

Punitive damages for intellectual property infringements in China – A cross-jurisdictional analysis

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Abstract. China's Civil Code provides for a system of punitive damages. In particular, it affirms the content of punitive damages for intellectual property rights. An analysis of the punitive damages regime for intellectual property rights in China aims to introduce to the reader legal elements for the entitlement of punitive damages, methods of quantification as well as existing problems found in the implementation of relevant provisions in China. A comparison is made between the concept of punitive damages under both common law and civil law jurisdictions with the example of the U.S. and Germany, and some recommendations are provided for foreign rights holders and the Chinese legislators regarding the implementation of punitive damages.

Keywords: Punitive Damages; Enhanced Damages; Intellectual Property; Chinese Civil Code

1. Introduction

Since the commencement of the Civil Code of the People's Republic of China in 2020, the institutional precondition of punitive damages for intellectual property infringement in China has been formally established. Section 1185 thereof is a declaratory provision for the award of punitive damages, providing the right holder with the legal basis for the right to claim.[1] Although the overall framework for punitive damages has been established, some problems remain unresolved in judicial practices, especially the lack of uniform standards for implementing the relevant provisions.

2. The Legislative Process of Punitive Damages for Intellectual Property Rights in China

China has made strong efforts in strengthening the protection of intellectual property rights by improving the punitive damages system in the past decade. The first punitive damages system was introduced by Article 63 of the Trademark Law in 2013, and the range of multipliers for punitive damages was further expanded in the 2019 amendment. In the following two years, both the Patent Law and the Copyright Law were amended, and punitive damages were introduced under both legislations (i.e., Article 71 of the Patent Law and Article 54 of the Copyright Law).

On observation of various legislations in the field of intellectual property in China, it is not difficult to find that the legal elements for punitive damages are very similar. Such provisions all stipulate two elements, a subjective "intentional" element, and an objective "seriousness" element. The former usually requires the infringer to have "prior knowledge" or "continuous infringement", and the latter aims to place some restrictions on the former in order to prevent the excessive application of the punitive damages. Factors such as the consequences of infringement, the scale of the number of infringing products and the duration of infringement are taken into account when determining the "seriousness" element.[1]

The quantification of punitive damages in various legislation is formulated in the same way, (i.e., the damaged base times a statutory multiplier). When determining the damaged base, the court will consider the actual loss of the right holder, the profit made by the infringer, and the license fee. In the event that the former cannot be determined, the latter will be used as the basis for consideration of the damaged base. Multipliers are selected from the statutory range in light of punitive factors (i.e., subjective intention, serious circumstances). The statutory range of multipliers is one to five times,

which is identical under various legislations (i.e., the Trademark Law, the Patent Law and the Copyright Law.)

3. Existing problems in the application of punitive damages system in China

The following four problems stand out in the Chinese judicial practices of punitive damages. Firstly, the application of assessment criteria for the two legal elements (i.e., "intentional" and "serious circumstances") is inconsistent across the court system. For example, it is unclear whether the duration of the infringement was a factor to be considered for "subjective intention" or "serious circumstances".

Secondly, relevant provisions for the finding of legal elements are rigidly applied by courts. For example, the court may directly reach the finding of intentional infringement simply because the infringer has the circumstances exemplified in the Interpretation of the Supreme People's Court on the Application of Punitive Damages in the Trial of Civil Cases of Infringement of Intellectual Property Rights. The determination did not comprehensively consider the types of intellectual property objects that were infringed, the status of rights, the popularity of related products, and other factors listed under Article 3 of the Interpretation.

Thirdly, the award of punitive damages is based on compensatory damages, which means that the determination of damaged base is a prerequisite for the application of punitive damages. However, in judicial practices, there are often times when the right holder struggles to provide evidence and the damage base is difficult to determine. In addition, China implements a life-long responsibility system of judges for erroneous judgments, and as a result, a conservative approach is generally taken towards punitive damages. The majority of the rights holders may only obtain statutory damages which is often less than punitive damages and capped at RMB 5 million (around USD 0.7 million.) The Judicial practice of punitive damages in China has not reflected the legislative intent and achieved the desired outcome. General conservatism by judges may have rendered the punitive damages system in vain to some extent.

