

# **IPR INFRINGEMENT AND SINO-JAPANESE RELATIONS**

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2005 witnessed a noticeable change in the way Japan deals with China on IPR infringement issue. Along with Switzerland and the U.S., Japan submitted the “Transparency Request”, urging the Chinese government to substantiate information regarding China's International Property Right [IPR] enforcement. Despite the enormous economic loss Japan has suffered resulting from China's rampant IPR infringement, the Japanese government has remained muted over the years, sometimes at the expense of Japanese companies. However, improved IPR environment within Japan and increasing economic losses and brand name damage sustained by Japanese companies in China have brought quiet changes among the Japanese government concerning what is deemed as the appropriate way to approach China on IPR issues.

Since first entering the Chinese market, Japanese companies have undoubtedly become one of the biggest victims of China's notorious IPR environment. The excellent quality associated with authentic Japanese products and their expensive prices are the main reasons for counterfeiting and other IPR infringement. Strangely, the Japanese government has mainly remained silent over the ever-increasing economic loss and reputation damage Japanese companies have suffered. Japanese companies are left to fend for themselves in the Chinese market. Though from time to time they would appeal to the international IPR protection groups they belong to for advice and guidance, Japanese companies have received little, if any, official support from the Japanese government to protect their IPRs like their American counterparts did from the U.S. government. While the U.S. has long been the most vociferous critics condemning China's IPR infringement and has on several occasions threatened trade war with the Chinese government, Japan's silence over the years might have been positively appreciated by Beijing.

Cultural factors such as favored views on copying and tendency to resolve conflicts through less confrontational means have sometimes been held accountable as contributing to the relative stability between China and Japan over the IPR issue. While the shared practice of calligraphy and similar examination systems certainly have bonded the two nations culturally and perhaps have indeed rendered duplication of others' work as less amoral as it is in the West, such factors are no more effective at preventing Japan from contending with China over IPR issue than, say, shared culture would prevent Germany from resolving its IPR disputes with France. In addition, the so believed less confrontational Eastern way has certainly not prevented Japan from going to war with China. Such shared cultural similarities have proven to be fragile and unable to exert substantive impacts on two countries' dealing of IPR issues.

Others argue that as the bilateral trade and economic cooperation between the two nations have reached such high levels that the Japanese government is reluctant to jeopardize its highly beneficial economic relationships with China over some IPR issues. However, comparing the Sino-Japanese economic relation with that of Sino-U.S. economic relation reveals that Japan and the U.S. are both China's most important trade partners. If economic

interdependence restrains one from adopting aggressive negotiation approaches, the U.S. should have behaved in a similar circumspect fashion as Japan did so as not to jeopardize its economic relation with China. Furthermore, during its 2001 trade conflict with China, the Japanese government adopted a fairly aggressive stance over products seemingly less valuable than IPR ones, obviously contrary to what the interdependence theory would have predicted.

While both the “cultural” and “interdependence” theories have offered us useful background information toward the current situation, two fundamental factors underpin the Japanese government's decision in adopting a more active stance when confronting China over IPR issues: Japan's improved IPR environment has freed Japan from foreign criticism and earned it the needed legitimacy to engage China on IPR protection from a moral high ground, and the increasing economic loss and reputation damage Japanese companies have sustained not only within China but also in other countries as a result of counterfeit goods exported from China has finally prompted the Japanese government to take direct actions.

Serving as the ultimate promoter and protector of overseas Japanese business interests, Tokyo has been expected by Japanese companies in China to pressure the Chinese government to strengthen its IPR protection and to punish IPR infringement activities. However, the backward IPR environment in Japan until the mid-1990's considerably limited options available to the Japanese government to deal with China on IPR issues. Japan's IPR environment faced many difficulties until mid 1990s. In fact, the IPR environment in Japan was in such disarray that the United States placed Japan on Special 301 Watch List from 1989 to 1995 to show its dissatisfaction with Japan's particular interpretation of IPR and some systematic deficiencies inherent with Japan's IPR systems.

While IPRs in the U.S. are believed to protect individuals and provide them with exclusive rights to commercialize and benefit from their inventions, IPRs in Japan, on the other hand, had long been thought of as merely serving to promote industrial development by disseminating new information and technologies. In addition, though Japan's annual issuance of new patents has been comparable to that of the U.S. and Europe, the majority of the new patents are in fact modifications and minor improvements on previous models, further reflecting the industry-oriented nature of Japan's IPR environment. IPRs were expected to directly contribute to industrial growth. Lack of IPR awareness can best be reflected through the famous Hitachi example when in the late 1980s one of Hitachi's high-ranking officers was caught red-handedly stealing hard disc hardware from IBM's plant.

