

STORY **DANIEL ALLEN**

China wants the world to see how much it's doing to fight counterfeiters in the ever-evolving intellectual property debate.

# FAKE OR BREAK

**“WE CAN COPY** everything except your mother” runs the well-known Shanghai expression, neatly encapsulating China’s rampant counterfeiting industry. Blatant breaches of intellectual property (IP) rights continue to sour the country’s trade relations with the developed world, attracting widespread condemnation and deterring overseas companies from entering the Chinese market.

Today, however, conditions in China’s IP environment are changing gradually. The value of China’s own IP is rising and the country’s legal framework is catching up with the West. In an intensifying battle against counterfeiting, China’s pirates are starting to see real action rather than just a few symbolic shots fired across their bows.

“In recent years there have been significant efforts in China to improve IP protection,” says Luise Schafer, a senior adviser at CRCC Asia, a China-focused British consulting company. “This is not only a result of more interaction with foreign businesses pressing for their rights, but also because more Chinese companies realise the real value of IP and want to protect home-grown inventions, patents, trademarks and copyright.”

While nobody denies counterfeiting is still a serious issue in China, some Chinese believe the country’s poor reputation on IP protection has been distorted by Western media. They say Beijing’s efforts to fight IP infringement have been largely overlooked.

Dan Harris, founding member of the international law firm Harris & Moure in Seattle and lead writer of the China Law Blog, believes that claim is partially justified. >

**Messi situation:** unlicensed soccer shirts from all the world’s famous and even not-so-famous clubs are readily available in Asia.



“Much of the criticism comes from Western companies that failed to do what they should have done to protect their IP in China,” Harris says. “When it comes to trademarks and trade secrets, China’s laws are excellent and its enforcement of them is quite good, computer hacking notwithstanding. China’s copyright laws are fine, but enforcement is not strong – in large part because enforcement can be so hard. China’s patent laws are not as strong as those in the West and enforcement is not as strong as it should be.”

Beijing certainly has the facts and figures to prove it is taking the IP problem seriously. In 2011 authorities arrested more than 3000 people and closed almost 13,000 factories in a concerted crackdown on counterfeiting. The number of annual IP registrations and enforcement actions are on an upward trend, while software piracy is down. China has also reformed legal infrastructure and amended copyright, patent and trademark laws to ensure compliance with World Trade Organization (WTO) rules.

Despite this raft of measures, many are yet to be convinced that Beijing is doing enough to contain the culture of counterfeiting that appears ingrained in the Chinese national psyche. Perhaps the more pressing question for many Western businesses today is not whether their IP will ever be safe in China, but whether the perils of operating in the Middle Kingdom are greater or less than shunning the world’s most potentially lucrative marketplace.

### LEGAL LOOPHOLES

While China’s piracy and counterfeiting problems have been widely documented during the past 15 years, many forget the country’s legal framework for IP protection was set up only quite recently. Modern copyright, patent and trademark laws were not introduced until after China opened up to the world in the late 1970s. Beijing overhauled its IP protection in response to US pressure in the late 1980s and early 1990s, and again before accession to the WTO in 2001.

Today, the Chinese legal system takes a multifaceted approach to stamping out counterfeiting. This includes the relevant laws and regulations, enforcement by multiple administrative bodies and the ability to bring suit in the people’s courts.

However, two obstacles continue to hinder enforcement efforts – an administrative and judicial inability (or unwillingness) to enforce IP laws and an overall lack of administrative and judicial transparency.

Chinese officials say most copyright breaches are by people who don’t know they are breaking the law. Yet enforcement remains patchy, despite a trademark law passed in 2011, and the suspicion is that corrupt local government officials and prosecutors often don’t want to act because they have financial links with the counterfeiters.

“Beijing needs to get local Chinese officials out of private business,” says Chris Devonshire-Ellis, managing partner at Asian foreign direct investment practice Dezan Shira & Associates. “When local officials are involved and use the state to hide behind their activities, it’s hard to deal with this kind of systemic failure.”

