



中国美国商会

**The American Chamber of Commerce
People's Republic of China**

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**Statement by
Christian Murck
President**

American Chamber of Commerce in China

**Hearing on
“Will China Protect Intellectual Property? New Developments in
Counterfeiting, Piracy, and Forced Technology Transfer”**

Congressional-Executive Commission on China

Washington DC

September 22, 2010

Mr. Chairman and Members of the Commission:

Thank you for the opportunity to testify before you on intellectual property rights in China.

I speak on behalf of the American Chamber of Commerce in China, comprising over 1,600 companies and 2,600 individuals, and representing the commercial interests of the American business community in China.

This Commission has a record of sustained attention to intellectual property rights protection in China for which we thank you. I testified before the Commission on June 6, 2002, and cited intellectual property rights as a case study of the impact of the rule of law on business. Revisiting this topic today, I will take the opportunity to comment on the progress, or the lack of it, in the past eight years, as well as new developments.

Infringement of intellectual property rights has consistently been among the top business challenges reported by our members in our annual business climate survey conducted for the past twelve years. In the 2010 survey, it ranked eighth, behind inconsistent regulatory interpretation, management level human resource constraints, obtaining licenses, protectionism, bureaucracy, unclear regulations, and lack of transparency. IPR protection was described as critically important to 25% of the respondents, and very important to 45%. 30% said it was slightly important or not important. You will not be surprised to hear the sectors most impacted are IT, high tech, software, research-based pharmaceuticals, entertainment, and consumer brand owners for which IPR protection is a crucial element of the business model.



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Least affected are service providers such as consultants, law firms, financial services, accountants and the like.

Our survey data confirms anecdotal evidence that IPR enforcement has gradually improved since 2002. In that year, 21% of respondents rated enforcement as totally ineffective, 63% as ineffective, and 16% as effective or very effective. In 2010, 11% rated enforcement as totally ineffective, 63% as ineffective, and 26% as effective or very effective. Given the attention and commitment of resources to this effort by the Chinese government, the U.S. government, and the private sector, such slow, modest improvement is a disappointment.

Nevertheless there has been significant improvement in the legal infrastructure supporting intellectual property rights.

Relevant laws are updated on a regular basis. The process takes about three years and circulation of drafts for comment is now routine.

Courts are increasingly professional and fair, especially in large cities. Enforcement of judgments against individuals and small companies is difficult, but there is adequate enforcement against large companies. Damages are growing, but still inadequate by international standards.

As a result of these improvements, litigation is now common, whereas in 2002 it was not.

The Supreme People's Court reported over 30,000 cases closed during 2009, a 29% increase on the prior year. Half of 2009 cases involved copyright disputes, 23% trademark disputes, 15% patents, 4% unfair competition, and 2.4% technology contracts, demonstrating the range of applicable law. A common assumption has been that once Chinese parties obtained intellectual property rights, they would seek enforcement. That is happening. In 2009, 95% of lawsuits involved two Chinese parties. Chinese rights holders are turning to the courts to assert their rights in large numbers.

Foreign parties litigate cautiously and they generally win. In Beijing's First Intermediate Court from 2002 to 2006, foreign parties won 60% of IPR cases. In Zhejiang Province, foreign plaintiffs won 95% of their cases from 2003-2008, and 99% in 2008.

One of our member companies for the first time recently filed a high profile suit against a state-owned enterprise infringer, won, and collected material damages. Though they did not recover the extent of their commercial loss, half a dozen similar companies subsequently quietly initiated negotiations to settle similar infringement situations.

While not completely satisfactory and limited by the difficulty of gathering evidence, litigation is now a much more realistic option than in 2002.



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As a general matter, however, infringement is still widespread and continues to evolve in order to evade enforcement.

In my 2002 appearance before you, I suggested that an unintended consequence of WTO entry might be an increase in counterfeit exports. That has unfortunately occurred. Customs has increased inspection of outward bound containers, but is dependent on intelligence from rights holders. Recently, counterfeiters have shifted to small packages rather than container shipments, complicating the interdiction effort. The counterfeit supply chain has globalized, with distributors operating in the Middle East and Eastern Europe. The recorded country of origin of counterfeit goods entering the U.S. or E.U. is often not China. Nevertheless, China is the known source of well over half the counterfeit goods seized at the borders of the U.S. and E.U.

