

# China 2011 – a review

Four leading lawyers based in Shanghai, Beijing and Hong Kong discuss recent IP developments in the People's Republic of China

By Jack Ellis

The Chinese IP marketplace continues to evolve at a bewildering pace. In our annual review of the most recent developments, we asked experts on the country – Linda Chang and Elliot Papageorgiou of Rouse in Shanghai; Mark Parsons of Freshfields Bruckhaus Deringer in Hong Kong; and Howard Tsang of Wilkinson & Grist in Beijing – to discuss a range of issues, including the indigenous innovation policy, patent quality, litigation and enforcement, and recent crackdowns on counterfeiting and piracy.

**What do you consider to be the most significant IP developments to have taken place in China in the past 12 to 18 months?**

**Mark Parsons:** The Chinese government has continued to make efforts to improve IP protection in China during the last 18 months, with revisions to its IP-related laws and regulations – the amended PRC Copyright Law, the amended Implementing Regulations of the Patent Law and the draft Trademark Law – and administrative measures, such as the Measures on Patent Administrative Enforcement and the revised Guidelines for Patent Examination.

China viewed the holding of the World Expo in Shanghai in 2010 as a good opportunity to enhance its IP enforcement capabilities. The government also launched

a special IP enforcement campaign in October 2010, in which various IP enforcement bodies – including the State Administration for Industry and Commerce, the State Intellectual Property Office (SIPO) and the PRC Customs Department – worked together to crack down on many manufacturing plants and retail outlets producing and selling counterfeit products.

In 2010 the PRC courts tried and concluded some milestone cases, such as *France Lacoste v Singapore Crocodile* and *US Eli Lilly v Jiangsu Haoseng*, and issued landmark rulings in respect of some important IP law issues, including on the issue of similar trademarks, each of which has a recognised reputation in its own right.

**Elliot Papageorgiou:** The last year or two has been an exciting time in China and there have been a number of notable IP developments. Three aspects stand out in terms of significance on the IP landscape.

First, the Chinese government's "Showing the Sword" special enforcement campaign has made a substantial difference to the way in which the authorities approach enforcement. I am sure that most people working in intellectual property in China were aware of this project which, as Mark says, involved all Chinese government IP authorities, as well as the Public Security Bureau and public prosecutors, working together. The special project ran until June this year and was effective in raising the profile and effect of IP enforcement in China.

Second, the past 18 months have shown that China is coming into its own in terms of innovating and creating its own intellectual property. There has also been a material increase in Chinese companies making use of IP rights to fortify their competitive position against foreign competitors. We are seeing Chinese



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companies using patents and especially utility models (rights that protect technical features like patents, but are of shorter duration and require a lower inventive step) as swords. In particular, we have seen a marked increase in the number of utility models granted over the past 18 months – growth of 75% from 2009 to 2010 alone, which is quite something.

Finally – and this flows from the last point – we have increasingly witnessed Chinese companies filing patent litigation cases against foreign companies. *Schneider v CHINT* appears to have encouraged companies to take this step; we are currently representing renowned foreign enterprises as defendants in no fewer than five patent infringement proceedings. This development has obvious repercussions for foreign businesses.

**Howard Tsang:** I would also like to mention three other developments:

- Continued efforts to reduce the heavy backlog in the examination of trademark pending cases, with the average time generally reduced from 36 months to 12 months.
- The issuance of regulations and measures against online IP infringement, including the Interim Regulations on Online Commodity Transactions and Related Services in July 2010. In April 2011 nine departments jointly issued two notices to shopping platform operators urging them to take effective measures to monitor online infringement and handle complaints.
- The opinion of the Supreme People's Court on Several Issues Regarding Examination of Cases Concerning Granting and Confirmation of Trademark Rights.

#### **What do you see as the key issues that patent owners should be aware of when operating in China and how can they best deal with them?**

**Linda Chang:** Operating in China is a challenge, and businesses need to take the right steps at the right time to ensure that they maintain their competitive space and freedom to operate.

