China, and advises foreign companies on their IP issues in China and Chinese companies on their IP issues outside of China. The Chinese companies are increasingly looking to protect their innovations as they expand their businesses and investments outside of China. Patricia Thayer joined us earlier this year from the circumstances of the collapse of the Heller Ehrman firm and her focus is specifically on pharmaceutical IP. As you know IP historically has been the domain of boutique firms with specialists existing in the narrow strata of people who had very unique backgrounds and education. It has become engrained as a fundamental, strategic topic for firms in many industries that law firms began buying up the boutique firms around 25 years ago. Orrick was among the first firms to see this trend coming so for many years it has been involved in expanding its IP capabilities globally. While we still do a great deal of soft IP, the focus has more recently been on the high-end, sophisticated work where the lawyer has to truly understand the science behind the designs they are defending. These are ‘bet the company’ kinds of issues because the stakes are enormous and if you lose them the consequences can be life threatening from a corporate perspective.The Chinese legal system has routinely been viewed with an eye of suspicion, especially by those in more developed markets who think it is bias against foreign entities.

Do you believe this stigma is warranted in any way and is it disappearing?

Christopher: Overall, the Chinese market is evolving as the country increasingly steps onto the world stage. In the wake of its accession to the WTO in December 2001, China has amended more than 2000 laws to accommodate the WTO’s requirements and to better integrate with the world standard. As they modernize and develop their own technology, they are gaining an interest in protecting the corresponding IP rights. This isn’t unique to China: If you bought a book or pamphlet 250 years ago on the streets of Philadelphia or New York, it would have been a pirated version of the European original. It was only when the US began to develop its own poetry and literature IP that there was any interest in creating the appropriate laws to protect it. China now has some skin in the game and is eager to protect its rights. China recently overtook Germany in the global ranking of patent applications to become the fifth largest source of filings, and has overtaken Japan as the world’s second largest spender on R&D. Currently, however, the development of technology in China is still driven largely by foreign investment and China needs to be able to show multinationals that it can protect their IP in order to attract more of it. Xiang: China is a leading manufacturer of commercial goods but when it comes to pharmaceuticals it still falls way behind. As you may know, the Chinese government has a very strong national IP policy and the pharmaceutical and life science sectors are the two the government pays high attention to. For

historical reasons, China today has more than 6000 pharmaceutical companies, which is more than many other countries combined, yet 97% of these companies are focused on making generics, the definition of which is very controversial. This means only 3% make R&D-based product which is a drastically different picture than the U.S. and many European countries. However, the Chinese government today pays a lot of attention and invests a lot of money into these sectors, therefore, soon China will likely change the current composition of the market. They have also created over 100 industrial parks solely for this industry which they have named ‘drug valleys’ in reference to California’s Silicon Valley. While the numbers are still low, the Chinese government is investing a lot of money to change this picture so I would not be surprised if in the next five years there will be a lot more companies in this sector coming out with new products and filing more patents. In the past two years, the number of new drugs actually dropped because the government revoked more than 6000 previous registrations. As you have likely heard, the former head of the SFDA was executed because he was found to be approving many drugs that had not gone through rigorous trials and whose files were comprised of fake data. The entire framework for the industry is under transition since the directors at fault were all arrested and sentenced to prison terms. Patricia: I began my focus on patent prosecution and litigation in the pharmaceutical, biotechnology industry in 1984 and at that time it was an absolutely accepted practice not to file a patent in China. There was little or no pharmaceutical commerce at the time and little other reason to look for patent protection outside of Europe and North America. This is very different to the scenario if you jump forward to today. I attended a conference last week in Shanghai where Lilly, Wyeth, Takeda, Roche and other pharmaceutical giants were there to discuss not only outsourcing manufacturing but R&D as well.

If you are a country that does not respect IP why would a pharmaceutical company come in to do research in your nation?

