

VIEWPOINT.

The American Chamber of Commerce in Shanghai - Viewpoint March 2020

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Battle of the Brands: Where China's IP Regime Falls Short

2020





ABOUT VIEWPOINTS

AmCham Shanghai's Viewpoint series provide insights and recommendations from AmCham Shanghai member companies on important policy issues impacting foreign companies in China. These reports are based on extensive interviews and research by the AmCham Shanghai Government Relations team. The reports are used in AmCham Shanghai's advocacy efforts with the Chinese and U.S. governments.

ABOUT US

The American Chamber of Commerce in Shanghai (AmCham Shanghai), known as the "Voice of American Business" in China, is one of the largest American Chambers in the Asia Pacific region. Founded in 1915, AmCham Shanghai was the third American Chamber established outside the United States. As a non-profit, non-partisan business organization, AmCham Shanghai is committed to the principles of free trade, open markets, private enterprise, and the unrestricted flow of information. AmCham Shanghai's mission is to enable the success of our members and strengthen U.S.-China commercial ties through our role as a not-for-profit service provider of high-quality business resources and support, policy advocacy, and relationship-building opportunities.

Find us online at www.amcham-shanghai.org

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All interviews for this Viewpoint were kept anonymous. AmCham Shanghai would like to thank all interviewees for their contributions to this report.

Executive Summary

Despite positive movement by Beijing in recent years to strengthen the country's intellectual property regime, a lack of IPR protection and enforcement remains a primary hindrance to American companies in China. In November and December 2019 AmCham Shanghai interviewed the in-house counsels of 12 of our member companies regarding intellectual property issues they face in China. The respondents, who represent the technology, consumer retail and healthcare industries, stated that current regulations do not adequately address trade secrets, punitive damages, political influence and local protectionism in court, counterfeiting on online platforms, trademark squatting and design infringement.

Inadequate Protection for Trade Secrets. China does not have a civil discovery process that allows infringed companies to collect evidence of trade secret theft from other parties. Coupled with high burdens of proof, this makes it almost impossible for companies to initiate trade secret theft investigations.

Damages too Low. Although minimum statutory damages have been steadily increasing, Chinese courts are reluctant to impose punitive damages except in high-profile cases. Court-imposed punitive damages and other penalties are too low to deter repeat IP offenses.

Political Influence and Local Protectionism in Courts. While China has made progress in creating a level playing field by establishing specialized IP courts, political influence and local protectionism in courts remains a serious issue, particularly in second- and third-tier cities and in more rural parts of the country.

Online Infringement. The rapid growth of Chinese e-commerce platforms like Taobao and Pinduoduo has amplified online trademark infringement. Most recently, infringers have been using social messaging platforms like WeChat, where user privacy settings make self-monitoring by companies impossible.

Bad-Faith Trademarks and Design Infringement. Unlike the U.S., China is a "first-to-file" jurisdiction, enabling an industry of trademark squatters who hoard trademarks for profit. Many member companies in the consumer retail industry also said that China's IP regime failed to adequately protect design infringement. The complexity of such cases coupled with the unwillingness of administrative agencies and online platforms to judge design infringement means that companies become mired in lengthy and expensive court cases.

Recommendations:

For Government:

- Create a standalone Trade Secrets Law.
- Lower the burden of proof for filing court cases.
- Strengthen infringement penalties on e-commerce websites and pressure social media platforms to take responsibility for infringements on their platforms.
- Increase minimum statutory and punitive damages and administrative fines.
- Better train and increase the jurisdiction of administrative enforcement agencies.
- Install a limited civil discovery process that enables better calculation of punitive damages and action against trade secret theft.

For Companies:

- Work with third-party organizations like the International Anti-Counterfeiting Coalition as well as with local partners to counter IP infringement. Coalition requests may better influence local Public Security Bureaus to act against infringements.
- Craft a specialized IP protection strategy for the China market.
- Form strong relationships with the government agencies that oversee IP protection in your sector.
- Register your IP with China Customs.
- Create internal processes that limit the number of people who can see sensitive information.