One of the biggest issues is getting the IP acquisition right in the first place. Many foreign companies are still filing too little, too late, and then struggling to secure those rights – in terms of both patents and utility models. It is therefore important to ensure that you adapt your foreign filing strategy to

the peculiarities of the Chinese system.

Further, foreign businesses are underestimating the potential of utility models. Although utility models are of shorter duration than patents, they offer a quicker and more straightforward manner in which to acquire protection for technical rights in China. Many clients for which we try to devise a “future-proof” IP strategy are advised to fortify their patent portfolio with utility models where possible.

Local searching of competitor rights should also not be neglected. It is critical that foreign companies understand what their local competitors are doing in China. This means supplementing foreign/remote searching with local searching in China, but always ensuring that they set out and agree an applicable search methodology with their China IP agents. You would be surprised how often local agents in China have a less than sophisticated search methodology.

Lastly, it is critical that foreign companies are aware of the formality requirements of any materials and prior art evidence to be submitted to the China Patent Office and to Chinese courts, and adapt their evidence-keeping strategies accordingly. Without getting unduly technical, formalities basically require evidence to have been notarised (if gathered in China), or notarised and legalised (if gathered overseas). If these formalities are not met, it can severely affect the probity of evidence, up to a point where it is effectively ignored by authorities.

**HT:** At present, the examination period for a patent for invention is still too long; it takes three years or so. It seems that in practice, only local applicants can successfully request expedited examinations.

Unlike for other types of infringement, no quick and effective administrative relief is available. Rights owners have to go to the courts to enforce their rights, except in those cases where the parties are prepared to have the dispute mediated by the authorities.

**MP:** Patent owners in China should be aware that urgent interlocutory injunctions in patent infringement cases are rarely available. Therefore, the risk of unauthorised use of patents, or their misappropriation, is best mitigated by limiting access to key patent technology and know-how, and relying on preventative measures against patent infringers rather than interim injunctive relief.

**There is much criticism that IP law in China does little to deter potential infringers. Do IP owners have sufficient reason to feel confident not only that the law protects their rights, but that those rights are realistically enforceable?**

**HT:** It would be an unfair criticism that IP rights are not realistically enforceable just because of the high incidence of IP infringements in China. China is the world's factory, so one should expect that there will be lots of infringements. IP infringement is not just a legal issue, but also a socio-economic one. China is a huge country; its consumers, businesspeople and officials have varied educational standards.

Though infringement is abundant, and much is left to be desired, generally things can still be done to tackle the problem. One has to be pragmatic and positive. With everyone putting in effort, China will improve every day. A lot of the time it is a question of how to deal with the problem. Our success rate is extremely high, for example. It requires playing with strategies and tactics. We did the first litigation in China concerning cybersquatting relating to a foreign party; we have successfully enforced 3D marks; we have won maximum statutory damages; and we have put infringers in prison. It is no use not having confidence in China.

**MP:** The Chinese government has achieved some notable enforcement successes against counterfeits for export in the past 12 months. PRC customs officials have continued to prevent counterfeit products from being exported, which impedes overseas infringers from using China as a manufacturing base. The Chinese IP enforcement bodies have focused on policing sales channels of counterfeit goods, which has proved to be a more effective way of enforcing IP rights in China. The Chinese central government has issued a requirement that government bodies at all levels allocate sufficient funds to purchase legal copies of software used by government departments, which has signalled to the market that the government itself respects IP rights.

However, a number of issues with IP enforcement in China remain. First, the PRC courts are usually very cautious about issuing preliminary injunctions, particularly in patent cases where complicated technical issues are involved or in cases of alleged trade secrets infringement.

Second, since China is still in the

process of modernising its IP laws, a number of provisions are still unclear or inconsistent (eg, exhaustion of trademark rights), and their practical implementation has yet to be determined.

**EP:** I agree that much of the criticism of IP law in China and its enforceability is unjustified. Many of the problems regarding enforcement stem from a lack of understanding of the Chinese system and the failure of foreign companies to adapt their strategies to reflect the peculiarities of this system.

