

## 6 Ways To Fight Counterfeiting In China

By Erin Coe

Law360, San Diego (August 22, 2011) -- While counterfeiting remains a rampant problem in China, the Chinese government is becoming more responsive to complaints and U.S. companies have a number of legal tools at their disposal to enforce their intellectual property rights, attorneys say.

Chinese authorities have increased enforcement over the last decade and raised fines for the making and selling of fake goods in part to avoid retaliatory action from countries fed up with China's historically lax enforcement efforts in the area of counterfeiting.

Ever since China became a member of the World Trade Organization in 2001, the country has stepped up actions against counterfeiters because it has to worry about discrimination against its own trade, according to Mark Zolno, founder and chairman of Katten Muchin Rosenman LLP's customs and international trade practice.

"If there is any kind of discriminatory nontariff trade barrier against U.S. trade, the U.S. has a right to retaliate," he said. "There's always an implicit threat that the U.S. can impose sanctions in the form of quotas or duties."

In 1999, China's State Administration for Industry and Commerce initiated about 17,000 enforcement actions and issued an average fine of nearly \$800, but in 2010, the agency launched more than 56,000 actions and imposed an average fine of nearly \$1,300, according to Daniel C.K. Chow, a law professor at Ohio State University's Michael E. Moritz College of Law.

"There is much more activity and more raids, but there is still no deterrent effect," he said. "The penalties continue to be very low and light, and it's just the cost of doing business for counterfeiters. They're fined, and then they are back in business in two weeks."

While China's increased enforcement effort is good news for U.S. companies, the likelihood that many counterfeiters will be repeat offenders makes it even more important for companies to enforce their IP rights and remain vigilant, attorneys say.

“U.S. companies need to have a strategy when it comes to counterfeiting,” said Horace Lam, an IP partner in Jones Day’s Beijing office. “They need to use different actions and adjust their strategy accordingly depending on the type of counterfeiting, the type of products, and the scale and scope of infringement.”

Here are six ways for U.S. companies to wage an attack against counterfeiting in China:

### **Review Portfolio**

Before a company can seek administrative, civil or criminal remedies, it needs to obtain the right registrations to cover its products, according to Lam.

“A number of large U.S. companies and small ones don’t have the right registrations in place in China,” he said. “They need to look at their trademarks, design patents and other types of IP rights and remember that in China because the legal system is a civil one, it places heavy weight on registrations.”

China uses a slightly different classification system, and while many companies have international registrations, their products in China may not be covered by them, he says.

“That can create problems because people can hijack your mark and register for the trademark that you didn’t,” he said. “Without a registration, it’s more difficult to use the Chinese enforcement system.”

The IP system in China does work, but U.S. companies need to have their IP registered first and then work with someone who understands the system well, according to Lam.

“Look at your portfolio, fill the gaps and make sure your registrations cover your products in China,” he said.

Once companies have a trademark registration for the Chinese equivalent of their brand name, they should record the registration with the local customs agency in China and conduct a periodic review, according to Toni Hickey, senior counsel at Foley & Lardner LLP.

“Then they can avail themselves of remedies against counterfeiting activity in China,” she said.

### **Request Administrative Action**

When companies suspect that counterfeiting of their products is taking place, most of them hire a private investigator to locate the source of the fake goods and then request for the local level of the SAIC, which is in charge of policing and promoting the markets, to conduct a raid, according to Chow, who used to work for a multinational company in China and went on a number of trips to seize counterfeit goods.

Once a brand owner shows its registration and files a complaint over the counterfeiting activity, SAIC officials tend to be very responsive and can be ready to carry out a raid in just 15 minutes, but Chow says he usually waited until getting into the van before telling officials where the activity was taking place so that they didn’t tip off the counterfeiter in advance.

“When you’re dealing with counterfeiting, the element of surprise is absolutely essential,” he said. “If you file a complaint in court, the counterfeiter disappears. The raid preserves the surprise.”

After officials seize fake goods, cash and anything else on the premises, they will destroy the products or auction them off and then fine the counterfeiter, but the fine tends to be too low to stop the counterfeiting, according to Lam.

“A raid is very quick and relatively cheap, but because the fine’s not heavy, counterfeiters treat it as an operating cost and they eventually go back to what they were doing,” Lam said. “An administrative action may be one strategy to consider, but it shouldn’t be the only action because it does not have a very long-lasting deterrent effect.”

In addition to the SAIC, a company can report counterfeiting activity for certain goods to China’s General Administration of Quality Supervision, Inspection and Quarantine, which ensures food and safety standards are met, and can crack down on counterfeit products from being placed on the market, according to Hickey.

“If a particular wine is not a quality product and could be harmful to the population, a company could rely on the AQSIQ,” she said. “Like the SAIC, it can get products off the market and impose fines against perpetrators.”

### **Seek Criminal Enforcement**

If the administrative agency collects a large amount of counterfeit articles, a brand owner can try to persuade the SAIC to refer the case to China’s Public Security Bureau to commence a criminal investigation, according to Chow.

The deterrent is high in such cases because a counterfeiter could be sent to jail, Lam says. However, the PSB is not just responsible for IP and might not consider going after counterfeiters a high priority, he adds.

A lot of times, companies need to build their case before they ask the agency to take on a criminal action, he said.

Sentencing a counterfeiter to a prison term is generally used in the most egregious cases, such as a case several years ago where fake pharmaceutical products turned out to be poisonous, according to Hickey.

