

2011 Special 301 Review

Submission of the US-China Business Council
February 15, 2011

Inadequate protection of intellectual property rights (IPR) is an issue that continues to plague both foreign- and domestic-owned companies in China. China has made progress in recent years by improving its legal and regulatory IPR framework and by making uneven and gradual improvement in IPR enforcement. Nonetheless, patent, trademark, copyright, and trade-secret infringement remains a major concern for US companies operating in China. The US-China Business Council's (USCBC) annual membership survey results show that US companies continue to battle counterfeiting of their IPR in China. Ultimately, these infringements have a significant impact on what products and technologies those US companies are willing and able to research, manufacture, and sell in the China market.

Yet USCBC survey results also reveal the challenges of addressing IPR infringement and the need for a differentiated strategy to attack the multiple layers of IPR infringement. IPR enforcement in China remains highly uneven across cities and provinces, indicating that any successful strategy must have national and local components. In addition, IPR issues vary widely for particular industries: IPR protection is the top concern of some industries, but it may be further down the list of top-10 concerns for other industries. Finally, enforcement of different types of IPR – trademarks, copyrights, patents, and trade secrets – is handled by different agencies within the PRC government, and infringement of these different types of IPR is rooted in different causes. Taken collectively, this diversity requires a consistent mix of approaches and strategies to be effective.

As part of the country's efforts to tackle IPR enforcement, China recently launched a six-month campaign to enforce intellectual property rights, overseen by the Ministry of Commerce (MOFCOM). USCBC appreciates that China's leadership is paying greater high-level attention to IPR enforcement. While our member companies have reported some positive results from this short-term campaign, we recommend that China extend the campaign beyond its March 2011 ending date and devote more resources at all levels to this initiative to ensure sustained improvement in IPR protection.

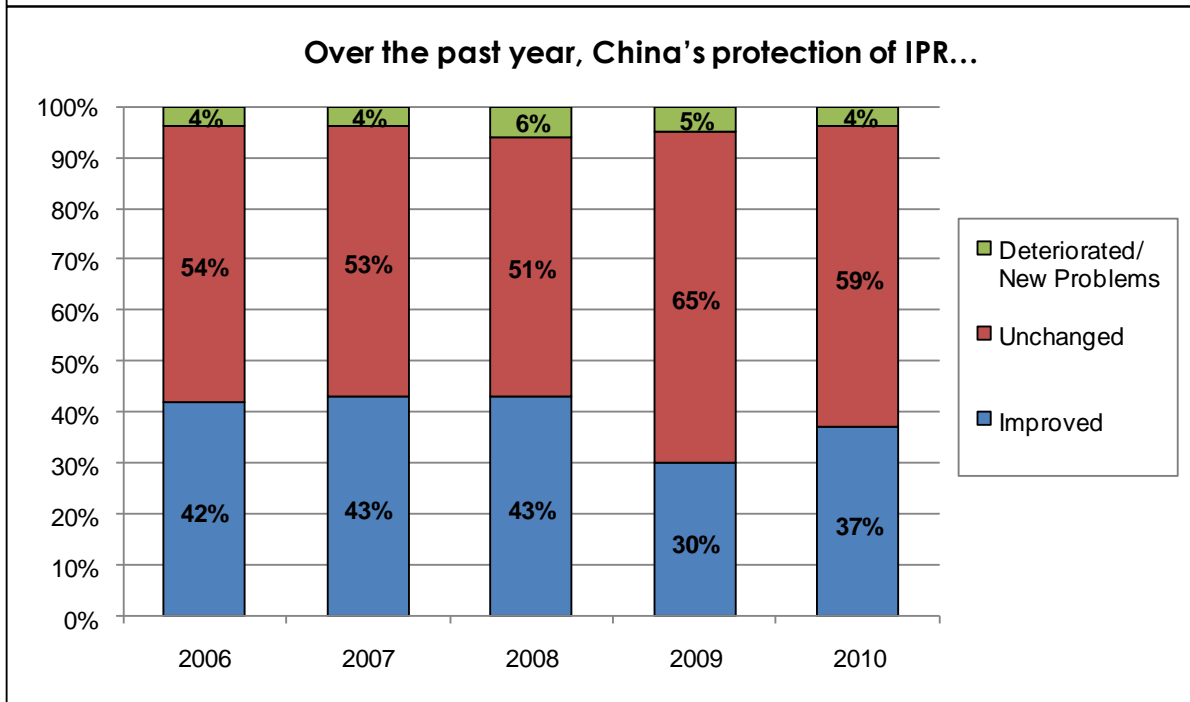
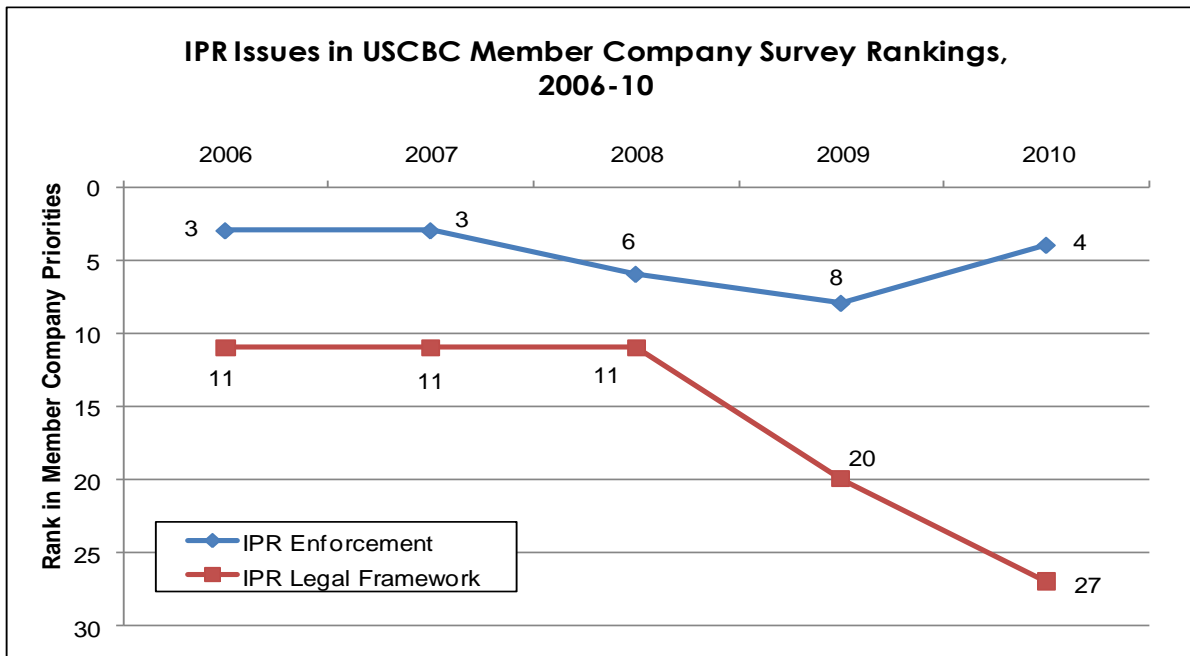
IPR as a Top Issue