In our view, there is every reason for IP owners to feel confident in China's IP system. That said, there is still variance in the competence and willingness of authorities in different Chinese jurisdictions to enforce rights. Generally, in first-tier cities such as Shanghai, Beijing and Guangzhou, there is a strong track record of effective IP enforcement. However, the further one ventures away from first-tier cities, the greater the potential differences in effectiveness of enforcement.

**Are there any regional differences in terms of protection and enforcement of rights that IP owners should be aware of?**

**MP:** It is true that judges and government officials outside of the major Chinese cities are less experienced in dealing with complicated IP cases than those in the main cities, such as Shanghai and Beijing, and may be prone to give greater weight to protection of local interests. These Tier 2 and Tier 3 cities are also particularly exposed to the *Shan Zhai* culture of brand imitations, lookalike and parody products, and standards of IP enforcement are generally considered to be weaker.

The new dilution standard introduced by the Supreme People's Court last year for marks that are well known within China will help to combat the *Shan Zhai* culture. This is already being enforced – for example, in the Beijing courts' rulings in the cases involving Toshiba and the famous Yi Li Dairy brand. However, the lack of awareness of the value which IP rights may add to the economy means that these issues will not go away overnight in Tier 2 and Tier 3 cities.

**LC:** While there are no formal differences in the IP protection systems between the regional provinces of China, because of differing levels of competence and willingness to implement the various IP



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enforcement measures, regional differences do exist in practice.

If one is set up appropriately and ensures that one's IP enforcement specialists have sufficient knowledge of the region in question, then there are ways in which these differences in enforceability can be minimised. If, for example, you want to have enforcement in the northeast of China, a different skill set will be needed from that required to enforce the same rights in the Pearl River Delta.

**HT:** As Mark and Linda say, courts and enforcement agencies in the more developed provinces/cities are more capable and impartial. These judges and officers are more technically sound. They are more experienced – not only generally, but also in the subject matter concerned. The environment in which they work makes it easier for them to adjudicate independently, so they are less susceptible to non-judicial factors.

**If an IP owner does find that its rights have been infringed, what strategies can it put into place to ensure that the problem is resolved as quickly and efficiently as possible?**

**EP:** This is a good question – the most important factor to remember is that the strategies must be adapted to each instance of IP infringement. There is a certain amount of preliminary work that an IP owner can do (eg, ensuring that rights are protected, that they are formally entitled to be enforced and that authorisations appropriately provided). Beyond that, however, the only thing that one can generalise is that every case of enforcement begins with a thorough investigation of the infringement and infringer, followed by devising and tailoring the enforcement strategy for the situation at hand.

So the strategy we would devise in taking action against a state monopoly in Beijing would be very different from the strategy we would devise in relation to a network of patent infringers around, for example, Guangdong province.

**HT:** It is essential to seek expert legal advice. The legal adviser will identify the legal issues, collect and preserve necessary evidence, and help to formulate strategies and tactics – such as deciding whether to commence legal proceedings or file an administrative complaint, and identifying who, where and when to sue or raid. There is limited discovery in China, and generally evidence must be notarised, and legalised

where it originated outside of China, evidence collection and preservation is extremely important, which may involve investigating the infringer.

**MP:** IP owners should examine the most effective legal route for them against the infringing manufacturers/suppliers. The routes available are either through civil proceedings against the infringing manufacturers/suppliers, where the prospects of success, most favourable litigation forum and preliminary proceedings versus proceedings on the merit should be considered; or through administrative proceedings against the infringing manufacturers/suppliers, where the advantages to the IP owner's business, availability and impact on its IP protection strategy as a whole should be analysed.

IP owners should get detailed intelligence on the sources of the infringement – company information on the infringing manufacturers/suppliers, scale of production, sources of supply, sales information and so on. This will inform their decision on what will be the most effective enforcement strategy against the infringer.

If court proceedings are to be initiated, the IP owner should undertake thorough evidence preparation, including notarisation of downloads of the infringing manufacturers/suppliers' websites and online business-to-business trading platform listings, where relevant; and notarised purchases of the infringing manufacturers/suppliers' infringing products. Original documentary evidence in court proceedings is given high evidentiary value and is essential for success in court.

