

Intellectual Property Enforcement in China: Challenges and Opportunities



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1. INTRODUCTION

There are multiple enforcement options available in China, including: administrative action, civil litigation, criminal prosecution, and customs border control.

While there is still a fair amount of criticism surrounding IP laws in China, in particular regarding enforcement, most IPR attorneys working in China report that the rules in place provide a good deal of protection.

The issue of IPR enforcement in China is often not one about the lack of choices, but how to effectively combine these enforcement options to make a strategy that works. The key to comprehensive IPR protection in China lies in understanding the enforcement options available, the weaknesses and strengths of each respective option, how the law is actually applied on the ground and how the relevant governmental authorities interpret and enforce the law. Additionally, due to the size of China and its rapidly developing economy and legal system, the difference between theory and practice may be quite large, especially in more removed areas or smaller cities and towns. Consequently, the formation of an efficient IPR enforcement plan requires a thorough understanding of how the different enforcement processes work.

This note is intended to provide guidance on some of the issues which companies need to consider when developing a strategy to enforce their IPR in China.

2. ADMINISTRATIVE ACTION

There are a wide variety of administrative agencies responsible for IPR in China. Internal rules and regulations can be place-specific, and it is always important to examine if there are options regarding which level or which agency can address the problem at hand. Generally, an IPR owner may file a complaint with relevant local enforcement authorities, for example:

- (i) The State Administration for Industry and Commerce ("SAIC") and its local branches regulate trade mark infringement and unfair competition acts;

- (ii) The local Quality and Technical Supervision Bureaus ("QTSB") under the State Administration of Quality Supervision, Inspection and Quarantine regulate inferior quality, substandard or fake products;
- (iii) The National Copyright Administration ("NCA") and its local offices regulate cases of copyright infringement; and
- (iv) The State Intellectual Property Office ("SIPO") and its local offices deal with patent infringement.

An administrative agency may accept a complaint falling within its scope of authority under relevant laws. Once a complaint is filed and accepted, it can take a range of actions, including visiting the infringer's premises; question the infringer; ordering the infringer to stop the infringing actions; inspecting and sealing or seizing the infringing goods; and/or taking away documents related to the infringing acts.

If, upon further investigation, infringement is proven, the agency can supervise and arrange destruction of all infringing products (sometimes also the tools and moulds for production of the goods) and impose a fine.

2.1 Advantages to Administrative Enforcement action

When dealing with counterfeit goods, administrative proceedings can advantages such as being relatively inexpensive; and ensuring quick action.

Another benefit of working with the governmental authorities is that penalty decisions issued by them may later be admissible in court. These penalty decisions may often record details such as the identity of the infringer and number of infringing products seized, which help verifying the infringing act and determining the amount of damages. Information obtained during private investigations on the other hand, is of little evidential value and may sometimes be inadmissible.

Administrative enforcement is generally effective in getting identical counterfeits off the market.

2.2 Drawbacks to administrative enforcement actions

(a) Low Deterrent effect

Administrative actions often do not provide the most deterrent or long term effect.

Theoretically, some administrative agencies can impose a fine of up to 3 times the illegal turnover of the infringer. In practice, the fines imposed are generally low -- so low that many infringers consider paying administrative fines as a cost of doing business.

(b) Clear cut case

It is not uncommon to find that an administrative agency is only willing to accept clear-cut infringement cases such as when the infringer makes an exact copy of the IPR owner's trade mark and places the copied trade mark on the same goods as the IPR owner's genuine articles. As a real life example, an IPR owner held the trade mark "ABCDEF" all in capitals. Local AIC's in Shanghai and Beijing refused to take enforcement action against an infringer selling "Abcdef" counterfeit goods, claiming that the infringer's trade mark was not all capitals!

(c) Strict formalities

There is now a trend that governmental agencies are becoming more stringent when it comes to the formalities of the relevant documents. For example, in the past, they might have accepted and acted on a complaint signed by an agent on behalf of its client; now agencies require an original notarized and legalized Power of Attorney ("POA") from the IPR owner to the agent before they will agree to take action. Getting a POA notarized and legalized can often take weeks. Delays may ensue, especially if the IPR owner cannot find a Chinese Embassy in its locality to legalize the POA.

