



**IP PROTECTION IN CHINA
& OFFSHORE SOFTWARE DEVELOPMENT:
*A PERSPECTIVE***

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Executive Summary

China is becoming an attractive alternative when choosing an outsourcing venue for the development of services or products with a substantial component of intellectual property (IP). In addition to being a fast-growing software market in the world, China has a substantial internal market, a strong growing economy with a low-cost, well-qualified labor force.

As a signatory of several fundamental IP international treaties, with laws in place that meet the highest international IP standards, and with substantial enforcement of IP rights, China provides now greater protection of industrial and IP than most developing countries and emerging economies.

Chinese IP laws are not a new untested add-on. These laws are simply receiving more rigorous application in the context of the emergence of China's new role in the world marketplace as the home of companies such as TCL or Huawei that are becoming international high technology leaders.

China's legal system is moving in step with international IP protection standards. As a general matter, a foreign contracting company can intervene, protect, and enforce its IP rights related to software developed in China with reasonable commercial certainty.

I. IP Protection: A Key Issue and China

A. Enforcement of IP Rights Is Key When Choosing an Offshore Outsourcing Partner

IP protection and its enforcement play a fundamental role in creating the necessary conditions for attracting the outsourcing of products and services with IP components.

When choosing a venue for this kind of outsourcing, companies should make sure that they have the ability to enforce and protect the IP rights.

Today, outsourcing IP development often refers to the development of software. With highly qualified personnel available at lower cost in emerging economies, many companies in developed countries rely on foreign outsourcing for software development. The desired result is a more cost-effective concentration on their core business.

B. Problems of IP Protection in China

IP protection in China is still at an early stage for a market economy. The situation of the IP protection in China is similar to the situation of environment protection: there is a gap between government policy and day-to-day reality.

Enforcement of IP remains weak and ineffective in most parts of China. Due to local protectionism and due to the lack of truly independent enforcement authorities, infringers of IP are often not prosecuted or punished. Fines imposed on infringers are still ridiculously low, too low to deter further infringing activities.

Small-scale counterfeiters often escape with low fines that cannot easily be collected and offer minimal deterrence, and the rights' holder receives minimal compensation. The court system still has a shortage of adequately trained judges and the resources of the police, prosecutors, and relevant administrative agencies are insufficient. It is often difficult for these various bodies to cooperate smoothly, particularly in transferring cases from civil to criminal proceedings.

The general perception of the international community remains that China is one of the world's largest infringers in the field of IP. China maintains a very high rate of piracy for CDs, audiocassettes and computer software.

Through State media, China has always shown that she is serious about stopping the booming piracy industry. However, what was openly destroyed is only a small part of the vast false and piracy industry in China. The counterfeiters and pirates still seem to sail safely on, while foreign producers of music, film and software, who claim Chinese piracy steals a large portion of their business, are obviously unsatisfied.

II. IP Laws Enforcement and Outsourcing to China

A. IP Laws Enforcement in China

1. Progress in IP Protection

During the last few years, essential improvements in the IP protection have been made in China.

First of all, knowledge and consciousness about the IP protection is growing in China. One of the main elements was the health risks to the Chinese population due to false drug production or prohibited use of agro-chemicals, not least due to infringements of Chinese firms. The Chinese authorities have realized that a sound system of IP protection is important for a favorable business environment. It will not only benefit foreign investment but the final consumers of the goods.

As a result, courses on IP law are now being offered at every top law school in China; high priority has been given to IP protection by the State Council, expressed in its continuous promulgation of legislation, administrative regulations, and enforcement guidelines; various IP cases have been settled in the courts in favor of the holder of the right.

Furthermore, China entered the WTO in December 2001. Prior to the accession, China amended her Patent Law, Trademark Law and Copyright Law and formulated other IP laws and regulations including regulations on the protection of new plant varieties and the layout designs of integrated circuits to bring her laws and regulations in line with TRIPS agreement of the WTO.