While patent constitutes a crucial link in the creation-protection-application process of intellectual property cycle, Japan's patent system has long been criticized by foreign companies as inefficient and inconvenient until the mid-90s. A survey conducted by the U.S. general accounting office indicated that 39% of the U.S. companies doing business in Japan were not satisfied with Japan's Patent System at the end of the 1980s (GAO, 5). The majority of the U.S. firms viewed Japan's Patent System as inefficient and providing limited scope of protection.

Specific problems with Japanese patenting process included high cost, patent flooding, insufficient staffing, long pending period, pre-grant opposition and default publication. Until 1995, Japan had the highest translation fee for patent application in the world. The cost of filing a 25-page application in Japan was \$4, 772 (GAO, 7). Patent

flooding and insufficient staffing led to a protracted pending period. It was believed that on average it took 6-7 years for JPO to issue a patent. John Killy's patent for Texas Instrument was filed in 1960 and was not granted until 1989. Corning Glass did not receive their patent until 10 years after they filed it in 1975. Since all the information related to the new technologies is by law made public 18 months after their submission, U.S. companies found the market monopolized by Japanese companies by the time their applications are approved. Some even believed that the Japanese Patent System had become a malicious tool with which Japanese companies colluded with the authorities to rip new technologies from American companies and to deny them market entrance.

Foreign firms were also disadvantaged by the pre-grant opposition system since domestic Japanese firms tended to band together to challenge the patent. A U.S. company in the advanced materials field simultaneously faced opposition from 17 Japanese companies, who separately submitted photocopies bearing marks from the same photocopy shop (MK, 15). Collusion was blatant and obvious. In the end, the company was forced into cross-licensing with those Japanese companies. Japan's legitimacy to apply pressure to China on IPR issues was, therefore, significantly compromised when its own patent system received heavy criticized from foreign companies as inefficient and inconvenient and when Japan's overall IPR environment was being held as unfriendly to foreign businesses.

Facing the contraction of the Japanese economy and offshoring of Japanese industries to China and other Asian countries, the Japanese government realized that a healthy innovation industry could go a long way toward reinvigorating the Japanese economy and preventing the much feared hollowing out of Japanese industries. As a result, the Japanese government has implemented many policies to shake up its patent system and to improve the overall IPR environment. Nowadays new patent applications are allowed to be filed in any language as long as the Japanese version is submitted two months after the initial submission. The Japanese authority has also become more lenient with translation. To prevent different interpretation of specific words appearing in the applications, companies are allowed to include the original words in parenthesis for future reference. Bills have been passed to expedite the patent review process. Not only have more official examiners been added but authorities are currently contemplating employing outside lawyers as part-time examiners. It has also become possible to file several claims under one application.

Other improvements have been made to render Japan an IPR friendly country. Japanese IPR authorities have strengthened their cooperative ties with Japanese universities to stimulate basic research. In order to encourage submission of patents not only in Japan but in foreign countries as well, authorities agreed to partially reimburse patent application fees for universities. An online electronic database containing past patents will have been built to facilitate information exchange and to promote public awareness of IPR. Japanese IPR authorities currently are also cooperating with counterparts in EU and the U.S. to materialize the possibility of instantaneous recognition of new patents through an integrated patent system. With improved legitimacy on IPR protection, the Japanese government earned the legitimacy needed to negotiate with the Chinese from a moral high ground. Prompted by the worsening of IPR infringement in China, it was logical for the Japanese government to decide to apply more direct pressure on China regarding IPR issues.

While counterfeiting and other forms of IPR infringement have haunted Japanese products in China, their magnitude and extent have been increasing rapidly over the past few years. According to JETRO-PKIP's annual reports, though majority of Japanese companies acknowledge that the Chinese central government has made certain progress on strengthening IPR law and enforcement mechanism, they unanimously agree that counterfeiting has worsened in China. In the same survey, from 2002 to 2004, the percentage of Japanese companies that believe that they have suffered severe loss from counterfeiting rose from 13.4% to 26.5%. The percentage of companies that answered that the estimated loss resulting from counterfeiting exceeded 100kuen doubled from 8.7% to 16.3% (PKIP, 5). While most of these answers are rather subjective and companies volunteered to participate the survey were different, it does, however, paint the general pictures that counterfeiting and IPR infringement in China has steadily deteriorated, almost locking step with its rapid growing economy. New methods to manufacture and distribute counterfeit goods have made it more difficult for Japanese companies to protect their IPRs and for Chinese law enforcers to crack down on counterfeiting.

