

# Barriers to Criminal Enforcement Against Counterfeiting in China

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## ABSTRACT

*Multinational companies (MNCs) with valuable trademarks in China seek criminal enforcement against counterfeiting because other available avenues of relief, such as administrative and judicial remedies, have proven to be ineffective. While MNCs prefer enforcement through China's Police, the Public Security Bureau (PSB), many MNCs are unaware of the significant hidden dangers of using the PSB.*

*Most MNCs will delegate enforcement of trademark rights to their Chinese subsidiaries. These subsidiaries are known to make illegal payments to the PSB that may violate the laws of the PRC as well as the United States Foreign Corrupt Practices Act (FCPA). These acts expose MNCs to draconian penalties under PRC law and the FCPA. MNCs can be unaware of these illegal practices because many MNCs organize their business structures and intellectual property (IP) management strategies in ways that shield MNCs from reviewing some of the on-the-ground actions by their Chinese subsidiaries. This Article exposes these risks, explains how some of these risks arise, and makes suggestions on how MNCs can structure their business organizations and IP management structures in China to eliminate or mitigate these risks.*

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## I. INTRODUCTION

Although multinational companies (MNCs) have engaged in two decades of intensive efforts in enforcement and lobbying in the People's Republic of China (PRC or China), counterfeiting of trademarked goods continues to be pervasive in China and a global

problem.<sup>1</sup> According to a recent study, China produces 80 percent of the world's counterfeits, and global counterfeiting is now a \$1.7 trillion per year industry, expected to grow to \$2.8 trillion in 2022.<sup>2</sup> Counterfeiting is now considered the largest criminal enterprise in the world, and China is its epicenter.<sup>3</sup> The recent explosion of sales of counterfeits from China on the worldwide internet has created new challenges for MNCs and other brand owners in the new millennium in protecting their intellectual property (IP) rights.<sup>4</sup>

MNCs that own trademarks in China have several avenues of relief available against counterfeiters, including administrative, judicial, and criminal remedies.<sup>5</sup> Many MNCs find, however, that

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1. See Daniel C.K. Chow, *Counterfeiting in China*, 78 WASH. U. L.Q. 1, 3 (2000) [hereinafter *Counterfeiting in China*]. Counterfeiting in China as a major business problem for MNCs first gained international attention at the beginning of the new millennium. *Id.* at 6–7. The controversy over counterfeiting arose when China was beginning its ascent to becoming one of the most powerful economies in the world. *Id.* at 7–8. It still rages on now that China and the United States have become almost equal competitors for the position of the world's top economic power. See *id.* at 13–14. For a general discussion of the US-China competition, see Daniel C.K. Chow, *Why China Established the Asia Infrastructure Investment Bank*, 14 VAND. J. TRANSNAT'L L. 1296 (2016).

2. See Wade Shepard, *Meet the Man Fighting America's Trade War Against Chinese Counterfeits (It's Not Trump)*, FORBES (Mar. 29, 2018, 3:52 AM), <https://www.forbes.com/sites/wadeshepard/2018/03/29/meet-the-man-fighting-americas-trade-war-against-chinese-counterfeits/?sh=7ba454a41c0d> [<https://perma.cc/SZ29-STQA>].

3. See *id.* (“The trade in counterfeit and pirated goods is currently a \$1.7 trillion per year industry . . . and is expected to grow to \$2.8 trillion and cost 5.4 million jobs by 2022.”). The US General Accountability Office reports that in 2016, 88 percent of all counterfeit goods seized by the United States originated from China and Hong Kong. See U.S. GOV'T ACCOUNTABILITY OFF., GAO-18-216, INTELLECTUAL PROPERTY: AGENCIES CAN IMPROVE EFFORTS TO ADDRESS RISKS POSED BY CHANGING COUNTERFEITS MARKET 13 (2018), <https://www.gao.gov/assets/690/689713.pdf> [<https://perma.cc/28H7-CE46>]. The European Union claims that China is the largest source of counterfeits that enter the European Union. *Report on the EU Customs Enforcement of Intellectual Property Rights*, at 6 (2018), [https://ec.europa.eu/taxation\\_customs/system/files/2019-09/2019-ipr-report.pdf](https://ec.europa.eu/taxation_customs/system/files/2019-09/2019-ipr-report.pdf) [<https://perma.cc/9HGB-XLVN>].

4. See Daniel C.K. Chow, *Alibaba, Amazon, and Counterfeiting in the Age of the Internet*, 40 NW. J. INT'L L. & BUS. 157, 161 (2020) [hereinafter *Alibaba, Amazon, and Counterfeiting*]. According to Xinhua, China's official press agency, more than 40 percent of all goods sold online in China are counterfeit or of bad quality. See Reuters, *More Than 40 Per Cent of China's Online Sales 'Counterfeits or Bad Quality'*, TELEGRAPH (Nov. 3, 2015, 1:01 AM), <https://www.telegraph.co.uk/news/worldnews/asia/china/11971401/More-than-40-per-cent-of-Chinas-online-sales-counterfeit-or-bad-quality.html> [<https://perma.cc/HQ33-WUF6>]. Xinhua does not distinguish between counterfeits and products of poor quality; it is unclear whether Xinhua believes that these are two separate categories of goods or a single category as most counterfeits are of poor quality. See *id.*

5. Administrative authorities and courts have jurisdiction over counterfeiting cases under Chinese trademark law. Zhonghua Renmin Gongheguo Shang Biao Fa (中华人民共和国商标法) [Trademark Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 23, 2019, effective Nov. 1, 2019) arts. 60–61, 2019 China Law LEXIS

administrative and judicial remedies are unsatisfactory.<sup>6</sup> While administrative enforcement remains the most popular option, it results in few criminal prosecutions and fines that are so low as to create no deterrence.<sup>7</sup> Counterfeiters subject to administrative enforcement are able to recommence counterfeiting operations in weeks, or even days, after the administrative action has been completed.<sup>8</sup> Courts have also proven to be an ineffective avenue of relief against counterfeiters who simply disappear at the first sign of trouble and never appear in court.<sup>9</sup>

Due to the deficiencies of administrative and judicial avenues of relief, MNC brand owners have sought to use criminal enforcement through the PRC Public Security Bureau (PSB), China's primary police force, as a weapon against counterfeiting.<sup>10</sup> The PSB is one of China's most powerful and feared entities.<sup>11</sup> The PSB has the broad discretion to detain persons suspected of crimes, and such decisions are not subject to judicial review or oversight by higher-level authorities.<sup>12</sup> Additionally, the PSB can hold suspects in custody under harsh conditions for many months without ever charging them with a crime.<sup>13</sup> These unchecked powers alone are sufficient to create fear in China. Furthermore, persons who are convicted of counterfeiting crimes face years in prison.<sup>14</sup>

MNCs may prefer criminal enforcement, but there are hidden dangers in using the PSB that appear to be unknown to many

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445 [hereinafter PRC Trademark Law]. The judicial authorities have jurisdiction to prosecute criminal counterfeiting cases under Chinese criminal law. Zhonghua Renmin Gongheguo Xing Fa (中华人民共和国刑法) [Criminal Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Nov. 4, 2017, effective Nov. 4, 2017) art. 140, 2017 China Law LEXIS 1583 [hereinafter PRC Criminal Law]. For a further discussion, see *infra* Section II.B.

6. See *infra* Section II.B.

7. See *infra* Section II.B.

8. See *infra* Section II.B; See Daniel C.K. Chow, *Anti-Counterfeiting Strategies of Multinational Companies in China: How a Flawed Approach is Making Counterfeiting Worse*, 41 GEO. J. INT'L L. 749, 750–60 (2010) [hereinafter *Anti-Counterfeiting Strategies*].

9. See *id.* at 758–59.

10. See *id.* at 758.

11. See *infra* Section II.B.3.

12. Zhonghua Renmin Gongheguo Xingshi Susong Fa (中华人民共和国刑事诉讼法) [Criminal Procedure Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 26, 2018, effective Oct. 26, 2018) art. 82, 2018 China Law LEXIS 761 [hereinafter PRC Criminal Procedure Law]. The PSB can detain persons based on its assessment that the person is suspected of a crime. See *id.* The PRC Criminal Procedure Law does not contain any mechanism for review of the PSB's decision to detain. See *id.*

13. See *id.* art. 156.

14. See PRC Trademark Law, *supra* note 5, arts. 214, 216 (setting forth terms of imprisonment for counterfeiting crimes).

US-based MNCs. These risks can lead to serious consequences and, in some cases, even threaten the continuing viability of the MNC.<sup>15</sup> Some MNCs lack knowledge of these practices due to their organizational structure and how they manage their IP rights in China, as further explained below.<sup>16</sup>

Under PRC law, MNCs are required to establish a separate legal entity to serve as their subsidiary in China.<sup>17</sup> At its inception, the subsidiary is an empty vessel that must acquire capital assets and IP rights. The MNC injects capital, usually in the form of cash, to the subsidiary. One approach to allow the subsidiary to acquire IP rights is for the MNC to register all trademarks in China and then license those rights to the Chinese subsidiary.<sup>18</sup> A second approach is for the MNC to allow the Chinese subsidiary to register the trademarks in its own name.<sup>19</sup> The reasoning for this latter approach is that it is less complex and involves fewer costs; because the MNC owns the Chinese subsidiary, the MNC also owns the trademark in China.<sup>20</sup> If the MNC's trademark is registered under the name of the subsidiary, however, then only the subsidiary has the legal standing to bring an enforcement action with the PRC authorities.<sup>21</sup> The PSB and other PRC authorities will demand to see the trademark certificate in the name of the petitioner before the authorities will initiate an enforcement action.<sup>22</sup> When the trademark is registered in the name of the MNC's Chinese subsidiary, the MNC has no legal standing and becomes unable to control or influence the course of the enforcement action.<sup>23</sup> This structure will lead some Chinese subsidiaries to engage in dubious activities, such as making illegal payments to the PSB in exchange for an enforcement action that would otherwise be unavailable.<sup>24</sup> The Chinese subsidiary obtains criminal enforcement,

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15. See *infra* Part III.

16. See *infra* Section II.A–B.

17. See *Zhonghua Renmin Gongheguo Waishang Touzi Fa* (中华人民共和国外商投资法) [Foreign Investment Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 15, 2019, effective Jan. 1, 2020) art. 2, 2019 China Law LEXIS 1665 [hereinafter PRC Foreign Investment Law].

18. See *id.* art. 30.

19. See *id.*

20. See *id.*

21. See PRC Trademark Law, *supra* note 5, art. 60.

22. See *id.* art. 62.

23. See *id.* art. 60.

24. See Daniel C.K. Chow, *Why Multinational Companies Doing Business in China Fall into the Trap of Making Payments to China's Police*, 16 RICH. J. GLOB. L. & BUS. 1, 8 (2016) [hereinafter *Payments to China's Police*].

and the subsidiary never informs the MNC about the details of the enforcement action.<sup>25</sup>

Payments to the PSB or other enforcement authorities in China lead to serious risks under the PRC legal and political system.<sup>26</sup> While payments are tolerated by PRC authorities, they are of dubious legality; there is always the possibility of a crackdown that will expose this practice and lead to embarrassment, as well as criminal liability, for the MNC and its officers.<sup>27</sup> Illegal payments also further entrench and perpetuate a business culture of corruption in China, which is detrimental to the long-term interests of MNCs and to the development of the rule of law in the country.<sup>28</sup> Payments to the PSB also create unseemly entanglements for the MNC's Chinese subsidiary as the PSB will seek to further exploit the subsidiary through continuing demands for additional payments.<sup>29</sup>

An additional and perhaps even more significant risk is the applicability of the United States Foreign Corrupt Practices Act (FCPA) and other foreign anti-bribery laws like the United Kingdom Bribery Act.<sup>30</sup> Payments by the Chinese subsidiary to the PSB could fall within the FCPA's proscription against the making of illegal payments for the purpose of obtaining or retaining business in China.<sup>31</sup> Other provisions that relate to accurate record keeping and internal accounting controls also apply to the actions of Chinese subsidiaries of US-based MNCs with publicly traded securities.<sup>32</sup> These latter provisions create independent obligations and can be breached even if no payment was ever completed or promised.<sup>33</sup> Penalties under the FCPA encompass severe civil and criminal penalties, including imprisonment of corporate officers.<sup>34</sup>

To mitigate these risks under PRC law, the FCPA, and other foreign anti-bribery laws, this Article argues that the MNC should

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25. *See id.*

26. PRC Criminal Law, *supra* note 5, art. 389.

27. *See id.*

28. *See Payments to China's Police, supra* note 24.

