China – Anti-Counterfeiting – New Challenges and Directions*

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Counterfeiting in the People’s Republic of China (PRC) is increasingly attracting global attention, most recently through media reports on Chinese exports of fake foods and medicines, as well as exports of products containing hidden and harmful ingredients. Various industry associations and Chinese research institutes have documented the rise and current scope of China’s counterfeiting plague over the last decade, and set out suggestions for addressing it more effectively¹. Nevertheless, while the PRC government and judiciary have made noteworthy progress in a number of areas, the problem as a whole remains severe, and China consequently is being called upon to adopt more fundamental reforms.

**WTO Dispute**

In response to growing political pressure from Congress and industry, the United States government, in early April 2007, requested WTO consultations over China’s perceived failure to comply with certain provisions of the TRIPS Agreement, including in particular Article 61 of the Agreement. The EU, Japan, Canada and Mexico quickly joined the United States in these consultations as “third parties”.

The primary focus of the pending WTO dispute is China’s over-reliance on administrative enforcement — which over time has shown to offer insufficient deterrence — and the existence of legal and other structural barriers to criminal enforcement. China’s over-reliance on administrative enforcement arguably has facilitated the enormous growth of counterfeiting in China over the last decade. The problem is now rife in most industries, and at all levels, including retail, wholesale, export and, of course, production.

Article 61 of the TRIPS Agreement requires governments to provide access to criminal enforcement against trademark counterfeitters where violations occur on a “commercial scale”.² China’s Criminal Code, however, requires prosecutors to prove that the value of fake products produced or sold exceeds

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¹ The February 2007 Report of the International Anti-Counterfeiting Coalition (IACC) the most recent review of the scope of counterfeiting and proposals to address this problem. See www.iacc.org. Informative surveys and research have also been prepared by the Quality Brands Protection Committee (QBPC), an association of multinational brand owners operating in China, as well as the Development Research Center (operating under China’s State Council). See the QBPC’s website at www.qbpc.org.cn.

² Art. 61 of TRIPS states: “Members shall provide for criminal procedures and penalties to be applied at least in cases of willful trademark counterfeiting or copyright piracy on a commercial scale. Remedies available shall include imprisonment and/or monetary fines sufficient to provide a deterrent, consistently with the level of penalties applied for crimes of a corresponding gravity.”
a numerical threshold of RMB50,000 or about 5,000 Euros. In practice, Chinese police routinely cite this threshold when refusing to pursue a criminal counterfeiting case. Consequently, brand owners seeking enforcement against counterfeiters have had to resort to administrative enforcement, mainly through local Administrations for Industry and Commerce (AICs), the Technical Supervision Bureaux (TSBs) and Customs, whose powers are generally limited to confiscating infringing products and imposing administrative fines. These authorities also have the power to transfer cases to Chinese police for criminal investigation. However, due to limited resources, “protectionism” and gaps in the law, such transfers are still the exception, rather than the norm, even where relevant numerical thresholds appear to be satisfied.

Ultimately, the pending WTO dispute may encourage China's legislature, the National People’s Congress (NPC), to amend the IP provisions in its current Criminal Code (last amended in 1997), to reduce substantially, or even to eliminate, numerical thresholds for trademark, as well as copyright and trade secret violations. Once the legislature takes a fresh look at the scope of counterfeiting in China today and the difficulties IP owners and enforcers face when applying the law, a new wave of reforms in both legislation and government policies will commence.

As in other countries, success in this regard will depend not only on changes in the law, but also on adequate allocation of resources for police investigations. Chinese policy makers will likewise need to introduce more practical measures to facilitate effective cooperation between police and administrative enforcers.

At present, China is in the process of amending its Trademark Law, which addresses civil and administrative enforcement of rights. Enactment of a revised Trademark Law is scheduled to take place by the end of 2008, although there is no formal timeline for the National People’s Congress to amend the Criminal Code. Observers believe amendments to the Trademark Law alone will have little impact on the current enforcement environment.