### PATENT PROGRESS

In March this year US electronics giant Apple appeared in a Shanghai court, defending charges that Siri, its voice recognition software, infringes a patent held by Chinese tech firm Zhizhen Network Technology. With the case still rumbling on, Apple has asked China’s intellectual property office to nullify the Shanghai company’s patent.

Apple executives are no strangers to Chinese litigation. Last year the company paid US\$60 million to Chinese computer maker Shenzhen Provview Technology to settle a dispute over the use of



## “A DEVELOPING ECONOMY AND RISING LIVING STANDARDS MEAN CHINA IS ALREADY LOSING ITS CHEAP LABOUR ADVANTAGE.”

CHRIS  
DEVONSHIRE-ELLIS,  
DEZAN SHIRA & ASSOC

the iPad name. In 2008 the company was sued over iPod technology and in 2010 a Shenzhen company threatened to sue over iPad design. Samsung, Sony, Philips, Canon and Dell have recently had their own China IP battles.

While it has been less than 30 years since China introduced its first modern patent law, the number of patents granted to Chinese inventors – domestically and internationally – is witnessing whirlwind growth.

“A developing economy and rising living standards mean China is already losing its cheap labour advantage,” Devonshire-Ellis says. “Beijing is preparing for this eventuality by significantly strengthening China’s patent law and enforcement to encourage innovation and become an IP exporting country.”

As it tries to move away from a “made in China” to a “designed in China” market, Beijing is actively encouraging the registration of home-grown IP, providing significant incentives to individuals and companies to seek patents. Chinese companies that file a certain number of patents receive significant tax breaks. Tenure



Faux pas: clockwise from main photo, Shanghai police crush 400,000 fake fashion accessories; a “Blackberry” phone, allegedly promoted by US President Barack Obama; the city of Shenzhen, a prime centre for counterfeit goods; and an iPhone knock-off, the Meizu M8.

### Copy fortress

China’s uneasy relationship with IP is due in no small part to the country’s burgeoning *shanzhai* culture. Literally translated as “mountain fortress”, implying banditry and a lack of state control, *shanzhai* has come to mean copying or parodying and commonly refers to China’s myriad brand-name knock-offs.

A growing number of Chinese counterfeiters seek legitimacy under *shanzhai*. Many label themselves heroes for taking on foreign forces. *Shanzhai* phones are often applauded for their ingenuity.

Western companies, tired of watching profits dwindle as cheap, poor-quality imitations of their products hit the Chinese market, are increasingly active in fighting *shanzhai*.

While some sue, others have moved part of their production overseas or update their products frequently enough to remain a step ahead of the counterfeiters.

is more likely for university professors who obtain patents. All patent application fees are covered by local governments.

Last year China’s State Intellectual Property Office (SIPO) approved 1.26 million patent applications, a 31 per cent year-on-year increase. Beijing has set a goal of granting two million patents a year by 2015 – a target former US Patent and Trademark Office (USPTO) director David Kappos describes as “mind-blowing”.

The rapid growth in Chinese patent applications has been underpinned by China’s growing emphasis on research and development (R&D). Last year Chinese telecom giant Huawei boosted R&D spending to US\$4.7 billion, a year-on-year increase of more than 25 per cent. The company already holds more than 50,000 patents worldwide.

China’s other telecom giant, ZTE Corp, invested US\$1.4 billion in R&D in 2012 and led the world in patent filings for the second year in a row, with more than 3900 applications (32 per cent more than second-placed Panasonic). China spends almost US\$300 billion on R&D, second only to the US, and is poised to overtake the US in the next decade.

While China’s headlong rush to boost patent numbers is undoubtedly affecting patent quality in some areas, the volume of applications being approved is increasingly having an impact on the way Western companies safeguard their IP. Any foreign company that wants to manufacture in China or operate in the burgeoning Chinese market would be foolish to disregard the challenges posed by China’s home-grown patents.

