

FOREIGN INVESTMENT IN CHINA: **PROTECTING INTELLECTUAL PROPERTY RIGHTS**

1. Overview: Intellectual Property Protection in China

Protection of a foreign investor's intellectual property ("IP") rights should be a primary concern for businesses wishing to establish operations in the PRC. It is often commented that the PRC has a poor record in the area of IP protection, due to numerous instances of local companies blatantly infringing IP rights for their own benefit. More recently, there has been greater recognition of the value of IP rights and increased protection is now offered. However, IP protection still yet to reach the level of security that is normally enjoyed in developed countries. Therefore, it is imperative for foreign investors to take appropriate measures in the PRC to ensure that all of its IP is given maximum protection.

1.1 Patent Protection

In the PRC, patents are divided into three types: *invention*, *utility model*, and *design*. The *Patent Law of the PRC* defines these types of patents as follows:

- (i) "Invention" patent is defined as any new technical solution relating to a product, a process or improvement thereof;
- (ii) "Utility model" is any new technical solution relating to shape, structure, or a combination of a product, which is fit for practical use; and
- (iii) "Design" patent is defined as any new design in shape, pattern, colour, or a combination thereof, of a product, which creates an aesthetic feeling and is fit for industrial application.

The substantive and procedural requirements for invention patents are more stringent than for the other categories. As such, protection provided in an invention patent is the most extensive among the three types. The process for obtaining an invention patent may take 2-3 years or longer, if the applicant is a foreign entity.

1.2 Trademark Protection

In the PRC, as in most jurisdictions, trademark protection is available for trademarks and service marks which are words, names, symbols, or devices used by

manufacturers and service providers to identify their goods and services and to distinguish their goods and services from those manufactured and sold by others. A trademark that merely describes a class of goods, rather than distinguishing a trademark owner's goods from others may not qualify for registration.

A trademark that so resembles a trademark already used in PRC as likely to cause confusion or mistake may not be registered. In addition, trademarks which are descriptive of functions, quality, or characteristics of goods or services must meet special requirements before they will be protected.

A mark, either in Roman letters, Cyrillic letters, or Chinese characters, is registered with the Chinese Trademark Office, which grants the owner a proprietary right in the name or mark to the exclusion of all others for use on the registered goods or services. The validity of the registered trademark is ten years and renewable 6 months prior to expiration.

PRC is a first-to-file jurisdiction for trademarks. This means that the holder of a trademark in a foreign jurisdiction has no priority in PRC unless and until it has filed its marks. The sole exception is "well-known" foreign trademarks, such as Coca-Cola or McDonalds. Therefore, even though a trademark is registered outside PRC, in almost all cases, it is not protected in PRC. Investors seeking to begin operations in China must ensure that all clients' foreign trademarks are registered in PRC as promptly as possible.

Foreign investors may also have several additional brand names other than their corporate name and logo, such as product names, which are sufficiently unique to be used as trademarks. If a prior registration blocks registration of a mark used by a foreign investor, there are several legal actions available to resolve the matter.

Because the PRC is a first-to-file jurisdiction, it is imperative that new marks are filed quickly, even before the actual product or service is introduced. It is possible that a disgruntled employee or competitor, with knowledge of new operations, could file a mark first. Therefore, whenever a foreign investor introduces a new product or service, it should register the relevant trademarks immediately.

1.3 Trade Secret Protection

In the PRC, a trade secret is defined as information of any sort that is valuable to its owner, not generally known, and that has been kept secret by its owner. It includes information, formulae, patterns, compilations, programs, devices, methods, techniques, databases, or processes that derive independent economic value from not

being generally known or readily ascertainable and are subject to reasonable efforts to maintain secrecy.

A trade secret owner has the right to prevent others from misappropriating and using the trade secret. Sometimes misappropriation is the result of industrial espionage. In PRC, however, most trade secret cases involve former employees who steal employer's trade secrets, hackers, end users, retailers, and foreign investment enterprise ("FIE") partners. Trade secret owners have recourse only against misappropriation. Discovery of protected information through independent research, or reverse engineering is not considered misappropriation.

Trade secret protection endures, so long as the requirements for protection (generally, value to the owner and secrecy) continue to be met. The protection is lost, however, if the owner fails to take reasonable measures to maintain the information's secrecy.

