

China's IP reforms Show Little Success: IP Enforcement Remains Problematic, but Clever Owners Can Beat the Odds

Doris Estelle Long

Special to IP Worldwide

The enforcement record of the People's Republic of China has led many intellectual property owners to wonder whether China's huge consumer market is worth the cost of exploitation – particularly when one of these costs appears to be the loss of enforceable rights over their technology.

However, the situation in China is not as bleak as some fear. Recent efforts to “perfect” the legal system under a new “rule of law” directive bode well for future IP enforcement. Moreover, IP owners can take practical steps to reduce the risk of piracy.

The current problem does not arise from China's IP laws. The country has a relatively complete set of IP laws¹ – including newly revised trademark counterfeiting provisions.²

Enforcement of these laws, however, remains problematic. For every article in the *China Daily* announcing the destruction of counterfeit goods, there are thousands of other instances of other that remain uninvestigated, unprosecuted, or otherwise unpunished.³

For instance, a month prior to President Clinton's 1998 visit to China, counterfeit CDs and videodiscs were readily available throughout China, including in some of the country's finest department stores.⁴ Several weeks after President Clinton's visit, the street peddlers who had been removed in well-publicized sweeps were back in business with little drop in activity. Enforcement of IP rights resides primarily with the courts and administrative tribunals, such as the State Administration of Industry and Commerce and the State Copyright Administration. These authorities are endowed with the legal power to decide infringement disputes and to authorize temporary and final relief in the form of monetary fines, seizure and/or destruction of illegal goods, and instances of criminal prosecution before the courts, imprisonment and criminal penalties. Despite efforts to establish more courts at the provincial and municipal levels to handle IP violations, procedures are reportedly slow and interim relief (in the form of seizures and enforceable temporary restraining orders) is difficult to obtain.

¹ Current statutes establish patent, copyright and trademark rights that are generally in accordance with the international standards set forth in the Berne Convention, the Paris Convention, and TRIPS.

² Supplementary Provisions Concerning the Punishment of Crimes of Counterfeiting Registered Trademarks.

³ The Software Business Alliance estimates that software publishers have lost over US\$ 1.4 billion in 1997 alone as a result of pirating activities in China. International Planning and Research Corporation, 1997 Global Software Piracy Report, <http://www.bsa.org/statistics/97ipr.pdf>

⁴ The author spotted counterfeit CDs and videodiscs in such well-known Shanghai department stores as Parkson's, Times Square (in Pudong New Area), and Orient Shopping Center. Sellers of counterfeit videos were visible throughout the city until approximately three weeks before Clinton's scheduled visit. Sellers in other cities, such as Beijing, went underground approximately a month before his scheduled visit.

Why is enforcement so weak? One factor is China's culture. The culture strongly embraces formalism – the belief that enactment of laws is sufficient, without concern for their enforcement. The culture similarly embraces the rule of man (*renzhi*) which places decision-making power in the hands of individuals with nearly unlimited discretion to decide disputes according to personal whims. These concepts are in direct contradistinction to western concepts of the rule of law (*fazhi*), which stress transparency of laws and unbiased and predictable enforcement of those laws.

Chinese culture's acceptance of *guanxi* (favor for favor), when taken to its extreme form, makes corruption and abuse of process more likely.⁵ Added to this mixture is the fact that many of the factories which create or distribute counterfeit and pirated products are purportedly owned by the People's Liberation Army or high government officials – making enforcement even less likely.

Counterbalancing these cultural and economic influences, however, is the strong political reality of China's avowed desire to participate in the WTO. One of the admission requirements to the WTO is conformance to the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS),⁶ and TRIPS requires that IP rights be enforced by the rule of law.⁷

TRIPS to the rescue

As interpreted by TRIPS, the rule of law requires that the IP enforcement regime must be transparent, so that all parties know what the rules are and can conform their conduct to such rules. It further requires that decisions by judicial authorities and other governing bodies be readily available to the public and not just concerned parties.⁸ The outcome of legal disputes must be predictable; the same principles must be applied each time the same issue arises.⁹