Introduction

Despite positive movement by Beijing in recent years to strengthen the country's intellectual property regime, a lack of IPR protection and enforcement remains a chief regulatory hindrance to American companies in China. In November and December 2019 AmCham Shanghai interviewed 12 of our member companies regarding intellectual property issues they face in China. The respondents, who represent the technology, consumer retail and healthcare industries, stated that current regulations do not adequately address trade secrets, punitive damages, political influence and local protectionism in court, counterfeiting on online platforms, trademark squatting and design infringement.

Most respondents agreed that the government had made good-faith attempts to strengthen China's IP protections in recent years, which had produced tangible results. Legal revisions have sought to decrease trademark squatting, expand administrative and judicial oversight and decrease filing burdens. Improvements in the quality of prosecutors and judges coupled with the establishment of specialized IP courts has further strengthened IPR in China. One respondent said: "There has been a marked increase in getting proper expertise to handle

these complicated cases. We're also seeing that the courts are trying their best to use the law in a way that's very protective of rights holders, including foreign rights holders like us."

But despite positive momentum, IP protection has consistently remained the number one impediment to AmCham Shanghai member companies. In AmCham Shanghai's 2019 *Business Climate Survey*, 57% of companies listed "lack of IPR protection and enforcement" as a hindrance. This percentage has barely changed from a decade earlier.

This report is an introduction to some of the IP issues AmCham Shanghai members face. It is not all-inclusive but rather consolidates the consensus opinions obtained from a series of interviews. A more comprehensive report would include interviews with more industries and a cross-sector comparison. The severity and style of IP infringement varies greatly across sectors, which is due in part to stronger regulations and government oversight in certain sectors like pharmaceuticals, but also reflects consumer concerns. For example, consumers are generally more wary of purchasing and using fake skincare and cosmetics than fake toys or shoes. Thus, strengthening IP protections in China requires not only more

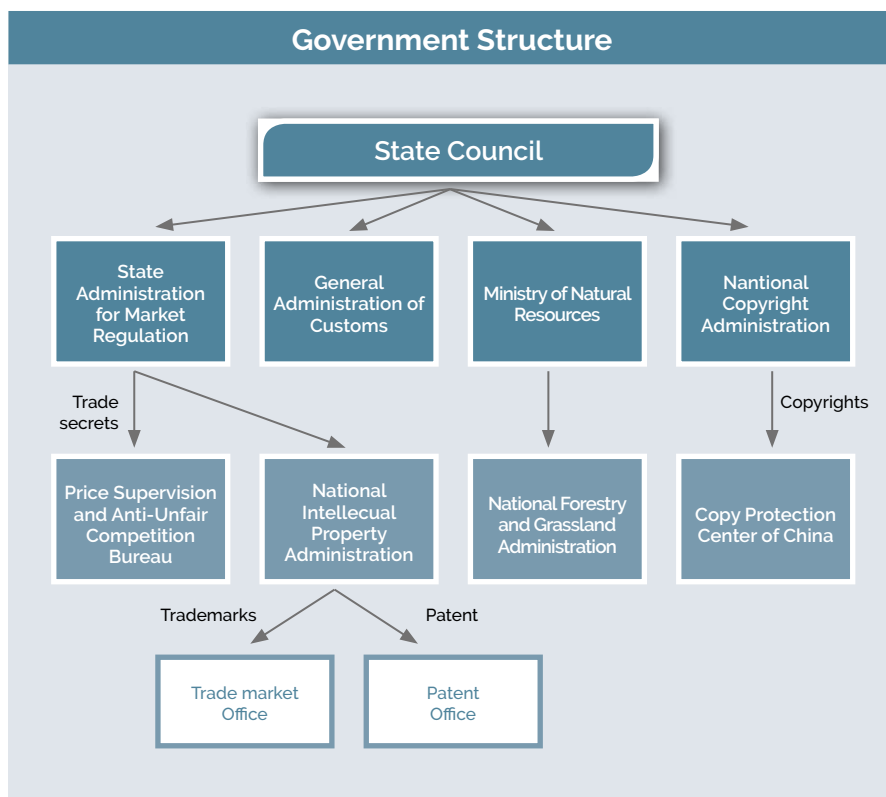
comprehensive regulations but also better public education on the costs of IP infringement.