29. *Id.*

30. *See* 15 U.S.C. §§ 78dd-1 to -3; Bribery Act 2010, c. 23 (U.K.). The UK Bribery Act imposes more severe penalties and is broader in scope than the FCPA. *See* Douglas Kelly, *Anti-Bribery Law Basics: FCPA and the UK Bribery Act*, EVERFI, <https://everfi.com/blog/workplace-training/fcpa-uk-bribery-act-bribery-basics/> [<https://perma.cc/K9QQ-H5SM>] (Nov. 23, 2020). A US-based MNC that has subsidiaries in the United Kingdom could be subject to both the FCPA and the Bribery Act. 15 U.S.C. § 78dd-1(a); Bribery Act 2010, c. 23, § 12 (U.K.).

31. *See* 15 U.S.C. § 78dd-1(a).

32. 15 U.S.C. § 78m(b)(2)(A)–(B).

33. *See id.*

34. *See* 15 U.S.C. § 78dd-2(g).

always register all important trademarks in its own name in China, and then license the trademark to its Chinese subsidiaries.<sup>35</sup> The licensing agreement should also authorize the Chinese subsidiary to enforce IP rights on behalf of the MNC. This approach will vindicate the principle that the MNC, not its subsidiaries, owns all of the important IP assets of the business. This approach will also allow the MNC, as the registered trademark owner, to exercise the maximum amount of control over the enforcement action and any conduct by its Chinese subsidiary. With this structure in place, the MNC can strictly control all enforcement activities and prevent the Chinese subsidiary from engaging in dangerous behavior.

This Article will examine these risks, many of them unknown to MNCs. Part II of this Article will present an overview of the enforcement system for trademarks in China and explain why many MNC brand owners seek criminal enforcement. Part II also explains the common approaches used by MNCs to register their trademarks and how some approaches create greater risks that a Chinese subsidiary will engage in illegal actions, such as making illegal payments to PRC authorities. Part III contains a detailed discussion of the FCPA issues that arise as a result of these practices. Part IV then proposes a number of suggested planning and preventative measures that MNCs should undertake to eliminate or limit these dubious practices. Finally, Part IV discusses alternative approaches to registering trademarks in China that should lessen the risks that the MNC's Chinese subsidiaries will engage in illegal actions during the course of protecting and enforcing trademarks. This approach requires the MNC to register the trademark in its own name and then license the trademark to its subsidiaries or affiliate entities in China.

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35. This is a basic principle of IP law that the author has advocated in all contexts. *See, e.g.,* DANIEL C.K. CHOW & EDWARD LEE, INTERNATIONAL INTELLECTUAL PROPERTY: PROBLEMS, CASES, AND MATERIALS 903 (4th ed. 2020) [hereinafter INTERNATIONAL INTELLECTUAL PROPERTY].

## II. CRIMINAL ENFORCEMENT AGAINST COUNTERFEITING IN CHINA

### A. MNC Brand Owners, Trademark Registration, and Enforcement in China

The entry of foreign brands and trademarks into China's internal market in the past three decades has been a key driver of the rise of China's consumer economy and its burgeoning middle class.<sup>36</sup> For example, MNCs such as Procter & Gamble, McDonald's, and Coca-Cola have introduced their brands for daily-use products—hygiene products, fast food, and soft drinks—into China with great success.<sup>37</sup> Many consumers in China are attracted to the allure, prestige, and glamour of foreign brands.<sup>38</sup> In turn, MNC brand owners are eager to capitalize on this strong appetite of Chinese consumers for the MNCs' products by producing and selling them in China.<sup>39</sup> However, before brand owners enter the Chinese market, they must take steps to protect their IP assets.

MNCs based in the United States (i.e., with US headquarters) that have valuable trademarks or brands that they wish to manufacture and then sell in China must first register their trademarks in China.<sup>40</sup> Unregistered trademarks receive no protection in China.<sup>41</sup> Many US-based MNCs have first registered their

36. See Dominic Barton, *Half a Billion: China's Middle-Class Consumers*, THE DIPLOMAT (May 30, 2013), <https://thediplomat.com/2013/05/half-a-billion-chinas-middle-class-consumers/> [<https://perma.cc/G8PX-N52F>]; Dominic Barton, Youngang Chen & Amy Jin, *Mapping China's Middle Class*, MCKINSEY & CO. (June 1, 2013), <https://www.mckinsey.com/industries/retail/our-insights/mapping-chinas-middle-class> [<https://perma.cc/YVV2-B84S>].

37. See DANIEL C.K. CHOW, THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA IN A NUTSHELL 34 (3d ed. 2015).

38. For example, it is a mark of prestige for a host to serve a famous foreign brand of liquor, such as a French made cognac like Hennessy or a western brand of whiskey such as Johnny Walker Black Label. See Jiani Ma, *Rich Post-80s Drive Chinese Whiskey Market Growth*, JING DAILY (Apr. 16, 2018), <https://jingdaily.com/chinese-whiskey-market/> [<https://perma.cc/Y9DA-HLP4>] (noting the demand for premium and super premium brands of whiskey and cognac in China).

39. See Lambert Bu, Benjamin Durand-Servoingt, Aimee Kim & Naomi Yamakawa, *Chinese Luxury Consumers: More Global, More Demanding, Still Spending*, MCKINSEY & CO. (Aug. 16, 2017), <https://www.mckinsey.com/business-functions/marketing-and-sales/our-insights/chinese-luxury-consumers-more-global-more-demanding-still-spending#> [<https://perma.cc/373M-4JY6>].

40. See PRC Trademark Law, *supra* note 5, art. 3. The only exception is for well-known trademarks, a special category. See *id.* art. 14.

41. See *id.* arts. 3, 56.



trademarks in the United States.<sup>42</sup> Then, based on the success of the US trademarked product, the MNCs attempt to expand their sales to China.<sup>43</sup> Due to the territorial nature of trademarks, a US trademark registration creates no rights outside of the United States.<sup>44</sup> Unless the trademark is registered in China, Chinese copycats and counterfeiters are free to make knockoffs of the trademark.<sup>45</sup>

A US-based MNC with a successful brand that it wishes to produce and sell in China will usually register both a Chinese language version and an English version of the US trademark with the PRC trademark authorities.<sup>46</sup> Both the English and Chinese language trademarks will then appear on the product together.<sup>47</sup> This is the typical practice of most MNCs in China.<sup>48</sup> For example, a can of Coca-Cola will have the English language trademark “Coca-Cola” next to the Chinese language trademark, 可口可乐 (Ke ko ke le, an alliteration that means “delicious happiness”).<sup>49</sup>

Foreign companies that seek to manufacture and sell their branded products in China are first required to establish a Chinese business entity under local law.<sup>50</sup> PRC law does not permit foreign entities to do business in China directly, but only through a business vehicle established under local law, a requirement that is typical in many countries.<sup>51</sup> Although China offers a number of business vehicles for foreign investment, most foreign companies have traditionally established either a joint venture with a local Chinese partner or a wholly foreign-owned enterprise (WFOE), which is a wholly owned

42. See, e.g., The Coca-Cola Company, BRITANNICA, <https://www.britannica.com/topic/The-Coca-Cola-Company> [<https://perma.cc/56RV-95TS>] (last visited Jan. 29, 2022); *McDonald's Trademarks*, GERBEN LAW FIRM, <https://www.gerbenlaw.com/trademarks/food-companies/mcdonalds/> [<https://perma.cc/FPC5-UWG3>] (Mar. 31, 2022).

43. See Zhong Nan & Wang Zhuoqiong, *MNCs Vow to Expand, Invest Further in Nation*, CHINA DAILY, <http://global.chinadaily.com.cn/a/202011/26/WS5fbf01a8a31024ad0ba9687d.html> [<https://perma.cc/55KR-NGY9>] (Nov. 26, 2020, 9:15 AM).

44. DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, *INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS* 330 (4th ed. 2021) [hereinafter *INTERNATIONAL BUSINESS TRANSACTIONS*].

45. PRC Trademark Law, *supra* note 5, art. 3.

46. See Daniel C.K. Chow, *Trademark Squatting and the Limits of the Famous Marks Doctrine in China*, 47 *GEO. WASH. INT'L L. REV.* 57, 79 (2015).

47. *Id.*

48. *Id.* at 76–77.

49. For an image of the Coca-Cola English and Chinese trademarks side-by-side on the product, see *Cola Bottle China Script Logo*, COCA-COLA, <https://us.coca-cola.com/store/coca-cola-bottle-china-script-logo> [<https://perma.cc/55KR-NGY9>].

50. PRC Foreign Investment Law, *supra* note 17, art. 2.

51. See *INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 44, at 400.

subsidiary of the US parent company.<sup>52</sup> The WFOE or joint venture is a Chinese legal entity but is wholly or partly owned by a foreign company.<sup>53</sup>

After the MNC has established a business entity in China, the MNC must then acquire IP rights for the entity.<sup>54</sup> The business entity begins as an empty vessel into which the MNC must inject capital and IP assets.<sup>55</sup> Among the IP assets are the brands or trademarks that will be produced and sold by its Chinese business entity.<sup>56</sup>

A crucial decision for an MNC when filing its trademark registrations in China is which entity will be the registered owner of the trademarks: either the US parent or the Chinese business entity or subsidiary.<sup>57</sup> One approach is to have the US-based MNC or the US parent company—the owner of the US trademark—also act as the trademark owner for the purpose of registering the marks in China. Once the registration is obtained in the name of the US parent, it will then license the trademarks to the Chinese subsidiary.<sup>58</sup> The licensing agreement is necessary because the Chinese business entity otherwise would not have the right to use the trademark on the products that it manufactures.<sup>59</sup> The other approach is to allow the Chinese business entity to register the trademark in its own name.<sup>60</sup> If this approach is

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52. PRC Foreign Investment Law, *supra* note 17, art 2. The Foreign Investment Law, effective in 2020, replaced the regime of foreign direct investment that had existed in China since China first opened itself up to foreign investment in the late 1970s. *Id.*; see Zhonghua Renmin Gongheguo Zhongwai Hezi jingying Qiye Fa (中华人民共和国中外合资经营企业法) [Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 15, 2001, effective Mar. 15, 2001) 2001 China Law LEXIS 4066 [hereinafter Equity Joint Venture Law]. Under prior law, foreign investors were required to set up joint ventures under the Equity Joint Venture Law (2001) or wholly foreign owned subsidiaries under the Wholly Foreign Owned Enterprise Law (2000). Equity Joint Venture Law, *supra*; Zhonghua Renmin Gongheguo Waishang Duzi Qiye Fa (中华人民共和国外商独资企业法) [Law of the People's Republic of China on Wholly Foreign-Owned Enterprises] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2000, effective Oct. 31, 2000) 2000 China Law LEXIS 3337.

53. INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 44, at 499–500.

54. *Id.* at 503.

55. *Id.*

56. *Id.*

57. *See id.*, at 340, 343 (using an example of two alternatives for obtaining IP rights in foreign markets and providing a sample licensing provision in patent licensing agreement); *see also* INTERNATIONAL INTELLECTUAL PROPERTY, *supra* note 35, at 903 (explaining that a parent company should register all IP rights in its own name and then license them to the foreign subsidiary, similarly rejecting the approach of allowing the subsidiary to register IP rights of the parent).

58. *See* PRC Trademark Law, *supra* note 5, art. 43.

