



E3G

Intellectual Property Rights in China

Myths versus Reality

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E3G is an independent, non-profit European organisation operating in the public interest to accelerate the global transition to sustainable development.

E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change.

E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.

More information is available at www.e3g.org.

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Context

E3G is an independent, non-profit European organisation operating in the public interest to accelerate the global transition to sustainable development.

E3G is currently undertaking a variety of coalition-building, analytical and advisory activities aimed at stimulating a step-change in the global response to the challenges of energy and climate security.

One of the areas of focus for E3G's analysis is on the potential roadblocks or barriers which, if not dealt with carefully, could slow down or halt progress on tackling climate change. This paper addresses this issue with a specific focus on Intellectual Property Rights in China.

While the issue of "technology transfer" has been on the climate change agenda since the inception of the UN Climate Change Convention, it has yet to make any progress, due to various political and economic constraints. One suggested reason for this that continues to emerge is that of Intellectual Property Rights (IPR), particularly in relation to China and other emerging economies.

In order to deepen the international conversation on these issues, which will be discussed at this year's G8 summit in Germany, E3G has partnered with the Intellectual Property Institute to outline the myths and facts around IPR issues in China and to begin to suggest ways forward.

A further piece of work will follow shortly including concrete suggestions of how to move forward on technology cooperation in the climate field.

Overview

This paper aims to give an objective evaluation of the state of IPR protection in China and create a setting for a productive discussion on the issue.

It is not well understood that the quality of IP law in China is very high and that IP rights are of good quality, inexpensive and relatively quick to obtain. It is also true, however, that the enforcement of IP rights varies widely across the regions of China – from very good to poor.

It is also clear that, in many cases, Western companies are not as focused as they should be on understanding the Chinese system and putting in place processes to ensure that their IPR is protected.

To operate effectively in China it is important to separate IPR myths from reality.

How big a problem is the issue of Intellectual Property Rights?

It is clear that the Chinese market is simply too important to be overlooked by Western firms. As China's economy continues to grow rapidly the IPR system is experiencing some problems. Firms therefore need to have an understanding of the Chinese market and the ability to respond with flexibility and patience. These attributes are essential to doing business in China as companies as varied as Philips, Microsoft, Zwilling-Henckels and HP have demonstrated.

Many of the “complaints” about the IP system in China are made by senior executives who actually do not understand the complexities of IP, nor the mistakes their own companies may have made in creating the problems. For example, filing a weak patent application or failing to register their IP at all (an all-too-common mistake).

The “IPR in China” debate must also be set in context. All too often, fair concerns about the ability of Western companies to compete with Chinese ones, or fears about the outsourcing of production to take advantage of cheap labour are miscategorised as IPR issues.

Certain difficulties encountered by companies from common law jurisdictions (such as the US or UK) are due to the fact that the IP laws in China are based on

a civil law model (such as in most of Europe). These difficulties are therefore not particular to China.

Myths versus Reality

This paper will discuss four common myths about IPR in China:

1. Chinese IP laws are unsophisticated.
2. The IP rights in China are of poor quality.
3. IP Laws and poor enforcement favour domestic interests.
4. Foreign parties cannot access the enforcement system.

Myth 1: Chinese IP laws are unsophisticated.

Chinese IP laws since the mid-1980s have been modelled on the German Civil Law IP system and there is an on-going collaboration with the German Ministry of Justice. After 2001, when China acceded to the World Trade Organisation, it overhauled its IP laws to bring them into line with WTO requirements. Today, international IP lawyers say that Chinese IP laws are amongst the best in the world. China is currently revising these laws yet again and is actively seeking international comments on the proposals.

Myth 2: The IP rights in China are of poor quality.

Patents issued to foreigners are generally of high quality as they are usually examined by the Chinese Patent Office's best examiners. However, there is a shortage of well-trained and experienced patent examiners. The Chinese Patent Office has a major recruitment and training programme, with substantial assistance from the European Patent Office. There is a similar shortage of Trademark Examiners, but progress in this area is thought to be slower.

Myth 3: IP Laws and poor enforcement favour domestic interests.

There is no bias in the laws or the judicial system. In the developed areas of China the court system is of good quality and the IP Tribunal of the Supreme Court is of high quality and is making sophisticated judgements. The cost of IP litigation is low by international standards and is a fraction of the cost of litigation in the United States. The time for the entire litigation is very fast (about 12 months) by international standards. In the lower courts many of the

judges have no formal training in IP and are inexperienced in IP. The EU has taken the lead in providing training and experience to these judges. In those parts of China which are less economically developed there can be problems of corruption and local bias – the Government is aware of these issues and aims to address them through a variety of measures. This will take time to improve.

A second method of enforcing IP rights is through the government-funded administrative system, which is cheaper and quicker than litigation: seizure/enforcement orders may be issued and acted on within five days. The local Administration for Industry and Commerce (AICs) can also impose fines and can take the initiative to act on their own once they receive credible evidence.

Myth 4: Foreign parties cannot access the enforcement system.

In 2004 there was more patent litigation in China than in any other country, including the USA. Only 2% of the patent litigation involved foreign parties and about 90% of those were found in favour of the foreign patent holder, compared with an estimate of 30-40% in the USA. The Chinese enforcement system is fast, which means that claimants have to respond rapidly (e.g. 5 days to agree an enforcement order). Many foreign companies lack IP representation in China, which means that proposed actions have to be sent to head office for approval. Consequently, injured companies fail to comply with the set timeframe.