This *Viewpoint* has two sections. It begins with a primer on China's IP regime, including an overview of the laws, oversight bodies and recent updates. It then introduces several IP concerns from AmCham Shanghai member companies. Finally, it offers recommendations to the Chinese government. Some suggestions can be achieved easily — for example, increasing minimum punitive damages — whereas others, like more adequately protecting trade secrets, require a systemic overhaul.

Primer on China's Intellectual Property Environment

Four Categories of Intellectual Property

Intellectual property is generally broken down into four categories: copyright, patents, trademarks and trade secrets. A copyright protects the original literary and artistic works of an author and in most cases provides exclusive rights for the creator to control modification or reproduction of the work. A patent is a right granted for an invention that gives the patent owner the ability to exclude others from selling,



ter ability to resolve complicated cases, the burdens of case filing and evidentiary collection are high. Documents collected outside of China must go through a strict notarization, legalization and translation process, and unlike the U.S., China has no formal civil discovery process to help parties collect evidence.

Criminal action may be taken when an infringement exceeds a certain monetary threshold. The local Public Security Bureau (PSB) will initiate an investigation and may refer the case to the Procuratorate before being tried in the People's Court. Infringers may be subject to jail time if found guilty. While criminal action is an effective method to deter infringement, the local PSB may be unwilling to investigate if it does not view IP enforcement as a priority. The PSB has sole discretion on whether to accept a case.

Customs seizure occurs when China Customs seizes IP-infringing products as they leave or enter the country. This is a popular, effective and cheap method for enforcing IPR. Rights holders should register their IP with Customs and be prepared to quickly post bonds and request seizures.

Notice-and-Takedowns are letters submitted directly to an internet platform by a rights holder that order internet platforms

making or using the patented invention. Trademarks protect a design, expression or symbol that distinguishes the product or service of an enterprise from those of other businesses. A trade secret is a confidential and commercially valuable design, formula, system, practice or piece of information that a business has taken steps to protect and which gives an enterprise a competitive advantage.

Enforcing IPR in China

There are five official enforcement mechanisms for protecting IPR in China: administrative enforcement, civil litigation, criminal action, customs seizures and Notice-and-Takedowns:

Administrative enforcement is typically easier and quicker than court proceedings. Administrative agencies can issue fines, conduct raids, seize and destroy infringing goods and impose injunctions to force infringers to desist. However, administrative bodies cannot order damages be paid to the infringed party and the agencies typically only accept clear-cut cases of infringement. Furthermore, deterrence may be lower than in court proceedings because fines are typically low.

Civil litigation allows the rights holder to sue infringers. Civil courts can issue injunctions and order infringers to pay damages to the rights holder. However, while civil courts may have a bet-

to remove infringing products from their websites. In China, Notice-and-Takedowns are commonly issued against e-commerce platforms. They are a simple and effective tool to enforce IPR and do not require rights holders to engage with a government agency. However, Notice-and-Takedowns are a weak deterrent to future IP infringements since the penalty inflicted on infringers is minimal.

Legislation

China's legal framework governing IP is based on four core pieces of legislation: the Patent Law, the Trademark Law, the Copyright Law and the Anti-Unfair Competition Law:

The Patent Law was adopted in 1984 and amended in 1992, 2000 and 2008. The National People's Congress Standing Committee is currently considering a further amendment to the law, which includes a new provision on patent term extension for innovative pharmaceutical drugs, increased punitive damages, expanded administrative enforcement, extension of statute of limitations and term of design patents and measures to address online infringement. The fourth amendment to the law has been under discussion for several years and is expected to be approved in 2020.

The Trademark Law was adopted in 1982 and amended in 1993, 2001, 2014 and 2019. Its most recent revision in April 2019 strengthened regulations against and penalties for bad-faith trademarks. Unlike the U.S., China grants trademarks — as well as patents — on a first-to-file basis, which leads to trademark squatting.