59. *Id.*

60. *Id.* arts. 4, 6.

taken, then no license agreement is needed because the Chinese subsidiary, as the registered trademark owner, has the right to use the trademark on the goods that it produces.<sup>61</sup> The US parent owns the Chinese subsidiary and thus indirectly owns the trademark registered in the subsidiary's name.<sup>62</sup>

One other common scenario is when the Chinese business entity uses a local trademark.<sup>63</sup> Suppose, for example, that a joint venture formed by the MNC and the local partner, a PRC company, wishes to use a trademark owned by the local partner. The local partner may permit the joint venture to use the trademark. Another approach is for the MNC to purchase the Chinese language trademark from the local partner,<sup>64</sup> register the local trademark in its own name,<sup>65</sup> and then license it back to the joint venture.<sup>66</sup> This latter approach involves more costs to the MNC and reduces the profits from the joint venture because of the initial capital expenditure for the purchase of the trademark from the local partner.<sup>67</sup>

Registering all of an MNC's trademarks in China under the name of the US parent company vindicates the principle that the US parent owns all of the business's IP assets and prevents any questions or disputes concerning who or which entity owns the IP assets of the business. The disadvantage of this approach is that it involves more costs and steps. The US parent will need to use licensing agreements and may need to purchase local trademarks, register the trademarks in its own name, and then license them back to the joint venture or WFOE.

The decision concerning which entity assumes the role of the trademark owner in registering the marks in China has important ramifications in counterfeiting enforcement actions, discussed in Section II.B. below.<sup>68</sup> Under PRC law, only the registered trademark owner can bring an enforcement action with the PRC authorities.<sup>69</sup>

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61. *Id.* art 3.

62. *See id.* arts. 42–43.

63. *See id.* art. 3.

64. *Id.* art. 42.

65. *Id.* art. 3.

66. *Id.* art. 43.

67. *See* PRC Trademark Law, *supra* note 5, art. 72.

68. *See infra* Section II.B.

69. PRC Trademark Law, *supra* note 5, art. 60.

*B. Role of Major Enforcement Authorities Against Counterfeiting in China*

China has established a legal system in which several different entities have overlapping authority to enforce trademark rights against counterfeiting.<sup>70</sup> These authorities can be broadly divided into administrative, judicial, and police organizations.<sup>71</sup> In general, the brand owner makes the initial choice regarding which authority to approach.<sup>72</sup> Although brand owners have several enforcement options, most brand owners find that enforcement in China is ineffective due to corruption and a lack of political will.<sup>73</sup>

1. Administrative Enforcement

Under PRC law, the State Administration of Market Regulation (SAMR), formerly known as the State Administration of Industry and Commerce, and its local branches (AMRs) are primarily charged with regulating and promoting commercial activity within China.<sup>74</sup> The SAMR is the government entity that has responsibility for regulating China's markets and regulating the activities of China's business entities.<sup>75</sup> All business entities must register with a local branch of the SAMR and obtain a business license.<sup>76</sup> No business entity, including foreign-invested companies, can lawfully operate in China without a business license issued by an AMR.<sup>77</sup> As the use of trademarks is essential to commerce in China (as in most countries), the AMRs' overall responsibility includes authority over the registration and enforcement of trademarks.<sup>78</sup>

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70. See *Anti-Counterfeiting Strategies*, *supra* note 8, at 754–55.

71. See *id.* at 750–51.

72. See *id.* at 751.

73. Daniel C.K. Chow, *Why China Does Not Take Commercial Piracy Seriously*, 32 OHIO N.U. L. REV. 203, 213, 218–20, 222–25 (2006).

74. Katherine Wang, Mimi Yang & David Zhang, *China's New State Market Regulatory Administration: What to Know and What to Expect*, ROPES & GRAY (Apr. 3, 2018), <https://www.ropesgray.com/en/newsroom/alerts/2018/04/Chinas-New-State-Market-Regulatory-Administration-What-to-Know-and-What-to-Expect> [<https://perma.cc/5TDB-5H3Z>]. The SAMR was previously known as the State Administration of Industry and Commerce (SAIC). *Id.* In 2018, the SAMR replaced the SAIC. *Id.* In the provisions cited in the text, the PRC Trademark Law still refers to the administrations of industry and commerce (AICs), but the AICs have been replaced by the AMRs.

75. *Id.*

76. *Alibaba, Amazon, and Counterfeiting*, *supra* note 4, at 189.

77. *Id.*

78. Wang et al., *supra* note 74.

Article 2 of the PRC Trademark Law provides that the SAMR shall establish a trademark registration system and a trademark review and adjudication board to resolve trademark disputes dealing with basic legal issues, such as eligibility for trademark registration and protection.<sup>79</sup> Article 60 of the PRC Trademark Law provides that in the case of infringement or counterfeiting, “the trademark registrant or an interested party shall request the relevant administrative department for industry and commerce to address the dispute.”<sup>80</sup> The PRC Trademark Law sets forth the investigatory powers of the AMRs in trademark cases in detail, including the power to interrogate suspects and seize and review financial records.<sup>81</sup> The PRC Trademark Law further provides that “if the administrative department for industry and commerce is of the opinion that the infringement is established, it shall order the relevant party to immediately cease the infringing acts, and shall confiscate and destroy the infringing goods and instruments mainly used for manufacturing the infringing goods and forging the registered trademark.”<sup>82</sup> The AMRs also have the power to impose fines,<sup>83</sup> and award compensatory damages to the trademark owner.<sup>84</sup>

The PRC Trademark Law further provides that during the course of a trademark investigation by the AMRs, “where a crime is suspected to have been committed, it shall promptly transfer the case to a judicial department for handling in accordance with law.”<sup>85</sup> Thus, the PRC Trademark Law contemplates that the AMRs should be the first avenue of recourse for the trademark owner in a trademark counterfeiting and infringement case; if the AMR uncovers criminal activity during the course of the AMR’s investigation, the AMR shall transfer the case to the Public Security Bureau (PSB) (considered part of the judiciary in China and further discussed below) for criminal enforcement.<sup>86</sup>

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79. PRC Trademark Law, *supra* note 5, arts. 2–3.

80. *Id.* art. 60.

81. *Id.* art. 62.

82. *Id.* art. 60.

83. *Id.*

84. *Id.* art. 63.

85. *Id.* art. 61.

86. All criminal cases are initiated by the PSB. *See* PRC Criminal Procedure Law, *supra* note 12, arts. 3, 19.

*a. Enforcement Process Through the AMRs*

Although AMRs and other authorities in China have investigatory powers, brand owners in China must usually conduct substantial preliminary investigatory activities on their own before approaching PRC authorities.<sup>87</sup> AMRs and other authorities do not have the resources or the inclination to conduct a lengthy investigation into counterfeiting activities.<sup>88</sup> For this reason, most brand owners will approach the AMRs after having first identified the counterfeiter, its operations, and its locations.<sup>89</sup>

Most counterfeiters use false identities and clandestine operations, so finding accurate information about the counterfeiter is difficult but essential.<sup>90</sup> Many brand owners will hire private investigation companies located in China or Hong Kong to conduct an investigation of the counterfeiter.<sup>91</sup> Although the use of private investigation companies can be controversial in the PRC, such companies are lawful and tolerated by the PRC authorities.<sup>92</sup> Some MNCs have large enough internal brand protection personnel to conduct investigations on their own, but as this work can be dangerous, many MNCs prefer to hire independent contractors who

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87. The burden falls on the brand owner to conduct an investigation and gather enough evidence to convince the PRC authorities to act. This observation is based on the author's own experience working in China. See Daniel C.K. Chow, *Cultural Barriers to Effective Enforcement of the Foreign Corrupt Practices Act in China*, 48 U. TOL. L. REV. 551, 555 & n.39 (2017) [hereinafter *Cultural Barriers*].

88. *Id.* at 555.

89. *Anti-Counterfeiting Strategies*, *supra* note 8, at 763–64.

90. See *id.*; e.g., Jeff Bercovici, *Small Businesses Say Amazon Has a Huge Counterfeiting Problem. This "Shark Tank" Company Is Fighting Back*, INC., <https://www.inc.com/magazine/201904/jeff-bercovici/amazon-fake-copycat-knockoff-products-small-business.html> [https://perma.cc/LKN5-SGCD] (last visited Feb. 4, 2022); David Pierson, *Extra Inventory. More Sales. Lower Prices. How Counterfeits Benefit Amazon*, L.A. TIMES (Sept. 28, 2018, 3:00 AM), <https://www.latimes.com/business/technology/la-fi-tn-amazon-counterfeits-20180928-story.html> [https://perma.cc/67L9-LS7X] (“[I]f Amazon shuts one store for selling knockoffs, the owner often shifts operations to another.”); Alana Semuels, *Amazon May Have a Counterfeit Problem*, ATLANTIC (Apr. 20, 2018), <https://www.theatlantic.com/technology/archive/2018/04/amazon-may-have-a-counterfeit-problem/558482/> [https://perma.cc/9XJQ-GC4F] (“These problems come up once a week.”).

91. ANDREW C. MERTHA, *THE POLITICS OF PIRACY INTELLECTUAL PROPERTY IN CONTEMPORARY CHINA* 196–98 (2018).

92. *Private Investigators Debated*, CHINA.ORG.CN (Sept. 5, 2001), <http://www.china.org.cn/english/2001/Sep/18678.htm> [https://perma.cc/ZMC8-NWPS]. Private investigation companies are controversial because they engage in what can be viewed as police work, which is solely the province of the PRC government. *Anti-Counterfeiting Strategies*, *supra* note 8, at 764. Nevertheless, such companies are tolerated by the PRC authorities under the guise of market information companies because they provide an essential service that the PRC government has neither the resources nor the interest to provide. See *id.*

specialize in this work and are willing to assume the risks.<sup>93</sup> Private investigation companies will sometimes infiltrate a counterfeiting ring through the use of false identities and by placing purchase orders for counterfeit goods, activities that most brand owners do not wish their own employees to undertake.<sup>94</sup> The need to use private investigation companies adds a significant cost to brand owners, as each investigation usually costs thousands of dollars, and many MNCs find it necessary to conduct multiple operations simultaneously on an annual basis.<sup>95</sup>

Once the brand owner has obtained the necessary information on the counterfeiter, the brand owner will approach the appropriate AMR to conduct a raid of the counterfeiter and a seizure of product, cash, and equipment.<sup>96</sup> The brand owner must produce a trademark certificate registered with the SAMR to demonstrate that it is the lawful owner of the trademark.<sup>97</sup> PRC enforcement authorities will not bring any enforcement action without proof that the complainant is, or has been authorized by, the registered trademark owner.<sup>98</sup> A representative of the brand owner, usually with its private investigators in tow, will appear before the AMR with a written one-page complaint and a copy of its trademark registration certificate.<sup>99</sup> In some cases, an oral application will be sufficient if the AMR and the brand owner have worked together in the past and have become familiar with each other.<sup>100</sup>

Typically, within the hour, the brand owner and its private investigators will then board a van with members of the AMR, trailed by other vehicles.<sup>101</sup> Typically, only then will the brand owner reveal the location of the counterfeiter.<sup>102</sup> Revealing the location at the last

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93. See *Payments to China's Police*, *supra* note 24.

94. See *id.*

95. *Id.* at 12. According to author's own experience, the budgets of MNC for enforcement can be in the millions of dollars per year. See Chow, *Counterfeiting in China*, *supra* note 1, at 23 n.81.

96. See Chow, *Counterfeiting in China*, *supra* note 1, at 19–20 n. 66 (describing raids conducted in Yiwu City, “a significant wholesale distribution center for counterfeit goods” in China from 1998 to 1999).

97. PRC Trademark Law, *supra* note 5, art. 60.

98. *Id.*

99. See Albert Tsui, *CHINA: New Standard on Trademark Infringement*, INT'L TRADEMARK ASS'N (July. 15, 2020), <https://www.inta.org/perspectives/china-new-standard-on-trademark-infringement/> [<https://perma.cc/Y8YF-DQ76>].

100. See *Payments to China's Police*, *supra* note 24, at 4.

101. *Anti-Counterfeiting Strategies*, *supra* note 8, at 761.

