

~~Made~~ Faked in China:

Protecting Your Trademarks in China

By Neal Zipser

Senior Editor

Although the counterfeiting of motor vehicle parts is global, the finger pointing typically begins with China. Controlling and enforcing the issue in a market most U.S. product manufacturers aren't familiar with is difficult to say the least.

According to Lindsay Esler, managing partner and head of the Intellectual Property Department with the Chinese law firm Deacons, limiting the effects of counterfeiting in China requires a long-term strategic plan for the protection of a company's intellectual property. This plan would also help tackle the problem of exporting counterfeit parts out of China.

"A plan is critical to deal with the highly sophisticated counterfeiting activity which will increasingly replace the low level, low profit and easily recognized knock-off parts that have frequently been encountered in the U.S. market," Esler said.

As counterfeit products become more difficult to distinguish from the original genuine product in terms of price, appearance and quality, they may give rise to product liability claims against the genuine manufacturers. In China, liability claims against foreign manufacturers are widely reported in the local media and even if they are subsequently disapproved, the damage has been done.

"The increasing sophistication of counterfeiting activity will require the use of different forms of intellectual property as a weapon," Esler said. "U.S. companies have been reluctant to engage in patent litigation in the Chinese courts; however, this is going to become an increasingly important means of enforcement in the future. It can take a long time to secure a patent registration in China, so the protection strategy must be put in place as early as possible."

A counterfeit product will generally have the genuine owner's trademark either on the product itself or on the packaging. Sometimes counterfeiters attempt to avoid liability under the Chinese trademark law by adopting identical packaging, but will use a slightly different trademark that may easily mislead Chinese consumers who are not very familiar with the original product name. Counterfeiting activities of this nature are generally handled as simple cases of trademark infringement, according to Esler.

"The Chinese courts and the administrative authorities responsible for conducting raid actions are familiar with the procedures for enforcing foreign trademark rights and their decisions are becoming increasingly consistent and predictable," he said, noting that in recent years, China has introduced numerous laws that can be of assistance to foreign companies, (There are now more than 1,200 laws in China which concern some aspect of intellectual property.)

Esler added it can be possible for a foreign company to rely on other laws such as the Unfair Competition Law, which prohibits misleading trade practices, or even printing regulations, which strictly control the printing and packaging bearing registered trademarks, to improve their chances of success in an otherwise weak case.

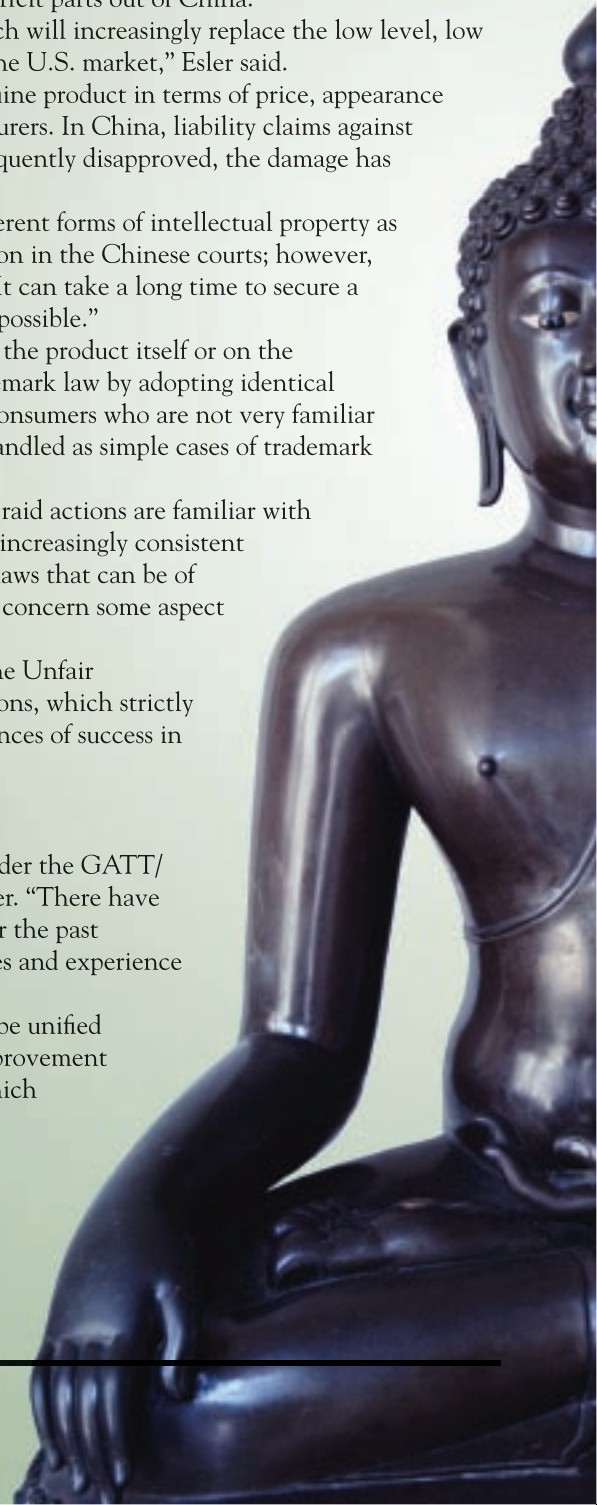
Is China Taking the Issue Seriously?