**The Chinese government has recently announced that it has made great strides in the crackdown on piracy. Does this reflect your experience, and what can IP owners working in the region do to ensure that their rights are being protected?**

**HT:** We have heard the same reports too, but piracy is still there and it is a continuing effort. Piracy is still very prevalent online and this is a worldwide problem. To ensure that its rights are protected, IP owners should:

- Register their rights in a timely fashion.
- Monitor the market for possible infringement of their rights.
- Understand the piracy market – where the factory is located, how the logistics operate, who the general distributor is, what the main market is and so on.
- Maintain a good relationship with local

China's tier one cities



administrations, procuratorates and even the court in the places where the piracy is centralised or most prevalent.

- Push for and participate in criminal proceedings, where possible.
- Do media and propaganda work to spread the message that they are serious and mean business, so that the market knows the consequence of being caught.

**MP:** The crackdown campaign on infringers that began in October 2010 did have an effect. The police raided more than 10,000 manufacturing premises and 2,600 distributors which were engaging in the manufacture and sale of counterfeit products. The government also shut down more than 1,000 websites which provided pirated copies of software or music for download.

However, Chinese manufacturers continue to produce counterfeit products, the majority of which are destined for the export market. IP owners should therefore record all of their IP rights with Customs in China. This will allow Customs to enter the

IP rights in its database that is shared by all customs authorities at the local level, and Customs will then proactively monitor shipments of goods for possible infringing products. IP owners should also look to incorporate product identification features into authorised products manufactured in China for export, to assist Customs in identifying infringing goods.

**LC:** As already mentioned, the special “Showing the Sword” campaign has had a positive impact on the enforcement of IP rights. However, a lot of this enforcement effort has focused on low-hanging fruit – straightforward counterfeiting cases. Perhaps opportunities were missed to tackle more challenging cases, such as lookalike infringements, a greater number of patent infringement cases and so on.

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**The annual growth rate of patent applications in China now far exceeds that of the other leading patenting countries. Can SIPO effectively manage**





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**this ever-growing number of applications or is the quality of patents suffering because of the quantity of applications?**

**MP:** China's National Patent Development Strategy has focused on strengthening the patent filing system following the Chinese government's national strategy to promote innovation and the development of new, indigenously developed technologies. The National Patent Development Strategy projects that the total number of domestic patent filings will double by 2015, and it is envisaged that adequate resources will be made available in order to meet this increase in applications. As utility model patent applications are not substantially examined during the application process in China, the quality of patents is likely to be affected more by the examination procedure than by an increase in the number of applications.

**EP:** It is true that there appears to have been exponential growth in patent applications, although a lot of that growth has centred on utility models. However, I am confident that SIPO will be able to handle this volume pressure. To give an example, the China Trademark Office hired over 300 new trademark examiners a couple of years ago to deal with backlogs and delays in examination. Similarly, as the volume at SIPO increases, we expect to see an increase in the number of examiners engaged by SIPO to maintain standards of examination and thus the quality of granted patents.

**HT:** In order to reduce the backlog, SIPO has been recruiting examiners over recent years at the rate of 500 per annum. Most of the new examiners have a master's degree. There are quality inspection groups for each substantive examination department, and these are responsible for the quality of each case. The examiners also receive training from time to time.

In fact, as compared with the other major patent offices around the world, the workload at SIPO is in the middle level – just like that of the USPTO and far less than that of the Japanese and Korean Patent Offices.

**Over the last few years, China has been working on introducing an indigenous innovation policy which would prioritise domestic innovation over that of foreign companies. Earlier this year, it was announced that the policy was to be revised and many of the measures that were widely criticised as discriminatory**

**would be retracted. What do these revisions entail and what do they mean for foreign IP owners working in China?**

**LC:** A country that is on the cusp of development, as China is often described, would be expected to do all that it reasonably can to encourage domestic innovation and thereby enable local companies to climb up the value chain. Indeed, this policy is reflected in both the 11th and again in the 12th five-year plan. Within this framework, China also encourages foreign companies investing in China to develop their technologies within China. This is exemplified by the fact that both domestic and foreign-owned companies can qualify for high-technology enterprise status, enabling them to reduce their tax burden from 25% to 15%.