Though China has seen some improvement in IPR protection in recent years, IPR enforcement has ranked among USCBC's top 10 operating issues every year since 2006. The IPR legal framework, however, has become less of an issue over time (falling from the 11th top issue in 2006 to 27th in 2010) because of China's efforts to build an increasingly comprehensive regulatory framework for IPR.

Over the same period, many – but not all – companies report that the overall IPR picture has shown steady improvement, though at a slow pace. Though most respondents in each of the past five years have indicated that China's protection of IPR has remained unchanged from the previous year, the second largest group – ranging from 30 percent to 43 percent of respondents – have indicated that IPR protection has improved to some degree. Only a small number of respondents – around 5 percent each year – have

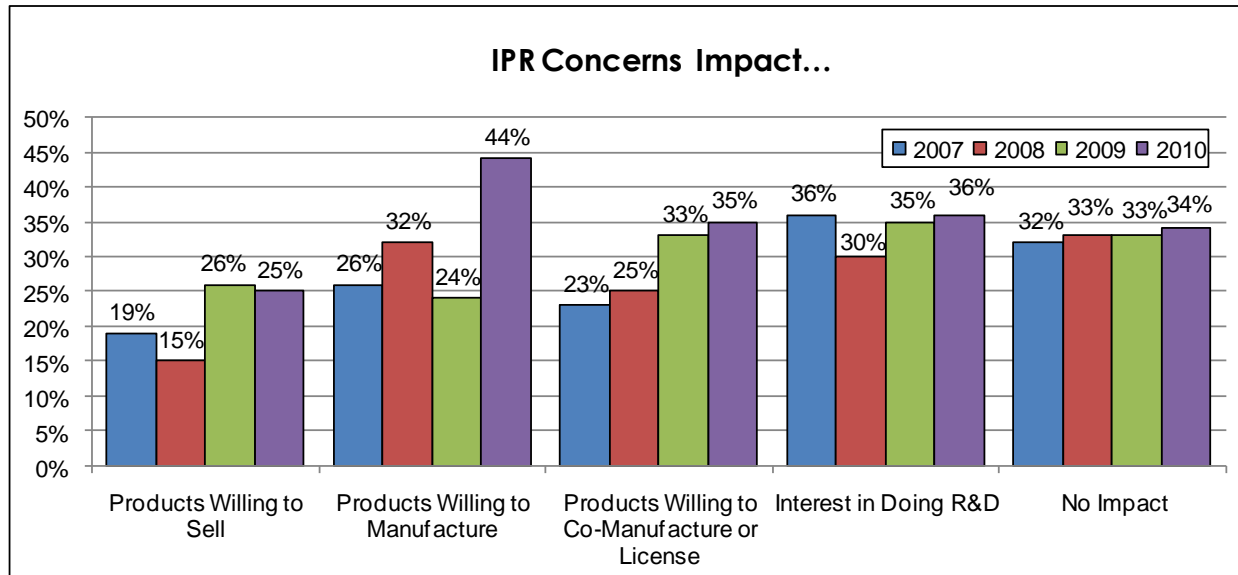
indicated that the situation has deteriorated or significant new problems have emerged. These percentages have remained remarkably consistent over the past five years. In 2006, for example, 54 percent of respondents said that the IPR situation was unchanged, while 42 percent said that it had improved and 4 percent said it had deteriorated. In 2010, those numbers were 59 percent, 37 percent, and 4 percent, respectively.

That said, for US companies in certain sectors – such as software, movies, and music – intellectual property piracy probably remains their top issue in China, and protection of IPR is fundamental to their business in China.



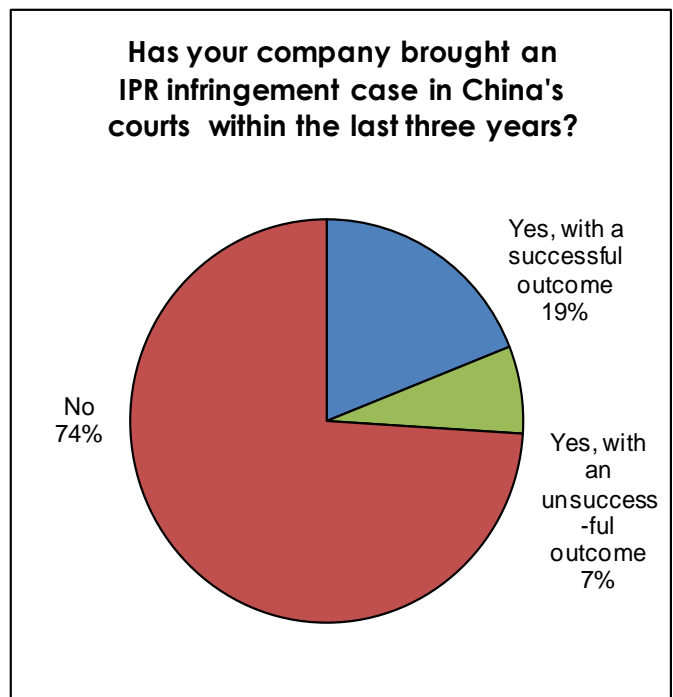
Impact of China's Record of IPR Protection on Company Strategy and Operations

Despite China's slow progress on IPR enforcement, concerns about infringement and counterfeiting have a broad impact on company operations. Company fears about IPR protection in China translate into a range of consequences for individual companies that affect not only those products that they are willing to manufacture in China, but also other key types of business activities, including research and development, sales, and product licensing. Only one-third of respondents say that China's poor IPR protection environment has no impact on their business, a number that has remained steady over five years.



IPR Challenges: IPR Protection Plagued by Inadequate Deterrents

USCBC survey results also reveal the challenges of addressing IPR infringement with a "one size fits all" strategy, as IPR enforcement in China reflects a mix of varying industries, types of IPR, and records of enforcement. IPR protection remains highly uneven across cities and provinces. For some companies and industries, IP infringement is concentrated in a few locations, while for others, counterfeiting spans multiple jurisdictions – across which funding, training, and procedure for IP investigators, police, and judges can vary widely. Because IPR enforcement primarily depends on these local officials, it can be challenging for companies to develop a consistent, centralized approach to battling IPR infringement. Of note, companies have reported some success in using administrative and judicial tools to address counterfeiting and IPR infringement. For