The Copyright Law was adopted in 1990 and amended in 2001 and 2010. A revision of the law is tentatively planned for 2020. China's law is consistent with the Berne Convention in that copyright is automatically protected.

The Anti-Unfair Competition Law was created in 1993 and amended in 2017 and 2019. An amendment to the law in 2019 attempted to strengthen trade secret protection by updating the definition of trade secrets to include all "trade information," increasing damages, reversing the burden of proof in certain civil trade secrets suit cases to the defendant and adding more misappropriations.

Adjacent laws include the Foreign Investment Law (adopted 2019), which promises national treatment of foreign investment and increases investment protection for foreign entities; the Advertising Law (revised 2015), which prohibits false or misleading content in advertisements; and the Administrative Licensing Law (revised 2019),

which protects trade secrets and technology transfer. Other adjacent laws include the Tort Liability Law (2009), the Corporate Income Tax Law (2007), the Antimonopoly Law (2007), and the Labor Contract Law (2007), among others.

Intellectual Property Rights in the Context of the U.S.-China Trade War

Intellectual property is one of the biggest points of contention in the U.S.-China trade relationship. The investigation under Section 301 of the Trade Act of 1974 that was released in March 2018 by the United States Trade Representative found that "acts, policies, and practices of the Chinese government related to technolo-

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Unless the government or the police go to the other company [themselves] and see some evidence, it's virtually impossible to make a trade secret claim.

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Timeline

Apr. 27, 2018:	National People's Congress Standing Committee (NPCSC) releases legislative plan, slating Draft Patent Law for deliberation in June 2018.
Jul. 6, 2018:	U.S. implements first China-specific tariffs.
Dec. 2, 2018:	U.S. and China agree to 90-day truce after a working dinner between Chairman Xi and President Trump at the G20 Summit in Buenos Aires.
Dec. 23, 2018:	The Draft Patent Law is considered during the last 2018 session of the NPCSC, eight months later than originally planned.
Jan. 1, 2019:	Supreme People's Court establishes an IP tribunal to serve as an appellate court on all patent and other technical IP cases nationwide.
Mar. 15, 2019:	Foreign Investment Law is rushed through and adopted by the NPC after only four months of deliberation.
Apr. 23, 2019:	NPCSC approves amendments to the Trademark Law, Anti-Unfair Competition Law and the Administrative Licensing Law.
May 10, 2019:	Trade negotiations break down and the U.S. increases tariffs on China.
Jan 15, 2020:	U.S. and China sign phase-one trade agreement in which China makes significant commitments to improving IP protection.

lectual property, geographical indications, trademarks, and pirated and counterfeit goods on e-commerce platforms. Chapter 7 outlines an enforcement mechanism in the form of a bilateral evaluation and dispute resolution agreement. The Trump administration said that it reserves the right to impose further tariffs on China if Beijing reneges on commitments made in the phase-one trade agreement.

Intellectual Property Issues Affecting AmCham Shanghai Members

Intellectual property issues vary greatly across industries. The problems below highlight some of our members' issues in the pharmaceutical, healthcare, technology and consumer retail industries.

Inadequate Protection for Trade Secrets

While most companies we interviewed believed China's overall IP environment had improved in recent years with regard to patents, trademarks and copyrights, there was a consensus that the IP regulatory regime had consistently fallen short in protecting trade secrets. Unlike the U.S., China does not have a civil discovery process that allows infringed companies to collect evidence of trade se-

gy transfer, intellectual property, and innovation are unreasonable or discriminatory and burden or restrict U.S. commerce." The finding followed decades of concerns voiced by the American business community in China, including many AmCham Shanghai members, to the U.S. government about Beijing's inadequate protection of IP.

There have been numerous legal developments in China's IP environment since the trade war began in 2018. These include updates to the Trademark Law, Administrative Licensing Law and

Anti-Unfair Competition Law in April 2019, as well as the passage of a Foreign Investment Law in March 2019. In January 2019 the Supreme People's Court also established an appellate-level IP tribunal that considers appeals of IP decisions issued by high people's courts, IP courts and intermediate courts.