(d) Protectionism

Most commonly, the authorities handling an administrative action will be outside the major

one and two-tier cities, and may have unknown ties to the infringer within the community. Particularly in smaller counties or remote cities, local protectionism is still prevalent in China, as is corruption. A local level administrative agency may be reluctant to act in cases where local citizens are devoted to producing pirated goods or the infringer's closure may cause many people to lose jobs.

(e) Fraudulent raids

With more and more foreign companies doing business in China seeking to protect their IPR, a recent phenomenon has emerged -- that of fake raids. It is not uncommon for in-house counsel (or even outside attorneys) to receive unsolicited emails from "investigators" reporting a sighting of counterfeit products and quoting a per raid estimate. Unfortunately, some portion of these unsolicited sighting reports may be fraudulent.

If authorized to proceed, the investigators will "raid", and then produce a report, complete with pictures of the seized products. The investigators may even produce a Penalty Decision. Unless the IPR owner has people on the ground, it may even be difficult to determine if the Penalty Decision is indeed genuine.

2.3 ISSUES WITH EACH ADMINISTRATIVE AGENCY

(a) Quality and Technical Supervision Bureau (QTSB)

The QTSB's jurisdiction is quite limited, because its power stems from the Product Quality Law, which is not designed to tackle IPR issues but to protect consumers from products of inferior quality. A QTSB action is therefore recommended if the infringing product concerned contain misleading indications as to its quality, or its quality is so inferior that poses a risk to consumers.

(b) Administration for Industry and Commerce

The AIC accepts a broader spectrum of cases than the QTSB, including trade mark

infringement and unfair competition. The AIC also has a broader jurisdiction, and can take enforcement actions against factory premises as well as booths and store fronts.

(c) Intellectual Property Office (IPO)

IPOs do not have power to seize the infringing products (except for passing off patented products), but only to record inventory. Therefore, the IPO more often mediates an agreement between the infringer and the patent holder.

(d) Copyright Administration

It is usually difficult to get the local Copyright Administration to act unless the infringement is a nearly identical copy of the original copyrighted work, or if they deem that the 'public interest' - a very vague and undefined term - is affected.

On occasion, the local Copyright Administration may require a copyright owner to produce its copyright certification as a proof of ownership before agreeing to take on any enforcement action. Copyright registration is, however, optional in China. Many copyright owners who choose not to register their works may later on find themselves losing privilege to have their work protected by administrative means.

3. CIVIL LITIGATION

The courts retain the ability to issue preliminary and permanent injunctions, and to determine damages. Administrative authorities do not have the power to determine compensation. While the court system features four tiers (Basic People's Courts, Intermediate People's Courts, Higher People's Courts and the Supreme People's Court), most of the IPR related matters are handled starting at the second level (or Intermediate) People's Courts and can be appealed to the Higher People's Court for a hearing of second and final instance. Due to the large case load, an increasing number of Basic People's Courts (county and district level) are being authorized to handle different kinds of IPR litigation.

Historically, many foreign IPR owners have been reluctant to use the Chinese court system to enforce their IPR. However, a great deal of the former judges who were appointed simply because they previously held positions in the military or were well connected, have been retired. There are an increasing number of excellent judges, especially in Beijing, Shanghai, Shenzhen and China's other large cities.

3.1 ADVANTAGES OF CIVIL LITIGATION

Most straightforward cases, resolved in the first instance, require six months to a year. It is also much less expensive than litigation in the US or Europe.

Unlike administrative enforcement actions, Chinese courts can award damages to the IPR owner or relevant licensees, in addition to enjoining infringers. Plaintiffs in civil litigation may apply to the courts for interlocutory asset and evidence preservation orders. If they win the case, the courts have the jurisdiction to order infringers to publicize their apology in the media if a certain moral right is involved in this case. Such public apologies are effective in deterring other infringers in the market.

Chinese courts are also rapidly improving in regards to sophistication, especially in the area of IPR, where many courts have set up specialist panels of judges to hear IPR cases. As the sophistication of the Chinese courts increases, more and more IPR owners are willing to bring borderline or difficult cases, which an administrative agency would likely refuse to accept. Indeed, in many cases, civil litigation is the only option for an IPR owner who has tried to deal with the infringement problem through other means (such as administrative enforcement).

With the improved court system, the costs involved, the time taken and the likely outcome (with a strong case), there are little reasons for foreign IPR owners to shy away from suing infringers in the Chinese courts.