“We’re talking about a high standard of health and safety concern before criminal enforcement is triggered,” she said.

While China has initiated more criminal prosecutions over the last decade, the referral of a counterfeiting case from an administrative agency to the PSB is still rare, according to Chow.

Out of the 17,000 administrative actions in 1999, 21 of those cases were referred to the PSB, while among the 56,000 actions in 2010, 175 were turned over to the PSB, or one in 320 cases, he said.

“Those are your chances of being criminally prosecuted, and that’s no deterrent,” he said. “People are afraid of two things: if you take away their money or put them in jail. It’s hard to stop counterfeiters if there are no consequences to being caught.”

## **Launch Litigation**

Although U.S. businesses tend to be wary of initiating lawsuits in Chinese courts, the quality of the judges has improved significantly, and the court system is now a practical avenue that companies should consider, according to Lam.

If a company comes across a big target, civil litigation should be seen as an option, and for smaller infringers, a company may want to bring a litigation campaign against them to send a message to the market, he says.

Seeking to show it was serious about fighting fake goods, Motorola Mobility Holdings Inc. filed several suits in different cities of China against smaller counterfeiters and received favorable rulings of infringement as well as an injunction and modest damages in the last couple of years, according to Lam, who represented the company.

Dealing with a suit can be much more time- and cost-consuming for a counterfeiter, and if a court finds for the brand owner, a damages award is usually much higher than an administrative fine, and an injunction may also be granted, according to Lam.

“Lawsuits send a signal to counterfeiters that rights owners are taking their IP much more seriously, in the sense that they are willing to spend the time and money to sue,” he said. “Because the damages to counterfeiters are higher, the deterrent effect of a lawsuit tends to be stronger.”

However, there are still challenges on the litigation front. Businesses need to prepare their case well before filing suit because there is no discovery in Chinese suits and companies cannot plan on collecting more evidence once a suit is brought, according to Lam.

The outcome of cases can be hard to predict since the courts do not rely on precedent, and brand owners must pair up with a local Chinese law firm to bring their cases, which tacks on another layer of expense, according to Hickey.

While Chinese courts are much more willing to award damages, they are much lower than those awarded in U.S. cases, and companies should not use the court system expecting to recover major damages, according to attorneys.

“Even if a company receives a damage award, it is low, and a counterfeiter is likely to go out of business before there’s a chance for recovery and later pop up under a new name in another region,” Hickey said.

Despite these obstacles, several U.S. businesses continue to bring suits and have secured IP wins in Chinese courts, according to Zolno.

A Xiamen court in June determined that Xiamen Xinkun Industrial & Trading Co. Ltd. copied Power Balance LLC US's silicone wristbands, its packaging and logo design, ordering the defendant to stop using the California-based company's logo and finding it liable for damages and reasonable expenses, according to Zolno.

Last year, a Guangdong court held that Jinjiang Kunxin Shoes Manufacturing Co. infringed the trademark rights of California-based Disney Enterprises Inc. by buying 5,100 pairs of shoes with fake Mickey Mouse graphics from a third party and selling them at a low price, and also found the activity constituted unfair competition, according to Zolno.

### **Complain to the U.S. Trade Representative**

Because counterfeiting also violates the WTO agreement, a U.S. copyright or trademark holder can lodge a complaint with the USTR's office under Section 301 of the Trade Act, which aims to protect U.S. companies, including their IP rights, from trade discrimination, Zolno said.

The USTR could pressure the Chinese government to take action against a Chinese infringer's activities, and if the Chinese government refuses to take appropriate action, the U.S. could issue sanctions against Chinese exports to the U.S., such as additional duties or quotas on select Chinese products, and those duties or restrictions would be enforced by U.S. Customs and Border Protection, he said.

"If nothing is substantively done by the Chinese government, the U.S. can retaliate against the exports of that country to the U.S.," he said. "It's a stick that can be activated if the U.S. doesn't feel that a foreign government is taking serious action against IP violations."

Although the USTR is quite responsive when receiving a 301 complaint, the proceedings could take a couple of years before a final decision is issued and are a lot slower than most IP holders would like, Zolno says. But he noted that the agency is often able to remedy the situation without having to file a formal complaint with the WTO.

Bringing a 301 complaint against China is far from a slam-dunk case because the WTO is a highly technical body with complex legal rules, and it can be difficult to show that China has failed to fulfill its obligations under the WTO to provide enough enforcement against counterfeiting, according to Chow.

"It's not clear that one can use the WTO effectively to put pressure on China because of the issues of proof and evidence," he said.

### **Team Up with Chinese Customs**

Working with customs officials in China also can be a cost-effective measure for U.S. companies to put in place to fight counterfeiting, according to Lam.

Once a company records its registered IP rights with Chinese customs, the agency will monitor suspected counterfeit products transporting across Chinese borders for the company, he says. If it finds questionable products, it will inform the rights owner, and if the brand owner confirms infringement, customs officials will seize the products, he says.

“Chinese customs is fairly good with border controls,” Lam said. “If the rights owner has any intelligence of infringing products going out of China, they could inform customs and ask customs to intercept and seize them.”

Companies need to think about enforcement in China at the local level while using a variety of legal tactics, such as combining the customs function with administrative remedies, according to Hickey.

“Companies need to be thinking locally and dealing with provincial government agencies to combat counterfeiting,” she said.

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