Finally, when determining the damages multipliers, courts are given great discretion due to the wide range of statutory multipliers (i.e., one to five times). It is not uncommon in judicial practices that substantially different judgments are reached for cases with similar facts. Insufficient reasonings are provided in written judgments for the determination of the damage multiplier. This exacerbates the situation and creates more uncertainties.

4. Punitive damages in other civil-law jurisdictions (with an example of Germany)

Punitive damage developed under the Anglo-American common law system is generally not available in most civil law jurisdictions where damage is designed to be compensatory in nature and punitive function is restricted to criminal law. Under German IP law, a typical civilian legal system, a claimant has three options to calculate the damages claimed for intentional and negligent infringements: (a) the actual damages, (b) a fictitious license fee; or (c) disgorgement damages[2]. Unlike the traditional compensatory nature of damages in civil law jurisdictions, the latter option is a gain-based remedy, awarding the illegal profits gained from infringement. Since the landmark case of BGHZ 145, 366 decided in 2000 by the German Supreme Court which held that the infringer's general overheads can no longer be deductible from the turnover in calculating the number of damages[3], the disgorgement damaged base has become increasingly attractive for the claimant due to the higher amount of damages awarded.

Disgorgement damages in Germany do not exercise a purely compensatory function as it also aims to have a preventative or even deterrent effect[2]. Therefore despite there being no punitive damages under the German IP law, disgorgement damages play a similar role as it is heavily influenced by punitive elements. This may be considered the German approach to introducing 'punitive damages'

into the system without actually acknowledging it because doing so may be contrary to the public policy.

Likewise, the codification of punitive damages in the Chinese civil code might be regarded as the Chinese attempt to blend in both the features of the civilian and common law system, but in a more direct way[2]. With the Chinese criminal law regime becoming less stringent, the introduction of punitive damages as judicial relief into civil law may be an adequate way to complement the former[4].

5. A Comparative Analysis of the Punitive Damages System for Intellectual Property Rights in China and the United States

The legal requirements and calculation for the reward of punitive damages under the Chinese and U.S. systems are fairly similar, though there are some notable differences. (in a finding of subjective elements for intentional/willful infringement and the calculation of punitive damages.)

5.1 The determination of "willful" in punitive damages in the United States and China

Under patent law, for example, punitive damages are prescribed under section 284 of the US Patent Act which allows for actual damages awarded to be punitively increased up to three times. Although the statutory provision itself does not provide specific criteria for deciding the grant of such reward, it is generally required that the infringement be deemed "willful". This "willful" requirement is largely the same as the subjective element of "intentional or bad faith infringement" for punitive damages under Article 1185 of the Chinese Civil Code.

In the U.S. context, the determination of willful requires egregious or culpable behavior on the part of an infringer, without regard to whether his infringement was objectively reckless[5]. Although culpability is generally shown by conduct that is "wanton, malicious, bad faith and consciously wrongful", they are not the strict standard for a finding of willful infringement. It has been clarified by the Federal Circuit Court that "willfulness" requires no more than deliberate or intentional infringement[6], which is consistent with the Chinese subjective element for punitive damages.

5.2 Chinese objective considerations and American regulations on the Read factors

In assessing whether an award of enhanced damages is appropriate, the Read factors are also relevant. These include the infringer's knowledge of the patent protection, the infringer's behavior as a party to the litigation, the duration of misconduct, the infringer's "motivation for harm", and attempt to conceal misconduct[7]. The Read factors exhibit some level of similarity with those listed situations where "serious circumstances" shall be preliminarily determined in China[8]. For example, the duration of the infringement and the infringer's behavior in the lawsuit are both considered in the Chinese and American contexts.