3.2 DRAWBACKS TO CIVIL LITIGATION

The largest obstacles are the lack of discovery, the "Best Evidence Rule" and the strict requirements on foreign documentation that the foreign IPR owner wishes to put forward as evidence.

Chinese courts strictly apply the "best evidence rule", meaning that the original documents must be submitted in order to be admissible. This is often a very difficult standard to meet for foreign IPR owners, as their original documents may be kept overseas. In order for evidence created in jurisdictions outside of China to be admitted into evidence, it has to be notarized, legalized, and translated unless it can be publicly obtained within mainland China. This process is not only cumbersome and time consuming, but can become quite expensive.

Typical methods of discovering evidence against an infringer include the following: (1) a petition to the Chinese court for evidence preservation; (2) for the IPR owner to collect original evidence from the infringer via independent investigations; or (3) for the IPR owner to petition the Chinese court to retrieve evidence from an authority after a successful enforcement action. Other drawbacks include:

(a) Evidence Preservation Orders Lack Bite

An evidence preservation order executed by a Chinese court is one of the ways to obtain evidence directly from an infringer. Evidence preservation orders are often granted depending upon the court's discretion but some courts may not take action when their evidence preservation order is ignored or the relevant party refuses to cooperate.

Generally speaking, it is not overly difficult to convince a Chinese court to grant an IPR owner's application for evidence preservation if the evidence is absolutely necessary for the litigation. However, the timing and enforcement of an evidence preservation order by the court usually leaves much to be desired.

In theory, evidence preservation applications should be decided by the court within 48 hours of application. However, in practice, it can take weeks, or even months, for a court to grant the plaintiff's application. During this time, the plaintiff's investigation may have gone "stale", in that inventory may have been sold off or moved by the infringer. Therefore, pretrial

evidence preservation is recommended if necessary.

(b) Local Protectionism

For run-of-the-mill anti-counterfeiting cases against smaller or low volume infringers, local protectionism and corruption is generally not an issue. This is especially true in courts located in Shenzhen, Shanghai, Beijing, and other larger municipalities. Local protectionism becomes more of an issue in Chinese courts located in smaller, more isolated jurisdictions, or where a foreign company is engaged in a lawsuit with a local state-owned enterprise, which in some cases may be the biggest employer in the vicinity of where the court is located.

One popular solution is to attempt to "manufacture" jurisdiction in the neutral Court by making a sample purchase of the infringer's products in that jurisdiction. For example if Beijing is considered a friendlier jurisdiction then the purchase is made there. Then, the IPR owner can sue the infringer (and its local distributor) in the Beijing Courts, away from the infringer's home jurisdiction.

There are some cases where it is impossible to change the jurisdiction, leaving the IPR owner with no choice but to sue in the home jurisdiction of the defendant. This can be the case when the product has not been put on sale in other places, and the infringing act is only conducted in the defendant's office or factory.

(c) Damages are Generally Low

Due to the lack of discovery, IPR owners often have a difficult time proving the amount earned by the defendant from the infringement. This keeps awards generally in the statutory damages range (for example, maximum RMB 1,000,000 for patent infringement), as Chinese courts are reluctant to award significant damages based on a sample purchase of a few counterfeits.

Sometimes the amount of damages available might be so low that it makes little sense to

even bring the case in the first place. However, this trend may be changing. There have been several reported IPR cases where significant damages were awarded, including:

- An RMB 3 million verdict in favour of a Chinese SME against Pepsi Co. for trade mark infringement;
- An RMB 336 million verdict in favour of a Chinese patentee against France's Schneider Electric for infringing the Chinese patentee's utility model;
- An RMB 20 million verdict in favor of an individual against G2000, a Hong Kong-based garment manufacturer and retailer, for infringing its "2000" trade mark.

3.3 DIFFICULTIES IN ENFORCING JUDGMENTS

Judgments are notoriously difficult to enforce in China. For this difficulty alone, many companies choose to settle even strong cases, because it is considered that in a settlement, there is a higher chance that the defendant will voluntarily comply. Many times the defendant's assets mysteriously disappear and whatever amount of damages was awarded is never paid. Sometimes local protectionism also enables losing parties to delay payment for years.