Counterfeiting has also gone online. In one case, a single individual was operating a virtual enterprise from his home where his website listed hundreds of fake products available, and manufacturing, storage, and shipping was outsourced to dispersed companies. He is now in jail, but his business model is no doubt flourishing in the hands of others. The issue of counterfeit goods for sale through online auction or purchasing sites is well-known. Internet intermediary liability is an under-developed area of law now receiving attention.

Anti-counterfeiting enforcement now often requires investigation across both provincial borders within China and international borders.

Cooperation among international enforcement agencies continues to lag the increasing sophistication of manufacturing, distribution, and sales of counterfeit goods.

Copyright and patent infringement is equally widespread.

I will leave the subject of music and film copyrights to my colleague on this panel, except to note that a significant part of the problem is caused by the limited number of foreign films permitted to be distributed legally in China every year. This is justified by China as necessary to protect consumers, enable censorship, and protect the domestic industry. It simply cedes a large market to pirates.

China now ranks second globally in the number of personal computers shipped domestically, but 49th in revenues of international software vendors. Most of the gap is filled by pirated software. AmCham-China is particularly disappointed that despite clear regulations requiring computers to be shipped with legally licensed software, and requiring state-owned enterprises to use only legally licensed software, compliance by SOE's is still problematic. We call on the State-Owned Assets Supervision and Administration Commission to establish a credible, transparent software asset management program under which all centrally-owned SOE's will



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certify annually under audit that all software on their computers, including operating systems and applications software, is properly licensed.

Over time best practices have emerged with respect to protecting intellectual property in China. An effective strategy usually includes:

- Registration of trademarks, patents, and copyrights so that they are effective in China;
- Strong internal and technical controls, including access limitations to intellectual property, control of packaging, IP audits, limits on subcontracting, etc.;
- Contracts with employees, distributors, suppliers and customers that include intellectual property provisions;
- Monitoring use of IPR by employees, competitors, suppliers, and partners;
- An enforcement strategy including use of investigation firms to gather evidence, supporting enforcement agencies in administrative and criminal cases, and private litigation; and
- Active, targeted engagement with enforcement agencies at central, provincial and local levels, both as an individual company and through industry associations.

Companies with a presence on the ground and the revenue scale that justifies an active, multi-faceted effort can control the commercial impact of infringement. However, smaller firms or those without an active presence in China are seriously disadvantaged.

In the past eight years, the U.S. and Chinese governments have devoted time and effort to this situation.

There is a particularly productive engagement between the U.S. Patent and Trademark Office and the State Intellectual Property Office. Last week, for example, a patent workshop was held in Beijing organized by USPTO, SIPO, and the U.S. Chamber of Commerce. Among the topics covered were:

- The national security review required by the Patent Law when patents registered in China are licensed abroad;
- Design and utility model patents, which meet a lower standard of invention and are often unexamined, making them a means of registering other's technology;
- Patent disclosure requirements, especially the requirement that direct and indirect genetic resources be disclosed on any biotech patent;
- Statutory damages;
- Compulsory licensing (we hope China will continue to construe the grounds narrowly and avoid using compulsory licensing);



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- Invention remuneration (the issue is differences between the national patent law and some provincial regulations that has led to legal uncertainty);
- Software patents

The same delegation participated this week in a workshop on bad faith trademark filings with Chinese, European, and Japanese representatives to review the law, procedural challenges and best practices to deter such filings.

These topics give a good sense of the range of subjects under active technical discussion.

Improving intellectual property rights protection has also been a major priority of the U.S. Embassy in Beijing, represented by the presence of an IPR Attaché, the annual Ambassadors IPR roundtable, and many other programs.

USTR and the Department of Commerce are actively engaged through the Joint Commission on Commerce and Trade, and its IPR Working Group.

The business community is well-linked to all of these ongoing efforts.