**New Strategies for Addressing Retail Counterfeiting: Landlord Liability**

Beginning in 2004, various European luxury brand owners, including LVMH, Gucci, Chanel, Prada and Burberry, embarked on an enforcement program against complicit landlords of major markets where counterfeits are sold openly. In December 2005 and again in April 2006, this program successfully secured civil judgments against the landlord of the infamous Silk Street Market in Beijing. The Supreme People’s Court recently recognized these decisions as model cases, thereby increasing their precedential value throughout China.

Building on these decisions, the above brand owners spearheaded the creation of a larger coalition of 23 apparel, sports and fashion brands, which is currently targeting complicit landlords in Beijing, Shanghai, Guangzhou and Shenzhen. To date, this coalition has helped to bring about a number of changes, including:

- The adoption of landlord liability strategies in the central government's 2007 Action Plan on IPR Protection.

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3 Following Soviet precedents, the Criminal Code mandates criminal liability only in “serious circumstances” or where illegal turnover of the infringer is “relatively large”. Judicial interpretations jointly issued by the Supreme People’s Court and the Supreme People’s Procuratorate in April 2007 and December 2004 define these terms.

4 See the March edition of World Intellectual Property Report for an overview of the coalition’s work.

The execution of a Memorandum of Understanding in June 2006 with landlords of three major markets in Beijing. This MOU introduced a “Two-Strike” rule, under which landlords are required to terminate the leases of outlets that have infringed trademark rights on two or more occasions.

The introduction by the Shanghai and Guangzhou AICs of “recommended” agreements on IP protection to supplement existing lease contracts. The Shenzhen AIC is currently preparing a similar template agreement.

Increase in AIC fines imposed on retailers — as high as RMB 50,000 (about €5,000) for first offenders, and double that for second offenders -- in cases involving infringement of luxury brands.

AIC disclosure to brand owners of information on penalties previously imposed on infringing outlets. This information can help brand owners concentrate their future enforcement efforts on repeat offenders, thereby increasing the cost-effectiveness of retail sweeps.

These and other strategies targeting landlords will need more time to mature before trademark owners notice significant results in terms of reduced counterfeiting in Chinese retail and wholesale markets. In the meantime, more pioneering brand owners may find their investments in enforcement at the retail and wholesale levels to yield more positive results in the coming year. The increased attention to intellectual property due to the 2008 Beijing Summer Olympics should help in this regard.

Best Practices

In recent years, a number of best practices have emerged for the handling of criminal, civil and administrative enforcement in China. The following is a brief overview of some of the more noteworthy ones.

Criminal

- Complain Direct to Police - To date, most trademark owners have sought criminal enforcement following the transfer of their cases from the AICs or TSBs to local police (the Public Security Bureaux or PSBs). However, the PSBs in many regions are willing to accept complaints directly from trademark owners. Police will normally respond more favourably if the trademark owner provides detailed information in written reports. Such reports should ideally identify not only the location of infringing stocks but also the persons and companies responsible, and evidence concerning the scale of the infringement, including prior production and sales figures.

- Follow-Up! - To increase the chances of a successful outcome, it is highly advisable to follow up with the police, prosecutors and court in all phases of a criminal case. This follow-up includes meetings, telephone calls and written submissions, as well as a “victim letter” to the court underscoring the harm caused by the defendant. If a brand owner fails to express adequate concern at each and every stage of the prosecution, there is a significantly greater risk that the court will drop the criminal case or that it may impose only a fine and/or a suspended jail sentence. Such negative results in this regard are routinely caused by “protectionism”. But quite often, poor results are more the result of a lack of awareness among the authorities of recent developments in the law. For this reason, trademark owners need to be ready to educate police, prosecutors and judges by providing copies of relevant judicial interpretations and case decisions from other Chinese courts that have previously resolved similar issues not otherwise addressed in statutes.

- Arguing Case Values – Whether a case is deemed a criminal offence (as opposed to a mere administrative violation) depends on the deemed “value” of the case, and whether this value
exceeds the minimum numerical threshold. Infringers will often flee if police do not detain them at the site of raid actions. Therefore, persuading police that thresholds are met before the infringers flee is critical. The following are tips on how a trademark owner can achieve this.