**HT:** The indigenous innovation policy involves government procurement and prioritises domestic innovation over that of foreign companies. General IP protection is one part of it. This policy is discriminatory. On the other hand, although China is a member of the World Trade Organisation (WTO), it has opted out of the WTO rules for government procurement. This therefore means that the indigenous innovation policy relating to government procurement is not in violation of its international commitments. Due to international pressure, on 1st July 2011 China announced that it would abandon this policy.

The original plan was to draw up a list of goods and services that fell under this policy, but as of now, this list has not yet been announced. However, it is understood to be a work in progress.

**MP:** The Chinese government had previously issued a guideline that the IP rights in products which are eligible for government procurement must be owned by Chinese parties (including joint ventures in which a Chinese party has a majority equity stake). Since the government procurement market in China is much larger than that of other countries, western governments and companies have applied huge pressure on the Chinese government to remove the IP ownership procurement restriction.

In our view, the retraction of these measures by the Chinese government may not have a major impact on foreign IP owners in China. The guidelines on IP ownership were advisory rather than mandatory *per se*, and we did not see them as having a substantial influence on the market – for example, many Tier 1 Chinese

cities have purchased railway locomotives whose IP rights are owned by German companies. Further, there are other compelling factors which appear to have a greater influence on government procurement decisions. For example, most Tier 2 Chinese cities would still prefer to purchase products whose technology is owned by Chinese parties, due to lower prices and faster response times for maintenance and repair of products in comparison with products which have overseas IP ownership.

As Howard says, China has not yet become a member of the WTO's Government Procurement Agreement, a voluntary accord directed at ensuring fair competition between foreign and domestic suppliers; but it has been working towards membership for a number of years. The government is expected to make a further proposal to join in the near future.

**In your opinion, should foreign IP owners doing business in the region see these revisions to the policy as an indication of a more foreign-friendly approach being adopted by the government?**

**HT:** It would be correct to say that protectionism is universal. At the international level, it is not just an IP issue; it is politics. Protectionism is always topical, making a value judgement is always difficult, and there may be many different answers depending on how one views the problem.

In terms of IP protection, it is incorrect to say that China is anti-foreign. Some locals complain that China is too pro-foreign. As a matter of fact, the voices of foreign companies often prove the loudest. Domestic industries also face local protectionism when they enter into other regions.

To see whether China is really minded to protect intellectual property, one must look at the issue on a larger scale and over a longer period of time.

**MP:** Although the revisions to these IP ownership restrictions may have no immediate impact for foreign businesses in China, it is helpful to see that the Chinese government appears to be supportive of a level playing field in the domestic market for foreign competitors and is not upholding protectionist measures which may have compromised efficiency and progress in the Chinese market.

**EP:** The policies adopted by the Chinese

government are often enacted in a form which invites and indeed provokes comment. Once both the potential impact of, and reaction to, these policies have been taken into consideration, they are revised and implemented in final form. To that extent, it is difficult to say whether the revisions are merely part of the ongoing revision process.

**How has the IP landscape changed in China in the past five years? What are your hopes and expectations for the coming five?**

**MP:** There is an increasing focus on branding in the Chinese retail and consumer product market, to take advantage of the high growth in Chinese consumer spending. The development by international companies of China-only brands is a particularly interesting development and demonstrates that the latest thinking on branding in China has come full circle. A good example of this is Hermès's launch last year of a new brand specifically for China called *Shang Xia*, the product line of which has Chinese themes and is aimed at Chinese consumers. Other examples include Nissan's recent launch of a lower-priced brand just for China, called *Qi Chen*, in conjunction with its joint venture partner, Dongfeng. Similarly, Honda has a China-only brand called *Li Nian*, also in a joint venture with Dongfeng.

