



**2010 SPECIAL 301 REVIEW**  
**Submission of the US-China Business Council**  
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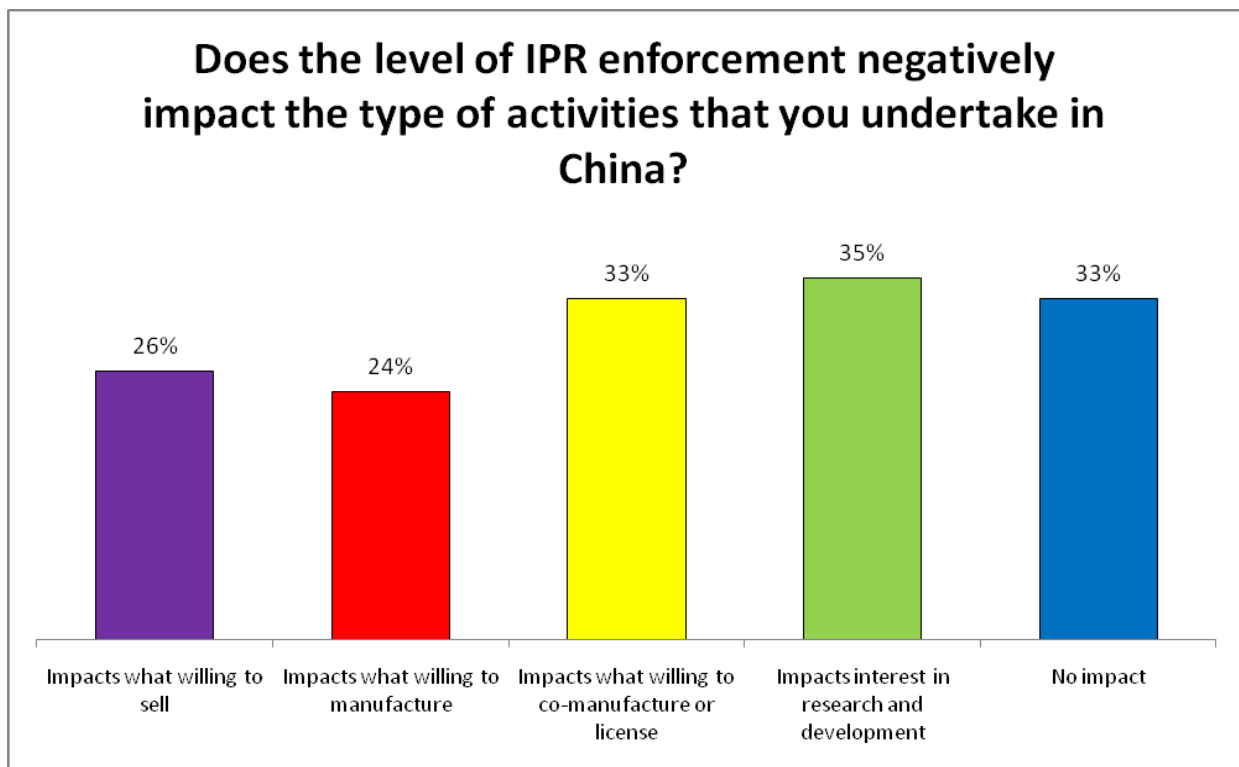
Inadequate protection of intellectual property rights (IPR) continues to plague companies doing business in China. Though China has made progress in recent years by building a comprehensive legal and regulatory IPR framework, IPR enforcement remains a major concern for most American companies operating in China.

### **Impact on Business Operations in China**

In the US-China Business Council's (USCBC) 2009 member survey report, USCBC members reported seeing continued incremental improvements in China's IPR enforcement. "Incremental," however, is far from a ringing endorsement of progress: almost 70 percent of respondents noted no changes in China's IPR protection regime in the past year. The remaining 30 percent said there had been some improvements, a slight trend of progress seen in the last five years of surveys. During that time, IPR enforcement has dropped from the number one issue for companies in 2005 to third in 2006 and 2007, to sixth in 2008 in our issues ranking. In 2009, the issue ranked eighth in importance.

Nonetheless, IPR enforcement remains a top concern for US companies and continues to affect the products and technologies that companies are willing to produce, license, or develop in China. Two-thirds of companies surveyed in 2009 indicated that IPR enforcement has an impact on their companies in some fashion (see figure below), and for certain industries—including software, entertainment and publications—IPR enforcement remains their top commercial issue. IPR infringement—including infringement of trademarks, copyrights, patents, and trade secrets—remains common in many jurisdictions, and companies must contend with administrative hurdles and insufficient penalties to secure the protections that existing regulations promise.