In January 2020 the U.S. and China signed a phase-one trade agreement. Chapter 1 focused on intellectual property, in which China promised to strengthen protections of trade secrets, patents, pharmaceutical-related in-

cret theft from other parties. One lawyer pointed out that since companies are unable to collect evidence themselves, "Unless the government or the police go to the other company [themselves] and see some evidence, it's virtually impossible to make a trade secret claim." Another respondent stated that the burden of proof required by the Public Security Bureau to launch an investigation is too high. "It is not like, if you have [a] strong suspicion already, such as you have this technology and then you find that several employees left the company, joined a competitor, and then months later this competitor has the same product. Police will not think that this substantial evidence is sufficient to launch an investigation. They always ask for more."

Inadequate trade secret protection has led companies to operate differently in China than in other markets. As one multinational company told us: "One way [to preserve our trade secrets] is to not bring any important technology to China anymore. As a local team, we really don't want to see that. But before we have a good solution to this, how can we convince our management team to continue to bring key technology to China?" Other companies said that they had developed strict internal approval for who in China can gain access to core technology as well as kept their supply chains diverse.

In China, "We just spend more resources in protecting trade secrets," one interviewee said.

Unfortunately, as one lawyer pointed out, finding a legal remedy to strengthen trade secret protections will be difficult because of a fundamental disagreement over corporate power in China. China's IP legal framework is less weighted toward protecting the commercial interests of large corporations than the U.S., where an unbridled discovery process comes at the detriment of smaller companies and where harsher criminal penalties more strongly disincentivize trade secrets theft.

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Damages too Low

Many companies agreed that court-imposed punitive damages and other penalties were too low to deter future IP offenses. Although minimum statutory damages have been steadily increasing, Chinese courts have been reluctant to impose punitive damages except in several high-profile cases. As one healthcare company said: "It's really difficult to get punitive damage in ordinary cases unless the court sees a particular advertising element in this, [in which case] they do this for show, for symbolic purpose. That is not a general practice."

Low deterrence often leads to repeat offenses. As one software company said, "The biggest challenge in terms of the effectiveness of the laws is the penalties, and if we win the case the damages are usually not as high as they need to be to really discourage the behavior." And in cases where damages are awarded, some companies expressed difficulty in having the judgment enforced. "You may get an award for damages and if it's a private company often they'll find ways to hide their assets and you're not able to enforce against them. That's a serious problem where when you win, it's a moral victory."

Political Influence and Local Protectionism in Courts

Many respondents were concerned by corruption in the courts, particularly in more rural parts of the country. "For some of the remote areas, the local government has a very close relationship with the court and judges," one consumer retail company said. "If the opposing party has a certain relationship with the government, then the government will influence the judges." Many companies echoed this sentiment, with several respondents pointing to Putian, a city in eastern Fujian province, as an example; foreign media outlets have dubbed the city China's "Fake Sneaker Capital," and it has gained notoriety for local court protectionism.

Beijing has made progress in leveling the playing field; in 2014 it established specialized IP courts in Beijing, Shanghai and Guangzhou. Most companies interviewed expressed confidence in the impartiality of these courts, with one interviewee stating: "The integrity of the judges, the anti-corruption policies of the courts, [makes them] better than outer cities." In January 2019 the Supreme People's Court also established an appellate-level IP tribunal that considers appeals of IP decisions issued by high people's courts, IP courts and intermediate courts, which many companies said was a

Legislative Diplomacy

Respondents noted the suspicious timing of some of China's legislating during the U.S.-China trade war. One person pointed to the Draft Patent Law. In April 2018, two months before the U.S. first levied China-specific tariffs, the National People's Congress Standing Committee (NPCSC) released its 2018 legislative plan, which slotted the first reading of the Draft Patent Law for its third session in June. It was listed as a top-priority Category 1 project. However, the first reading of the law was delayed until the NPCSC's sixth session in December, immediately following President Donald Trump and Chairman Xi Jinping's meeting in Buenos Aires, where the leaders agreed to a 90-day tariff moratorium. Many observers have also attributed the expedited passage of the Foreign Investment Law in March 2019 as a concession to Washington.

positive development.