Typically, FIEs enter into stringent employment, non-compete, trade secret, conflict of interest, and related agreements in order to avoid later problems. Certainly executing these agreements does not prevent unethical behaviour. The agreements do, however, provide excellent evidence and legal recourse in Chinese courts. Several different agreements are necessary for two reasons:

1. In the event a Chinese tribunal does not uphold one agreement, the others may still be enforceable;
2. Further, there are a number of specialized Chinese tribunals, which will only hear disputes regarding certain issues (i.e. labour tribunals hears labour issues, trademark office hears trademark disputes, etc).

Trade secrecy should therefore be emphasized in a number of different contexts/contracts.

1.4 Domain Name Protection

It is advisable that foreign investors register all their domain names with the Chinese country code, ".com.cn" or ".cn". To ensure that other companies do not reserve the domain name in the PRC with the intention of publicizing counterfeit products or cyber squatting, a foreign investor should register their domain name both in Chinese and English in the PRC. Domain names should be registered with the PRC Internet Network Information Center (CNNIC) in Beijing.

2. Overview: IP Enforcement Strategies in China

Despite China's clichéd reputation as a haven for infringers, IP owners have an increasingly broad set of tools to enforce their rights in China.

2.1 Administrative Protection

A large number of administrative agencies exist on national, provincial and local levels. As a general rule, IP infringement is handled at a local level, as follows: Administrations for Industry and Commerce (AICs) handle trademark and unfair competition cases; Copyright Administration Bureaus (CABs) handle copyright cases; and Intellectual Property Offices (formerly Patent Administration Bureaus, or PABs) handle patent cases. Depending on the industry in question, recourse may also be sought from other agencies such as the Quality and Technical Supervision Bureau (QTSB), the Administration for Quality Supervision, Inspection and Quarantine (AQSIQ), and the Food and Drug Administration (FDA).

Although administrative agencies have the power to initiate investigations and gather evidence on their own initiative, in practice a complaint is required, together with materials establishing a preliminary likelihood that a law or regulation within the agency's purview has been violated.

The most important of an administrative agency's powers is the on-site inspection or raid, during which infringing articles and related records may be seized and premises sealed. In the event of a dispute however, administrative agencies will generally not issue a corrective order until after they have reached a final decision. Furthermore, unless the parties specifically request mediation on the amount of compensation for infringement, agencies do not have the power to determine this issue.

The fundamental drawback of administrative enforcement is that complainants are not compensated – instead, the government receives any fines levied against the infringer. In addition the jurisdiction of administrative agencies is typically quite local in scope, and multiple complaints may be required when dealing with infringement on a regional or national level.

2.2 Civil

Chinese courts operate on four levels: district, intermediate, high, and supreme. IP-related lawsuits are traditionally the preserve of specially-designated intermediate courts in major cities and provincial capitals, but the number of courts with original

jurisdiction over IP matters has skyrocketed in recent years. High courts have original jurisdiction over particularly high-value disputes, and conversely in some areas district courts may be available to hear the smallest cases; the senior courts are preferable due to their generally greater sophistication and experience.

Potential litigants must face two main hurdles. The first of these is evidentiary: in keeping with China's civil law traditions, there is no discovery, and evidence exchange procedures are limited at best. The second problem is closely related: in order to file a case, it must first be accepted by the court, which requires supporting evidence.

2.3 Criminal

As a general rule, criminal liability for intellectual property infringement in China is limited to large-scale or repeat cases of commercial counterfeiting. Although the possibility of private prosecution exists, the vast majority of criminal cases are handled by the police and public prosecutors.

Since there are no direct benefits to an individual IP owner (although a custodial sentence stops the targeted infringer in their tracks and the 'feel-good' factor can be high) criminal enforcement does not normally feature highly in most intellectual property strategies.

2.4 Customs

When infringement crosses borders, customs enforcement can play a particularly useful role. Owners of patents, registered trademarks, or copyrights may take advantage of customs enforcement, for which there are two options.

Passive Protection (Protection by Application): If an IP owner learns of an infringing shipment, they may apply to customs authorities directly ('protection by application' or 'passive protection'). Customs will detain the shipment provided that the IP owner puts up a guarantee equal to the value of the goods in question, after which the IP owner has twenty working days in which to go to court and apply for judicial protection. For protection by application, customs authorities do not have the right to determine infringement and will not take any action without an IP owner making a specific request.

