



**THE US-CHINA BUSINESS COUNCIL**

美中贸易全国委员会

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## **Trade with China: Intellectual Property Rights**

### **Statement of the US-China Business Council to the House Committee on Ways and Means Subcommittee on Trade**

**February 15, 2007**

Like all World Trade Organization (WTO) members, China is required to provide legal protection against intellectual property infringement and to provide penalties for enforcement that are sufficient to deter future violations. Despite this obligation, inadequate protection for intellectual property continues to impede US companies in China. Respondents to the US-China Business Council's (USCBC) 2006 membership survey ranked intellectual property rights (IPR) enforcement as China's most serious shortfall in implementing its WTO commitments. Though 33 percent of respondents said there had been some improvement in China's IPR enforcement, more than half of survey respondents said there had been no improvement in China's enforcement of IPR in the previous 12 months.

As policymakers consider ways to address China's problems in IPR protection, it is important to keep in mind that "IPR" is a broad term encompassing many distinct areas, including copyrights, trademarks, patents and trade secrets. Companies view the IPR problem differently depending on their industry and the nature of their problem. A motion picture company sees the problem differently from a pharmaceutical company, and both have a different view than an industrial company. The severity of the problem is different for each sector, the policy redress is different, and importantly, the actions companies support are different in each of these areas. Furthermore, for some companies, particularly in the media sectors, IPR problems are aggravated by market-access restrictions that limit the availability of legitimate products to Chinese consumers. In the end, a differentiated approach to the IPR problem in China—one that accounts for the unique problems and solutions in the various areas—is the most productive way to achieve advancement for US companies on this issue.

The ineffectiveness of China's IPR enforcement regime stems in part from China's primary reliance on administrative authorities, which are able to impose only very low penalties to enforce IPR laws, instead of the court system, in which civil suits and criminal prosecutions could impose higher penalties on IPR infringers. PRC courts handled only 385 IPR-related cases in 2004, according to China's 2005 White Paper on IPR. In contrast, local copyright administrations resolved nearly 9,500 copyright infringement cases, local administrations of industry and commerce handled nearly 52,000 trademark violations, and local patent administrations dealt with roughly 10,000 patent infringement cases. While government agencies are generally responsive to the

requests of IPR holders to take administrative actions against infringers, the low penalties these government bodies can impose without court authorization serve as only a minimal deterrent to future infringements.

To be fair, China's central government has taken a number of steps in an attempt to address these and other issues that limit the effectiveness of its IPR enforcement. These steps generally have been in response to the US government's persistent pursuit of improving IPR protection via the Joint Committee on Commerce and Trade (JCCT) process. In March 2006, China's National IPR Working Group, an interagency body under the State Council and chaired by Vice Premier Wu Yi, issued its 2006 IPR Protection Action Plan. Though much of the plan focuses on ways to promote innovation, it also expresses an intention to boost enforcement activities. Most of the plan's provisions are still in the implementation process, so its effectiveness cannot yet be fully determined.

Stemming from the action plan, China's Supreme People's Procuratorate, the Ministry of Public Security (MPS), the Ministry of Supervision, and the Leading Group on National Rectification and Standardization of Market Order jointly issued an opinion in March 2006 to facilitate the transfer of IPR cases from administrative agencies to public security bureaus for criminal investigations. MPS and the General Administration of Customs in March 2006 also jointly issued rules to boost coordination in IPR cases involving products scheduled for export. China has also conducted a handful of special IPR enforcement campaigns in accordance with the action plan. These include Mountain Eagle, aimed at copyright violators; Sunshine, designed to clear cities of pirated recorded materials; and Blue Sky, targeted at individuals who distribute infringing products at trade fairs.

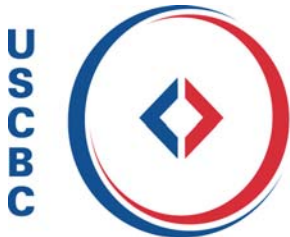
Continuing in China's pattern of taking incremental steps toward an improved IPR environment, the Ministry of Culture issued in November 2006 regulations giving local culture authorities more tools to address piracy of recorded music and cinema products. In December, the Beijing Number One Intermediate Court ruled that Pfizer, Inc.'s patent on the drug Viagra is valid, thereby reversing an early ruling that had revoked the patent and had allowed Chinese producers to legally manufacture what were, in essence, counterfeit pills. Also in December, the PRC National People's Congress approved the World Intellectual Property Organization Copyright Treaty and Performances and Phonograms Treaty, thus meeting a commitment China made at the 2006 session of the JCCT. In early 2007, China's Supreme People's Court issued an opinion that could streamline judicial proceedings on IPR cases and make them more accessible and cost-effective for companies protecting their rights.