And yet some respondents noted the limits of court impartiality. One American conglomerate said that "the chance of getting a fair judgment is pretty high" in tier one cities when "dealing with a small company with no political influence." However, "If you are selecting an extremely influential company, even if you go to Shanghai or Beijing, the chance of you getting a fair judgment is totally low, even in the IP court."

Another respondent gave a specific example. In a case brought by her company in a tier one city against a large Chinese multinational, she said: "They [the police] know they have to take this case. It's pretty serious stuff... But meanwhile they contact [the Chinese company] to tell them, to give our case information to them without notifying me... And they cut us out of the communication, so they only talk to [the Chinese company]. We had

to really struggle to get through the whole procedure." Other companies suspected courts were in some cases delaying issuing judgments until progress had been made in the trade war.

Online Infringement

The rapid growth of Chinese e-commerce platforms like Taobao and Pinduoduo has amplified online trademark infringement. Several consumer retail companies said that they have teams to monitor these platforms and take action after spotting trademark infringement, beginning with issuing a Notice-and-Takedown. One said: "Basically, we will send letters to Taobao or Alibaba to file a complaint first. So, they will do certain investigation. After a certain period, they will delete or remove certain shops from their platform. For some of them, the key violators, then we will file certain complaints with administration authority or even file litigation against them."

Several respondents noted that Taobao has implemented stricter measures in recent years to stop IP infringements: "They improve the terms, they improve the technique, and they will do proactive monitoring." In 2017 Alibaba, Taobao's parent company, also set up an Anti-Counterfeiting Alliance that works with companies to counter IP infringement. And yet e-commerce platforms remain overwhelmed by the volume of fake stores that continue to surface. One toy company said: "It's just too many and we can't take it down one by one, so we have to choose the bigger ones to deal with them."

Recently, infringers have also been using social messaging platforms like WeChat. Although companies can self-patrol online public sales platforms like Taobao and Pinduoduo, WeChat's privacy settings make monitoring by companies impossible. One technology company said their issues with WeChat were twofold: "First, it's more difficult to trace [the infringers]. When using WeChat, to view someone's post, they have to know you and agree to add you as a friend. They protect themselves by screening their potential customers." The company also stated that unlike e-commerce platforms like Taobao, it is not possible to do keyword searches for their products on WeChat. Second, since WeChat is a social messaging service, purchases are not made through the

platform itself. Thus, infringers can manipulate the platform — for example, by using multiple accounts — to ensure anonymous transactions. "There's not necessarily any log of the deal... So even [if] police get their transaction records, according to the law, if we go to the court, they can still argue that's not for business, that's not a sales revenue."



When using WeChat, to view someone's post, they have to know you and agree to add you as a friend. They protect themselves by screening their potential customers



Bad-Faith Trademarks and Design Infringement

Unlike the U.S., China is a "first-to-file" jurisdiction, which has given rise to an industry of trademark squatters who hoard trademarks for profit. One toy company said that they had just registered one of their core trademarks after

lengthy court proceedings despite having operated in China for nearly two decades.

To counter trademark squatting, companies try to file early and ensure that no news leaks before brand launches. One consumer retail company said: "We have a very early phase planning for all trademark registration in China. Also, for [our] China team, if the marketing teams have various new ideas, my team will work with them to make sure we file the registration before we officially announce a brand or launch the product to make sure everything is well protected."

Many companies in the consumer retail industry also said that China's IP regime failed to adequately protect design infringement, which is more subjective than an outright trademark counterfeit. This type of infringement usually requires a court judgment since its subjectivity requires a "fine legal analysis," said one technology company. "[Administrative agencies] don't feel comfortable making those judgments. They feel comfortable enforcing when it's black and white that there's a violation." The complexity of such cases and the unwillingness of administrative agencies and online platforms to judge design infringement means that companies get mired in lengthy and expensive court cases.

Recommendations

For Government:

- Create a standalone Trade Secrets Law.
- Lower the burden of proof for filing court cases.
- Strengthen infringement penalties on e-commerce websites and pressure social media platforms to take responsibility for infringements on their platforms.
- Increase minimum statutory and punitive damages and administrative fines.
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