Active Protection (Protection by Function): For a nominal fee, IP owners may also apply in advance for so-called 'protection by function' or 'active protection', in which case customs authorities will actively monitor imports and exports. If a shipment is suspected of infringement then it will be held and the IP owner's designated contact

person notified. The IP owner then has three working days to apply for detention of the goods, and must again provide a guarantee. Customs authorities will then investigate and attempt to determine infringement; they are empowered to seize infringing products, issue administrative punishments to infringers, and pass criminal cases on to police. If officials are unable to reach a decision, then the IP owner may go to court for judicial determination.

2.5 Remedies

Intellectual property owners have three basic classes of remedy against infringement in China: cessation of infringement (injunction); monetary compensation (damages); and punitive measures (punishment). An enforcement strategy is in large part driven by which of these remedies is desired.

Injunction: Injunction and related measures are the most important enforcement goal for the majority of intellectual property owners.

Damages: Damage awards are only available through judicial proceedings. Hence, if financial compensation or cost recovery are important goals, an enforcement strategy should include litigation as a prominent option. As a general principle of Chinese law, damages are intended to make the injured party whole again; to compensate, rather than to punish the wrongdoer. Intellectual property cases are no exception, and the standard quantum of damages is therefore the loss suffered by the plaintiff as a result of the infringement. The compensation principle, lack of punitive damages, standards of proof, and historical reasons mean that average damage awards in China remain small.

Punishment: Administrative authorities and courts sitting in either a civil or criminal capacity have powers to punish intellectual property rights infringers through fines and confiscation of profits. Importantly, this money goes entirely to authorities rather than to the owner or owners of the rights in question.

The important thing about punitive measures is that they fall under the umbrella of law enforcement, and are not intended to directly benefit a specific IPR owner. As such they should not be the key focus of most IP enforcement strategies.

3. In Depth: IP Enforcement Strategy in China

3.1 Trademark Infringement

Article 52 of the *PRC's Trademark Law 2001* outlines the following as infringing acts:

- (i) use of a trademark that is the same as or similar to a registered trademark on the same or similar goods without the permission of the trademark registrant;
- (ii) sale of goods that infringe the exclusive right to use a registered trademark;
- (iii) forgery or unauthorized manufacture of representations of another's registered trademark, or sale of representations of a registered trademark that were forged or manufactured without authorization;
- (iv) substituting the trademark of a trademark registrant without his consent and putting back on the market goods bearing such substituted trademark; or
- (v) causing other harm to another's exclusive right to use a registered trademark.

Point (v) has been clarified further under Article 50 of the *Implementing Rules* to include:

- (i) using another party's identical or similar mark as a product name or trade dress on identical or similar products, so as to mislead the public;
- (ii) intentionally providing storage, transportation, delivery, or concealment for trademark infringing acts.

3.2 Trademark Remedies

Injunctions:

Injunctions may be in the form of both preliminary injunctions, and permanent injunctions.

Damages:

The following, under Article 56 of the *PRC Trademark Law 2001* will be taken into consideration when assessing the level of damages to be awarded:

- (i) Profits made by the infringer during the infringing period, or
- (ii) The losses suffered by the mark holder during the infringing period, including reasonable costs paid for restraining the infringing acts, or
- (iii) If the above cannot be ascertained, the Courts has discretion to render the statutory damages not exceeding RMB 500,000.

Criminal Remedies:

Under Article 61 of *The Guidelines for Prosecuting Certain Economic Crimes*, any party without authorisation uses a mark that is identical or similar to a registered mark for on identical or similar goods or services, will be subjected to criminal proceedings if:

- (i) Illegal revenue exceeds RMB 100,000 for an individual
- (ii) Illegal revenue exceeds RMB 500,000 for an organisation
- (iii) The use amounts to passing off another party's well known marks, or marks, or used on drugs for human treatment

- (iv) The infringer has already been infringed twice previously, and
- (v) The use causes serious negative influences

3.3 Patent Infringement

Article 60 of the *PRC Patent Law* concerns the infringement of a patent without authorisation from the patent holder. Under recent amendments to the *PRC Patent Law* (which came into effect on 01 October 2009) if this occurs the following stages should be perused:

- (i) Infringement should be resolved through negotiation between the parties;
- (ii) If either the negotiations are not successful, or either party refuses to participate in such negotiations then the patent holder, or an interested party may initiate legal proceeds in a people's court; or
- (iii) That party may petition the department in charge of the administration of patent work to resolve the matter. If the department states that an infringement has occurred, then it may order the infringer to halt the infringement immediately. If the concerned party is dissatisfied, they may initiate legal proceedings under the *PRC Administrative Procedure Law* within 15 days from the issue of the notice from the department;
- (iv) If the infringer does not halt the infringement, nor applies within the 15 day time period, then the department may apply to the people's court for enforcement;
- (v) If overall mediation proves to be unsuccessful, then a concerned party may initiate legal action in the people's court in line with the *PRC Civil Procedure Law*.

Article 62 of the *PRC Patent Law* states that the exploitation of prior art, or existing design shall not constitute patent infringement.

Under Article 63 of the *PRC Patent Law*, if passing off has occurred, the department in charge of patent work are capable of:

- (i) An order to rectify the matter;
- (ii) An announcement of the same;
- (iii) Confiscation of illegal income;
- (iv) Impose a fine less than four times the illegal income;
- (v) If there was no illegal income, then it may impose a fine less than RMB 200,000;
- (vi) If a criminal offence has been committed under PRC legislation then criminal liability will follow.

3.4 Patent Remedies

Damages:

Article 65 of the *PRC Patent Law* outlines the damages that can awarded as a result of infringement.

Damages will be based on the actual loss incurred by the patent holder as a result of infringement. If this figure is too difficult to determine, then damages will be based on the benefits derived by the infringer from the infringement.

Should it be the case that both the losses and benefits from those respected parties are difficult to determine, then damages shall be calculated based on the multiple(s) of the royalties for a licence of the patent. The damages shall include reasonable costs and expenditure the patent holder has incurred.

If all three factors are difficult to determine (i.e. loss incurred by the patent holder, the benefit derived by the infringer, and the royalties for a licence of the patent) then it is within the courts power to award damages of no less than RMB 10,000, but no more than RMB 1 million.

Under Article 68 of the *PRC Patent Law* infringement of a patent shall be counted back from two years, as of when the patent holder, or an interested party knew or should have known of the infringement.

3.5 Patent Criminal Remedies:

Under the Trade-Related Aspects of Intellectual Property Rights (“**TRIPs**”) Agreement, only limited criminal remedies for patent infringement are required. Criminal liability may arise if:

- (i) Illegal profits exceed RMB 100,000
- (ii) Direct loss to patent holder exceeds RMB 500,000
- (iii) If infringer has been subjected to sanctions twice previously – and
- (iv) If infringer has caused negative impact

3.6 Copyright Infringement

There are two forms of patent infringement, these are:

- (i) **Direct Infringement:** any exclusive rights listed under Article 10 of the *PRC’s Copyright Law 2001* amounts to a direct infringement of the copyright.
- (ii) **Contributory Infringement:** the infringer with knowledge of the infringing activity, induces, causes, or materially contributes to the infringing conduct of

another.

3.7 Copyright Remedies

Injunctions:

Injunctions may be in the form of a preliminary injunction.

Damages:

Damages are based on actual losses, or illegal profits formula. If this cannot be ascertained then under Article 48 of the *PRC Copyright Law 2001* a court may award RMB 500,000 as the maximum statutory award.

3.8 Copyright Criminal Remedies

Outlined under Article 217 of the *Criminal Code*, the follow may constitute a custodial sentence of up to three years, and/or a fine:

- (i) Reproduction and distribution of literary works, musical works, motion pictures, television, or visual recording works, computer software, and other works, without the copyrighters permission; or
- (ii) Publication of books where others have exclusive publications rights, without the copyrighters permission; or
- (iii) Production and sale of unauthorised fine art reproductions; or
- (iv) Reproduction and distribution of sound recordings, without the copyrighters permission.

* This is an edited version of the article provided to Stephens Lawyers & Consultants by Lehman, Lee & Xu which deals with issues relating to establishing businesses in China. Stephens Lawyers thanks Lehman, Lee & Xu for its contribution.

* Stephens Lawyers & Consultants assists Australian companies wishing to expand their operations into China.

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