102. *Id.*

minute is necessary to avoid tip-offs from the AMR.<sup>103</sup> During the raid, the brand owner's representative will identify the product suspected to be counterfeit and needed to be seized.<sup>104</sup> The AMR officers depend on the brand owner to identify the counterfeit product because these officers are enforcement authorities and have no training in or knowledge of trademark law or IP.<sup>105</sup>

The AMR will seize any counterfeit product and equipment on the premises.<sup>106</sup> Then, the AMR will destroy the seized materials or sell them in a public auction with any infringing trademarks first removed from the products.<sup>107</sup> The ease with which brand owners can obtain raids through AMRs is one reason why using the AMRs remains popular.<sup>108</sup>

*b. Lack of Deterrence*

Although enforcement through the AMRs remains a popular option for brand owners, this approach contains significant deficiencies, as illustrated by the enforcement statistics below.

**AMR-AIC Trademark Enforcement Activity, 1999–2017<sup>109</sup>**

<i>Year</i>	<i>Cases</i>	<i>Average Fine</i>	<i>Average Damages</i>	<i>Criminal Prosecutions</i>
1999	16,938	\$754	\$40	21 total (1 in 806 cases)
2000	22,001	\$794	\$19	45 total (1 in 489 cases)

103. *Id.*

104. *Id.*

105. *See id.* at 771–72.

106. PRC Trademark Law, *supra* note 5, art. 60.

107. Zhonghua Renmin Gongheguo Zhishi Chanquan Haiguan Baohu Tiaoli (中华人民共和国知识产权海关保护条例) [Regulations of the People's Republic of China on the Customs Protection of Intellectual Property Rights] (promulgated by the Order of the State Council, Mar. 24, 2010, effective April 1, 2010) art. 27, 2010 China Law LEXIS 2985.

108. See Danny Chen, *How to Run an Administrative Raid in China*, WORLD TRADEMARK REV. (Feb. 27, 2015), <https://www.worldtrademarkreview.com/how-run-administrative-raid-china> [<https://perma.cc/BTB7-VW89>] (explaining that “administrative raids are a popular anti-counterfeiting tool”).

109. This table was compiled using the STATE ADMIN. OF INDUS. & COM., CHINA, ANNUAL DEVELOPMENT REPORT ON CHINA'S TRADEMARK STRATEGY 2013–2017. Prior to 2018, the State Administration of Market Regulation was known as the State Administration of Industry and Commerce (SAIC). *See id.* These statistics above track AIC enforcement activity. *Id.*



2001	22,813	\$1150	\$18	86 total (1 in 265 cases)
2002	23,539	\$1136	\$19	59 total (1 in 265 cases)
2003	26,488	\$1142	\$51	45 total (1 in 399 cases)
2004	40,171	\$834	\$26	96 total (1 in 418 cases)
2005	49,412	\$1017	\$40	91 total (1 in 209 cases)
2006	50,534	\$1158	\$53	252 total (1 in 200 cases)
2007	50,318	\$1220	N/A	229 total (1 in 209 cases)
2008	56,634	\$1212	N/A	137 total (1 in 413 cases)
2009	51,044	\$1117	N/A	92 total (1 in 555 cases)
2010	56,034	\$1164	N/A	175 total (1 in 320 cases)
2011	79,021	\$1119	N/A	421 total (1 in 188 cases)
2012	66,227	\$1206	N/A	576 total (1 in 115 cases)
2013	56,876	\$711	N/A	477 total (1 in 119 cases)
2014	55,202	\$2610	N/A	355 total (1 in 155 cases)
2015	30,716	\$1725	N/A	238 total (1 in 129 cases)
2016	31,754	\$1273	N/A	293 cases (1 in 108 cases)
2017	30,130	\$2413	N/A	240 cases (1 in 125 cases)

The statistics above track AMR-AIC enforcement activity beginning in 1999 to 2017, the most recent year for which data is available.<sup>110</sup> The beginning of this period is significant because counterfeiting began to gain international attention as a major

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110. *Id.*

problem for MNCs in China.<sup>111</sup> As a result, the number of AMR-AIC enforcement cases rose rapidly from about seventeen thousand cases in 1999 to a peak of almost eighty thousand cases in 2011 and settling to above thirty thousand cases in 2017.<sup>112</sup> While the number of cases increased dramatically during this period, remedial measures in the form of compensation and fines remain at a level that is too low to create deterrence.<sup>113</sup> In 2017, fines for counterfeiting averaged \$2,413, while for most of the decade, fines typically were under \$2,000, and only \$711 in 2013 when nearly fifty-seven thousand AMR-AIC enforcement actions were brought.<sup>114</sup> Fines at these levels are so low that they are commonly considered just the “cost of doing business” by counterfeiters.<sup>115</sup> Historically, compensatory damages have also been trivially low, although no statistics on compensatory damages have been available for over a decade.<sup>116</sup> In sum, such low monetary penalties against counterfeiters do not create deterrence.

Under PRC law, AMRs are required to transfer cases to the PSB for criminal investigation when the AMRs discover evidence of criminal activity in the course of their enforcement actions.<sup>117</sup> In 2017, only 1 in 125 cases (240 cases of 30,130) were transferred to the PSB.<sup>118</sup> The recent trend indicates that more cases are being transferred to the PSB than in the earlier years of this period, but the number of cases (less than 1 percent) in recent years shows that enforcement actions of the AMRs that result in criminal investigations are rare.<sup>119</sup> The unlikely prospect of criminal enforcement in cases initiated by AMRs is another reason why MNCs believe that AMR enforcement does not create effective deterrence.<sup>120</sup>

One reason why AMRs transfer so few cases to the PSB has to do with institutional competitiveness and internal bureaucratic

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111. See *Counterfeiting in China*, *supra* note 1, at 9.

112. See STATE ADMIN. OF INDUS. & COM., *supra* note 109.

113. See *Counterfeiting in China*, *supra* note 1, at 33.

114. See STATE ADMIN. OF INDUS. & COM., *supra* note 109.

115. See *Anti-Counterfeiting Strategies*, *supra* note 8, at 757; KRISTINA SEPETYS & ALAN COX, INTELLECTUAL PROPERTY RIGHTS PROTECTION IN CHINA: TRENDS IN LITIGATION AND ECONOMIC DAMAGES 4 & n.15 (2009), [https://www.nera.com/content/dam/nera/publications/archive1/PUB\\_IPR\\_Protection\\_China\\_0109\\_final.pdf](https://www.nera.com/content/dam/nera/publications/archive1/PUB_IPR_Protection_China_0109_final.pdf) [<https://perma.cc/TV8Q-LPNX>].

116. See *Anti-Counterfeiting Strategies*, *supra* note 8, at 757. See SEPETYS & COX, *supra* note 115.

117. PRC Trademark Law, *supra* note 5, art. 61.

118. See STATE ADMIN. OF INDUS. & COM., *supra* note 109.

119. SEPETYS & COX, *supra* note 115, at 5–6.

120. See *id.* at 5.

rivalries.<sup>121</sup> If the AMR transfers the case to the PSB, the AMR must also transfer all seized products and any cash and equipment.<sup>122</sup> The AMR has less to report on to its supervisory organ and loses the opportunity to sell the seized materials and earn revenue.<sup>123</sup> AMRs will have expended time and resources in conducting the raid but have nothing to show for these efforts when a case is transferred to the PSB.<sup>124</sup> This possibility leads to a reluctance by AMRs to transfer cases to the PSB.<sup>125</sup>

These statistics indicate that while AMR enforcement remains a popular option, such enforcement does not deter future illegal conduct due to the lack of meaningful repercussions for the counterfeiter.<sup>126</sup> Moreover, each enforcement action can cost brand owners thousands of dollars in fees for private investigation companies and law firms.<sup>127</sup> For enforcement actions to have any effect on counterfeiters, the brand owner must continuously bring these actions, or else the brand owner will gain a reputation that it does not actively enforce its rights. The mounting costs of numerous enforcement actions and their lack of deterrence are a source of significant frustration for many brand owners. Some brand owners believe that AMR enforcement actions are futile and a waste of resources; these actions only antagonize and anger counterfeiters, who are able to shortly resume their illegal activities.<sup>128</sup>

## 2. Courts and Civil Litigation

Brand owners have the option of pursuing civil litigation in courts instead of following the route of administrative action through AMRs.<sup>129</sup> Most brand owners find, however, that court-based litigation is useful only in cases involving lawful business entities with a legitimate business dispute relating to trademarks.<sup>130</sup> For example, if two lawfully registered companies have a dispute concerning a registered trademark, the companies may wish to litigate their claims

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121. See *Counterfeiting in China*, *supra* note 1, at 32 (discussing bureaucratic competition in China).

122. *Id.* at 24–25 (describing several other administrations with similar functions transferring confiscated goods to PSB).

123. *Id.* at 32.

124. *Id.*

125. *Id.* at 33.

126. *Id.*

127. See *Payments to China's Police*, *supra* note 24.

128. See *id.* at 12.

129. PRC Trademark Law, *supra* note 5, art. 60.

130. See *Counterfeiting in China*, *supra* note 1, at 47.

in court instead of having the SAMR resolve the dispute through the less formal administrative process. In the case of counterfeit goods, the counterfeiter will abscond at the first sign of trouble.<sup>131</sup> In many cases, the counterfeiter is also an illegal, underground operator using a false name and identity and may be engaged in other petty criminal activities.<sup>132</sup> Even if the counterfeiter can be located and served with legal process, the counterfeiter flees immediately and never arrives in court.<sup>133</sup> For this reason, most brand owners avoid using courts because they do not provide an effective means to resolve counterfeiting cases.

### 3. The Public Security Bureau

The deficiencies of administrative and judicial enforcement have led many brand owners to pursue criminal enforcement.<sup>134</sup> Most brand owners believe that criminal punishment, including imprisonment, is the most effective deterrent against any type of criminal activity, including counterfeiting.<sup>135</sup>

All criminal investigations in China must be initiated by local PSBs, which are under the control of the Ministry of Public Security, the central-level authority in charge of suppressing crime and preserving social order.<sup>136</sup> The PSB is the primary police force in China charged with maintaining social safety and stability.<sup>137</sup> To maintain stability and order, the PSB focuses on suppressing violent crimes, such as homicide, rape, robbery, and assault.<sup>138</sup> The PSB also focuses on stopping domestic terrorism, political dissent, and criticism of the Communist Party.<sup>139</sup> Both violent crime and political dissent are viewed as directly threatening social stability, and their prevention and suppression are considered to be core duties of the PSB.<sup>140</sup>

131. See *Payments to China's Police*, *supra* note 24, at 4; *Alibaba, Amazon, and Counterfeiting*, *supra* note 4, at 163.

132. See Elizabeth Schulze, *Counterfeit Goods from China Are Crushing American Small Businesses – and They're Calling on Trump to Fight Back*, CNBC, <https://www.cnbc.com/2020/02/28/small-businesses-are-pushing-trump-to-fight-chinese-counterfeits.html> [<https://perma.cc/CVM6-DW8X>] (Mar. 1, 2020, 11:04 PM).

133. See *id.*; *Payments to China's Police*, *supra* note 24, at 3.

134. *Payments to China's Police*, *supra* note 24, at 4.

135. See *Counterfeiting in China*, *supra* note 1, at 33.

136. *Ministry of Public Security*, STATE COUNCIL OF CHINA, [http://english.www.gov.cn/state\\_council/2014/09/09/content\\_281474986284154.htm](http://english.www.gov.cn/state_council/2014/09/09/content_281474986284154.htm) [<https://perma.cc/QX6N-RJU5>] (Aug. 25, 2014, 4:04 PM).