When China entered the World Trade Organization it also assumed obligations under the GATT/TRIPs agreements to improve and protect intellectual property rights, according to Esler. "There have been some improvements in the protection of intellectual property rights in China over the past 18 months, but the strength of the enforcement on the ground depends on the resources and experience of the courts or officials who are involved in the process," he said.

"Over time, it is intended that the enforcement of intellectual property rights will be unified under the State Intellectual Property Office; however, we have not yet to see much improvement from the historically inconsistent standards of enforcement by the separate agencies which were responsible for enforcement of trademarks, patents and copyrights," Esler added.

Copyright protection is currently an unreliable form of intellectual property. In the near term, the copyright will not itself be a worthwhile tool for enforcement of intellectual property rights relating to the automotive industry, Esler noted.

Similarly, experience shows that it is difficult to succeed in actions under the Unfair Competition Law alone, although judges frequently rely on this law to justify



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making favorable decisions in trademark cases, for example. In other words, the principles of the Unfair Competition Law may be just enough to tip the balance in the plaintiff's favor.

Patents are likely to become increasingly important as an enforcement tool, particularly since it has become possible to apply for injunctions to prevent infringing activities continuing while the case is waiting to be heard.

“Foreign companies should not base their views of patent litigation in China on their experience in the United States or other countries,” Esler explained. “China does not have a sophisticated pre-trial discovery process and the court hearing itself should only take approximately two or three days. Decisions are handed down relatively quickly and appeals are also heard relatively quickly. As a consequence of the shorter, document-based process, the legal costs of taking patent actions in China are small in comparison to costs in the United States.”

Targeting the Problem

It is possible to undertake intellectual property enforcement at many different levels: retail, wholesale, manufacturer or trader. While it may not be economically justifiable to take legal action through the courts against retailers of counterfeit products, there may be other ways of putting pressure on distributors of counterfeit parts at retail level.

While it is often worthwhile to undertake raid action against manufacturers and seizure of products molds can be a deterrent to manufacturers, the factories themselves are often not the root of the problem.

“This is a fundamental misunderstanding,” Esler said. “The factory is often operating as a contract manufacturer and is not the ultimate source of counterfeits, which may readily be obtained from other factories if the one factory is discouraged from counterfeiting a particular product. Generally speaking, the most effective means of enforcing intellectual property rights in China is to identify and take legal action against the individuals or traders who are actually sourcing and arranging for the distribution of products.”

According to Esler, these companies are often located in Hong Kong, Guangdong Province (Canton) or Shanghai, and the factories themselves may be located almost anywhere in China. This is a particular problem for the auto industry, because unlike other industries, the manufacture of parts is decentralized, with automobile factories in 27 of China's 31 provinces.

Esler noted that it can also be worthwhile to take action in the United States, once the products have reached the U.S. market. Action through the U.S. Customs Department can be particularly effective, because once the products have reached the retail distribution points, it is often too late to take any effective action.

Attorneys or Investigators?