For this industry, IP is the most important protector of a company’s value and the potential for recovering the enormous cost associated with developing a new drug. If you cannot protect your IP you cannot survive as a business. Many things have happened since 1984 but one of the more notable is a much more robust IP protection regime in China. We have seen the transition from companies solely relying on courts in the US for protection to now enforcing their rights here in China. Over this same period I have seen a shift from China being a solely manufacturing site to being a truly innovative location. When you go from making something for somebody else to creating your own technologies, of course you are going to become far more knowledgeable and invested in protecting those innovations.While previously it was necessary to have partnerships with local companies in order to for foreign companies to be present in the market this is no longer

the case and it is possible to be a stand alone enterprise in China. Thus many companies are dissolving their partnerships either for different reasons in culture, mentality or goals and moving into independent operations. As a result of these breakups there have been difficulties in agreeing on rights to IP that was produced over the collaborative period.

What would you say is the best way to protect the IP that is developed with a local company and untangle these issues?

Christopher: Step number one is to hire an experienced lawyer because these issues are typically poorly handled at the time these companies enter China. This is not limited to the pharmaceutical sector but rather these mistakes are made throughout industry. Before the WTO agreements in 2001, joint venture was the only way most manufacturers could get into China. There was no domestic market to speak of because foreigners weren't permitted access to local markets, and there was no one to buy here anyway. It was only after the WTO phased in that the Chinese market opened to goods and services that had formerly been made under joint ventures and exported out of the country. Thus the WTO accession marked the first time most companies could enter China, manufacture goods, and then distribute domestically. It also changed the rules for incorporation, and joint ventures were no longer necessary for business, so many of the legacy joint ventures exist today because that was their only way into the market back in the 1990s. At the same time, because of the enormous wealth being created here, a burgeoning middleclass has arisen with hundreds of millions of people with meaningful levels of disposable income for the first time in China's long history. As a result, the demand for healthcare and pharmaceutical products is exploding. This is why there are 6000 pharmaceutical companies that are mainly producing generic goods with a lot of IP piracy in the market. If you were entering the market now, a wholly foreign-owned vehicle is likely the best way to control and protect your IP.Xiang: There are some interesting phenomenons going on in China at the moment. For example, many multinational companies used to only want IP owned by the parent company but when it comes to R&D for pharmaceuticals many are now outsourcing their operations on a global level. Every company involved in this process in the Chinese market is running into the same hurdle. However, they are not sure if their IP developed under collaboration will be protected in China. Last week while discussing this topic at the conference in Shanghai, a multinational company's general counsel was asked by a member of the audience,

"What do you think you are getting by doing R&D in China?"

His answer was, 'not much at all really.' This is because they do not put their real core IP here because they don't feel like they could protect in this environment. In fact their main argument

was that they were here for policy reasons and tax advantages. For instance, if you file a foreign patent in the market here the government might reimburse you with a 30,000 RMB refund. However, there are several traps that companies can fall into here. One is to use your IP as investment capital and reduce your tax impact but once you do this you cannot gain back your IP because it is indivisible, thus a 1% share holder is just as good as 99%. Of course, this policy is very much encouraged by the government here even though it is an unwise move for IP owner entrants. Secondly, when a company does research in China or outsources to a local firm, there is an issue in relation to IP as to who actually owns the rights to improvement. This is because under Chinese law, whoever makes the improvement shall own the improvement which is why many multinational companies will often have contracts stating the improvements belong to them but the law here prevents them from doing this. Obviously, these create a lot of practical issues when coming to the market here and there are practical ways to deal with them but if you are not well informed, you will be caught by surprise. Foreign companies have to really examine the market before making their decisions because you have to take the right steps for your operations. Take, for example, the difference between joint ventures and wholly foreign owned enterprises, to many it seemed like a good idea to close out of their previous collaborations and begin independent operations but many have found despite their investments they are getting less business. The speculation is that because of the lack of any Chinese party involved, therefore there is less incentive for others to engage in business. Thus you have to be careful to explore all options before coming to a decision.Patricia: When you're talking about pharmaceutical and biotech inventions and doing research for modifying pre-existing technology, it can be difficult to discern who are the one or four people that are the correct inventors. Patent lawyers across the globe can study very hard and still make a mistake as to who exactly gave what contribution. One way to avoid this hassle within a corporation is to have all involved employees assign rights so that if there has been a mistake it can be corrected without fanfare. If you cannot by contract override the debate about the true inventor and where the rights reside, then it creates an uncertainty in IP rights that is intolerable in this industry. This was a heavy concern for multinational companies at the latest conference on R&D outsourcing because they cannot afford a situation where the rights are in question. Xiang: This is a critical issue that China is not very good at addressing yet. Theoretically, when it comes to invention in China, inventors are limited to only those that actually participated in the project, namely, made the invention. However, it is often the case that people will get their names on a patent because they either paid for the research or were leaders of the team. Although this has been challenged, this has not happened enough yet to become a real issue in the eyes of lawmakers. Some companies have been willing to come to China to do some of their research and