Nevertheless, the Chinese courts are making progress in the area of enforcing judgments. The PRC Civil Procedure Law was amended to address how to strengthen enforcement of court rulings. In addition, in May 2011, the Supreme People's Court issued The Guideline on Sanctioning Behaviour Avoiding the Courts' Execution of Judgments. The main goal of the Guideline is to enhance enforcement of judgments in civil lawsuits so as to strengthen judicial authority. Other difficulties include:

(a) Low Penalties for Lack of Compliance

The low penalties imposed against defendants for failure to comply makes it difficult for Chinese courts to enforce their rulings. The Civil Procedure Law provides for RMB 10,000

for an individual offender and RMB 300,000 for corporate offenders.

(b) Defendants Hide Assets amongst Numerous Companies and Bank Accounts

The open and liquid financial system in Hong Kong allows infringers to transfer funds easily (monies obtained from their infringing activities). Infringers often keep their monies in Hong Kong since Chinese judgments are not automatically enforceable in Hong Kong.

(c) Local Protectionism

The court that awards the IPR owner a favourable verdict is not always the court that enforces the verdict. For example, if the IPR owner obtains a judgment against an infringer from Urumqi in the Beijing Courts, the Beijing Courts may well ask the IPR owner to turn to the Urumqi Courts for enforcement.

4. CRIMINAL ACTIONS

Under the Criminal Law of the PRC, IPR infringements that reach certain thresholds constitute criminal offences. These thresholds are determined by legal interpretations jointly issued by the Supreme People's Court and Procuratorate.

4.1 THE CRIMINAL THRESHOLDS

Thresholds stipulated for sanctions are different amongst various types of IPR cases. For example, trademark related cases, where the illegal proceeds of sales are not less than RMB50,000 (and not more than RMB200,000), are considered as serious and attract a criminal sanction of maximum two years imprisonment and/or fines. If the proceeds are RMB200,000 -500,000 the case is considered as very serious, and is punishable with two-seven years imprisonment as well as fines.

4.2 CRIMINAL ACTION PROCEDURE

The Public Security Bureau ("PSB") is responsible for IP-related crimes that reach the criminal thresholds. Although it may take the initiative to investigate, the

PSB more often relies on complaints filed by the aggrieved IPR owners. Alternatively, when taking administrative action, the authority finds that their case involves serious infringement, they ought to transfer the case to the PSB.

Once the case is taken up or transferred to the PSB, it will then conduct investigation against the infringing activities. If the evidence obtained warrants indictment of an infringer, the case will be transferred to the Procuratorate, which decides on whether to prosecute the infringer in the People's Court.

4.3 DRAWBACKS TO CRIMINAL ACTION

While criminal actions have a strong deterrent effect on infringers, an IPR owner may find himself spending considerable time and resources on liaising with the local PSB without even arresting anyone, let alone putting the infringer in jail. Since the PSB handles all kinds of crimes ranging from armed robbery to petty theft. A local PSB may not entertain an IP case unless it is so significant that the handling of it may let the local bureau stand out from other bureaus, or generate other forms of benefits. However, if an IPR owner has initial evidence to prove the infringer's criminal offence, it may directly bring a criminal action before the Court even if the PSB would not like to handle the case, and the right owners may apply for the Court to collect the necessary evidence.

5. CUSTOMS ACTION

Chinese Customs maintains a centralized recordation system of IPR at the General Administration of Customs ("GAC") in Beijing, which is the highest level Customs authority in China. According to Customs Regulations, there are two circumstances in which an IPR owner can apply for goods to be detained pending import or export in cases where they suspect infringement of their rights:

- (a) when the IPR owner has knowledge of the impending import or export; and
- (b) When the IPR owner is notified of a seizure of a shipment by Customs.

To record IPR with the GAC, an IPR holder needs to provide required documentation such as an

application form, copy of trade mark certificates or patent certificates, certificate of good standing or certificate of incorporation. The GAC is required to decide whether to grant a recordal within 30 working days, which is effective for 10 years (unless the remaining life of the recorded IPR is less than 10 years). It normally takes several months to obtain a recordal including the recordal procedure as well as the time needed for the IPR owner to provide the required documents.

