

You Can
Protect IP
in China
By Catherine Y. Sun

Know the people. Know the law. Decide to act.

More and more U.S. companies are looking to China as the land of future profits. They make energetic plans for manufacturing and marketing. And yet when it comes to protecting their intellectual property in the course of Chinese business, those same companies can suddenly hesitate.

They seem to shrug and say, "Why bother? You can't really protect intellectual property in China. Everybody knows that."

It is true that the intellectual property system in China is still evolving. It is true that the Chinese system is quite different from the American system. But there is much that companies can do to effectively and efficiently protect their intellectual property there, and no good reason not to.

CHOOSING PARTNERS

Protecting your intellectual property in China begins with the people you choose to do business with.

Your Chinese partners are, unfortunately, the parties most likely to steal your technology and violate your IP rights if you do not exercise care. They have access to it. They know its

value. And they are seeking to make a profit, too. Other companies have already learned this the hard way.

It is crucial, therefore, to choose your Chinese partners wisely. Before signing on with local business partners, licensees, distributors, retailers, and wholesalers, be certain to conduct due diligence. Ask questions. Learn their history.

Take care to educate local partners about your expectations about how you will work together. Warn them of the potentially grave consequences of infringing your IP rights. And then memorialize this in writing by drafting thoughtful business agreements.

Before you dive into any discussions, however, be sure that you understand the cultural implications and interpretations of your messages. For instance, declining a drink offered by your host may be perfectly fine in the United States, but your Chinese counterparts may read a refusal negatively.

Finally, don't despair. If you build strong relationships with your local partners, they can become your greatest ally in protecting your intellectual property. Just as they are well-placed to infringe, they are well-placed to help you detect infringers. Under certain circumstances, they may even enforce IP rights on your behalf in China.

AUDITING ASSETS

Besides the right partners, a foreign company planning to enter the Chinese market needs a thorough understanding of all intellectual property at stake. That means before licensing technology to Chinese parties, before setting up franchise operations, before forming a joint venture or wholly foreign-owned enterprise, before building factories and research-and-development centers in China, you should audit your own intellectual property and that of the Chinese companies you plan to work with.

When conducting your own audit, keep in mind the company's plan for China. Think about your business entry and business growth strategies. The audit and related due diligence should specifically focus on the strengths and weaknesses of your intellectual property in the context of future acquisitions, exploitation, and enforcement in China.

If your company plans to buy a Chinese company or license technology to a Chinese partner, you must also conduct an IP audit and due diligence on the Chinese party. Needless to say, you will be reviewing a substantial number of documents and conducting interviews with senior officers of the company. The audit team should include someone who speaks and reads the Chinese language. Do not rely on translations only, which can lead to costly misinterpretations of important issues.

Obviously, IP audits done with an eye to China differ from those done solely for U.S. purposes. Different issues arise depending on the types of intellectual property in question.

Patents: Are your vital innovations protected overseas? Because China has a first-to-file system, rather than a first-to-invent system, you must move quickly to protect patent rights there.

In other words, the best time to think about patent protection in China is when you think about it in the United States.

Because both the United States and China are signatories to the Patent Cooperation Treaty, you can designate China as an additional country in which you seek a patent at the time you file the U.S. application. Doing so allows you to claim the U.S. filing date as the Chinese filing date. If you have already skipped that step, you can still claim the U.S. filing date if you file a patent application in China within 12 months of the U.S. filing.

However, any disclosure worldwide destroys novelty in China. Unlike in the United States, there is no one-year grace period for filing an application after first public use or sale.

China provides for three types of patents: invention, utility model, and industrial design. Invention patents are the counterpart to U.S. utility patents. Invention patent applications receive substantive examination, and the patent rights are granted for 20 years. Applications for utility model and industrial design patents receive a lesser degree of examination, and the patent rights last only 10 years.

Any audit of patent rights should, of course, look at pending applications. Patent prosecution in China has a unique wrinkle: You need to file a request for the substantive examination of an invention patent application within three years of filing the initial application. Failure to make the request (without appropriate justification) will cause the application to be deemed abandoned.

So always instruct your Chinese patent agent to make a request in due course. And when a Chinese partner refers to pending applications, ask about the examination requests.

Trademarks: If your company is planning to do business in China, a Chinese-language trademark is highly recommended. Chinese consumers are generally not accustomed to English-language characters.

But choose your new mark with care. English-language trademarks and corporate names can have negative or humorous connotations when translated directly into Chinese.

Moreover, if you do not provide a Chinese name for your product, consumers themselves may create a name based on their understanding, pronunciation, or interpretation of your original English-language mark, which may dilute the strength and reputation of your brand.

As in the United States, a registered trademark has stronger protection. Well-known marks enjoy protection across classes of products and services only if registered. Unregistered marks are protected only for identical or similar products or services.

Trademark registration in China is based on the first-to-file principle. Failure to use a registered trademark for three years makes it subject to cancellation.

You should also seriously consider acquiring a Chinese domain name and setting up a Chinese-language Web site to help support your business presence there. During your IP audit, the contents of your Web site should be carefully examined.