- Case values may be calculated by referring to the infringer’s actual sales prices, provided that there is hard evidence of prior transactions. Local enforcers normally overlook this requirement. The trademark owner’s lawyers and investigators must argue this point in order to convince police to press infringers to produce evidence of prior transactions immediately.

- To help raise an inference that the infringer has committed a criminal infringement, trademark owners need to provide the authorities with a declaration indicating the normal retail price of the legitimate product before any raid actions begin.

- Trademark owners can increase their chances of timely arrests as well as custodial sentences by obtaining early support from other brand owners who have experienced infringement of their own brands by the same offender. The basic threshold for criminal liability for counterfeiting is RMB50,000. However, where the infringer is a manufacturer who has infringed two or more brands at the same time, the threshold goes down by 40%, i.e., to RMB30,000 (or just €3000). This “discount” also applies when calculating the standard for an aggravated offence (now RMB250,000). Consequently, if a trademark owner can demonstrate infringement of two or more brands, and the threshold of RMB150,000 (€15,000), a minimum three-year jail term applies.

Administrative

- **Monitor Repeat Offenders** – Since administrative penalties often lack adequate deterrent impact, offenders will sometimes resume their infringing activities within hours or days after a raid. Investigators should conduct compliance checks at various intervals (preferably within a week, a month and three months) after a raid. Compliance checks by telephone inquiries, rather than by on-site visits, are often sufficient. In cases where repeat offences take place, a trademark owners should consider filing criminal complaints directly with the police, rather than seeking another administrative raid. There is currently no rule which mandates criminal liability for second and subsequent offences, but if the infringer did not receive any administrative penalties for the first offence, the total value of fakes seized in the first and second actions may be combined for the purposes of calculating the relevant case value.

- **Obtaining Penalty Decisions** – As indicated above, obtaining positive enforcement results requires a trademark owner to track offenders, and sharing of enforcement data with competitors is one way to accomplish this. Local AICs have recently given enforcement data on vendors in particular markets to trademark owners, and some authorities have even posted details of penalty decisions on the internet.

Civil

- **Seizing Assets** – As anywhere, pursuing a civil case in China normally makes sense where there is a reasonable prospect of obtaining meaningful compensation. Since 2002, the Trademark Law has provided judges the power to award compensation of up to RMB500,000 (about €50,000). Over time, the amounts of these awards have increased substantially in major cities, especially in cases involving repeat offenders. To ensure that a
plaintiff actually receives compensation, China’s Civil Procedure Code permits plaintiffs to request the court freeze the defendant’s assets on an ex-parte basis and at any time before or during proceedings. This so-called “asset preservation” procedure normally targets the cash infringers maintain in their bank accounts. To use this procedure, a plaintiff must provide the court with bank account numbers or other information clarifying the location of the defendant’s assets, and plaintiff must pay a bond equivalent to the amount of the funds targeted for freezing.

- Push for Undertakings, Apologies and Compensation – Since administrative penalties normally fail to generate much deterrence, negotiating settlements with infringers, often immediately after the administrative penalty decisions, is key for a brand owner to increase the chances of more deterrence. As in other countries, it is advisable to press for a written undertaking, a public apology (which a trademark owner can pay, if necessary), and token compensation.

Customs Cases

* After recording IP rights with customs, trademark owners can increase their chances of obtaining seizures of potential fakes by providing leads and other profiling data to local customs offices. A trademark owner must promptly respond to each sighting of potential fakes so that customs authorities do not lose interest in monitoring for the brand. Meanwhile, the above best practices for administrative, civil and criminal enforcement can all be useful in following up on cases that begin with simple customs seizures.

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While the above best practices, including landlord liability strategies, can help companies achieve more satisfying results from their investments in anti-counterfeiting, none of these options offers a magic cure. Likewise, the pending WTO dispute against China is unlikely to lead to substantial improvements in enforcement results in the short or medium terms. Consequently, trademark owners will need to keep realistic expectations for the foreseeable future, and support improvements over the longer haul by continuing to experiment with available enforcement remedies and reporting the results of these efforts to interested industry associations and governments.

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