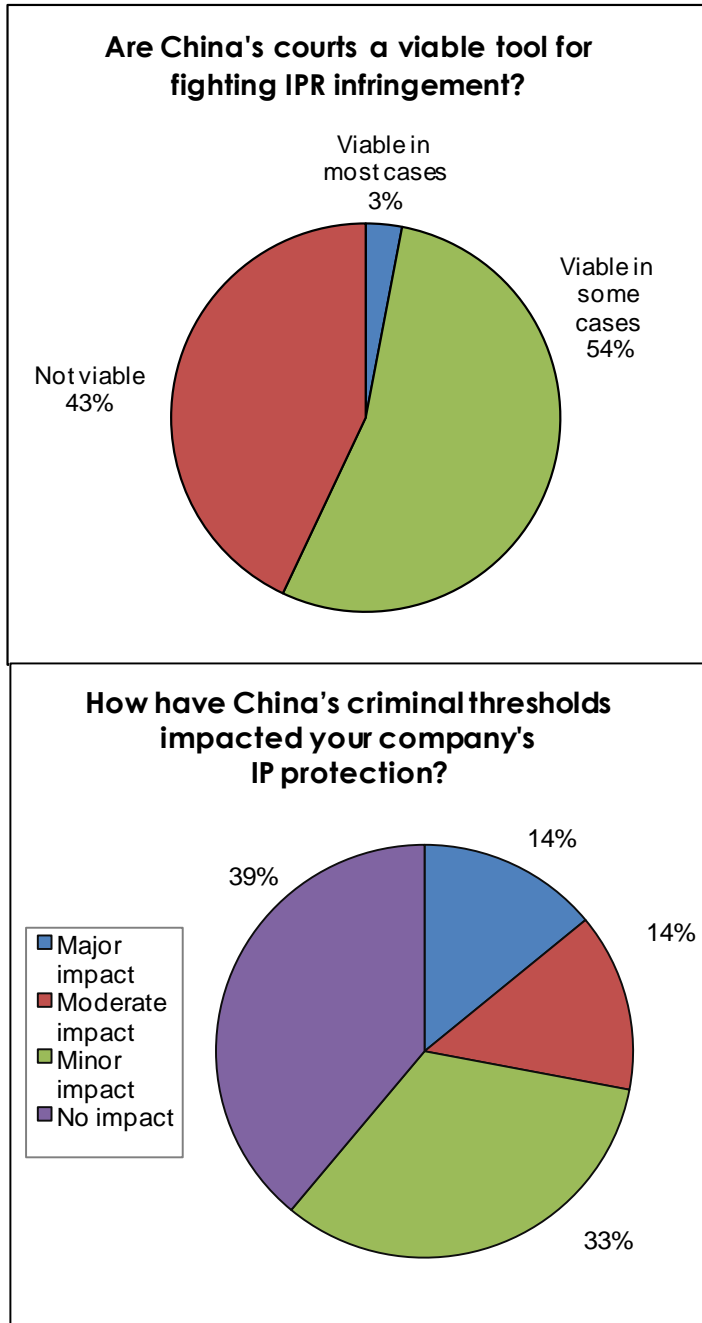


example, in our 2010 survey, just over a quarter of respondents (26 percent) reported filing an IPR infringement case in China's courts over the last three years, and of those, nearly three-quarters reported a successful outcome.

Yet companies remain skeptical about the viability of China's courts as an option for battling IPR infringement. Last year, 43 percent of respondents said that China's courts were still not a viable option in any cases, while 54 percent said that they would be viable in some cases. Even when companies are successful, however, fines and punishments for administrative IPR enforcement cases and court cases are

often too low to serve as adequate disincentives. Companies continue to report considerable variation between courts in different jurisdictions, due both to inadequate training and experience on IPR issues and to the strength of local protectionism in some courts. Finally, the cost of civil proceedings – and the continued high thresholds required for companies to initiate criminal cases – serve as barriers that prevent full access to the stronger deterrents and legal protections that can be achieved in court proceedings.

Criminal thresholds have been one particular focus in this discussion, as IPR cases must meet minimum thresholds for the value and number of infringing products before they are eligible for criminal prosecution. Despite some PRC efforts to lower these thresholds, and US government attempts to bring this issue before the World Trade Organization (WTO), China's thresholds remain too high to bring a significant number of IPR infringement cases to criminal courts and thus to discourage counterfeiting. In 2009, on the tail end of the United States' WTO case against China that challenged China's criminal thresholds, USCBC asked member companies whether China's criminal thresholds had an impact on their company's ability to protect IPR. Of those responding, the majority – 61 percent – said that it had some impact on their ability to protect their own IPR because thresholds can undermine the deterrent effect of criminal prosecution. Nearly 30 percent said that it had a major or moderate impact on their ability to protect IPR.