5.3 Calculation of punitive damages under US and China systems

The calculation of the punitive damages under Chinese and U.S. systems is formulated in a similar way (i.e., basis times multiplier). Enhanced (i.e., punitive) damages in the U.S. are computed based on actual damages which can be calculated using either the "lost profits" or "reasonable royalty" methods[9]. This is comparable to the concept of "actual loss suffered by the plaintiff" and "license fee" in China.

Although the basis for calculation of punitive damages is similar, the U.S. case law offers more detailed guidance on its implementation. Firstly, regarding the determination of loss. The award for lost profits in the U.S. requires a causal nexus between the infringer's misconduct and lost profits. The required causation is often established by applying the four-factor Panduit test which includes "(1) demand for the patented product, (2) absence of acceptable non-infringing alternatives, (3) capacity to exploit the demand, and (4) the amount of profit the patentee would have made"[10]. Additionally, U.S. case law set out some considerations when calculating "lost profits", which include diverted sales, price erosion, and increased expenses resulting from the infringement[11]. Secondly,

regarding the determination of "reasonable royalty". While China currently lacks a unified set of rules for calculating hypothetical license fees (analogous to reasonable royalty), the U.S. framework is much clearer. The *Georgia-Pacific Corp. v. United States Plywood Corp.* set out fifteen hypothetical negotiation factors to be considered when determining a reasonable royalty, for example, the duration of the patent, the term of the license, the established profitability of the product made under the patent, etc[12]. This might be of some reference for the Chinese counterpart in their legislative development.

6. The advantages/ disadvantages of claiming punitive damages in China compared to the U.S.

6.1 Advantages

Firstly, a wider range of multipliers. One of the most noticeable differences between the two jurisdictions is the range of multipliers applied in the calculation of punitive damages. China offers a wider range of multipliers capped at 5 times the calculation base, while a U.S. court can only award damages up to threefold. Theoretically, more damages might be awarded in China due to the larger applicable multiplier. However in judicial practice, among all cases that awarded punitive damages over the past seven years in China, the largest multiplier ever applied was three times (equivalent to the U.S. counterpart), and the highest total damage amount is RMB 50 million (approximately USD 7.3 million)[13]. On the other hand, an empirical study of willful patent infringement cases in the U.S. shows that the median patent damages award is around \$10 million over the past ten years, and billion-dollar damages were also not uncommon in cases involving corporate giants[14]. Therefore despite China having a theoretical advantage in the statutory range of multiplier, the actual damages awarded in judicial practice are not necessarily higher.

Secondly, a possible reversal of the burden of proof. The claimant in China also has some special advantages resulting from the operation of different rules of evidence. Although the burden of proof in both jurisdictions lays on the claimant of punitive damages, there is a possible reversal of the burden of proof to the defendant in certain circumstances. Specifically, under Article 71(4) of the Patent Act, the burden of proof might be reallocated to the defendant given the plaintiff's best efforts to adduce evidence[15]. This is done by a court order to provide relevant evidence such as account books and materials. It is even more beneficial to the plaintiff that the defendant's failure to produce evidence or provide false information may be taken as a factor in the assessment of the seriousness of the willful infringement. For example, in the first punitive damages case decided by the Intellectual Property Tribunal of the Supreme People's Court, the defendant's refusal to produce evidence of compensation was considered an obstruction to evidence discovery factored into the assessment of the seriousness of the case[16]. This is highly advantageous for any potential claimants of punitive damages in China.

Thirdly, potentially lower pleading standards for subjective elements. China potentially has offered a lowered threshold to obtain punitive damages. The newly commenced Civil Code requires the claimant to prove "intentional infringement" rather than the previous "bad faith infringement" standard which theoretically requires a degree of maliciousness or "egregiousness" in the U.S. context. As stated in the case of *Halo*, a U.S. district court may only award punitive damages in "egregious cases of misconduct beyond typical infringement"[5]. Egregious or bad faith misconduct normally involves the defendant actively pursuing harm, whereas intentional misconduct only requires requisite knowledge and the defendant allowing the harm being done. Therefore, the standard of "intentional infringement" in China is more likely to be satisfied.