137. *Id.*

138. See *id.*

139. *Id.*

140. *Id.*

Despite the key role of the PSB, limits on its current funding levels adversely impact its institutional capacity and ability to do on-the-ground criminal enforcement.<sup>141</sup> Funding limits and shortages of manpower are chronic problems for the PSB, making performance of its work difficult and forcing the PSB to prioritize the type of cases that it will investigate.<sup>142</sup> Economic crimes, such as counterfeiting, are not viewed as priorities; the PSB will actively pursue such cases only in certain special situations involving victims who have been harmed or killed.<sup>143</sup> For example, the PSB will actively pursue cases involving counterfeit liquor, which has caused deaths by alcohol poisoning; counterfeit pharmaceuticals, which have caused persons to become sick or die; or counterfeit money, which is viewed as a direct threat to the State.<sup>144</sup> Victimless counterfeiting cases, such as those involving purely economic harm that does not cause injury or death to consumers, are not considered priorities by the PSB.<sup>145</sup>

The PSBs have the authority to bring a criminal action in counterfeiting cases pursuant to Article 140 of the PRC Criminal Law.<sup>146</sup> In order to join the World Trade Organization (WTO) in 2001, among other changes, China enacted Article 140 to satisfy the WTO requirement that it must have criminal penalties for counterfeiting on a commercial scale.<sup>147</sup> Similar to many other PRC criminal statutes, Article 140 uses a monetary threshold test, with the level of criminal liability increasing based on the value of sales of counterfeit goods.<sup>148</sup>

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141. Suzanne E. Scoggins, *Policing Modern China*, 3 CHINA L. & POL'Y REV. 79, 82 (2018).

142. *Id.*

143. See *Payments to China's Police*, *supra* note 24, at 9–10.

144. See, e.g., *13 Jailed for Making Fake Moutai Liquor in SW China*, XINHUANET (Dec. 28, 2020, 6:51 PM), [http://www.xinhuanet.com/english/2020-12/28/c\\_139624357.htm](http://www.xinhuanet.com/english/2020-12/28/c_139624357.htm) [https://perma.cc/858Z-QKEB] (reporting that Chinese police arrested suspects with twenty-seven thousand bottles of fake liquor); *Chinese Police Seize 422-mln-Yuan Counterfeit Money*, XINHUANET (May 15, 2020, 12:26 AM), [http://www.xinhuanet.com/english/2020-05/15/c\\_139057549.htm](http://www.xinhuanet.com/english/2020-05/15/c_139057549.htm) [https://perma.cc/SK9W-T5Y7] (“Police from Heilongjiang and Guangdong provinces captured 16 suspects and seized equipment and raw materials for money counterfeiting in a joint operation.”); *China Arrests 1,900 in Crackdown on Fake Drugs*, BBC NEWS (Aug. 6, 2013), <https://www.bbc.com/news/world-asia-china-19144556> [https://perma.cc/AF7B-496T] (“Police in China have arrested more than 1,900 people in a crackdown on the manufacture and sale of fake medicine.”).

145. *Payments to China's Police*, *supra* note 24, at 7.

146. PRC Trademark Law, *supra* note 5, art. 140.

147. Agreement on Trade-Related Aspects of Intellectual Property Rights art. 61, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299.

148. PRC Criminal Law, *supra* note 5, art. 140

(Any producer or seller who mixes impurities into or adulterates the products, or passes a fake product off as a genuine one, a defective product as a high-quality one, or a substandard product as a standard one, if the amount of earnings from sales is

For example, if sales of counterfeits are between 50,000 Renminbi (“people’s currency” or RMB) and 200,000 RMB (about USD \$7,720 to \$31,000), the suspect faces two years of imprisonment.<sup>149</sup> For sales between 200,000 to 500,000 RMB (about \$31,000 to \$77,000), the suspect faces imprisonment of between two to seven years.<sup>150</sup> The maximum penalty of fifteen years imprisonment is imposed in cases where sales exceed 2 million RMB.<sup>151</sup>

The procedure for initiating a case with the PSB is similar to that used in administrative enforcement cases.<sup>152</sup> The brand owner must present a copy of its trademark certificate and be prepared with information about the identity and location of the counterfeiter.<sup>153</sup> The PSB will then initiate a raid and seize counterfeit products, equipment, and cash.<sup>154</sup> As in the case of PRC administrative authorities, the PSB does not have the resources or the interest to investigate counterfeiting cases to independently locate the counterfeiter or determine the number of completed sales and whether various thresholds have been met.<sup>155</sup> Instead, the brand owner provides this evidence to the PSB.<sup>156</sup> In most cases, the brand owner will need to hire a private investigation company to assist in making these determinations.<sup>157</sup>

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more than 50,000 yuan but less than 200,000 yuan, shall be sentenced to fixed-term imprisonment of not more than two years or criminal detention and shall also, or shall only, be fined not less than half but not more than two times the amount of earnings from sales; if the amount of earnings from sales is more than 200,000 yuan but less than 500,000 yuan, he shall be sentenced to fixed-term imprisonment of not less than two years but not more than seven years and shall also be fined not less than half but not more than two times the amount of earnings from sales; if the amount of earnings from sales is more than 500,000 yuan but less than 2,000,000 yuan, he shall be sentenced to fixed-term imprisonment of not less than seven years and shall also be fined not less than half but not more than two times the amount of earnings from sales; if the amount of earnings from sales is more than 2,000,000 yuan, he shall be sentenced to fixed-term imprisonment of 15 years or life imprisonment, and shall also be fined not less than half but not more than two times the amount of earnings from sales or be sentenced to confiscation of property.).

149. *Id.*

150. *Id.*

151. *Id.*

152. *See Payments to China’s Police, supra* note 24, at 3.

153. Chen, *supra* note 108.

154. *Id.*

155. *See Payments to China’s Police, supra* note 24, at 9–10.

156. *See Counterfeiting in China, supra* note 1, at 23.

157. *See Payments to China’s Police, supra* note 24.

*a. PSB's Reputation*

The PSB is one of the most powerful entities in the PRC and is also one of the most feared.<sup>158</sup> Most people in China are terrified of the PSB and will do everything possible to avoid any interaction with it.<sup>159</sup> The PSB is notorious in China for using torture to obtain coerced confessions, most often in cases involving political dissent or in serious criminal cases like homicide.<sup>160</sup> In some instances, the use of torture in obtaining confessions results in the suspect's death, including the recent case of a twenty-eight-year-old man who was dead less than two hours after being detained.<sup>161</sup> Other suspects in custody simply disappear and are never heard from again.<sup>162</sup> The PSB is also known to beat up, abuse, and torture suspects.<sup>163</sup> The PSB is almost universally viewed as corrupt by the public in China.<sup>164</sup>

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158. Scoggins, *supra* note 141, at 80.

159. See, e.g., Paul Mozur & Aaron Krolik, *A Surveillance Net Blankets China's Cities, Giving Police Vast Powers*, N.Y. TIMES (Dec. 17, 2019), <https://www.nytimes.com/2019/12/17/technology/china-surveillance.html> [<https://perma.cc/JN43-MHXT>]. This observation is based on the author's own experience living in China and based on discussion with Chinese academics and lawyers.

160. CONG.-EXEC. COMM'N ON CHINA, 116TH CONG., ANNUAL REPORT 92 (2020), <https://www.cecc.gov/sites/chinacommission.house.gov/files/2020%20ANNUAL%20REPORT%20FINAL%201223.pdf> [<https://perma.cc/23SZ-4496>].

161. Yuning Wu & Ivan Sun, *Chinese Police Legitimacy and Public Trust*, ASIA DIALOGUE (Feb. 16, 2018), <https://theasiadialogue.com/2018/02/16/chinese-police-legitimacy-and-public-trust/> [<https://perma.cc/9EJW-LCLA>] (reporting that in 2018, Lei Yang, a twenty-eight-year-old state employee, was declared dead less than two hours after being detained by the police, allegedly on suspicion of soliciting a prostitute).

162. Stanley Lubman, *Arrested, Detained: A Guide to Navigating China's Police Powers*, WALL ST. J. (Aug. 12, 2014, 3:51 AM), <https://www.wsj.com/articles/BL-CJB-23571> [<https://perma.cc/TN7V-55K4>] (discussing human rights activists who "disappeared" after being taken into police custody).

163. E.g., SAFEGUARD DEFS., CHINA AID, CHRISTIAN SOLIDARITY WORLDWIDE, FRONT LINE DEFS., HUM. RTS. WATCH, REPS. WITHOUT BORDERS & WORLD ORG. AGAINST TORTURE, SUBMISSION TO SELECT UN SPECIAL PROCEDURES ON: CHINA'S PRACTICE OF EXTRACTING AND BROADCASTING FORCED CONFESSIONS BEFORE TRIAL 3 (2020), <https://safeguarddefenders.com/sites/default/files/pdf/Submission%20to%20select%20UN%20Special%20Procedures%20%20China's%20practice%20of%20extracting%20and%20broadcasting%20forced%20confessions%20before%20trial%20Redacted.pdf> [<https://perma.cc/TEX5-YQPQ>] ("The televised confessions are now well and truly normalized in China. They are systematically linked to other abuses such as torture, threats, forced medication, arbitrary detention and prolonged solitary confinement during investigation phase."); see *Beijing PSB: Few Criminal Suspects Meet with Lawyers During the First Stages of Detention*, CONG.-EXEC. COMM'N ON CHINA (July 1, 2015), <https://www.cecc.gov/publications/commission-analysis/beijing-psb-few-criminal-suspects-meet-with-lawyers-during-the> [<https://perma.cc/VL5X-2M7R>].

164. Scoggins, *supra* note 141, at 23.

*b. The Ability of PSB to Detain Without Arrest and Without Charging*

The PSB has earned a notorious reputation among the public in China partly because of its ability to hold suspects in custody for long periods of time even though the suspect is never charged with a crime.<sup>165</sup> PRC law draws a basic distinction between detention and arrest. Under the PRC Criminal Procedure Law, the PSB has broad discretion to detain persons suspected of criminal activity.<sup>166</sup> For example, the PSB can detain a suspect “if he is preparing to commit a crime,” and it is up to the PSB alone to decide whether this condition has been met.<sup>167</sup> Such decisions by the PSB are not subject to review by courts or oversight by any higher authorities.<sup>168</sup>

Under the PRC Criminal Procedure Law, once the PSB detains a suspect, the PSB has three days to apply to the Procuratorate,<sup>169</sup> the supervisory authority that also acts as the prosecutor for an arrest warrant.<sup>170</sup> The period can be extended for another one to four days, or even thirty days in the case of a suspect who is involved in committing crimes in multiple locations or as part of a gang.<sup>171</sup> If the PSB decides to wait thirty days, there is no process to review its decision.<sup>172</sup> The Procuratorate is required to reach a decision on whether to approve an arrest within seven days from the date of the request by the PSB.<sup>173</sup> Unless the Procuratorate approves the arrest, the detainee must be immediately released.<sup>174</sup> These provisions allow for the PSB to detain a suspect for nearly a month and a half before the Procuratorate denies a request for an arrest warrant, leading to the detainee’s release.<sup>175</sup>

A person detained by the PSB may be exposed to brutal conditions. Detainees are held in detention centers, not prisons.<sup>176</sup>

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165. Lubman, *supra* note 162 (noting that the police have many extralegal means to detain persons).

166. PRC Criminal Procedure Law, *supra* note 12, art. 80.

167. *Id.*

168. *See id.* art. 83. The PSB must prepare a detention warrant, but there is no process for review of the warrant by a court or a higher-level authority. *See id.*

169. *Id.* art. 91. The Procuratorate has powers other than as a prosecutor. The Procuratorate also supervises the other judicial organs, including the courts. *People’s Procuratorates*, CHINA.ORG, <http://www.china.org.cn/english/features/Brief/192298.htm> [<https://perma.cc/B2YV-8QD6>] (last visited Jan. 28, 2022).

170. PRC Criminal Procedure Law, *supra* note 12, art. 89.

171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.*

175. *See id.*

176. *Id.* art. 91.



