



Companies juggle IP risks in China

Published: Friday, September 10, 2004

China struggles to enforce intellectual property laws that may protect valley companies

BY STEVE TANNER

Protection of a company's valuable intellectual property seriously lacks in China, where an estimated 92 percent of all software sold is pirated, experts say. Yet, despite the risks, China's cheap labor and lucrative new technology markets continue to draw Silicon Valley companies to the awakening economic dragon.

Calculating risk

A who's who of valley companies have development facilities in China or are selling to the Chinese market, including San Jose-based Cisco Systems Inc., Santa Clara-based Intel Corp., Redwood Shores-based Oracle Corp., Palo Alto-based Hewlett-Packard Co. and Santa Clara-based Sun Microsystems Inc.

But theft of intellectual property (IP) by rivals that use it to develop products and the rampant black market in pirated software are among IP-protection concerns for tech companies doing business in China.

"It's just a calculated risk, since it's such a large market and the labor pool is so robust there," said Bijal Vikal, an IP attorney and partner at McDermott, Will & Emery LLP in New York.

One of Silicon Valley's most high-profile cases of IP theft in China involved the alleged theft of Cisco source code by Chinese contractors working on behalf of Chinese rival router maker Huawei Technologies Co. Cisco sued Huawei. The two parties reached a settlement two months ago. Cisco did not return calls by press time.

For San Rafael-based Autodesk Inc., which sells design software for building and infrastructure projects, China is the fastest-growing region for its revenue.

Still, a vast majority of its software, which costs roughly \$10,000 per license, is sold on

the black market for mere dollars, said Marcia Sterling, vice president and general counsel of Autodesk.

"For every one legal copy of our software in the world, there are at least five pirated copies. In China, that rate probably is between 90 percent and 95 percent," Sterling said.

Autodesk last year opened a development center in China to create software specific to the Chinese market, with help from the Chinese government, Sterling said.

Despite widespread piracy, Autodesk still sees China as a very lucrative market and is patient with China's struggle to enforce IP protection, Sterling said. The risk of opening facilities in China is that trade secrets could be stolen and used by a competitor, similar to the Cisco-Huawei case, she said.

"That's exactly the kind of thing that keeps me up at night," Sterling said. "If you look at the developing patent law in China, it actually looks a lot like ours. But the court system hasn't caught up yet."

Fighting for IP law enforcement

A lack of government pressure on China's courts means the laws that protect IP are not enforced, said Ray Mota, chief research officer with Phoenix-based Synergy Research Group Inc.

Companies are moving into China for cheap labor and to get into new markets early, he said, and, therefore, the Chinese government perhaps does not feel pressure to step up its enforcement of IP laws.

He expects the government will enforce IP laws more vigorously in the future, mainly to protect the new crop of Chinese software companies that have invested in their own IP.

"I think [the Chinese government] is realizing that China is tough even on China," Mota said. "I think in the long term, they will be forced to come up with stricter protections."

Slow but steady progress

Progress is being made, said Frank Bernstein and Lin Deng, partner and associate, respectively, in the Mountain View office of IP law firm Sughrue Mion PLLC.

"Now the counterfeiters are going more underground, and they're moving to the more remote areas," said Deng, who worked as an IP attorney in China from 1993 to 2000. She said IP enforcement, especially in China's cities, gets better every day.

Bernstein said China is enforcing IP protection as best it can, given IP theft is just one of the myriad challenges facing the large and dynamic country, in which new business

markets have rapidly grown in recent years. After all, foreign investment in China began just 15 years ago, he points out.

"There is an implication that the Chinese government is not taking this seriously. But I don't think that's the case," Bernstein said. "When we're advising clients, obviously there are valid concerns, but things are changing very rapidly."

A vast and quickly developing country, China is comprised of 6 million square miles and 1.28 billion people. China also is one of the oldest civilizations in the world. Combined, these factors mean change in China cannot happen overnight, said Usha Haley, professor of management with the University of New Haven, in New Haven, Conn. and co-author of "The Chinese Tao of Business."

The Copyright Law of the People's Republic of China, a broad piece of legislation that recognizes the propriety of patents and copyrights held by foreign companies and individuals, was adopted in 1990. But this law only can be enforced in provincial courts, which are not in sync with the country's capital, Beijing, she said.

So if a U.S. company successfully litigates a patent infringement claim, there is no guarantee the penalty -- whether it is a cease-and-desist order, a fine or both -- will be enforced by the provincial courts, Haley said.

"It's a fight between the foreign dragon, Beijing, and the local snakes, the provincial governments," she said. "We advise foreign companies investing in China to go through a series of moves. One of them is to not release your newest technology in China; go with your older-generation software."

China is improving its IP protection, experts agree. But they caution that IP law enforcement will take several years to catch up with other regions of the world, including India.

Until then, Sughrue Mion's Bernstein said, companies should realize "there always are risks going into any market, even in the United States."

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