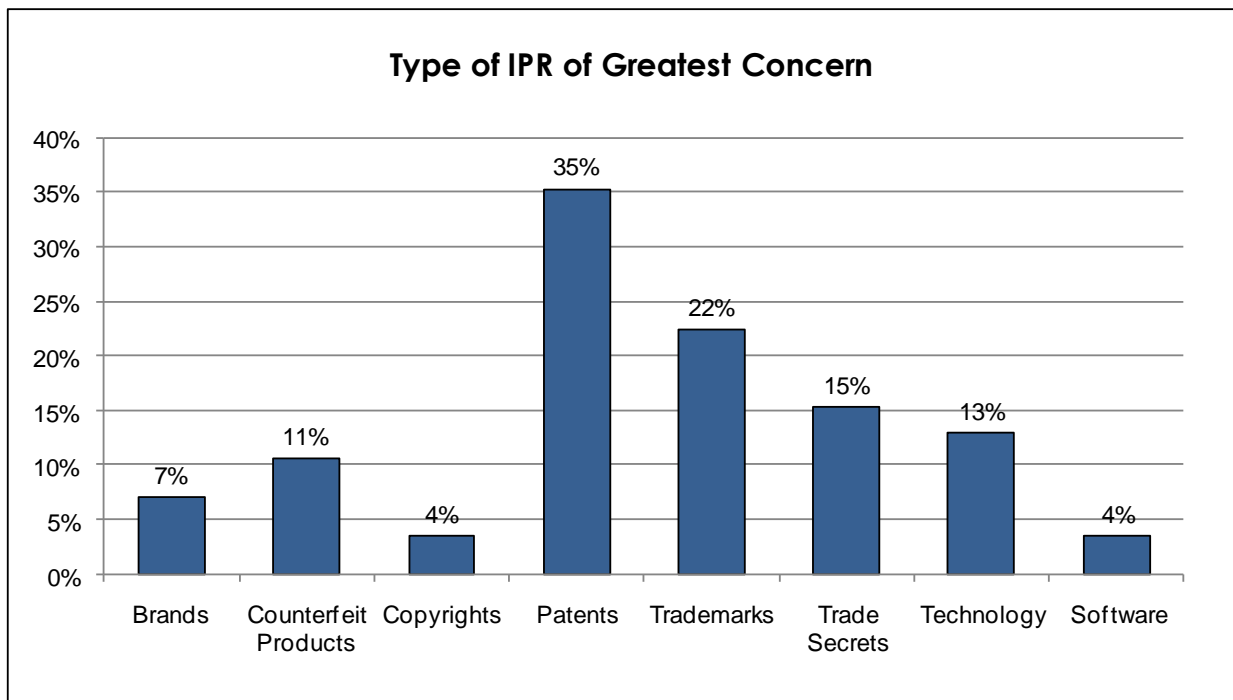


USCBC continues to recommend that China take proactive steps to strengthen its deterrents to IPR infringement, including by eliminating thresholds and allowing for criminal penalties in cases of

infringement on a commercial scale; and by raising the statutory cap and the effective level of fines and damages for IPR infringement. In addition, USCBC recommends that China increase resources and authority for IPR enforcement officials at all levels, particularly local public security bureaus (PSBs) and Administrations of Industry and Commerce (AICs), to proactively tackle counterfeiting and IPR infringement.

IPR Diversity: Finding a Winning Solution

IPR issues vary widely for particular industries, and enforcing different types of IPR – trademarks, copyrights, patents, and trade secrets – requires different approaches and strategies. USCBC’s 2010 member company survey asked respondents to list the type(s) of IPR that was of the greatest concern to their companies. Though patents (including designs) were the most frequent response, US companies show considerable diversity in their responses. Respondents rated the top IPR protection concerns as patents (35 percent), trademarks (22 percent), trade secrets (15 percent), product technology (13 percent), and counterfeit products (11 percent), with copyrights and software also generating responses.