The rule of law under TRIPS also requires an impartial judiciary, so that decisions are made on the basis of legal principle and not private interest.¹⁰ Rights must be readily enforceable and decisions must be based on the evidence presented, not on private considerations or secret evidence.¹¹

The rule of law under TRIPS requires that judicial relief be available in an acceptable amount of time.¹² Such relief must include the right to "adequate compensation"¹³ and seizure and destruction of both the illegal goods and the means used to create those goods.¹⁴ Temporary

⁵ Mayfair Mei-Hui Yang, *Gifts, Fairs and Banquets: the Art of Social Relationships in China* (Cornell University Press 1994).

⁶ Agreement on Trade-Related Aspects of Intellectual Property Rights, 33 I.L.M. 81 (1994).

⁷ See, e.g., TRIPS, Article 63 (requiring transparency of law), Articles 41 to 50 (establishing minimum enforcement procedures for civil violations, and Article 61 (establishing minimum enforcement requirements for criminal counterfeiting and piracy violations).

⁸ *Id.*

⁹ *Id.* Article 41.

¹⁰ *Id.*

¹¹ *Id.* Article 43

¹² *Id.* Article 41.

¹³ *Id.* Article 45.

¹⁴ *Id.* Article 46.

relief must be available in the form of injunctions to stop parties from violating another's legal rights.¹⁵

Finally, rule of law under TRIPS requires that all legal proceedings allow notice to both parties, and such parties must be allowed to participate in a meaningful manner.¹⁶ Specifically, the parties must be allowed discovery, the right to be represented by counsel in a legal proceeding, the right to present evidence, and the right to be heard before judgment is rendered.¹⁷

While publicly affirming that China is already in compliance with TRIPS and needs no grace period under Article 65 to comply,¹⁸ the Chinese government has, nevertheless, begun to take positive steps to develop an enforcement system that will meet TRIPS' criteria for enforcement based on the rule of law.

Forces for reform

In March 1998, the First Session of the Ninth National People's Congress outlined a five year plan that emphasized wide-ranging legal reforms to correct a variety of economic and social problems. Among the areas targeted for reform by the Communist Party of China (CPC) were the perfecting of legal enforcement mechanisms to increase efficiency and reduce corruption.¹⁹ "Governing the country by law is an important component of Deng Xiaopeng Theory and a basic strategy employed by the CPC in leading the people," Li Peng, Chairman of the Standing Committee of the Ninth People's Congress, declared in a well-publicized speech at the end of the First Session.²⁰

"Implementation of 'rule of law' in earnest is the thing I care about most now," said recently appointed Justice Minister Gao Changli in an interview with *China Daily*.²¹ Acknowledging that "rule of law" constituted an important part of then-General Secretary of the Central Committee of the CPC Jiang Zemin's report to the 15th National Congress in September 1997, Minister Gao went on to declare: "This is a milestone in the development of China's democracy and legal system."²²

These words appear to be more than empty rhetoric. In recent months, the government has publicized efforts by judicial and administrative authorities to identify and correct deficiencies in the Chinese legal system. Among the problems that have been identified are: the lack of adequately trained personnel, the need for open hearings in accordance with Chinese Administrative law, the tendency of provincial officials to ignore national laws when enforcement is contrary to local desire, and the lack of efficient procedures for securing prompt and effective relief.²³

¹⁵ Id. Article 44.

¹⁶ Id. Article 42.

¹⁷ Id.

¹⁸ See, e.g., "Li, Shu meet with Luxembourg PM," *China Daily* (June 5, 1998).

¹⁹ "Zhu Charts Development Course. Excerpts from Premier Zhu Rongji's Press Conference," *China Daily* (March 20, 1998).

²⁰ "Li Outlines NPC's Transcentury Goals," *China Daily* (March 20, 1998).

²¹ "Minister: Promoting 'Rule of Law'," *China Daily* (April 27, 1998).

²² Id.

²³ See, e.g., "Legal Reform to Keep Pace with Market," *China Daily* (Feb.20, 1998).