Improved technologies available to counterfeiters have expanded the categories of Japanese products being counterfeited from stationeries and instant noodles to include products that are more technology-intensive. On the other hand, the quality of counterfeit goods is also rising so that sometimes even employees working for Japanese companies are unable to tell apart counterfeits from authentic products. In the past, counterfeited Japanese products mainly concentrated in categories that required much less technologies and production skills such as batteries and soy sauce. And the quality of counterfeit products was rather shoddy that average consumers could relatively easily recognize that they were counterfeits. But now, counterfeiting has gone high-tech, counterfeiters have begun to counterfeit goods that are more technology-intensive such as laser optical appliances (DVD players and CD-ROMS) and automobile designs.

Over the years, counterfeiters have nearly driven the Japanese motor bikes out of the market by duplicating their designs through reverse-engineering. It is estimated that now two thirds of the bike market is dominated by counterfeits (PKIP, 16). As China develops into the third largest automobile production and the fourth largest consumption country, the motor bike scenario can easily be applied to the booming automobile industry. In fact, worrying signs have already surfaced indicating that the feared scenario is becoming reality. Counterfeiters build automobiles based on Japanese designs and sell those cars under their own brands after making one or two symbolic modification to the model to avoid being accused of committing dead-copying.

At the same time, distribution and retailing methods among counterfeiters have become more and more elusive for the law enforcement authorities to target. Recent trends of counterfeiting such as the Just-In-Time technique, the No-Brand production, and Mixed Parts method, and shift of manufacturing bases inland are especially alarming. The Just-In-Time technique ironically imitates the on-demand/just-in-stock practice of retailing management first developed by the Japanese. The technique helps counterfeiters to evade legal punishment by having parts of the counterfeit goods produced across the country and only bring them together for final assemblage as orders from customers come in. The no-brand production entails that counterfeited goods are produced and stored without any labeling. Only when orders from customers come do they receive labeling. The shrewder method among all is the

mixed part technique where counterfeited goods are produced with some authentic parts while the rest are made with counterfeit parts. Example includes counterfeit SEIKO, CITIZEN and other brand-name watches produced with authentic crystal oscillator and fake parts. Retailers of these counterfeited goods usually tout their high quality, and these watches have been popular not only with Chinese but they have been exported to various Middle Eastern countries. In addition, as human resource expenses increases in areas such as Guangdong and Jiangsu, more and more counterfeit criminals have shifted their production bases inland where law enforcement is more fragile.

Judicial deficiencies still mar China's current IPR environment. Administrative protection for products of foreign companies can disappear instantly as evidenced by Huake's case. Huake Pharmacy IPR consulting company had been designated by authorities to handle all new pharmacy patents submitted by foreign companies in China. One day the vice president of the firm suddenly disappeared and all pending cases of IPR were pronounced nullified, effectively causing Japanese firms that had applied for IPR through the vice president to lose all their new technologies. In addition, Japanese companies have also complained that sometimes IPR authorities would deliberately delay processing/issuing their patent, while stealthily collude with Chinese companies to achieve technology transfer. Finally, unreasonable technicalities existing such as the following one also hamper IPR enforcement: inability to collect the required amount of evidence for damage-estimation renders cases stop short at administrative protection level and no legal responsibilities may be charged to companies that committed counterfeiting.

The most alarming trend has been the rising volume of counterfeit goods exported to foreign countries. Southeast Asia, Middle East, Russia where awareness of IPR protection is weak have witnessed an influx of Japanese counterfeit goods produced in China ranging from watches to electronics. Exporting counterfeit goods abroad expose a larger number of people to danger from using shoddy cosmetics and defunct electronic goods. These counterfeit products also damage the brand images and the hard-earned goodwill Japanese companies have gained worldwide. In addition, once counterfeit products cross the Chinese border, locating and retrieving these products no longer solely remain under the sole jurisprudence of Chinese authorities. Japanese companies would have to cooperate with INTERPO and local IPR enforcement authorities to enforce IPR protection, further complicating the situation.