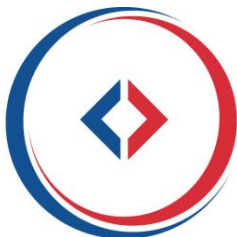
The severity and nature of a company’s IPR problems also vary considerably depending on the industry. A heavy machinery company’s primary concern may be trade secrets, while a consumer company’s top concern may be trademark infringement. The advocacy approaches to and solutions sought from PRC government agencies must be tailored to tackle these varying challenges specifically, yet coordinated enough to show progress generally. In particular, we note that patents and trademarks must be an area of increased attention for PRC government officials, as substantive progress in protecting patents and trademarks will give foreign- and domestic-owned companies greater confidence in China’s IPR system and make them more willing to expand the scope of their operations in China.

USCBC Recommendations

USCBC encourages China to extend and expand the focus of this campaign beyond its March 2011 ending date through committing sustained attention and resources on this issue at all levels. In addition to making substantive, measurable progress on IPR enforcement, USCBC recommends that China take a number of steps to improve the IPR enforcement environment:

- Eliminate the value-based thresholds on counterfeit goods for criminal prosecution and allow criminal penalties to be applied in cases of commercial scale;
- Increase the effective level of administrative and civil penalties for IPR infringement, by imposing a statutory minimum and raising statutory maximums on fines and damages for IPR infringement and encouraging local regulators and judges to levy larger fines that will serve as more effective deterrents;
- Establish more frequent and consistent feedback and communication mechanisms to facilitate communication between companies and relevant agencies and among relevant government agencies on IPR-related matters, perhaps through the establishment of a permanent, State Council-led interagency group focused on IPR enforcement;
- Simplify procedures to bring IPR cases (administrative, civil, and criminal) through a variety of means, including by:
 - Encouraging local public security bureaus to initiate investigations based on prima facie evidence of probable cause;
 - Eliminating the requirement of some local AICs that companies provide legalized power of attorney forms before AIC is willing to proceed; and streamlining the process for, and expand the enforcement of, injunctions against infringers;
- Provide clearer guidance and increased communication between central- and local-level government agencies, including greater information sharing and dialogue between provincial and local IPR regulators to share experiences and best practices and to promote more consistent IPR enforcement across regions and jurisdictions;
- Promote the legal use of software, as agreed by China and the United States during PRC President Hu Jintao's January 2011 visit to the United States, by:
 - Allocating government budget funding for legal software purchases;
 - Auditing the use of legal software and publishing the results of those audits; and
 - Promoting the use of licensed software in private companies and in state-owned enterprises through software asset management programs;
- Formulate more effective regulations on counterfeit-producing machinery and equipment, such as to mandate that infringing goods – and the equipment used to produce them – be destroyed upon seizure and not be permitted to enter the market under any circumstances; and
- Pay greater attention and apply more resources to counterfeiting Internet-related IPR infringement, including by:
 - Increasing resources and authority for IPR enforcement officials at all levels, particularly local PSBs and AICs, to proactively tackle counterfeiting and IP infringement.
 - Drafting and enforcing new rules to define and regulate IPR on the Internet, including use of trademarks on websites, use of websites as platforms for goods, and trademark-related aspects of domain name registration;
 - Increasing the monitoring of Internet sales and distribution channels to crack down on counterfeiting; and
 - Strengthening intermediary liability rules on the Internet for both trademark-infringing goods and copyright piracy.

For a full list of recommendations, please see USCBC's IPR recommendations, included here as Appendix 1.



Appendix 1: Intellectual Property Rights Recommendations List

July 2009

Executive Summary

The US-China Business Council (USCBC) remains active and engaged on issues surrounding the protection of intellectual property rights (IPR) in China, a top concern and a notable barrier to its member companies' full and effective business operations in China. Drawing on ongoing outreach to its members about their views of the innovation and IPR environment in China, USCBC has compiled a list of IPR issues that encompasses the full IPR landscape, including systemic issues, counterfeiting, judicial proceedings, and specific areas of IPR (patents, trademarks, copyrights, and trade secrets). The list provides a summary of US companies' perspectives on IPR protection as a part of doing business in China and offers US stakeholders key priorities for their IPR discussions with PRC agencies.

During the past few months, the US-China Business Council (USCBC) canvassed its membership about their views of the environment in China for promoting innovation and protecting intellectual property rights (IPR).

Though China has made progress in these areas over the last few decades by building a comprehensive legal and regulatory IPR framework, IPR protection and enforcement remain key concerns for all companies operating in China. Though USCBC member companies no longer rank the IPR legal framework among their top 10 business challenges in China in USCBC's annual membership survey, IPR enforcement remains one of their top concerns each year and affects the products and technologies that companies are willing to produce, license, or develop in China. IPR infringement – including infringement of trademarks, copyrights, patents, and trade secrets – remains common in many geographical areas, and companies must contend with administrative hurdles to secure the protections that existing regulations promise.