The type of enforcement action that is contemplated will determine what resources are needed. Investigation companies are springing up everywhere in China and offer services that can provide a reasonably economical way to organize an administrative raid on a particular factory or group of factories. Since investigation companies are not permitted to engage in litigation before the courts, it is recommended that administrative action should be taken against infringing factories. While this may help to reduce the volume of counterfeit products being produced, it will not eliminate the root of the problem.

“Since many investigation companies operate on a ‘success fee’ basis, it is common for dishonest investigators to fabricate evidence, or even cooperate with factories that may actually agree to be the subject of a raid, in return for a share of the success fee paid to the investigator,” Esler said. “We have also uncovered several cases where documents issued by the Chinese administrative authorities have been altered to increase the numbers of counterfeit products sold or to suggest that products

have been seized when in fact no seizure was made.”

Foreign companies should adopt a flexible approach regarding court proceedings or raid actions. Administrative action may be the most appropriate tool in some cases, while legal action through the courts may be more effective in others. The most important issue is the decision whether or not to take action at all. It can be extremely counterproductive, as well as expensive, for a company to take action against every instance of counterfeiting.

“It is important for foreign companies to maintain good records of all counterfeiting activity in order that patterns may be detected and the most effective strategy chosen to deal with the infringement,” Esler said. “It is also important to ensure that action is taken in a favorable or neutral forum. Foreign companies should keep in mind that the administrative officials who conduct raid actions are part of the same government agency that is responsible for the control and promotion of industry and trade generally. As such, they can be extremely reluctant to take action in certain cases, particularly if a factory making counterfeits is a major employer of local staff. Judges are not generally susceptible to local protectionism of this nature.”

In addition to local protectionism, judges or officials may be subjected to political influence or pressure from powerful local industry interests. The extent to which this pressure is felt may be quite different from one town or city to the next. In general, courts in Shanghai and Beijing are more sophisticated than courts in smaller towns. Similarly, judges in Shanghai and Beijing often specialize in intellectual property matters and the Chinese government can ensure that the judges in these cities are both internationally aware and skilled in intellectual property matters. If the infringing products are available in Shanghai and Beijing, there may be an opportunity to have the case heard by the courts in those cities, even if the factory making the counterfeits is located elsewhere.


Playing the Game for the Long Term

There is one point that cannot be emphasized too strongly: The Chinese government has taken great efforts to put in place a strong set of intellectual property laws. Foreign companies have to recognize that enormous progress has been made in this area, since the first modern intellectual property laws were not introduced until the early 1980s, according to Esler.

“It is true that the practical standards of applying and enforcing the law are not consistent, but they will undoubtedly improve as they are used more frequently by foreign companies,” Esler said.

As Chinese companies continue to develop increasingly sophisticated products, they will also put pressure on the government to ensure that their own intellectual property rights are protected. This is the same pattern that has been followed by both Japan and Taiwan, according to Esler.

“It is important for U.S. companies to be seen making the effort to use the existing legal system,” he said. “We do not note any significant level of anti-foreign sentiment or prejudice against foreign companies on the part of administrative officials and judges.

“U.S. companies should play the game according to the rules that have already been established. If the conditions are unfavorable, it is always possible to choose not to play the game. Only as a last resort should political pressure be applied,” Esler added. 

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Smarter Aftermarket Pricing

(continued from pg. 7)

Are customers still capturing discounts that originally had an expiration date? The possibilities are almost endless.

Pricing in the aftermarket is not a trivial task; there is no doubt about that. But in our experience, the tendency of aftermarket participants to throw up their hands in despair at making pricing any more sensible is just not right. Relatively simple adjustments to value drivers and to transaction “leakages” can lead to immediate gains to the bottom line, without any necessary damage to top-line volumes. Some very sophisticated aftermarket firms, notably a few national retailers, have already mastered these simple tools and have moved on to more sophisticated fine tunings. For those aftermarket firms that have not taken even the first few steps listed above, the risk of

loss to the more advanced firms is both clear and present. On the upside, however, if aftermarket companies managed their pricing decisions with the same focus and attention to detail that they do fill rates and service levels, the payoffs would be both large and quick to earn. Changing pricing strategy and tactics is not as hard as it looks. It all starts with a willingness to at least take the first step and actively address the problem. 

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