These are welcome steps, but China's legal capacity for effectively protecting IPR remains limited. China's use of value thresholds to determine whether IPR infringers face criminal charges reduces the efficacy of Beijing's recent steps to facilitate criminal prosecutions of IPR violators. These thresholds, although lowered in China's Supreme People's Court December 2004 judicial interpretation, provide a loophole for IPR infringers to escape criminal prosecution by, for example, keeping the value of inventory

stored at any one location below the threshold level. Moreover, calculations to determine whether the thresholds have been met are based on the price of the counterfeit product rather than that of the legitimate—and higher priced—product it imitates. China’s use of numerical value thresholds appears to be inconsistent with its commitments as a signatory of the WTO Agreement on Trade Related Aspects of Intellectual Property (TRIPS), which calls for criminal sanctions in all cases of IPR violations on a “commercial scale.” The Supreme People’s Court is reviewing its 2004 judicial interpretation as part of the action plan; US officials should press for a TRIPS-consistent application of criminal sanctions on IPR violations.

For its part, USCBC has urged the PRC government to take this course. In numerous meetings in 2006 with Vice Premier Wu Yi and other senior and working-level PRC officials in various agencies, USCBC advocated the abandonment of thresholds and the adoption of the “commercial scale” criteria. USCBC complemented these meetings with a written submission to several PRC government bodies suggesting detailed changes to PRC laws that would provide for an enhanced legal framework for enforcing IPR protection. Those recommendations are attached to this statement. Adopting the “commercial scale” criteria and other changes to its laws governing IPR enforcement would be important steps the PRC government can take to benefit numerous companies in a broad array of sectors.

To fully solve the country’s IPR protection problems, China must make improvements in several areas on a sustained basis. China must engage in initiatives such as increasing enforcement resources; training prosecutors and judges in IPR investigations and case law; and educating officials and the public at all levels on how IPR infringement harms China’s consumers and the development of its own innovative economy. Greater market access for legitimate products would provide consumers an alternative to pirated products. And, specific revisions to aspects of China’s legal code—including the revision of the current thresholds used to determine criminality—are important steps to addressing this top problem faced by US companies in China and, increasingly, in other markets.



**RECOMMENDED IMPROVEMENTS TO CHINA’S IPR LAWS AND REGULATIONS**

<b>INTERPRETATION BY THE SUPREME PEOPLE’S COURT AND SUPREME PEOPLE’S PROCURATORATE ON SEVERAL ISSUES OF CONCRETE APPLICATION OF LAWS IN HANDLING CRIMINAL CASES INVOLVING INTELLECTUAL PROPERTY (DECEMBER 22, 2004)</b>	
<b>EXISTING</b>	<b>SUGGESTED MODIFICATION</b>
The Judicial Interpretation includes thresholds for determining copyright, trademark and patent criminal violations.	Eliminate thresholds for criminal violations, and define criminal violations as infringing activities that occur on a “commercial scale.” Revise Criminal Code Articles 214, 217, and 218 accordingly.
Articles 5 and 6 specify that violations must have been made with the purpose of making profits.	Eliminate the requirement that copyright offenders be proven to have acted with profit-making motive. Replace with language that adjudicates cases based on inflicted harm.
No provisions stipulating the treatment of unauthorized rental, broadcast, and exhibition of software, film, sound recordings, and other works.	Confirm that unauthorized rental, broadcast, and exhibition of software, film, sound recordings, and other works may be transferred for criminal prosecution.
N.A.	<p><u>Suggested additions:</u></p> <p>Make repeat offenders subject to automatic criminal liability.</p> <p>In cases where no sales transaction occurs or no sales records exist, make criminal penalties applicable based on value of inventory, using the victim’s price.</p> <p>Include presumptions of knowledge for landlords on intellectual property (IP) crimes, including counterfeiting trademarks, pirating copyrighted material, or providing production technology.</p> <p>Restrict access for violators to raw materials and other ancillary services like electricity, in accordance with international practice.</p> <p>Confirm that criminal liability applies to end-users of infringed software.</p>