At the same time, China loosened the limitation for foreign patent applicators. The gap between total patents applied by and patents granted to foreign applicators is narrowing. Patents received from foreign applicators are growing steadily in China. The total accumulated number of patents applied reached 258,000 by the end of July 2002. After Japan, USA, Germany, France and Korea, Swiss applications ranked 6th.

2. Stronger Judicial and Administrative Enforcement

China's courts and judges have begun to improve judicial protection with the guidance of WTO regulations. China set up the No. 3 Civil Court in 2000 and gave it the responsibility for hearing IP case trials in her 31 mainland provinces. China has also provided special training for judges to make them more familiar with TRIPS regulations and the newly amended IP laws. More and more judges have been given formal education in science and technology, given opportunities to communicate with their foreign counterparts and study in the US or Europe.

Progress in IP protection is more obvious in big cities in China. In Beijing, for example, a copyright protection center was set up by the government in 1993 to monitor newspapers (some 2,000) and magazines (about 7,000). The center also protects the rights of artists in the music industry and in the performing arts. Shanghai carried out a series of activities to celebrate the first "World IP Day" on April 26th, 2001. From October 23rd to 27th, the Shanghai government held a symposium named "Preparing Tactics for IP Issues after China's WTO Entry". Participants were many high-ranking government officials.

3. Some Illustrations of the Steps Taken

Statistics reveal that 5265 civil cases (5041 concluded) and 319 criminal IP cases (314 concluded) were initiated at all court levels in China in 2001. Among them was a case submitted by Rolex. The Swiss watchmaker Rolex has successfully prevented a Chinese Internet company from using the domain name rolex.com in 2001. The People's Intermediate Court in Beijing decided that CINET, a local Internet service provider, did not have the right to the rolex.com.cn web address because Rolex is a famous brand in China. In addition, Rolex won RMB 10,000 from CINET in compensation for damages.

Some other notable cases: In April 2001, Microsoft was awarded \$34,000 in damages in a suit against Shanghai Huahai Computer. The same year, Adobe filed a suit against Shanghai Nianhua Computer Imaging Technologies and was awarded \$18,000 in damages.

4. Copyright Enforcement

The Copyright Law of the People's Republic of China was adopted on September 7th, 1990, and revised on October 27th, 2001. The implementing Rules for the Copyright Law also came to effect on September 15th, 2002. Following are the most important aspects especially for foreign companies:

Copyright protection under the new law was expanded to compilation works in order to protect databases and the right to transmit via the Internet as well.

The "fair-use doctrine", which under the previous law allowed for certain uses of copyrighted material without permission from the owner, has been restricted. Radio and television stations must pay for the use of published music.

Stronger enforcement measures have been introduced to combat copyright infringement. The defendant, rather than the plaintiff, must testify the legal source of its production at a lawsuit. The burden of proof is now placed on the party suspected of infringement. Any producer, manufacturer, or distributor who cannot prove that their copying is authorized will now be held liable.

Foreign copyright owners will receive legal protection equal to that of their Chinese counterparts, according to the new regulation for the implementation of the Copyright Law. The previous regulation stipulated that only the State copyright authority was eligible to handle complaints of infringement on foreigners' copyrights. The new regulation eliminates this restriction and allows foreign copyright owners to seek redress from local administrations. Protection of the copyrights held by foreigners or stateless persons whose works were first published in China starts from the day their works are published.

The fine for infringement is also increased from RMB 10,000 or less to RMB 100,000 or less, if the infringer's business volume is not to be determined.

5. China's Incentives to Improve Copyright Enforcement

Chinese government officials now understand why improving enforcement of software IP rights is in the national interest. However, Chinese government officials may have an inducement to lax enforcement, at least for educational or small business use. Promoting the development of a local software industry is now a goal that motivates these authorities to engage in sustained efforts to improve IP protection.

Today, the Chinese government is thus more receptive to international efforts to improve IP protection if these efforts are congruent with domestic policies to strengthen local software industries and establish competitive supplier markets.