Ongoing problems and challenges

There are a number of ongoing problems in China which include:

1. A continuing backlog of patent applications. This is due to the lack of qualified staff to deal with the number of applications growing at 30-40% per year driven by China's economic growth. China currently has as many domestic patent applications as the USA, but with one third the number of patent examiners. Two thirds of examiners have less than two years experience, which, in turn, affects the quality of the patent assessment. Massive training will increase the number of examiners, but they are running hard to stand still.
2. Few international patents. China was previously filing only about 2% of its patent applications outside China. It has about 4% of the number of

international patents that you would expect from its R&D spend. It is beginning to catch up and its international patent applications grew five-fold in 2006. This rapid growth in patents from China will soon cause major processing problems in the patent offices of the US, EU and Japan.

3. Lack of IP skills. Most countries have a strong base of professional service firms who provide IP services to companies. The development of this sector by foreign firms has been restricted in China, which therefore lacks a major source of expertise.
4. Inconsistencies in the courts' dealings with patent cases. There are strong regional differences and 60% of judges have had no IP training. However, the government has started training programmes of which the EU has been the major supporter.
5. A continued lack of respect by some Chinese companies and regional governments for patents and IPR. Corruption in the interior is still a problem. To counteract this, the central government has encouraged foreign companies to use the "federal" Supreme Court.
6. Counterfeit goods remain a very big problem. European businesses in 2006 identified China as by far the most problematic market for counterfeiting and abuse of IPR for European companies. The Chinese government states that it is increasing enforcement. However, in some cases, successful trademark infringement actions have resulted in the imposition of only relatively moderate fines by international standards. It is clear from the numerous complaints by the legitimate trademark owners that enforcement procedures are currently far from adequate. A growing number of Chinese companies are also now pressing for the strengthening of enforcement.
7. Forced disclosure of highly detailed technical information, for instance, when bidding for public tenders as such bids have to be prepared with Chinese partners.

IPR in China is at a turning point

China is turning towards innovation-based growth: since 1995, China has not only more than doubled its R&D spending (R&D as a percentage of GDP) passing from 0.6 to 1.3% of GDP, but the number of researchers has also

increased by 77% between 1995 and 2004, mainly because researchers' increased salaries encourage talented Chinese scientists and engineers to remain in China. China intends to spend 2.5% of GDP on R&D by 2015.

This is leading to an intensified demand by Chinese companies for IPR domestically and for doing business abroad, including joint ventures and collaborative IPR.

This increased demand by Chinese companies is also creating pressure to improve enforcement. The development is reflected in the fact that China now is the world's most litigious country in terms of IPR and that there is also a significant increase in patents filed by local firms.

Although there is still significant underinvestment in IPR in China, the Chinese system is in a better position to facilitate high quality IP decisions than the USA: as mentioned above, in China IP cases are heard in front of a specialist judges (although admittedly many of them still lack experience), whereas in the USA IP case are heard in front of a jury and a non-specialist judge.

What foreign companies should do to protect their IPR

1. Register their rights (patents, trademarks and design rights).
2. Strengthen their on-the-ground China IP expertise so that they can adequately monitor the market for infringements and take rapid, appropriate action.
3. Use the available processes to protect their IPR. Companies need to understand how the Chinese system works. "Forum Shopping", i.e. filing their complaints with courts with a successful IP litigation record, is as relevant in China as in Europe or the USA.
4. Promote IPR. Take part in IP industry groups and use them to create bridges to local companies and communities as well as commenting on and voicing concerns about IP protection. Educate their own management teams about the importance of IPR.

What could the upcoming G8+5 Summit in Germany lend to the IPR debate?

1. Increased understanding in the media and business world of the myths versus the facts.
2. Increased efforts on training of both Chinese judges and Western companies. The EU has providing excellent training for the judges and SIPO. The G8 should encourage the USA to follow suit.
3. The world patent system will be in danger of breaking down under the flood of patent applications coming out of China. We should urgently explore the way to have mutual recognition of part or all of the patent granting process. Currently each patent office repeats the work of everyone else in the global search for “prior art” (has someone already invented it?) and decision about “novelty” (is it really new and inventive?).

Case Studies

The two short case studies below outline the key elements of a successful company IPR strategy in relation to doing business in China.

Phillips started its IP strategy in situ in China in 2001. Key points in its IP strategy are IP creation, counselling, enforcement, licensing, and standards. Phillips has about 50 IP lawyers in China, 95% of whom are Chinese. It currently has 11 research laboratories and 11,000 patents in China of which 1500 were generated in China. Also, the company has 560 trademark registrations and 550 design rights in China. Phillips has funded IP Academies in 3 universities, organises IP seminars for knowledge sharing and runs open discussions at the IP Media Club. The company’s focus is on establishing IP partnerships and talent growth. As a result 15% of Phillips’ global patents now originate in China and it is predicted that this number will increase to 50% over time.

Zwilling J.A. Henckels AG. faced counterfeiting problems in the 1990s and sent its head of IP to China to work with the local council on IP issues. The company now has registered its IP rights, monitors the market for potential infringements, initiates opposition proceedings to trademark applications for marks that are misleadingly similar to its own registered ones, and protects its

rights by making active use of the enforcement system. 20 raid actions were initiated in 2002/3 (in some cases counterfeiting items were seized within 3 hours by the local AIC!). In 2004 no raid actions were instigated – there was no infringement. The company organises IP training for the local authorities it works with, has allocated adequate resources for IP protection and now operates very successfully in China, its head of IP having learned to speak Chinese.