These centers are known to be harsh, degrading, and repulsive.<sup>177</sup> Conditions are unsanitary, and diets are ascetic and inadequate.<sup>178</sup>

Once a suspect is arrested, they are subject to long periods of custodial detention without being charged with a crime. Unlike the US legal system, which requires probable cause for an arrest,<sup>179</sup> the Criminal Procedure Law allows a suspect to be arrested upon suspicion of having committed a crime with an investigation to proceed afterward to find evidence of a crime.<sup>180</sup> In accordance with the Criminal Procedure Law, the PSB will continue to investigate the case post-arrest for evidence of criminal guilt.<sup>181</sup>

If the Procuratorate issues an arrest warrant, the PSB can continue to hold the suspect in custody for up to two months, during which the PSB is to continue its investigation of the crime.<sup>182</sup> If the PSB finds the crime to be complex, the investigation period can be extended for an additional month upon approval by higher-level authorities.<sup>183</sup> The PSB can add another two months of investigation in certain cases deemed “grave,” upon approval by higher-level authorities.<sup>184</sup> The PSB can add yet another two-month extension for crimes punishable by imprisonment of at least ten years if the PSB is unable to conclude its investigation.<sup>185</sup> Under these provisions, the total period of investigation can total seven months.<sup>186</sup> Added to the month and a half of pre-arrest detention, the total period during which a suspect can be held without being charged with a crime can be up to eight and a half months.<sup>187</sup> Finally, if additional crimes are discovered during the investigation, then these periods are to be recalculated

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177. See, e.g., *Former Salesman Repeatedly Persecuted for His Faith over the Past 22 Years (Part 1)*, MINGHUI.ORG (Nov. 16, 2021), <https://en.minghui.org/html/articles/2021/11/16/196605.html> [<https://perma.cc/UW2A-QQKE>]; Li Enshen, *Prisonization or Socialization? Social Factors Associated with Chinese Administrative Offenses*, 27 UCLA PAC. BASIN L.J. 213, 244 (2010) (detainees accused of all different types of crimes, from the pettiest to crimes of violence, are commingled in a single room where they must remain at all times, including at night when they sleep); Xu Zhiyong, *The Plight of a Young Chinese Volunteer*, CHINA CHANGE (July 12, 2012), <https://chinachange.org/2012/07/23/the-plight-of-a-young-chinese-volunteer-by-xu-zhiyong/comment-page-1/> [<https://perma.cc/GNQ8-Z7KX>].

178. Xu, *supra* note 177.

179. U.S. CONST. amend. IV.

180. PRC Criminal Procedure Law, *supra* note 12, art. 82.

181. *Id.* art. 115.

182. *Id.* art. 156.

183. *Id.* art. 156.

184. *Id.* art. 158.

185. *Id.* art. 159.

186. *Id.* art. 156, 158–59.

187. *Id.* art. 91.

from the beginning.<sup>188</sup> Although any additional periods beyond the first two months of post-arrest investigation require higher-level approvals, PSBs are known to continue the investigation without obtaining the needed approvals.<sup>189</sup>

Most people in China are generally aware of the coercive powers of the PSB to subject persons to long periods of detention and police custody even though they are ultimately never charged with a crime.<sup>190</sup> The public in China is also generally aware that suspects are held under harsh and vile conditions and that the PSB can be abusive to suspects.<sup>191</sup>

Given the PSB's reputation, brand owners believe that criminal prosecution through the PSBs is the most effective deterrent against counterfeiting.<sup>192</sup> For these reasons, many brand owners seek to use the PSB, when possible, in counterfeiting investigations.

### *c. Case Fees*

A major problem that results from using the PSBs is their demand for payments of "case fees." Brand owners who approach the PSB for a criminal investigation of counterfeiting usually find that the PSB will claim that, due to its limited funds and manpower, it cannot initiate an investigation into counterfeiting activities that do not result in harm to or death of consumers.<sup>193</sup> PSBs will inform the brand owner, however, that if it pays a "case fee," then the PSB will bring a case because it will use the fee to defray the expenses of the investigation and will not need to tap its own resources.<sup>194</sup>

Although the use of case fees is well known in circles among IP lawyers and private investigation companies in China, many MNCs are unaware of this practice.<sup>195</sup> Case fees are a controversial and sensitive topic due to their dubious legality. There is nothing written about case fees in any official publication or in the secondary literature on IP legal practices in China. Nevertheless, payments of

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188. *Id.* art. 160.

189. *See* Expert Report of Daniel C.K. Chow at ¶¶ 99–100, *Styller v. Hewlett Packard Fin. Servs.*, No. 1:16-CV-10386 (D. Mass. dismissed Dec. 15, 2021) [hereinafter *Chow Expert Report*].

190. *See* Mozur & Krolik, *supra* note 159 ("China's police . . . enjoy broad powers to question and detain people."). This observation is also supported by the author's discussions with persons in China, including academics and lawyers.

191. *See* Mozur & Krolik, *supra* note 159; SAFEGUARD DEFS. ET AL., *supra* note 163.

192. *Counterfeiting in China*, *supra* note 1, at 33.

193. *See Payments to China's Police*, *supra* note 24, at 9–10.

194. *Id.* at 11.

195. *Id.* at 8.

case fees have become so common that there is now a known schedule of case fees that brand owners can be expected to pay.<sup>196</sup>

*d. Risks Created by Paying Case Fees*

Although the practice of paying case fees to the PSB is now commonplace,<sup>197</sup> MNCs are exposed to several significant risks created by this practice. The risks involved in making payments to the PSB, including the significant FCPA risks discussed in Part III,<sup>198</sup> make this practice considerably more dangerous than using AMRs, even with all of their limitations.

First, although many lawyers in China argue that case fees fall into a gray area of the law, case fees could fall within provisions of the PRC Criminal Law proscribing bribery.<sup>199</sup> For example, Article 389 of the Criminal Law provides in relevant part: “Whoever, for the purpose of securing illegitimate benefits, gives money or property to a State functionary shall be guilty of offering bribes.”<sup>200</sup> At present, no one openly discusses case fees, and no court in China has ruled on whether case fees constitute bribes; however, the possibility remains that a court or other authority, such as the Procuratorate, will issue a ruling that case fees are illegal. The PSB and the Procuratorate could also decide to launch an investigation into this practice. Such developments could subject MNCs, as well as their officers and representatives, to embarrassment and criminal liability.

Second, while the practice of paying case fees may advance an MNC’s interests in the short term, it could harm MNCs in the longer term. Some MNCs might see better results in protecting their brands in the short run, but this practice further increases and entrenches corruption in the PRC legal and political system. PSBs are already known as notoriously corrupt, and many other parts of China’s legal apparatus suffer from the same complaint by MNCs.<sup>201</sup> Perpetuating corruption is damaging to the long-term interests of MNCs because a corrupt business environment creates unpredictability and adds many

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196. See *Counterfeiting in China*, *supra* note 1, at 30–31.

197. See *Payments to China’s Police*, *supra* note 24, at 7.

198. See *infra* Part III; 15 U.S.C. § 78dd-1.

199. See *Payments to China’s Police*, *supra* note 24, at 3; PRC Criminal Procedure Law, *supra* note 12, art. 389.

200. PRC Criminal Procedure Law, *supra* note 12, art. 389.

201. See *Payments to China’s Police*, *supra* note 24, at 13–14; Daniel C.K. Chow, *How China’s Crackdown on Corruption Has Led to Less Transparency in the Enforcement of China’s Anti-Bribery Laws*, 49 U.C. DAVIS L. REV. 685, 698–700 (2015).

additional costs to doing business in China. These costs will harm the business prospects of MNCs in the long term. Perpetuating corruption is also harmful to the long-term interests of China, as it undermines improvements and progress in China's legal system.<sup>202</sup>

Third, case fees can easily become a trap for the MNC. Once the MNC pays a case fee to initiate the filing of a case, the PSB is known to ask for additional payments.<sup>203</sup> The PSB could claim that mounting expenses require new payments or that the continuation of the investigation beyond the initial stages requires additional payments.<sup>204</sup> If the PSB detains suspects for extended periods, the PSB might ask for continuing payments to defray the cost of detention.<sup>205</sup> If the MNC refuses to make the payments, the PSB will threaten to immediately terminate the investigation.<sup>206</sup> The MNC then finds itself trapped and pressured into making continuing payments to the PSB.<sup>207</sup> As a result, the MNC finds itself involved in a prolonged and unseemly entanglement with the PSB.<sup>208</sup>

The risks associated with the payment of case fees discussed above and those under the FCPA examined in Part III below,<sup>209</sup> indicate that MNCs must prevent the payment of these fees. Having the MNC register the trademark in its own name and then license the trademark to its China subsidiaries will give the MNC the greatest amount of control necessary to prevent the payment of these fees. The registered trademark owner is the entity that must file a petition with the PRC enforcement authorities, either the AMR or the PSB.<sup>210</sup> Chinese enforcement authorities will insist on seeing a copy of the trademark registration certificate to verify that the petitioner has the right to enforce the trademark.<sup>211</sup> As the trademark owner, the MNC

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202. See Chow, *supra* note 201, at 700–01.

203. This observation is based on the author's own experience in hiring private investigation companies in China and in working with PSBs and administrative authorities in China. See *Payments to China's Police*, *supra* note 24, at 9.

204. See *Cultural Barriers*, *supra* note 87, at 555–56.

205. See *Payments to China's Police*, *supra* note 24, at 6, 9; PRC Criminal Procedure Law, *supra* note 12, arts. 82, 156, 158–59. In a different context, the enforcement of trade secrets, PSBs are also known to ask additional and continuing payments, leaving the MNC trapped in an ongoing entanglement with the PSB. See Daniel C.K. Chow, *Navigating the Minefield of Trade Secrets Protection in China*, 47 VAND. J. TRANSNAT'L L. 1007, 1036 (2014).

206. See *Payments to China's Police*, *supra* note 24, at 11.

207. *Id.* at 2–3.

208. *Id.*

209. See *infra* Part III; 15 U.S.C. § 78dd-1.

210. PRC Trademark Law, *supra* note 5, arts. 3, 67.

211. *Id.* arts. 60–61.

will send its representatives to appear before the PSB.<sup>212</sup> The MNC is in a position to control the actions of its representatives and can firmly and directly instruct them not to pay case fees. If the MNC has hired a private investigation company, the MNC can also instruct the private investigators not to withhold payment. If the PSB will not act without a case fee, then the alternative is for the MNC to bring an enforcement action before the AMR, which do not insist on case fees. As noted earlier, the use of AMR does not create significant deterrence,<sup>213</sup> so this alternative is not ideal; but it may be the best option under China's current enforcement system given the risks associated with the payment of case fees.

A different legal situation exists if the US-based parent MNC is not the registered owner of the trademark in China. As discussed earlier, some MNCs will allow their Chinese business entities to be the registered trademark owner, as this approach is less complicated and involves lower costs.<sup>214</sup> If the Chinese business entity is the registered trademark owner, then this entity, not the MNC, must file the petition with the PRC enforcement authorities.<sup>215</sup> If, instead, the MNC attempts to file the petition, the PRC enforcement authorities will reject it on the grounds that the MNC has no legal standing to assert trademark rights.<sup>216</sup> Even if the MNC is the US parent of a wholly owned Chinese business entity, it is the Chinese entity, not the MNC, that is the registered owner of the trademark.<sup>217</sup> The Chinese business entity is a discrete legal entity under PRC law,<sup>218</sup> and the corporate structure of the MNC and its subsidiaries are not relevant to the PRC authorities.<sup>219</sup>

In situations where the Chinese business entity is the registered trademark owner, the business entity might pay case fees to the PSBs without informing the US parent.<sup>220</sup> Many Chinese business entities believe that they must conduct themselves in accordance with the general business culture that is widely accepted

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212. See *Payments to China's Police*, *supra* note 24, at 7.

213. See *Anti-Counterfeiting Strategies*, *supra* note 8, at 757; SEPETYS & COX, *supra* note 115, at 2.

214. See *supra* Section II.A.; PRC Trademark Law, *supra* note 5, arts. 3, 43, 60; and PRC Foreign Investment Law, *supra* note 17, art. 2.

215. PRC Trademark Law, *supra* note 5, arts. 3, 43, 60.

216. *Id.*

217. PRC Trademark Law, *supra* note 5, arts. 3, 43.

218. Zhonghua Renmin Gongheguo Xingshi Shang Biao Fa (中华人民共和国公司法) [Company Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 10, 2018, effective October 10, 2018) art. 3, 2018 China Law LEXIS 1597.