<b>PRC CRIMINAL CODE</b>	
<b>EXISTING</b>	<b>SUGGESTED MODIFICATION</b>
Part I, Chapter 4, Section 1, Article 64 requires that illegally obtained property be recovered or restitution and compensation paid.	Include provision that property used in the commission of a crime shall be confiscated and destroyed.
Part II, Chapter 3, Section 2, Article 214 does not specify that exports constitute a type of sale.	Include the export, rental, and possession of counterfeit trademark goods as types of sale under Article 214.
Part II, Chapter 3, Section 2, Articles 217 and 218 specify that violators must have acted “for the purpose of reaping profits.”	Eliminate the requirement that copyright offenders be proven to have acted with profit-making motive. Replace with requirement that offenders be proven to have inflicted harm.
Part II, Chapter 3, Section 2, Article 218 sets the threshold for the crime of knowingly selling pirated copyright works at RMB 100,000 and sets the threshold for knowingly selling counterfeit trademark goods at RMB 50,000.	Remove all value thresholds for criminalizing trademark and copyright violations and define violations as infringing activities that occur on a “commercial scale.”  Criminalize end use of pirated copyright works or counterfeit trademark goods, including unauthorized rental, broadcast, or exhibition of software, film, sound recordings, or other works.
Part II, Chapter 3, Section 2, Article 219 limits punishment for violating commercial secrets to those who cause “significant loss.”	Eliminate “significant loss” threshold for violations.
N.A.	<u>Suggested addition:</u>  Subject violators with repeat offenses to stronger penalties.

<b>PRC CRIMINAL PROCEDURE LAW</b>	
<b>EXISTING</b>	<b>SUGGESTED MODIFICATION</b>
Part II, Chapter II details the standards for criminal investigations. Article 83 indicates that cases are filed and investigations conducted “upon discovering criminal facts or criminal suspects.”	Allow public security bureaus (PSBs) to initiate investigations based on prima facie evidence of probable cause so that assets may be frozen before raids are conducted.
N.A.	<p><u>Suggested addition:</u></p> <p>Revise the Opinion on Promptly Transferring Suspected Criminal Cases during Administrative Investigation, issued by the Supreme People’s Procuratorate, Ministry of Public Security (MPS), Ministry of Supervision, and Leading Group on National Rectification and Standardization of Market Order, and the Interim Rules on Strengthening Cooperation between PSBs and Customs in IPR Enforcement, issued by the General Administration of Customs (GAC) and MPS, to clarify PSB obligations to file cases and initiate investigations based upon reasonable suspicion of crime.</p>

<b>PRC IMPLEMENTING REGULATIONS TO THE TRADEMARK LAW</b>	
<b>EXISTING</b>	<b>SUGGESTED MODIFICATION</b>
Chapter VII, Article 52 sets the maximum fine for violations of trademarks at three times the illegal revenues or, when revenues cannot be calculated, at less than RMB 100,000.	<p>A minimum fine that is sufficient to deter future infringements should be specified to remove the infringer’s monetary incentive.</p> <p>Include punitive damages sufficient to deter future infringements.</p>
N.A.	<p><u>Suggested additions:</u></p> <p>Require violators to pay for storage and destruction costs for counterfeit goods.</p> <p>Mandate that counterfeit merchandise be destroyed.</p>

<b>IMPLEMENTING MEASURES ON THE PRC CUSTOMS IPR PROTECTION RULES</b>	
<b>EXISTING</b>	<b>SUGGESTED MODIFICATION</b>
Chapter 3, Article 15 requires brand owners to post a bond to request Customs to seize possible infringing goods. Once Customs seizes the goods, Chapter 4, Article 27 requires brand owners to get an order from a people's court to sustain the validity of the seizure, which requires a second bond with the people's court.	Mandate the transfer of bonds from Customs to people's courts so that two bonds are not required.
Chapter 4, Article 26 gives Customs 30 working days to report to IP owners with the findings of their investigations.	Provide IP owners with immediate access to information on counterfeiting cases gathered by Customs.
Chapter 4, Article 27 stipulates the conditions for transferring cases from Customs to people's courts.	<p>Include presumptions of knowledge in the transfer rules that include individuals who would have reasonable grounds to know IPR violations are occurring.</p> <p>Stipulate that if counterfeit labels are not <u>on</u> the products but being shipped <u>with</u> products, the products can be seized as well.</p> <p>Make trading companies liable for counterfeit products shipped using their permits or under their names.</p> <p>Require import/export companies to make public information on destination and purchaser/receiver of counterfeit shipments.</p> <p>Create a system to monitor counterfeiters involved in previous Customs seizures and list their names publicly. Require future shipments from the same counterfeiters to undergo Customs auditing for a specified period of time.</p>
Chapter 4, Article 29 allows travelers to carry a "reasonable amount of counterfeit or pirated goods for personal use."	This provision should be deleted—no counterfeit or pirated goods should be allowed to be used or carried under the law.
N.A.	<p><u>Suggested additions:</u></p> <p>Apply presumption of knowledge and criminal procedures to factory suppliers and trading companies that export counterfeit and pirated goods.</p> <p>Give Customs power to impose fines that are sufficient to deter future infringements on exporters of counterfeit and pirated products.</p>