Our progress since 2002 can be described as a “three yards and a cloud of dust” offense, slowly grinding our way forward. It isn’t very exciting, but we’re better off than we were and we see a path toward the future. There is both bureaucratic momentum and the common interest of the Chinese and foreign business communities in improving IPR enforcement.

Our attention at AmCham-China and in the foreign business community in China at large is shifting from enforcement to a new consideration: the impact on our market access and American competitiveness of Chinese industrial policies explicitly intended to strengthen national champion companies by encouraging them to acquire or develop intellectual property, giving them protected domestic markets in which to gain scale, and planning that they will then be globally competitive.

I discussed this issue earlier this year in testimony at the International Trade Commission on June 15 and at the Ways and Means Committee on June 16.

As the recovery from global economic crisis continues, China is embarking on rebalancing its growth model to move back to a balanced trade account and shift toward domestic demand as the driver of economic growth. At the same time, the economy is being restructured to be more efficient in its use of energy, natural resources, and capital. Significant investments are being made in health care and education. Wages, especially manufacturing wages, are growing strongly after a long period of stagnation. Part of China’s strategy to adjust to new circumstances is to move its industrial sector up the value-added curve by encouraging the development of intellectual property through research and development, technology transfer, and adaptation of acquired technologies.



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Late last year, we and others were alarmed by the release of policies that appeared designed to exclude imported products and the products of foreign-invested enterprises from catalogues of products certified as the result of “indigenous innovation”, with the likelihood that such catalogues would be used in government and SOE procurement. In response to comments from many quarters, the Chinese government entered into a serious dialogue. The Ministry of Science and Technology has removed the most egregious aspects of the 2009 regulations from the 2010 draft. Premier Wen Jiabao on several occasions, most recently earlier this month at the World Economic Forum meeting in Tianjin, has directly stated that foreign-invested enterprises in China are regarded as Chinese enterprises and will not be discriminated against. These are welcome statements, but it is important to recognize that there are broader concerns about the future direction of Chinese policy and the market access of foreign companies.

Our concerns include:

- Import substitution policies such as the Guiding Catalogues of Major Indigenous Innovation Technologies and Equipment of 2009, which specifies import substitution as a goal.
- The Government Procurement Law directly discourages procurement of imported products. China is not a member of the WTO Government Procurement Agreement and its first offer to join was not commercially meaningful; a second offer made in July was a modest improvement, but much work remains to be done.
- Standardization mandates such as the Ministry of Industry and Information Technology requirement that the Chinese WLAN Authentication and Privacy Infrastructure (WAPI) standard be included with any Wi-Fi enabled mobile device. Since this standard has not been commercially accepted anywhere, including in China, this mandate is purely rent-seeking.
- The 2008 Patent Law expanded the grounds for compulsory licensing, though China has not yet used them. It also requires foreign companies in China to submit to a review by Chinese authorities of whether a patent originated in China “relates to the security or vital interests of the State”, including “the substantial economic interest of the State”, before it can be exported.
- The Standardization Administration of China is developing standards rules that could lead to compulsory licensing or licensing on non-commercial terms of foreign technologies used in “mandatory national standards”, and possible anti-trust consequences for refusal to comply.
- Exclusion of representatives of foreign-invested enterprises from participating in and/or voting in China’s standards setting committees.



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- Exemptions from infringement in the patent law and drug registration rules for “research” and “non-commercial use” and for research for the purpose of producing generic pharmaceuticals. These facilitate stockpiling of infringing products, reverse engineering, and generic competition with innovative pharmaceutical companies in advance of patent expiration.
- Technology transfer on terms favorable to the Chinese party required to win necessary government approval for large contracts.
- Selective enforcement of the Anti-Monopoly Law, which rarely reviews transactions involving no foreign party.
- Bid specifications that favor local producers, for example in the wind power sector.
- The Multi-level Protection Scheme requiring that technology infrastructure in key sectors runs on domestic hardware and software where possible. This is already reducing foreign market access in the banking sector.
- Sectoral restructuring policies that generally involve consolidation driven by state-owned enterprise expansion as the expense of the private sector, for example, in the coal industry and also in the rare earths industry.