As the Sino-Japanese relations sank to its lowest point in the postwar period, cooperation on protecting intellectual property rights and fighting counterfeiting and other IPR infringement represents one of the promising areas in which both governments might still remain willing to work with each other. As the domestic IPR environment undergoes fundamental improvements, Japanese government is placing very high priority on stimulating innovation at home and protecting IPR rights of Japanese companies abroad. They have a high stake in cooperating with the Chinese government not only to salvage economic profits rightfully belonging to Japanese companies, but also to prevent China's counterfeit goods from spreading across the globe, ending up damaging the reputation of Japanese products. Beijing, on the other hand, also sees benefits in cooperating with Tokyo because counterfeit goods, especially those shoddy products that might expose consumers to much danger and perhaps even life threatening situations, are wreaking havoc in their society, heightening people's distrust of the government on law enforcement. In addition, counterfeits pose threats to foreign investors' confidence in continuing their investment in China. If the expense saved

from shifting production base and R&D is eaten away by counterfeits, foreign investors could logically consider take their business somewhere else where IPR environment is more conducive and law enforcement stricter. Consequently, the Chinese government also has high stake in cooperating with Japan and other advanced nations to strength its IPR protection.

It would be wise for Japan and also other foreign countries to take cooperative action in approaching China on the IPR issue. The logic is simple: if China's major trading partners like Japan and the U.S. band together to deal with China on IPR issue, naturally the pressure/threat would be more credible and effective than if any of those countries were to take unilateral actions. Also, participation in an alliance lowers the possibility that China might hold grudges against any particular country and choose to take retaliatory actions in the future. Especially in Japan's case, despite its considerably improved domestic IPR environment, the image of Japanese companies collude together to force American and other foreign companies into cross-licensing and Hitachi's case will take some time to wither away. During the meantime, it would be prudent for Tokyo to join other nations in dealing with China on IPR so as to lend more credibility to its demands.

Finally, when foreign countries negotiate with China on IPRs, they tend to be blinded by self-interest and often choose to take actions that would directly benefit their companies without considering the Chinese side of the story. Lacking comprehensive understanding of counterfeiting and other IPR infringement issues, their threats and demands are often rendered ineffective by their motives. Cases can be made to show that counterfeiting and other IPR infringement activities in China now actually benefit the government, companies and potentially consumers. Keeping moral judgments aside, one certainly can argue that the prosperous counterfeiting business have provided employment opportunities for many workers who have been laid off by the State Owned Enterprises (SOEs) and farmers who are looking for more enriching way of life. Less unemployment means less social instability for the central government, which is working hard in recent years to shore up its weakening legitimacy.

In addition, counterfeiting sometimes provide Chinese entrepreneurs with needed initial capital and distribution channels. There have been several cases in which counterfeiters, accumulating much personal wealth and establishing retailing networks from selling counterfeit goods, transform their "projects" into legitimate companies and use the capital and distribution channel to compete with foreign companies whose products they were counterfeiting. Therefore, it also could be argued that nowadays China where personal loan services are still developing, counterfeiting provides a shortcut for laid-off workers and immigrant farmers who wish to get rich fast and perhaps even start their own companies.

Consumers also benefit from counterfeiting and other IPR infringement. Despite the infrequent exposure of events involving consumers becoming fatally ill after using counterfeit medicines and/or food, the majority of the consumers are quite happy to purchase counterfeit products with similar quality but much cheaper such as DVDs and other CD-ROM products. A common misunderstanding is often made here that most Japanese and U.S. companies calculate the entire counterfeit market as rightfully belonging to them, thus complaining loudly about the rampant IPR infringement. The truth, however, is that had there been no counterfeiting and pirating at all, the majority of the Chinese consuming currently purchasing private CDs, DVDs, game software made by Japanese or U.S. companies would

more than likely choose to abandon their hobbies and take up something new rather than to pay the high price charged for authentic products. Therefore, calculating transaction of these counterfeit goods as company's economic loss is unrealistic and renders claims based on these figures hollow and meaningless. It is crucial to understand that counterfeiting and other IPR infringement is a complex phenomenon that cannot and should not be dealt with simple threats and demands. Only after carefully studying the situation and figuring out what serves the interest of both the companies themselves and the Chinese can Japanese and other foreign companies hope to receive genuine support from the Chinese government.

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