219. PRC Trademark Law, *supra* note 5, art. 3.

220. See *infra* Part II; *Payments to China's Police*, *supra* note 24, at 9.

in China. Part of this business culture involves the use of petty bribes in conducting business on a daily basis.<sup>221</sup> This practice is widespread and tolerated in China and long predates the current Communist regime.<sup>222</sup> The Chinese business entity might deliberately avoid informing the US parent that it is paying case fees because it believes that the US parent might lack an understanding of the prevailing business culture and object.<sup>223</sup> Because it is an independent legal entity, the Chinese business entity might believe that it does not have to inform the parent of these practices.<sup>224</sup> Where the business entity pays case fees, it indirectly involves the US parent in the entanglement with the PSB with all of its attendant risks discussed above.<sup>225</sup>

Aside from issues rising under PRC law and politics, another even more significant threat to MNCs lies in US statutes, such as the Foreign Corrupt Practices Act,<sup>226</sup> and other foreign laws that could capture the case fee as an illegal payment.<sup>227</sup> These risks are so significant that they must be examined in detail in the next Part of this Article.

### III. ISSUES UNDER THE UNITED STATES FOREIGN CORRUPT PRACTICES ACT

Aside from the considerations already discussed, the payment of case fees to the PSB could also raise issues for the MNC under the United States Foreign Corrupt Practices Act and other anti-bribery laws.<sup>228</sup> As many MNCs with headquarters in the United States also have operations in multiple countries, they may be subject not only to the FCPA but also to similar legislation in foreign countries, such as the United Kingdom Bribery Act,<sup>229</sup> which has been viewed as having an even broader application than the FCPA.<sup>230</sup> The discussion below

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221. See *Cultural Barriers*, *supra* note 87, at 552.

222. Daniel C.K. Chow, *China Under the Foreign Corrupt Practices Act*, 2012 WIS. L. REV. 573, 575 (2012).

223. Chow Expert Report, *supra* note 189, at ¶¶ 78–81.

224. *Id.*

225. See, e.g., Alexion Pharm., Inc., Exchange Act Release No. 89214, 2020 WL 3630000 at 2, 7 (July 2, 2020) (holding a US company responsible for failing to monitor the actions of its foreign subsidiaries to detect misconduct).

226. 15 U.S.C. § 78dd-1.

227. See, e.g., Bribery Act 2010, c. 23 (U.K.).

228. 15 U.S.C. § 78dd-1

229. Bribery Act 2010, c. 23 (U.K.).

230. See Jon Jordan, *Recent Developments in the Foreign Corrupt Practices Act and the New UK Bribery Act: A Global Trend Towards Greater Accountability in the Prevention of For-*

focuses on the FCPA, but it is important to emphasize that other national legislation targeting foreign bribery might also be applicable to US-based MNCs in place of or together with the FCPA.

The FCPA contains three sets of provisions: (1) the anti-bribery provisions that apply to all persons or entities; (2) the books and records; and (3) internal controls provisions that apply only to issuers of securities on a public exchange and registered with the Securities and Exchange Commission.<sup>231</sup> The United States Department of Justice (DOJ) enforces the anti-bribery provisions in criminal cases, and the Securities and Exchange Commission (SEC) enforces the anti-bribery, books and records, and internal controls provisions against issuers in administrative cases.<sup>232</sup> Publicly traded companies are subject to the anti-bribery, books and records, and internal controls provisions,<sup>233</sup> while companies without securities traded on a public exchange are subject only to the anti-bribery provisions.<sup>234</sup> The anti-bribery provisions are contained in section 30A of the Securities and Exchange Act of 1934 (Exchange Act); the books and records provisions and the internal controls provisions are contained in sections 13(b)(2)(A) and (B) respectively.<sup>235</sup> As many US-based MNCs are publicly traded companies, they would be subject to all three sets of FCPA provisions.<sup>236</sup>

These provisions of the FCPA create separate, discrete sets of obligations and liabilities. A violation of any one provision—for example, the internal accounting controls—gives rise to liability regardless of whether the anti-bribery or books and records provisions have also been violated.<sup>237</sup>

The SEC has stated that “[p]ublic companies are responsible for ensuring that their foreign subsidiaries comply with [s]ections 13(b)(2)(A) and (B) [books and records and internal controls], and 30A of the Exchange Act [anti-bribery provisions].”<sup>238</sup>

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*eign Bribery*, 7 N.Y.U. J.L. & BUS. 845, 866 (2011); Sharifa G. Hunter, *A Comparative Analysis of the Foreign Corrupt Practices Act and the U.K. Bribery Act, and the Practical Implications of Both on International Business*, 18 ILSA J. INT’L & COMPAR. L. 89, 92 (2011).

231. 15 U.S.C. §§ 78dd-1 to -3, 78m(b)(2)(A)–(B).

232. CRIM. DIV., U.S. DEP’T OF JUST., & ENF’T DIV., U.S. SEC. & EXCH. COMM’N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 3–4 (2020), <https://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf> [<https://perma.cc/SZN5-HZ8E>].

233. 15 U.S.C. §§ 78dd-1, 78m(b)(2)(A)–(B).

234. *Id.* § 78dd-2.

235. *Id.* §§ 78dd-1 to -3, 78(m)(b)(2)(A)–(B).

236. *Id.*

237. *Id.*

238. Diagnostic Prods. Corp., Exchange Act Release No. 51724, 2005 WL 1211548 at 3 (May 20, 2005).

A. *The Anti-Bribery Provisions of the FCPA*

The anti-bribery provisions of the FCPA, contained in Section 30A of the Exchange Act, prohibit public companies from making improper payments to foreign officials for the purpose of influencing their decisions in order to obtain or retain business.<sup>239</sup> *In the Matter of Diagnostic Products Corporation* involved Diagnostic Products Corporation (DPC),<sup>240</sup> a California company based in Los Angeles, which manufactured medical diagnostic test systems and test kits.<sup>241</sup> DPC's wholly owned subsidiary, DePu Biotechnological & Medical Products Inc. (DePu), was based in Tianjin, China.<sup>242</sup> From 1991 to 2002, DePu made payments to doctors and laboratory employees who controlled purchasing decisions.<sup>243</sup> DPC was unaware of these payments until 2002.<sup>244</sup> DPC then instructed DePu to discontinue these payments in January 2003.<sup>245</sup> Under these facts, the SEC found that "DPC violated Section 30A of the Exchange Act, which prohibits making improper payments to foreign officials for the purpose of influencing their decisions in order to obtain or retain business."<sup>246</sup> DPC was found liable under the FCPA for payments made without its knowledge by its wholly owned Chinese subsidiary.<sup>247</sup>

Under the FCPA, a payment is unlawful if made for the purpose of "obtaining or retaining business," also known as the business nexus test.<sup>248</sup> In *United States v. Kay*, the US Court of Appeals for the Fifth Circuit rejected a narrow reading of the business nexus test as limited to obtaining or retaining government

239. 15 U.S.C §78dd-1

(It shall be unlawful for any issuer which has a class of securities registered pursuant to section 78l of this title or which is required to file reports under section 78o(d) of this title, or for any officer, director, employee, or agent of such issuer or any, to make use of the mails, or any means or instrumentality of interstate commerce corruptly in furtherance of any offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of any of value to— (1) any foreign official for purposes of— (A)(i) influencing any act or decision of such foreign official in his official capacity, (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official . . . (B) . . . in order to assist such issuer in obtaining or retaining business.).

240. *Diagnostic Prods. Corp.*, *supra* note 238.

241. *Id.* at 1.

242. *Id.*

243. *Id.* at 2.

244. *Id.*

245. *Id.*

246. *Id.*

247. *Id.*

248. *Id.*



contracts.<sup>249</sup> The defendants in *Kay* paid bribes to Haitian authorities to understate customs duties and sales tax on rice shipped to Haiti by American Rice, Inc., the defendants' employer.<sup>250</sup> Defendants argued that such payments were not violations of the FCPA because they were payments to reduce costs and were not for the purpose of obtaining a new government contract or renewing an existing one.<sup>251</sup> Payments to reduce costs did not satisfy the FCPA business nexus test, i.e., that the payments were for obtaining or retaining business.<sup>252</sup> The Fifth Circuit stated that the business nexus test included payments made "to engender assistance in improving the business opportunities of the payor . . . irrespective of whether it be related to administering the law," awarding, or renewing a contract.<sup>253</sup> Thus, the SEC might view the PSB enforcement action in exchange for the payment of case fees as a benefit "related to administering the law" and as falling within the meaning of "retaining business."<sup>254</sup> Suppressing counterfeits allows a brand owner to protect and retain its sales of authentic products.

These precedents suggest that if the Chinese subsidiary makes a case fee payment to the PSB, the payment might also be captured under the anti-bribery provisions of the FCPA. In any event, the SEC might believe that a further investigation is warranted into the nature and type of payments made for the purpose of obtaining police protection of a business otherwise not available without the payment. Any investigation would be disruptive to a company's business because it places the company under severe pressure and will require many hours of time by senior executives who must respond to inquiries by the SEC.<sup>255</sup>

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249. 359 F.3d 738, 748 (5th Cir. 2004).

250. *Id.* at 740.

251. *Id.* at 743.

252. *Id.* at 759.

253. *Id.* at 749.

254. *See id.*

255. *See* Steven R. Peikin, Co-Director, Enft Div., U.S. Sec. & Exch. Comm'n, Reflections on the Past, Present, and Future of the SEC's Enforcement of the Foreign Corrupt Practices Act (Nov. 9, 2017), <https://www.sec.gov/news/speech/speech-peikin-2017-11-09> [<https://perma.cc/D8HJ-ENCD>] ("FCPA investigations are often the cases that take the longest to develop.").

*B. The Books and Records and Internal Controls Provisions*

1. Books and Records

Section 13(b)(2)(A) of the Exchange Act requires issuers to “make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.”<sup>256</sup> This provision prevents companies from falsely reporting or disguising illegal payments as innocuous expenses.<sup>257</sup> The SEC has repeatedly stated that for the purposes of section 13(b)(2)(A), the books and records of the subsidiary are consolidated with those of the issuer for financial reporting.<sup>258</sup>

*In the Matter of Alexion Pharmaceuticals, Inc.* involved Alexion Pharmaceuticals, Inc., a Delaware corporation with its headquarters in Boston.<sup>259</sup> Alexion developed and sold drugs for patients with life-threatening rare and ultra-rare diseases.<sup>260</sup> Alexion had wholly owned subsidiaries in Turkey, Russia, Brazil, and Columbia.<sup>261</sup> Alexion’s Turkey and Russia subsidiaries made improper payments to officials in those countries in exchange for favorable regulatory treatment for Alexion’s drugs.<sup>262</sup> The Alexion subsidiaries in Turkey and Russia did not accurately record these payments but maintained false books and records.<sup>263</sup> The SEC found “that these transactions were not recorded accurately in the books and records of these subsidiaries, which were consolidated into Alexion’s books and records.”<sup>264</sup> The SEC held Alexion, the US parent, liable for violating the books and records provisions because its foreign subsidiaries made inaccurate and false records of the payments.<sup>265</sup> Under these precedents, the records of a US-based MNC’s enforcement actions

256. 15 U.S.C. § 78m(b)(2)

((2) Every issuer which has a class of securities registered pursuant to section 78l of this title and every issuer which is required to file reports pursuant to section 78o(d) of this title shall—(A) make and keep books, records, and accounts, which, in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer.).

257. *Id.*

258. Alexion Pharm., Inc., Exchange Act Release No. 89214, 2020 WL 3630000 at 3 (July 2, 2020) (noting that “Alexion Russia’s books and records were consolidated into Alexion’s financial statements”).

259. *Id.* at 2.

260. *Id.*

261. *Id.* at 3.

262. *Id.* at 2.