However, the advantage of the seemingly lower pleading standard of "intentional infringement" in China may have disappeared followed by the newly decided case in the United States Court of Appeals for the Federal Circuit which held that the subjective "willfulness" element requires only deliberate or intentional infringement (consistent with the Chinese position)[6]. Moreover, the U.S. has lowered the burden of proof for subjective elements i.e., from "clear and convincing" to

"preponderance of the evidence" post-halo. The standard is easier to prove for the claimant, which requires only the proof that the infringer has actual knowledge or should have the knowledge that its actions constituted an unjustifiably high risk of infringement[5].

6.2 Disadvantages

Firstly, inclination towards statutory damages. Chinese judges are well-known for their conservative approach and inclination towards statutory damage. As discussed previously, the reluctance to award punitive damages is mainly due to the inconsistent judicial interpretation of punitive damages and the Chinese judicial accountability system which holds judges life-long responsible for the quality of cases they handle. It is well possible that the petitioner only is awarded statutory damages with a very low cap (i.e., RMB 5 million, less than USD 0.8 million)[15]. It should also bear in mind that damages awarded for patent infringement in China were historically much lower than in the U.S, with no more than 2.5% of cases being awarded damages greater than RMB 5 million, according to statistics in 2019[16]. However, with the codification of punitive damages, it is likely that more damages to be awarded in the future.

Secondly, uncertainty regarding the implementation of the law. Punitive damages for intellectual property infringement is a relatively new concept in China. As for now, the civil code and relevant legislations only provide a general framework. There is an apparent lack of judicial guidance in applying the entitlement criteria as well as the methods for quantifying damages. Judges are given great discretion under the circumstances. Research has shown that there are substantial differences in the judgments across regional courts. For example, a study of punitive damages cases over the past seven years shows that regional courts not only differ significantly in the reasoning for the award of punitive damages; but also the multiplier applied to the calculation base[13]. The assessment relies heavily on judges' subjective judgment, especially the determination of multipliers sometimes is even done arbitrarily. This lack of certainty might be a significant disadvantage for punitive damages claimants in China.

Thirdly, recommendations for foreign intellectual property rights holders. Given the current lack of relevant standards in the implementation of punitive damages in China, further legislative amendments or modification is expected. Potential claimants are advised to watch out for any updates, especially those related to the requisite proof. As the burden of proof is primarily on the claimants, intellectual property rights holders should be mindful of evidence collection which is the basis of success in any litigations.

Potential claimants in China may also refer to some of the well-established U.S. case law. Considering the high level of similarity between the Chinese and U.S. punitive damages system, a Chinese court might find a U.S. precedent persuasive when dealing with areas of law that have not been given much guidance in its implementation.

Additionally, if intellectual property rights holders prefer the U.S. IP law with the advantages of more certainty and a higher possibility of awarding punitive damages, they may engage in forum shopping practices, for example, by inserting a valid choice of law clause into the patent license agreement. It should be noted that U.S. courts generally apply the doctrine of *lex loci delicti* as a choice of law rule. Therefore, if China is likely the place where the infringing conduct occurred, then the law of China would generally be applicable.

7. Conclusion

With the adoption of the Civil Code, China has formally established its punitive damages system which has a relatively high level of similarity with the U.S. counterpart. Although the punitive damage has its roots in the Anglo-American common law system, it is not unjustifiable for China as a Civil law jurisdiction to adopt such a concept within the domain of tort law. Similar incorporation of punitive elements into the traditional compensatory tort law system is also found in Germany in the form of disgorgement damages. Infringed right holders in China are entitled to punitive damages

if the subjective element of "intentional infringement" and the objective element of "serious circumstances" can be satisfied. The damage amount is calculated using one of the calculation bases (i.e., plaintiff's actual loss, infringers 'profit or license fee) times a multiplier selected from the statutory range (i.e., one to five times). Note that despite the legal framework of punitive damages has been structured, there is still a great deal of uncertainty as to its implementation in judicial practices. Any right holder who intends to claim punitive damages in China should be mindful in regard to relevant legislative updates, evidence collections and apply forum shopping strategies if necessary.

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