“With many Western companies moving their manufacturing facilities either >

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exclusively or primarily into China, effectively putting all their eggs into one basket, losing a Chinese IP battle can potentially mean a complete stop to company exports,” Devonshire-Ellis says.

“All companies should weigh up the cost versus benefit ratios and advantages of being in China against perceived or actual risks,” he adds. “A company that decides to enter China should register all its IP in the country before arrival. Commercial awareness and market understanding need to be well developed; close monitoring of your business inside and out is critical to minimise risk of infringements.”

#### THE FAKE STAKES

Today, counterfeit goods make up about 2 per cent of world trade, worth about US\$250 billion a year, according to a recent report by the United Nations Office on Drug and Crimes. According to data on goods seized worldwide between 2008 and 2010, nearly 70 per cent of those counterfeit products originated in China.

Last year US customs and other law enforcement agents made almost 15,000 seizures of counterfeit goods, more than three-quarters of which came from China. Handbags were third on the list, behind consumer electronics and footwear – the top item for the past four years. Everything from fake Chinese euro coins to fake Chinese condoms have hit the headlines this year.

As the world’s single largest producer of pirated goods, China has an extensive sophisticated network of infringers who copy products of every description. Illicit manufacturers operate factories across the

**“A LOT OF COUNTERFEITING COMES FROM PEOPLE WHO KNOW YOUR PRODUCT WELL. THIS COULD BE YOUR MANUFACTURERS, DISTRIBUTORS, YOUR RETAILERS, YOUR OWN EMPLOYEE.”**

DAN HARRIS,  
HARRIS & MOURE

country, producing cheap knock-offs so cleverly packaged they are hard to distinguish from the genuine article. Many of these counterfeit goods end up on the global market and it is often impossible for distributors to tell if they are receiving bootleg or bona fide products.

Employing millions, China’s black market is a significant segment of the national economy. The US-China Business Council says counterfeit products account for as much as 20 per cent of China’s total GDP, equating to about US\$25 billion. Counterfeiters have even begun to counterfeit the retail experience by replicating the storefronts and interiors of global chains such as McDonald’s, Starbucks and KFC.

“A number of our Western clients manufacture products that sell for relatively high prices in China due to the nature of the brand,” says Harris. “In other words, exactly the kind of product Chinese counterfeiters love to copy.

“In China a lot of counterfeiting comes from people and entities that know your product well. This could be your manufacturers, your distributors, your retailers, your own employee,



Glaringly obvious: clockwise from far left, fake sunglasses headed for destruction in Shanghai; a brazen Rolex rip-off shop on a main street in Xian, central China; crackdown at a counterfeit goods store in Hong Kong; and replica scooters made in China are scrapped in France.

or an employee of a company with whom you are doing business. An overseas company should do its utmost to conduct business with well-run and reputable Chinese companies – and still keep its eyes on them and marketplace websites such as Amazon and Alibaba.”

#### FUTURE FOCUS

China’s enormous trade surpluses with the US and the European Union make it hard for anybody to justify the counterfeiting of Western products. But there is also an increasingly compelling national case for properly enforced IP rights. Chinese companies are now innovating in ever-larger numbers and want to see their products effectively protected.

As Chinese incomes continue to grow, and as more Chinese companies seek to safeguard their IP through patenting and legal recourse, many predict counterfeiting will decrease. This was the case in Japan and Korea, both once notorious for counterfeiting in the past.

International pressure, cooperation and guidance, and continued monitoring and lobbying by law firms all have their place in ensuring that the Chinese market is an increasingly secure environment for overseas companies. However, the major drivers for change in China’s IP rights environment are, and will surely continue to be, self-interest, economic prosperity and a rising standard of living for the average Chinese citizen.

“Realistically, nobody from the outside is going to force China to improve its IP protection,” Harris says. “Protection will only develop as a result of a powerful domestic clamour for change. That clamouring has already begun and is getting louder.” ■

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