The following list, informed by feedback from USCBC member companies operating in China, offers recommendations for the PRC government to strengthen IPR protection. Though many of the recommendations may already be well-known, USCBC believes the list provides a useful summary of the current perspectives of US companies seeking to protect IPR while doing business in China and provides US stakeholders with priorities for their IPR discussions with PRC agencies.

IPR Landscape

- Release for public comment IPR-related laws and regulations, as well as changes to examination guidebooks, for a period of at least 30 days – in line with China's commitments under the Strategic

Economic Dialogue (the predecessor of the Strategic and Economic Dialogue) – to allow companies to participate in the legislative process. (See USCBC’s July 8, 2009 [transparency report](#) for an analysis of the State Council and National People’s Congress track record over the past year to publish regulations for public comment.)

- Promote an open, fair landscape for innovation and IPR by setting and implementing regulations and policies in IPR-related areas (such as standards, tax policies and incentives, and government procurement) that treat foreign-invested enterprises (FIEs) and domestic companies equally, to ensure that all IPR holders – foreign and domestic – receive equal legal protection for their IPR.
- Encourage even enforcement of IPR across cities and provinces through increased central oversight of, and dialogue with, provincial and local IPR regulators. In addition, encourage greater information sharing and dialogue between provincial and local IPR regulators to share experience and best practices and promote greater consistency across regions.
- State explicitly that “indigenous innovation” includes innovation carried out by China subsidiaries of foreign companies, such as FIEs, in regulations issued by the Ministry of Science and Technology and other key PRC government agencies.
- Reach out to, and coordinate with, appropriate industry associations, FIEs, standards organizations, and government-supported institutes that work on IPR issues to collaborate on programs, events, seminars, and workshops designed to build capacity among PRC officials.

IPR and Counterfeiting

- Eliminate or lower value-based thresholds that counterfeit goods must meet to secure criminal transfer.
- Clarify that value calculations used to calculate criminal thresholds must be based on the market value of the infringed goods, not the market value of the infringing goods.
- Increase the number of cases transferred from administrative to criminal proceedings by
 - Actively encouraging the training of, and interaction between, local administrative and public security officials;
 - Clearly stating and enforcing the obligations of local public security bureaus (PSBs) to proactively file and investigate criminal investigations; and
 - Changing policies and practices that limit local prosecutors from initiating and investigating potential criminal cases, and changing incentive structures that encourage administrative agencies to retain infringement cases so that they benefit from fines collected and credit earned.
- Allow PSBs to initiate investigations based on prima facie evidence of probable cause so that assets may be frozen before raids are conducted.
- Increase the effective level of administrative penalties for IPR infringement by raising the statutory cap on fines for IPR infringement and encouraging local regulators to levy larger fines that will serve as more effective deterrents.
- Raise the maximum amount of statutory damages available for civil penalties in cases of patent, trademark, and copyright infringement to deter counterfeiting more effectively.
- Include presumptions of knowledge for landlords in IPR crimes, including counterfeiting trademarks, pirating copyrighted material, or providing production technology.
- Increase funding and resources for local administrative agencies that investigate IPR infringement.
- Strengthen the legislated authority of local administrative agencies to investigate IPR infringement fully, including mandating seizures of both counterfeit goods and the equipment used to produce counterfeit goods and allowing administrative agencies to work cooperatively on cases that cross jurisdictional boundaries.

- Mandate that infringing goods – and the equipment used to produce them – be destroyed upon seizure and not be permitted to re-enter the marketplace under any circumstances.
- Require infringers to be financially liable for the storage and destruction costs of counterfeit goods.
- Make repeat counterfeiters subject to criminal liability for their actions.
- Encourage local investigators, such as administrations of industry and commerce (AICs) and PSBs, to tackle IPR enforcement proactively, and state explicitly that adequate enforcement of IPR is an important component of their work and performance evaluations.
- Eliminate the “double-bond” requirement, which requires companies facing exported counterfeits to post one bond with PRC Customs to seize possible infringing goods and a separate bond from the courts to sustain the validity of the seizure, by allowing transfer of the bond from Customs to the courts.
- Stipulate that if counterfeit labels are not *on* products being exported or imported but are included alongside products, then the products may be seized.
- Make trading companies liable for counterfeit products shipped using their permits or under their names.
- 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.
- Remove provisions in the Implementing Regulations for PRC Customs IPR Protection Rules that allow travelers to carry a “reasonable amount of counterfeit or pirated goods for personal use.”
- Authorize Customs to impose fines on exporters of counterfeit and pirated products sufficient to deter future infringement.