China has further undertaken a well-publicized campaign to reduced corruption in the legal enforcement community. Various officials, including court officials and police officers, have been subjected to public criticism, fines, and (in some instances) prison.²⁴

Dr. Gao Lulin, Commissioner of the new State Intellectual Property Office (SIPO), has indicated that reform of the patetn laws is high on his agenda for the coming year.²⁵ The primary goal of this reform is expected to be the improvement and streamlining of patent application and examination procedures, but there are informal indications the government may also attempt to improve damage remedies for patent infringement.

The sad reality

Despite the hopes occasioned by all these reform efforts, the reality is that any reforms will not be rapidly instituted. The Chinese government has traditionally been cautious in adopting corrective measures.²⁶ Moreover, there are fundamental, practical problems that may further delay legal reform.

Legal reform requires people educated in the law to aid in crafting better procedures and, more importantly, to serve as judicial and enforcement personnel in a system operated in accordance with rule of law. Yet China currently suffers from a dearth of trained lawyers and judges.²⁷

Legal education reform is underway but such reform is not expected to result in a rapid influx of trained personnel until the end of the century. Thus, both people to shepherd reform and trained personnel to operate the reformed system will be in relatively short supply for the near future.

The strong cultural belief in formalism, *renzhi*, and *guanxi* also will work against any rapid change in legal enforcement procedures and methodology.

Finally, there is an economic argument against these reforms. Enforcement of IP rights, particularly where such enforcement related to technology, is largely viewed as contrary to China's interest in rapid industrialization. Simply put, enforcement of IP rights raises the cost of much-needed technology when China's limited financial resources must be utilized for other purposes, such as solving the problems of population control, full employment and agricultural self-sufficiency. Given the government's unremitting focus on technology as the engine to fuel China's economic development,²⁸ when "rule of law" goals conflict with "economic development" goals, it is not clear that that rule of law (and its companion legal reform) will take precedence.

A 5-step program for owners

²⁴ See, e.g., "Court Officials Sentenced," People's Daily (April 15, 1998); "Vice President of High People's Court Sentenced," China Daily (July 24, 1998).

²⁵ "New IPR Commissioner Interviewed," China Daily (April 14, 1998).

²⁶ For example, although pollution has been identified as a national problem, China is still testing various methodologies for resolving this problem, utilizing localized testing sites, and has not adopted a nationwide policy.

²⁷ See, e.g., "Qualified Judges Required," People's Daily (April 16, 1998).

²⁸ See, e.g., "Science Research Reform Stresses Agriculture," China Daily (Feb. 10, 1998); "New Guide Calls for Technology Progress," China Daily (November 19, 1997).

Despite the undeniable (but not necessarily insurmountable) roadblocks to developing an effective legal enforcement system in China, IP owners are not at the mercy of pirates and counterfeiters. There are five practical steps IP owners can take to reduce infringements and assure greater enforcement of their rights during the lengthy reform process that is now underway.

First IP owners can remove the economic benefit of buying counterfeit products. Chinese consumers are no different than any other consumers. They are interested in obtaining value for their money.

Warranty service, replacement part guarantees, free upgrades (or those offered at a minimal charge) give consumers tangible post-sale benefits – benefits that are not available to purchasers of counterfeit goods. These benefits would, in the mind of such consumers, warrant the higher prices paid for such legally manufactured goods. Other types of value-added benefits may be less obvious, but no less useful in promoting the desirability of legal products.

It is undeniable, for example, that sales of pirated movies on videodiscs in China have resulted in large losses for Western film companies.²⁹ But China has no heritage of good movie theater, with comfortable seats, air conditioning, or the other benefits that make movie-going a value added experience for consumers (as opposed to simply buying or renting the illegal videos). Developing theaters which offer such comforts may provide the additional value that is presently lacking.

Other short-term post-sale benefits may include contests or giveaways that require lawful products to participate. The success of developing such post-sale benefits is limited only by the ingenuity of the intellectual property owner in creating such value and in his ability to sell this value to the public.