We have also seen significant growth of online markets and e-commerce now that China is the largest online market in the world, with over 500 million internet users. Online sales platforms and auction sites play an increasing role as a nexus bringing together producers of counterfeit products, their supply chains and the distributors and wholesaler buyers of counterfeit products. Tackling online routes to market for infringing products now forms a crucial part of any well-thought-out enforcement strategy. We have also been asked to assist on handling takedown requests, supporting investigations and making complaints to internet service providers, hosting service providers, the Ministry Public of Security and the State Administration for Industry and Commerce in China.

The pharma market in China is expanding, with over 20% annual growth, and is expected to become the world's third largest pharma market by 2013. International pharma companies are increasingly targeting the high-end pharma products retail market and are ramping up R&D activities on the mainland. For



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example, Novartis is building a US\$1 billion R&D centre in Shanghai, which will be its largest after Cambridge in the United States and Berne; and Pfizer, Merck, Serono and Bayer have all started to invest heavily in R&D in China. This should lead to a greater interest and incentive to enforce pharma patents in China. The coming patent cliff, when a number of blockbuster drugs will come off patent, will have relatively less effect on the pharma sector in China, because fewer patents for these drugs were registered in China at the time. However, some international pharma products will lose the benefit of corresponding administrative protection when they go off patent in the United States, the European Union, Switzerland and Norway, which offer reciprocal protection for seven years post-regulatory approval for the corresponding pharmaceuticals. Pharma multinationals may need to make acquisitions of Chinese domestic pharma companies to offset impending patent expiries and sluggish home markets, and to increase distribution capability. Joint ventures are continuing to feature strongly, alongside R&D collaborations and co-marketing arrangements, in this sector.

**LC:** The last five years have seen a tremendous growth in innovation by Chinese industry. This has been backed up by the acquisition of IP rights (patents and utility models on the one hand, but also trademarks, where over 1 million new applications were filed in 2010 alone).

In this context, there has been a decisive movement of Chinese companies up the value chain to a point where we now see a lot of former low-margin/original equipment manufacturer producers emerging as fully fledged companies, innovators in their field, and indeed credible competitors to foreign counterparts.

Looking to the future, we hope to see both a continuing improvement in the IP protection and enforcement landscape, as well as continuing innovation by local companies.

On the enforcement front, we would encourage enforcement authorities to maintain the momentum reached during the "Showing the Sword" campaign, but on a permanent basis – in other words, let's see the authorities continuing to enforce IP to the same extent and with the same enthusiasm on a day-to-day basis. We would also like to see the authorities, and especially courts, take on more challenging cases and then develop a consistency of approach – at

the moment, given the divergent approaches between some courts, there is plenty of scope for infringers to seek out locations where IP enforcement may be patchy. These gaps need to be closed.

Finally, we are hoping that as Chinese companies become more IP aware and IP rich, and China's stake in the IP system grows, the existing challenges to IP enforcement will continue to be reduced, to a level when IP enforcement in China consistently delivers just results.

**HT:** China has been compliant with the Agreement on Trade-Related Aspects of Intellectual Property Rights for 10 years, such that any change in the last five years has not been revolutionary, but merely an improvement on existing law and practice. The Patent Law was amended in 2010. Moreover, there were fundamental changes in certain areas – namely, clarification in relation to criminal enforcement of IP rights. With clear stipulations of the criminal thresholds as well as other enforcement guidelines, it is now much easier to enforce rights criminally. In fact, I handled many such cases ending with imprisonment terms of up to seven years, and a landlord was also given a suspended sentence of 40 months for contributory infringement. The Supreme People's Court has been helpful in issuing its interpretations, opinions and suchlike, making the law and regulations more clear and transparent.

In the next five years, law and practice will continue to develop. There will be a new Trademark Law and possibly a new Anti-unfair Competition Law, as well as changes to the Copyright Law.

It is also to be hoped that there will be more changes at the court level; that cases are solely decided by virtue of law, not politics; that administrative appeals against authorities are genuinely substantive; and that the efforts of different IP authorities can be more coordinated. ■