while some have been successful others have had disasters.

What can Orrick and other law firms do on the IP front to distinguish companies as a winner rather than a loser when they try to do their research in the Chinese market?

Xiang: Whether or not a company in this industry is successful in China has a lot to do with the operations they bring here. Very few of our clients are looking to bring their core IP to China, whether it's original R&D or more frequently improvements. There are several things that companies should do. First and foremost, they should have their employees assign IP rights to employers, this is true especially in joint ventures scenarios, so that it is clear that IP rights are owned by the employers. Another typical mistake is that many have thought that because someone works for them, therefore there is adequate consideration for non-compete and non-disclosure obligations which is not the case in the Chinese market. Therefore, the employees can compete freely and disclose confidential information so you have to ensure they sign non-compete and non-disclosure waivers. Christopher: The better companies are sensitive to the market risks and adjust better to the differing legal landscape.Patricia: These deals rely, first and foremost, on business people so you must rely on them to have done their homework on the businesses and companies they wish to get involved with. Lawyers can really be more of a help than a hindrance in this enterprise by laying the groundwork for the protection of a company's IP. There is no way to do this right without first getting the proper agreements in place and that cannot happen without lawyers. This doesn't guarantee nothing will go wrong even with good documentation but there would be a lot less commerce without people like Chris and Xiang on the ground creating agreements that corral the activity and conform the party's expectations. There are a lot of multinationals facing patent cliffs in the US and looking for ways to get more life out of their portfolios in the Chinese market. Simultaneously, some are looking to make acquisitions in order to increase their own pipeline.

Could you speak to this activity in the market?

Patricia: I would suspect that the generic companies already present in the marketplace would be a step ahead, if not in-step with multinationals looking to bring older portfolio products to the market that have outlived patents. However, part of this is a regulatory consideration within the Chinese landscape which I cannot speak to because, of the many legal focuses in the pharmaceutical industry (IP, FDA regulatory and healthcare reimbursement), I concentrate on IP issues. As far as acquisitions are concerned, if you have a late stage product which has passed Phase I or II trials, then there is huge interest from large players. This is exemplified by Roche acquiring Genentech; it signals what is going on in big pharmaceuticals. Christopher: The M&A activity in this sector is

driven by a confluence of several trends which include the rising affluence and the burgeoning middle class which is growing in double digits annually. The government policy is geared towards broadening healthcare and making it more accessible, and all this arises in the context of a highly fragmented marketplace. Meanwhile, as big as this market is, China is only producing somewhere around 2% of the world's pharmaceuticals, so the room for further growth here is almost daunting. The industry has an enormous need for capital to fuel the necessary growth and advancing R&D, so there is a historic opportunity for investment. Private equity is a common source of funding because it is a popular precursor to the IPO to which every company in China aspires. Once they set their sights on going public, the private equity investors can come in with capital, management, know-how and technology, knowing that the exit is already lined up. Foreign and domestic health care related funds are entering this market, but few have the needed management know-how to evaluate the opportunities and assess the risks.

Can you provide any examples of successes you have seen in this sector of the industry?

Christopher: There are several investment funds on the drawing board but we are still in the midst of a global recession and fund-raising from institutional investors remains challenging. However, I think there is a perception that the pricing and opportunity are unique in the market so there are more companies getting their capital together in anticipation of deploying it early next year.

What will be the opening of gate that will push the market forward again?

Is there any moment that could signal the change of tide of investment or will it be a gradual transition?