Carrots, not sticks

Second, IP owners should take positive steps to educate consumers about the benefits of purchasing legal products. In a culture that has absorbed the Confucian ideals of unfettered access to information and the societal benefits of copying,³⁰ railing about the immorality of purchasing infringing goods has little impact.

Stories about the harmful effects of counterfeit products (computer viruses on pirated software; illness or death from tainted goods; physical injury from unsafe items) can educate consumers that what looks like a bargain may end up costing more in the long run. Such stories need not be limited to press releases or newspaper articles. They should be included in print and television ads that get the message across in a non-threatening manner.

Third, owners must make legal products readily distinguishable from their pirated counterfeits. The use of holograms, special labels, or other markings that cannot be readily duplicated can

²⁹ For instance, the film “Titanic” was scheduled to open theatrically in China in April 1998 but by February pirated copies of the film were widely available at 15 to 30 yuan (approximately US\$ 2 to 4).

³⁰ See, e.g., To Steal a Book is an Elegant Offense: Intellectual Property Law in Chinese Civilization (1995), Liwei Wang, “The Chinese Traditions Inimical to the Patent Law,” 14 NW J Int’l L. & Bus. 15 (1993).

help consumers distinguish between legal and illegal products. Advertising these markings in a fashion that gives them cachet may further bolster their desirability.

Such markings will also make it easier for consumers to take advantage of China's Consumer Rights Law.³¹ This law provides that if a business operator has committed "fraud" in providing goods or services, consumers may obtain double the price they paid to such operator.

Wang Hai availed himself of this law, and his efforts have been widely reported as an example for others to follow. In an eight-month period, Wang, a 23-year old former store clerk, purposefully sought out and purchased 14 batches of counterfeit or otherwise shoddy products, most with famous trademarks. He then sought compensation for violation of the Consumer Rights Law.

He ultimately succeeded in obtaining about US\$ 938 and was commended by the National Anti-Counterfeit Office. Wang's example can be used to turn consumers into unpaid policemen for foreign IP owners.³²

This leads into the fourth thing IP owners can do to protect themselves. They can take advantage of the numerous consumer social groups and private investigators that have sprung up since the enactment of the Consumer Rights Law. These private investigators (or "anticounterfeiting organizations") have received increasing media coverage praising their efforts to work with local enforcement officials to investigate consumer fraud and counterfeiting activities.³³ These private investigators may provide a useful link between foreign companies and the local enforcement officials such companies must rely on to protect their IP rights.

The power of money

Finally, since the primary onus of enforcement resides with provincial and municipal officials, such officials need to be educated about the economic benefits of enforcing IP laws. The problem is that counterfeiting factories employ workers. This is particularly important to local officials since Asia is in the midst of a financial crisis and Chinese unemployment is rising as a result of the downsizing of state-operated enterprises. A strong counter-consideration is required to encourage local judges and enforcement personnel to close down profitable factories.

The loss of tax revenues may provide such a powerful economic incentive. Quite simply, illegal production and distribution facilities do not produce taxable income. Lawful ones do.

Returning money to the community in the form of cultural or educational benefits may also help encourage local officials to protect intellectual property that gives rise to these benefits. For example, under the auspices of Project Hope, Motorola has contributed funds to assist in the construction of local primary schools throughout China. These efforts not only give back to the

³¹ Law of the People's Republic of China on Protecting Consumers' Rights and Interests, Article 49.

³² Another way to obtain public assistance is to offer a reward for information leading to a successful seizure of illegal products. The scope of the problem is so great, however that the enforcement benefits may not be worth the cost unless the reward is tied to the successful closure of the pirate plant.

³³ See, e.g., "Anti-Fake Business Flourishing," China Daily (Aug. 13, 1998).

marketplace, they allow local officials to share in the success of the IP owner's business, a success which depends upon enforcement of IP rights.

It has never been easy to enforce IP rights in China. The good news is that, because of the Government's current focus on legal reform (including perfection of the rule of law), there may finally be tangible efforts to improve China's enforcement record. The bad news is that reform will come slowly and, in the meantime, creative self-help must fill the gap.