B. Outsourcing to China is a Good Alternative

1. China Is Not The Only IP Offender

When most businesses think of outsourcing to offshore companies, a developing country, India, come first to mind. This as well as many other offshore jurisdictions may raise substantial concerns about the protection of valuable IP.

It may be good to remember that some of the leading recipients of software foreign direct investment have the worst levels of enforcement, despite changes in domestic formal rules that expand the scope of IP protection. Korea, Taiwan and especially India are clear examples of this trend.

Though mentioned less frequently, China is becoming an appealing outsourcing jurisdiction in terms of technological standards, competitive pricing, and enforceability of IP rights.

2. Why Choose China?

In addition to a highly trained work force, China has comparatively low labor costs, a very large internal market, and IP protection legislation now substantially similar to that of Western Europe and the United States. Though China does have unresolved piracy issues, these tend to relate more to consumer products.

There are a number of indications that China possesses outsourcing conditions superior to those found in other developing countries. Chinese enforcement of existing IP protections is increasing and recognized as essential to China's economic development.

Internal economic pressures to expand exports, the increased use of China as world manufacturing base for foreign companies with operations worldwide, and the strategic need of China to come to an international agreement with respect to the enforcement of IP rights in order to participate in global trade, all evidence a substantial evolution towards a highly competitive, technologically competent and secure business environment.

3. Global Software and Hardware Firms Leading The Way

Software companies view enforcement of copyright, trade secret, and trademark protection as a means of protecting and recouping research and development costs, but considered only as one of a number of factors influencing overseas investment decisions.

This goes some way towards explaining why some countries with comparatively weaker enforcement are leading recipients of foreign direct investment by U.S. software companies for instance. In the case of China and India, market potential presumably offsets the risk of loss from poor IP enforcement.

Examples are software giants such as Microsoft, Adobe, and Oracle that have research and software development facilities in China. Interestingly, Intel and Sun also set up sizable software development centers in China in the last few years as reported in the international business press.

III. How Objectiva Protects its Clients' IP

Extralegal Means of IP Protection

It is important for foreign firms to establish an effective management of IP at the corporate level with companies (partners/suppliers...) in China. The purpose of corporate measures is to create small but strong IP defenses against a big but less than stellar IP environment.

Enterprises should rely even more heavily on extralegal means of IP protection than they currently employ in operations in Western countries. They must limit access to IP by employees who do not need it and by other enterprises by taking some practical measures.

Objectiva Software Solutions, a leading offshore software development firm headquartered in the USA, is such a company that takes seriously the protection of its clients' IP. It should also be noted, as a US-based company, the clients are protected under US laws.

All Objectiva's Clients Benefit from the Following Measures

- IP clauses routinely included in contracts that bind Objectiva to the client
- All employees sign PIIA papers that bind them to Objectiva to form a full legal chain
- Enterprise's operations staff in China has access only to the IP required to do their jobs. Employees only have access to files/documents regarding their project (not others). This includes VSS/CVS, document libraries, source code, etc.
- Careful screening of potential employees including at least 3 interviews, reference checks.
- Loyal senior technical staff that have been with the company on average 2 years + and are trusted
- Education given to employees on professionalism and IP protection as part of orientation and on a recurring basis
- Implementation of elaborate password protection of high-value business models or computer code, and the libraries that contain them

Objectiva Provide Additional Layers of Protection

- Dedicated networks
- VPN connection to client offices where files are stored, none stored locally
- No laptops or storage devices for the team
- Work split between US and China team so no person has the "whole" picture
- High flexible and ready to work with client until client is comfortable

As a result of these strong guarantees and comprehensive measures, Objectiva has yet to have an IP issue even after doing product development work for Motorola, Qualcomm, Document Sciences and many others in the past 5 years.

III. About Objectiva Software Solutions

Objectiva Software Solutions is one of the pioneer companies that focus on offshore outsourcing in China and one of the leading firms serving the US market.

The Company is a US company headquartered in San Diego that specializes in software development and that possesses a wholly owned subsidiary and development center in Beijing, China.