Though some companies have seen pockets of improvement in particular localities, IPR enforcement in China remains highly uneven across cities and provinces. Foreign and Chinese companies are using legal channels to protect IPR more often, but fines and punishments for administrative IPR enforcement cases remain too low to serve as adequate deterrents. In addition, barriers that prevent full access to civil and criminal channels—including value and volume thresholds for bringing criminal cases that are set far too high—prevent many companies from accessing stronger legal protections. Just over 60 percent of USCBC members surveyed reported that high thresholds for criminal penalties in China had at least some impact on their companies' ability to protect their IPR.



### **A New Aspect: Indigenous Innovation and Intellectual Property Rights**

In addition to mandating identification of IPR enforcement issues around the globe, Section 182 of the Trade Act of 1974 also requires the US Trade Representative (USTR) to identify countries that deny fair and equitable market access to those who rely on intellectual property protection. Recent government procurement policies issued by China raise the specter of limited market access for US IP products which USTR should take note of and prioritize in its discussions with the PRC government.

In the last few months, US companies have noted with concern a number of “indigenous” or domestic innovation policies that have important ramifications for US companies’ IPR strategies. In November 2009, the National Development and Reform Commission, Ministry of Science and Technology, and the Ministry of Finance released two circulars. The first covered application procedures, and the second was a notice that lays out provincial responsibilities for the new central-level indigenous innovation catalogue. The documents set a December 10, 2009 deadline for companies to submit applications for indigenous innovation status and a December 30, 2009 deadline for provinces to make recommendations on the scope of the catalogue to the central government. Four of the six areas identified for inclusion in the indigenous innovation catalogue are information-technology related: computers; communication (believed to include mobile phones); office equipment (such as scanners); and software. The remaining two are related to new-energy equipment and energy-efficient products.

Foreign -company concerns center on Section IV of the application procedures, which reiterates seven conditions, including patent and trademark restrictions, that will likely either exclude foreign companies from qualifying their product or require them to transfer intellectual property

(IP) to China to remain competitive in the government procurement market. The November 15 notice does not appear to include any new requirements beyond what local catalogues were already requiring, but as the first national catalogue, its impact will likely exceed that of the local catalogues.

Many foreign companies have noted the difficulty their products will have qualifying for China's various indigenous innovation catalogues for two reasons:

- **Patents** Products are required to have IP owned by an entity in China.
- **Trademarks** Products must have their original, first registration of trademarks within China.

The biggest obstacle for foreign companies is the requirement that the applying China entity fully own the IP and must first register the trademark in China. Some companies are concerned about IP protection in China, but the bigger issue is structural: To remain competitive, companies must be able to sell their products and services globally, rather than be restricted to selling only products that are based on IP developed in a particular market. Though many countries have government procurement policies that require a certain amount of local content, current international norms for government procurement do not include IP ownership requirements. Many governments around the world provide incentives to foster innovation, but these are usually in the form of tax incentives or research and development support; none appear to require domestic IP ownership or brand names for government procurement market access.

USCBC members have typically invested in China to serve the China market. They employ thousands of employees, pay taxes, and contribute positively to the overall economic and technological development of the market. In many cases, the parent company has licensed certain technology to its China subsidiaries to expand upon or develop new product for China, thereby bringing innovative products to China's market, even if the patent or trademark itself is owned in another jurisdiction. New indigenous innovation regulations linked to procurement preferences could therefore limit or slow the introduction of innovative products into China, as well as introduce market access barriers for these products.

### **Strategies to Address IPR**

To address these concerns, the US government and US companies need to pursue a comprehensive strategy to seek improvement on IPR in China that mixes bilateral and multilateral channels and integrates efforts promoting legal improvement, training, enforcement, and company best practices. This strategy must also take into account that one size does not fit all on IPR enforcement—that is, one enforcement strategy will not be suitable for all types of IPR violations. IPR issues for the film and software industries are different than those of the pharmaceutical industry and industrial manufacturers. Enforcement of trademarks, copyrights, patents, and trade secrets face different problems, and thus require different solutions. This complicates the strategic approaches that US companies and government officials must take in addressing these concerns, but it must be an important factor in designing an approach to IPR enforcement issues.

One central aspect of this approach is to seek continued improvement in China's IPR regulatory regime. USCBC's recommendations on improvements to China's IPR regime – which provide

specific examples of concrete steps and improvements on IPR issues – are attached to this submission.

### **Recommendation for Special 301**

While overall improvements have been slow but steady, the issue of IPR enforcement remains a top concern for companies operating in China. As noted above, only one-third of USCBC members say the issue has no impact on their operations in China. For certain industries, such as software or entertainment, piracy is THE top issue.

Based on the above reasons, USCBC recommends that USTR maintain China on the Priority Watch List in 2010 and engage at senior levels of the PRC government on the issues reviewed in this submission.



## 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.

**D**uring 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.