Patents

- Avoid issuance of compulsory licenses except in clear cases of egregious IPR abuse, and avoid encroachment on the normal, internationally accepted exercise of IPR.
- Clarify under China’s Antimonopoly and Patent laws that measures taken by antitrust authorities to rectify IPR-related anticompetitive behavior are specifically targeted at the anticompetitive behavior, in line with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 31(c).
- Clarify use and issuance of compulsory licenses, including processes and criteria for revocation and appeal of licensing decisions.
- Amend the PRC Patent Law Implementing Regulations to state that for an antitrust action to be taken, anticompetitive effects must be established under the PRC Antimonopoly Law, and the anticompetitive effects of the enterprises’ behavior must outweigh any pro-competitive effects.
- Amend the PRC Criminal Law to include automatic criminal sanctions for counterfeiting of food and pharmaceuticals.
- Expand the definition of patents to include software.
- Continue to increase the number of patent examiners and their field experience through increased hiring and cooperative exchange programs with international patent agencies.
- Clarify the PRC State Intellectual Property Office’s security review process for foreign filing license applications to ensure that the process does not cause delays in the filing and protection of patents and that data submitted remains confidential.
- Allow for the full restoration of the portion of a patent term lost because a competitor has produced or used the patented product in preparation for applying for a generic license.
- Clarify the scope of inventions whose completion “depends on genetic resources” to provide reasonable guidance to companies about what inventions might be patentable.
- Remove procedures that require disclosure of genetic resources under the PRC Patent Law.

Trademarks

- Clarify the differences, legal protections, and procedures for obtaining well-known marks, famous marks, and famous brands.
- Allow China-based subsidiaries of foreign companies to handle trademark registrations and trademark matters directly without having to go through a trademark agent.
- Draft clear guidelines on criteria and practices for review of applications for non-traditional trademarks, including sounds, smells, and dynamic marks, and issue these guidelines for public comment.
- Allow companies to file trademarks in more than one trademark category with one set of application materials.
- Increase protection under China's Trademark Law for personal names, including Western personal names, both via explicit provisions and strengthened enforcement.
- Remove or clarify language in the latest draft Trademark Law that allows local AICs to suspend investigations based on "actual circumstances that may impact the handling of the case."
- Draft and release new regulations designed to define and regulate Internet-related trademarks, including use of trademarks on websites, use of websites as platforms for goods, and trademark-related aspects of domain name registration.
- Eliminate the requirement used by some AICs that companies bringing an infringement case provide legalized power of attorney forms before the AIC is willing to proceed.
- Continue to increase the funding and staffing of the China Trademark Office to avoid long delays in future reviews of trademark applications and to eliminate current backlogs.

Copyrights

- State explicitly that criminal liability applies to end users of infringed software, regardless of how it is obtained.
- Eliminate requirements that copyright offenders must be proven to have acted with profit-making motive, replacing this with language that adjudicates cases based on harm inflicted.
- Implement existing regulations and policies designed to support purchase and use of legitimate versions of computer software fully (including the Computer Maker Legal Operating System Pre-Installation Requirements, Government Legal Operation System Procurement Requirements, and the Enterprise Legalization Plan).

Trade Secrets

- Clarify the Anti-Unfair Competition Law and related judicial interpretations further to define vague terms such as "consumer confusion" with clear, objective standards for evaluation and practical means for establishment, including consumer surveys admissible in court and notarized statements where appropriate.
- Issue judicial guidance for district courts confronting possible trade secrets cases, especially on the types of evidence admissible and sufficient to document protection of trade secrets.

Judicial Proceedings

- Continue to push for greater enforcement of court rulings and full enforcement of preliminary and post-case injunctions.
- Streamline the process for, and expand enforcement of, injunctions against infringers.
- Streamline the process for admissibility of promotional materials and third-party evidence (including market and consumer surveys) as evidence in IPR cases.

- Issue Supreme People's Court model cases and judicial interpretations for emerging areas of IPR law to provide greater clarity.
- Draft laws and regulations relevant to court handling of IPR cases, such as the PRC Tort Liability Law.
- Support and promote international training for IPR judges, including those at the district and intermediate levels, and broaden their exposure to Western legal experts in existing and emerging areas of IPR law.
- Clarify the roles, qualifications, and operating procedures for courts' use of expert panels in IPR cases, including patent and trade secrets cases.
- Release monthly updates on IPR-related cases, including administrative, civil, and judicial cases.