5.1 ADVANTAGES OF CUSTOMS RECORDAL

Recording IPR with Customs is inexpensive and easy. Once a seizure is made, there are several benefits for an IPR owner:

- (a) First, it is effective because the seizure removes the counterfeit products from the stream of commerce.
- (b) Second, assuming the IPR owner files a "tag-along" civil action, the seized products may prove useful as evidence in a civil litigation in China against the shipper or the manufacturer of the counterfeits.
- (c) Third, the seizure also provides the IPR owner with useful evidence about the overseas buyers of the Chinese infringer. More often than not, these overseas buyers are themselves infringers, planning to resell the counterfeit goods in an overseas jurisdiction.

5.2 Verification within 3 Days

After the IPR is recorded with Customs, if Customs finds suspected infringing goods through their inspection of imported or exported goods, Customs can detain the goods and notify the IPR holder. Thereafter, the IPR holder has 3 working days from receipt of the Customs notice to decide whether to request Customs to detain the goods. If the IPR holder confirms the goods are infringing and requests detention, the IPR holder should pay a bond to Customs (further discussed below). If the IPR holder does not consider the goods to be infringing, or the required bond is not paid timely,

Customs will release the related goods. In this case, neither the IPR holder nor Customs are liable for any damages caused by the detention.

This 3-day limit is a short timeframe for the IPR owner to inspect the seized goods, especially in a country as large as China with multiple ports. It is therefore good practice to have pre-designated trained agents ready, with executed Powers of Attorney, at each of the ports where infringing goods may be seized.

5.3 Trainings to Customs Officials

Customs officials have pointed out that training for their inspectors can dramatically increase the chances of successful interception of infringing goods. Trainings can be provided as half-day sessions, and offer benefits such as: building strong relationships between the IPR owner and Customs officials; teaching Customs inspectors how to distinguish authentic products from fake products; and providing the IPR owner a better understanding of the overall procedures used by Customs.

5.4 Bond for the Seized Goods

An IPR owner that wishes Customs to seize infringing goods must post a bond for the seizure. The bond will be used for compensating the Customs' expenses for storage, custody, and disposal of the infringing products as well as the sender/receiver of the goods in the event of wrongful detainment.

In addition, the IPR holder can post a general bond of RMB 200,000 with Customs by filing an application to satisfy the bond requirement for multiple seizures.

The bond for detentions is calculated as follows:

- If the value of the seized goods is under RMB 20,000, the amount of the bond is the same as the value of the seized goods.
- If the value of the seized goods is above RMB 20,000, the bond should be equal to 50% of the value but the bond shall not exceed RMB 100,000.

As with any customs program anywhere in the world, to achieve effective customs IPR protection, the IPR owner needs to work closely with Customs to identify infringing products.

6. CONCLUSION

Despite the challenges that are present, companies that have a comprehensive strategy that utilizes multiple enforcement methods will be more successful in protecting their IPR in China. It is important to recognize that the system is improving. There have been significant legislative reforms, including amendments to many IP laws since China's accession to the WTO in 2001.

Moving forward, the change and evolution of the relevant laws in China are likely to continue to make it easier for foreign and domestic companies to enforce their IPR.

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Members of our IP team work closely with lawyers in other practice areas, such as Capital Markets, Corporate, Competition and Information Technology to ensure a comprehensive and fully integrated service.

The intellectual property areas we advise on include:

- brand protection
- trade mark registration and management
- domain name registration and protection
- design registration and management
- patents and know-how
- copyright and entertainment
- litigation and dispute resolution
- regional and international anti-counterfeiting programmes
- intellectual property transactions

OUR CHINA INTELLECTUAL PROPERTY PRACTICE

With more than 50 full-time IP lawyers and professionals in Hong Kong and Mainland China, Hogan Lovells maintains one of the largest and most experienced teams of IP professionals in the China region, based at our offices in Beijing, Shanghai and Hong Kong.

We advise on all aspects of contentious and non-contentious intellectual property law. Contentious work includes the enforcement of rights through the Courts and administrative bodies as well as the development of international IP protection strategies involving Hogan Lovells' offices and associates worldwide. Non-contentious work includes advice on the protection and exploitation of rights, including licensing, franchising and technical assistance and technology agreements.

We also have particular expertise in patent law. We provide advice on patent infringement and validity; inventorship and other disputes involving the ownership of patents; patent portfolio audits in connection with investments, negotiation of licenses and technical co-operation agreements; and on offensive and defensive patenting strategies and patenting policies.

Hogan Lovells' China IP practice was awarded a first tier ranking in IP matters by the Asia Pacific Legal 500 and in Patent matters in Managing Intellectual Property.

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