Christopher: We had this debate within our own company just a few days ago on whether or not the recovery will be 'U' shaped or 'V' shaped. I think it will vary depending on the sector, so the real question is the timing and the location of the bottom, whether it is behind or still in front of us and when will it be clear to us. It will be in a short period of time, not years off.Many have said that the economy has not suffered as big a hit as some of the more developed regions of the world that were heavily involved in some more curious financing.

Do you think its true that Asia will rebound quicker?

Christopher: Unlike 1997, there is a lot more liquidity in Asia today. The Asian financial crisis of 1997 started in Asia and depleted most of the region's foreign currency reserves while world demand for products exported from Asia remained high. The crisis of 2008-2009 started in the U.S. and other developing countries, and world demand has plummeted but foreign exchange reserves

are at record levels in Asia. Fifteen years ago, all of the investment going on in the market would have had to come from either Europe or the US to match the same kind of opportunity present. China is clearly the most attractive venue for R&D investment in the region as it spends more than any European country or Japan and is only second to the US in total R&D expenditure. Several years ago China surpassed Germany in patent filings but interestingly more than 80% of those international filings are from foreign invested companies with a presence in China. This underpins the Chinese interest in continuing to attract foreign investment and support these industries because without it progress would be slower. As you know, China has long been known as the world's workshop but it now seeks to become a world-class technology superpower. The Chinese realize that their manufacturing advantage may have another 20 years left and that it will move on to locations like Bangladesh, Africa or South America in the long-term so they have begun to climb up the value chain. The government has made it their clear intention to move from a manufacturing to an innovation driven economy.

How are you positioning yourselves to help facilitate companies in this transition?

Christopher: We are a business just like any other business so we have to adjust our own strategy based on what we observe markets that affect our clients' strategies and their perception of the market. This is why we bring in people like Patricia and Xiang who can comfort clients that we are the best-equipped firm to advise them on the execution of their strategy and achieving their results.Patricia: It's no coincidence that Xiang and I are at this firm because Orrick is very focused on where the business opportunities are. When you're talking about life sciences and China there has to be a strong IP consideration. Thus we want to built a platform where our clients understand we can be there for them whether it's in China, the US or Europe because these issues will further globalize over time.Christopher: We go after specialists because we need their expertise to best fulfill our clients' requirements. You need to deeply understand the science that is behind the value proposition in order to figure out what the patent rights are and to understand the clients' strategy for deploying that technology commercially. Orrick decided to focus on this sector because of the opportunity and the relationships we have with our long standing clients. In order to best support them we need to be bigger and deeper in the areas that are important to them.

What is your vision for Orrick's Asia operations in the context of your global strategy?

Christopher: The group has to get bigger and there is a convergence of specialties in the market. As private equity becomes more popular and begins to fill the void left by cautious commercial banks, we need to ensure our team understands the risks so they can properly advise clients and work in closer communication with our IP team. Of course, our IP practice is not only doing litigation

but consultation as well which is a strategic piece to our offering in order to inform both companies and investors of their risks. This approach requires a large amount of collaboration and depth in our teams which is a challenge to find in any market. We require people with a solid background in sciences who then thought it was a good idea to go to law school afterwards. Patricia: One of the big draws to this firm for me is its approach to talent. When you're looking at the IP and regulatory issues, the best person may not be a lawyer but rather a molecular biologist. Orrick is not just searching for lawyers with engineering and business degrees; the firm brings in people with the right skills whether or not they are career lawyers. This is a great approach for the clients as well as our teams because you cannot always find someone who is both a tremendous chemical engineer and great trial lawyer. If you can bring the right talent together and work across borders in the way that our clients do, then you can get the results.We have seen that throughout the various sectors of the Chinese market whether that there is a 'talent war' going on as multinational companies expand their presence and domestic companies increasing in number.

How do you attract the top talent to come to China?

Christopher: You have to provide an attractive platform and be competitive in the functions people are looking for. It isn't just about the money and there are certainly people who are attracted to working in an international environment. There is an opportunity to work cross-border on complex transactions and disputes that are critically important to our clients. We are looking for a lot of different people and trying to give them a meaningful, competitive and rewarding career opportunity.

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