263. *Id.*

264. *Id.*

265. *Id.*

against counterfeiting are consolidated to the records of its Chinese business entity for the purposes of the books and records provisions of the Exchange Act.<sup>266</sup> If the Chinese business entity does not accurately report its payments, the US-based parent could be deemed liable under the books and records provision of the FCPA.<sup>267</sup>

## 2. Internal Accounting Controls

The SEC also found Alexion to be in violation of the internal controls provisions.<sup>268</sup> Although often discussed together with the books and records provision, the internal controls provisions create a separate and discrete obligation and serve as the basis for finding an independent violation of the FCPA.<sup>269</sup>

Section 13(b)(2)(B) of the Exchange Act requires issuers to “devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that [] (i) transactions are executed in accordance with management’s authorization; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles . . . , and (II) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management’s . . . authorization; and (iv) the recorded accountability for assets is compared with the existing assets [periodically] and appropriate action is taken with respect to any differences.”<sup>270</sup>

In *Alexion Pharmaceuticals*, the SEC found that Alexion, the US parent, “failed to devise and maintain internal accounting controls that were sufficient to provide reasonable assurances that payments to HCPs [health care providers] in Russia were supported by adequate

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266. *Id.*

267. *Id.*

268. *Id.*

269. *Id.* at 7.

270. 15 U.S.C. § 78m(b)(2)

(2) Every issuer which has a class of securities registered pursuant to section 78l of this title and every issuer which is required to file reports pursuant to section 78o(d) of this title shall – (B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that – (i) transactions are executed in accordance with management’s general or specific authorization; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management’s general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.).

documentation and were for legitimate business purposes.”<sup>271</sup> The SEC also found that, because Alexion’s subsidiaries in Turkey, Brazil, and Columbia maintained inaccurate records, Alexion was also in violation of its duty to maintain internal accounting controls to prevent the false reporting by those subsidiaries.<sup>272</sup> In each case that the SEC found the parent company to be in violation of the books and records provision due to false reporting by a foreign subsidiary, the SEC also found a violation of the internal controls provision by the parent for failure to provide controls to preclude the false reporting by a foreign subsidiary.<sup>273</sup>

Note that it is possible to violate the internal accounting controls provision even if no bribe or other illegal payment was ever made.<sup>274</sup> The provision requires that the US parent ensures that a set of internal accounting controls are put in place for its China-based and other foreign subsidiaries. If no such controls are in place, this omission alone is a violation.<sup>275</sup> As noted earlier, some Chinese business entities want the freedom to operate in China in accordance with the prevailing business culture, which includes the use of petty bribes on a frequent basis. Some of these local entities might want to maintain a level of independence from the US parent in order to conduct business and thus might resist the imposition of a set of internal accounting controls.

#### IV. PREVENTATIVE MEASURES

The deficiencies of administrative and judicial enforcement of trademark rights against counterfeiting in China have led many brand owners to choose criminal enforcement through the PSB as the preferred remedial method. This Article has argued, however, that the PSB’s demand for case fees in routine counterfeiting cases resulting purely in economic harm creates significant risks for MNCs under both PRC and US law. The discussion below contains suggestions on how MNCs can best prevent or mitigate the risks outlined in this Article.

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271. Alexion Pharm., Inc., Exchange Act Release No. 89214, 2020 WL 3630000 at 6 (July 2, 2020).

272. *Id.* at 7.

273. *Id.*

274. 15 U.S.C. § 78m(b)(2)(B).

275. *Id.*

A. *The MNC as the Registered Trademark Owner in China*

The US-based MNC should always serve as the registered owner of all important trademarks in China. By serving as the entity named as the owner on the trademark registration certificate, the MNC now becomes the only entity legally entitled to use and enforce trademark rights in China.<sup>276</sup> The MNC can then license those trademark rights to its Chinese business entity, required by PRC law to be established as the vehicle through which the MNC does business in China.<sup>277</sup> The MNC can also impose conditions on the use of the trademark in the licensing agreement with its Chinese subsidiaries. These conditions can include an explicit prohibition of illegal payments, such as case fees. The licensing agreement can also impose a direct obligation to comply with the FCPA and other business ethics rules. In the licensing agreement or a separate agreement, the MNC can also appoint its Chinese subsidiary as its agent or representative to assist the MNC in enforcing its trademark rights. Under this arrangement, the MNC's Chinese subsidiary will show the licensing and agency agreements to PRC authorities, which will permit the MNC's Chinese subsidiary to enforce its trademark rights.<sup>278</sup> As the registered trademark owner, however, the MNC retains the ultimate authority over the enforcement action, and its Chinese subsidiary must take instructions from the MNC. While representatives of the Chinese subsidiary will be tasked with the daily task of on-the-ground enforcement, the MNC can intervene and terminate any investigation with the PRC authorities at any time if concerns of improprieties arise.

In some situations, the China business entity will need to use a trademark that is owned by a local Chinese entity. This occurs, for example, when the local partner in a joint venture has a valuable trademark that the joint venture will need to use. In these circumstances, the MNC should purchase the trademark from the local partner, obtain a new registration certificate with the MNC as the owner, and then license the trademark to the joint venture. The MNC does not need to follow this approach for minor local trademarks. Minor trademarks are those marks that have a low level of sales and are not highly popular with consumers. These trademarks are not likely to be counterfeited, as counterfeiters usually choose to copy trademarks with high market value and that can be easily sold to

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276. PRC Trademark Law, *supra* note 5, art. 60.

277. PRC Foreign Investment Law, *supra* note 17, art. 2.

278. PRC Trademark Law, *supra* note 5, arts. 43, 60.

consumers. Any important trademarks in China, such as those with substantial sales, should always be registered in the name of the MNC.

Installing the MNC as the registered owner of the trademark in China is the best method for avoiding and preventing the Chinese subsidiary from making payments to the PSB or other PRC authorities.<sup>279</sup> If the MNC allows the Chinese subsidiary to be the registered owner of the trademark, then the subsidiary, not the MNC, is the only legal entity entitled to enforce trademark rights in China. If the subsidiary makes payments to PRC authorities to obtain criminal enforcement, the MNC might see a short-term gain, but such gains will be outweighed in the long term by the risks and dangers discussed in this Article.<sup>280</sup> This suggested approach has the disadvantage of involving more costs; it also has the drawback of forgoing criminal enforcement by the PSBs if such enforcement cannot be obtained without making an illegal payment. The suggested approach, however, has the major benefit of ensuring that the actions of the MNCs' subsidiaries are always lawful and has the advantage of mitigating the serious risks discussed in this Article.<sup>281</sup>

*B. Guidelines and Transparency for Chinese Subsidiaries and Independent Contractors*

The MNC should insist that its China subsidiaries follow strict guidelines prohibiting all payments to the PSB and other PRC authorities except those required by PRC law, if any. These guidelines should apply to the MNC's China subsidiaries and third-party independent contractors performing services for its Chinese subsidiaries. These third parties include private investigation companies and law firms.

Including third-party contractors in these guidelines is important because these entities could pay fees on behalf of the Chinese subsidiary. For example, a private investigation company or law firm could pay fees to the PSBs or other PRC authorities and then charge the fees disguised as other expenses to the Chinese subsidiary.<sup>282</sup> In these situations, the Chinese subsidiary may be unaware that such fees were paid.<sup>283</sup> The private investigation

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279. For example, the author has first-hand knowledge that Procter & Gamble, the US parent company, always licensed its most important trademarks to its Chinese subsidiaries.

280. *Supra* Section II.B.3.d.

281. *Supra* Section II.B.3.d.

282. *See Payments to China's Police*, *supra* note 24, at 8.

283. *Id.*

company or law firm makes payments to PRC authorities and achieves a good result for the brand owner.<sup>284</sup> The third-party contractor is then rewarded with professional success in the form of higher fees, additional work, and a reputation for achieving results.<sup>285</sup> MNCs should impose clear guidelines on these third-party contractors prohibiting such payments.

The MNC should be wary if its Chinese subsidiary insists on being able to operate independently to enforce trademark rights.<sup>286</sup> Some Chinese subsidiaries take the position that they must be allowed to operate in accordance with China's indigenous business culture, which includes the use of petty bribes as a routine part of doing business and in dealing with PRC authorities.<sup>287</sup> These subsidiaries do not want to be hamstrung by restrictive policies of their US parent company that they believe are not appropriate for China's business culture, and so insist on a high degree of independence to conduct their own affairs.<sup>288</sup> The MNC should never agree to an arrangement with its Chinese subsidiary under which the actions of the subsidiary might be shielded from its review, and the subsidiary might engage in conduct of which the MNC is unaware. This Article has discussed how such a hands-off approach entails high risks.<sup>289</sup>

### C. Compliance with the FCPA

US-based MNCs need to be on high alert with respect to FCPA compliance issues involving their Chinese subsidiaries and IP enforcement by their subsidiaries in China. To the extent that MNCs have operations in other countries with legislation similar to the FCPA, such as the United Kingdom,<sup>290</sup> US-based MNCs need to also be aware of the requirements of foreign anti-bribery laws.

The FCPA not only prohibits payments for the purpose of "obtaining" business, but also for "retaining" business.<sup>291</sup> This two-pronged prohibition applies both to payments to obtain rewards of new business contracts and also to actions that protect existing

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284. *Id.*

285. *Id.*

286. *See Cultural Barriers, supra* note 87, at 559–60.

287. *Id.*

288. *Id.*

289. *Supra* Section II.B.3.d.

290. Bribery Act 2010, c. 23 (U.K.).

291. 15 U.S.C. § 78dd-1(a)(1).

business activities.<sup>292</sup> One interpretation of “retaining” business is that enforcing IP rights allows the MNC to protect or retain profits that would otherwise be lost to counterfeiters. The payment of case fees to the PSB or other PRC authorities could be seen as a bribe to obtain an enforcement action that would otherwise not be available to the MNC in order to retain business.<sup>293</sup>

Aside from the anti-bribery provision of the FCPA, the books and records and internal accounting controls provisions also create serious concerns.<sup>294</sup> MNCs must be aware that they may be in violation of these provisions even if their Chinese subsidiaries never complete or promise a bribe.<sup>295</sup> The SEC has frequently admonished US issuers of securities whose subsidiaries’ books and records are consolidated with those of the US parent for the purpose of financial reporting.<sup>296</sup> The crux of this statement is that the US parent has a *duty* to accurately report the financial transactions of its Chinese subsidiaries, including any payments made to PRC authorities.<sup>297</sup>

The internal controls provision creates an additional duty on the part of the MNC to establish a set of internal accounting controls for its China subsidiaries sufficient to adequately record financial transactions and ensure that the subsidiary accesses assets only in accordance with the MNC’s general or specific instructions.<sup>298</sup> The absence of such controls, without more, constitutes a violation of the FCPA.<sup>299</sup>

## V. CONCLUSION

MNCs that rely upon their Chinese subsidiaries to bring criminal enforcement actions against the counterfeiting of their trademark rights may be exposed to risks of which they are unaware. For a number of reasons explained above, the Chinese subsidiary may make payments to the PSB without the knowledge of the MNC. The purpose of this Article is to expose these risks and the conditions that encourage and magnify them. While some of these risks arise purely under the local laws of the PRC, other risks arise under the FCPA and

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292. *Id.*

293. *Id.*

294. *Supra* Section III.B.

295. *Supra* Section III.B.

296. *See, e.g.*, Alexion Pharm., Inc., Exchange Act Release No. 89214, 2020 WL 3630000 at 3 (July 2, 2020).

297. *Supra* Section III.B.2.

298. 15 U.S.C. § 78m(b)(2)(B).

299. *Id.*



other foreign anti-bribery laws. The risks that such payments can occur without the knowledge of the MNC are highest when its Chinese subsidiary serves as the registered owner of the MNC's trademarks in China. MNCs that allow their subsidiaries to be the registered owner of trademarks in China may be unaware of the risks to which this practice will expose them. This Article has argued that the MNC should always register all important trademarks in its own name and license them to its Chinese subsidiaries. This approach is more complicated and costly than simply allowing the Chinese subsidiary to register the trademarks, but it also mitigates the risks created by the latter approach. Careful advanced planning in accordance with the suggestions set forth in this Article and continuing vigilance by US-based MNCs can eliminate or mitigate many of the dangers lurking in the criminal enforcement against counterfeiting in China.