These problems are qualitatively different from inadequate enforcement of intellectual property rights. We agree in principle that IPR infringement is illegal, undesirable, and a drag on China’s development. We are working together toward solutions of a wide range of genuine practical difficulties to improve enforcement. We might wish that there were stronger political will on the Chinese side, or that better enforcement would be given a higher priority, and they might wish we were more patient, but we share a basic stance.

The industrial policy issues listed above, however, reflect considered, deliberate policy choices inimical to our commercial interests that restrict both national treatment and development of a market economy.

The underlying problem exposed by these policies is the very different regulatory and economic systems of our two countries. In China, the government’s regulatory and planning bodies, state-owned enterprises, and the institutions of the Party all play a large role in managing the society and the economy. Only the first of these have counterparts in the U.S. and their role is much different. How should we relate to an economy and a market driven to a large extent by industrial policy?

SOE’s can be simultaneously customers, suppliers, partners, and competitors. The leaders of major SOE’s are ministerial level officials, who often hold senior Party office as Central Committee members or alternate members. Yet given the size and growth potential of China’s markets for many products, it is strategically necessary to compete successfully there in order to be a global leader. We cannot throw up our hands and abandon the market because of its differences with our. Of course, the



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same is also true for Chinese enterprises with respect to the U.S., EU, and Japanese markets, where Chinese home market advantages often turn into disadvantages.

In our active discussions with the Chinese government and media, we often make the fundamental points that restricting competition stifles innovation, and that protected markets based on unique domestic standards prevent local firms from succeeding in global markets based on harmonized international standards. We recognize there is a vigorous policy debate within China, with many unresolved issues.

In thinking about the future, the American Chamber of Commerce in China starts with the premise that it is realistic to think in terms of three trillion dollar long-term goals:

1) Increasing US exports to China from \$80 billion dollars to one trillion dollars annually;

2) Increasing the revenues of US firms producing goods and services in China for the Chinese market from approximately \$100 billion dollars to one trillion dollars annually; and

3) Welcoming cumulative foreign direct investment from China in the United States of one trillion dollars. Just as Japanese capital has contributed to job creation and economic development in the U.S., so too can Chinese direct investment, giving the investors a deeper interest in our mutual prosperity and broader exposure to our market norms.

If we think in terms of building on the synergy between the U.S. and Chinese economies on this scale, what must be done?

We suggest the following:

- We need to understand better China's policy framework. Based on that understanding, we can better define the goals of our trade negotiators and private companies. For this reason, we have supported the investigation of the International Trade Commission now underway by arranging for member companies to be interviewed. We look forward to the ITC reports and hope that they will provide useful strategic input for all parties. We hope to contribute to an ongoing strategic discussion of U.S. options.
- We support the National Export Initiative, noting that China is our third largest and fastest growing export market.
- In support of the NEI, we support increased funding for the Trade Development Administration. AmCham-China participates in two private sector/public sector partnerships in aviation and energy that bring together Chinese and U.S. government agencies with American and Chinese



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enterprises in capacity-building programs partially funded with seed money from TDA. These are generating business opportunities as well as institutional and personal relationships that will be of last benefit to both countries.

- We also support increased funding for export promotion through the Department of Commerce.
- We support reform of U.S. export controls on the principles proposed by Secretary Gates in March of this year.
- We support prioritizing negotiation of China's accession to the Government Procurement Agreement of the WTO, with sub-central as well as central government commitments. This would provide welcome assurance of future access to important markets for both American and Chinese companies.
- We support resumption of negotiation of a bilateral investment treaty to support both American investment in China, recognizing the large role of the state-owned sector, and Chinese investment in the U.S.
- Finally, we believe the U.S. must strengthen its own competitiveness by examining R&D tax credits, developing a forward-looking national energy policy, maintaining immigration rules that attract talented engineers and scientists to our country, improving our educational system, reducing the fiscal deficit to a sustainable level and similar measures. To a great extent, our fate is in our own hands and does not depend on others.

Thank you for the opportunity to appear. I look forward to your questions.