Copyrights: With the exception of foreign software programs for sale, copyright registration is not mandatory in China. However, registration of a copyright is considered prima facie evidence of ownership. So if you want to enforce the copyright in China, it is highly recommended that you register it there.

Trade secrets: China protects trade secrets under the Anti-Monopoly Law, the Anti-Unfair Competition Law, and a number of administrative regulations and local rules. Be careful in drafting employment, confidentiality, and noncompete agreements so you don't inadvertently abandon that protection. And beware that strong clauses may be rendered unenforceable if certain fees are not paid.

Under Chinese labor law, the employer must pay confidentiality preservation fees to its employees during the term of the employment agreement. Otherwise the employees' confidentiality obligation expires with their employment. Up to three years' post-employment restriction is acceptable, but you must define the confidential information carefully in the agreement.

With noncompete covenants, keep enforceability in mind as well. To bind ex-employees, the employer must pay compensation fees, which vary from city to city but generally are no less than 50 percent of the employee's annual compensation received during his final year of employment. Otherwise, the noncompete clause is deemed invalid.

Other issues: China provides for several sui generis IP rights, such as those covering plant varieties and semi-conductor layout design. IP protection and regulatory compliance for pharmaceuticals has its own unique set of demands, which are overseen by the State Food and Drug Administration.

Perhaps most importantly, as a foreign company acquiring or seeking to enforce intellectual property rights, you must designate a Chinese party as your authorized agent if you do not have a business address in China.

TIME TO ENFORCE

Assume the audits went well. The due diligence led you to appropriate Chinese partners. You have intellectual property duly recognized by Chinese law, and you're in business. There will probably come a time when you need to take additional steps to protect your intellectual property against infringers.

When conducting IP enforcement in China, you need to be clear and realistic about what you are seeking. Is it injunctive relief or monetary compensation? Is the problem an immediate loss or a longer-term erosion of your product's reputation? Is it more important to punish the infringer or build relations with local business people and government officials?

Then you must decide whether to pursue administrative enforcement, civil litigation, or criminal litigation.

Administrative enforcement is most effective for addressing straightforward trademark, copyright, and design patent infringement. The agencies that conduct such enforcement include the State Administration for Industry and Commerce and its local offices (also called the local AICs) and the General Administration of Quality Supervision, Inspection and Quarantine and its local offices (called Technical Supervision Bureaus). The Ministry of Public Security and its local Public Security Bureaus may get involved in some high-profile actions.

Administrative enforcement is fast and less expensive. On the down side, no damages will be awarded to IP owners.

Civil litigation is suitable for complex infringement cases—in particular, infringement of invention and utility model

patents. Be aware that damage awards in China are only a fraction of what you would expect in the United States. But the good news is that attorney fees are also a fraction of what you would spend in the United States. Court fees in China are fairly expensive and are calculated on a sliding scale according to the amount of damages, which a plaintiff must specify in the complaint. You should expect to pay between 1 percent and 1.5 percent of the claimed amount in court fees.

The dedicated IP courts in China vary significantly in terms of resources, education, knowledge, fairness, transparency, and capability. To put it bluntly, venue shopping is very important. The IP courts in the major cities, Beijing and Shanghai, are the best in the country. Judges in these cities are much better trained and have more experience in resolving IP disputes. If your company has a presence in Beijing or Shanghai, or the infringing products are sold or the infringement otherwise occurs in these cities, you may file directly in their intermediate courts.

Criminal prosecution is permitted for certain trademark, copyright, and patent infringements. Cases can be initiated by the state or by the private IP owner. Criminal prosecution is more common for trademarks than for patents.

Because enforcement has tended to be a weaker point in China's IP system, you need your own enforcement team—even when the government is officially on your side. If your company already has a presence in China, you may consider putting together a local enforcement team to reduce costs. For junior-level personnel, you can hire local Chinese lawyers relatively inexpensively. But to recognize and bridge gaps in understanding, you should have at least one lawyer on the team who speaks Chinese and English, and who has had Chinese as well as U.S. legal training and experience.

When looking for local legal help, beware that law firms in China, as anywhere else, vary greatly in terms of professionalism, knowledge, quality, and expense. Seek referrals from people who have previously hired local lawyers. Note also that just as foreign businesses are moving into China, so are foreign law firms, bringing with them valuable international experience (albeit often with higher fees).

From time to time, you may also want to hire local investigators—for instance, to collect evidence or to conduct administrative raids jointly with your local IP enforcement team. Be especially careful to instruct your local agents and investigators not to provide false evidence or bribe local officials. Otherwise, you risk subjecting the company to liability under the Foreign Corrupt Practice Act—just a word to the wise.

A FINAL THOUGHT

No company should avoid China because of well-worn tales about past intellectual property struggles. China's markets offer unparalleled expansion and investment opportunities for American business. Set aside reasonable time and resources to protect your intellectual property, while paying close attention to the unique cultural and legal aspects of the country, and your business too can grow. ■