

Intellectual Property Protection as Economic Policy: Will China Ever Enforce its IP Laws?

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Dirksen Senate Office Building, Room 192

Statement of James M. Zimmerman, Esq.

AmCham-China's Views on China's IPR Enforcement Record

Thank you Mr. Chairman and staff members for this opportunity to present the views of the American Chamber of Commerce, People's Republic of China.

My name is James M. Zimmerman. I am the Vice Chairman of the Board of Governors of AmCham-China and Co-Chair of AmCham's Legal Committee. I am a partner and Chief Representative of the Beijing office of the international law firm of Squire, Sanders & Dempsey L.L.P.

AmCham-China, which is based in Beijing, is an organization that represents the interests of the American business community in China. Along with its sister organization in Shanghai, AmCham-China represents over 2000 companies and individuals from virtually every state in the union, including small to medium sized businesses and U.S. exporters without a formal presence in China. We do not represent the interests of Chinese companies or the PRC government. AmCham-China and its member companies are in the field every day fighting for market access for U.S. products and services.

One of our core tasks is to meet with the Chinese government on a broad range of issues such as for greater market access of U.S. goods/services, timely implementation of China's WTO obligations, increased enforcement of intellectual property, and continued improvement of China's legal system and business environment.

AmCham-China and its member companies – given our on-the-ground presence and years of in-country first-hand experience – are committed to assisting this Commission and members of Congress in obtaining information and data to assist it with respect to its investigation concerning the issues addressed in this forum today.

I am here today to share our concerns and efforts with respect to IPR protection and enforcement in China.

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Since its accession to the World Trade Organization (WTO) in December 2001, China has made significant improvements to its laws governing intellectual property rights (IPR). However, there has been minimal progress in establishing a system of effective enforcement.

Indeed, counterfeiting and piracy problems in China are worsening and affecting both Chinese domestic and foreign brands. More sophisticated infringement schemes, combined with an increasing number of exporters, mean more counterfeits are showing up in foreign markets. Piracy not only amounts in a tremendous loss of revenue to IPR holders, but is also a consumer health and safety issue since counterfeit product rarely meets stringent quality standards.

The violation of intellectual property rights impacts almost all industry sectors including consumer and industrial goods. Among a few examples, computer software, films, music recordings, clothing, cosmetics, auto parts, pharmaceuticals, and food and beverages have all felt the sting of piracy.

In the media sector, it is common for a newly released film in the U.S. to surface within days of its American release as a pirated copy in China. Pirated DVDs in high quality packaging are now widely available in DVD stores throughout Beijing, despite the Chinese government's repeated commitments to crack down on piracy.

Piracy is a deeply frustrating problem for our members. More than three-quarters of respondents to the 2004 AmCham-China & AmCham-Shanghai membership questionnaire are negatively impacted by China's poor IPR protection. Ninety percent of our members believe China's IPR protection is ineffective.

AmCham-China believes that the answer to the problem will only be tackled with stronger national leadership to address IPR enforcement issues.¹ Large department stores and markets openly selling counterfeit and pirated goods are widespread throughout China, including in Beijing itself. Chinese agencies report that they periodically raid these markets, sometimes imposing modest administrative fines on vendors. However, the fact that these markets continue to operate in the public eye, with seemingly no fear of meaningful legal penalty, creates the impression that China's national leadership lacks the will to stop counterfeiting and piracy.

Among other things, we believe that strong IPR protection is not just to protect the interests of foreign multinational corporations but also to guard the rights and interests of domestic intellectual property rights holders and to protect the health and safety of consumers worldwide that may purchase pirated goods.

With these general comments in mind, AmCham-China supports the USTR in placing China on a Priority Watch List and initiating WTO consultations with China under the TRIPS agreement. We believe that China needs to be put on notice in the strongest and most direct terms possible, that the IPR problem must be effectively contained or the USG will be forced to either take WTO action (with all the uncertainty that entails given the untested nature of the WTO TRIPS Agreement).

AmCham is in favor of exploring ways to taking action against specific regions, cities, or provinces in the PRC that are areas of flagrant IPR abuse, or specific Chinese companies which engage in repeated and gross violations of IPR.

While enforcement efforts have been lax, we believe the Chinese are growing more aware of their poor performance on IPR there is nowhere near the required effective and deterrent enforcement measures as required by WTO. As we have stressed to the PRC leadership, the key to enforcement is credible criminal sanctions that deters commercial-scale IPR counterfeiters and pirates.

For its part, AmCham-China has developed an exchange and education program of its own to encourage more effective enforcement in China and this program in general includes, among other things, the following components:

- **IPR Index of Enforcement:** AmCham-Beijing has created an IPR Index which measures whether China's IPR enforcement is improving or not. We are currently conducting the baseline survey and plan to publish the results three times a year. This information will be available to the public, including the PRC and U.S. governments. We recognize that we in the private sector – here and in China – need to provide much more data on specific examples of inadequate Chinese enforcement. Our IPR Index will aid this effort and we are also taking steps to advise and inform our members of the importance of collecting and sharing such information directly with the USG.

- **Legal Exchange and Education Efforts:** AmCham is pressing various PRC government agencies and judiciary to take certain key steps during the next year.² In short, we have stressed to the PRC government that several laws must be amended/adopted to provide stronger protection, enhanced penalties, and further clarification of standards. As part of its efforts, AmCham-China and AmCham-Shanghai jointly publish an English/Chinese language issues White Paper on an annual basis for purposes of educating the Chinese government on areas of concern for U.S. business, and included in the White Paper is a detailed analysis of U.S. industries' concerns with IPR enforcement. At the end of this Statement is a draft of excerpts from our White Paper and reflects some of the issues we continue to emphasize to the PRC leadership.
- **Benchmarks and Performance Criteria:** This will be indicative of its commitment to IPR (we developed this list independently but it bears many similarities to the list of tangible results expected of China in USTR's April 30 Special 301 Report):
 - Impose criminal sanctions against a significant number of large-scale Chinese counterfeit operations. This crackdown should be widely publicized in the media.
 - There should be a significant decline in seizures of counterfeit goods at US and EU ports as a result of Chinese customs interception actions.
 - Chinese patent authorities should avoid retroactive rule-making which undermines the perceived value of Chinese patents and creates unpredictability for foreign investors. An example of this behavior is the invalidation of Pfizer's Viagra patent.
 - China should substantially increase its budget dedicated to enforcement of IPR and give national police the authority to operate across jurisdictions within China.
 - China should substantially increase the budget for the Trademark Office to resolve the backlog of invalidation cases pending (i.e., 20,000 cases and some pending since 1999).

AmCham further believes that the U.S. Government should dedicate additional resources to counter the effect of PRC-based counterfeiting and to support China's efforts to develop an effective enforcement system, including the following:

- Significant increase of US Customs personnel dedicated to interception of Chinese counterfeit goods.
- Increase in US Customs' cooperation in cross-border criminal investigations with China and EU.
- US government, particularly USPTO, to engage in more cooperative technical assistance programs to assist China in raising the level of IP practice so that U.S. companies can benefit. An improved patent/trademark examination system may expedite the grant of IP rights to U.S. companies.

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In summary, the AmCham-China and AmCham-Shanghai believe that China has made progress in the past three years with respect to its IPR laws, but much focused and aggressive work remains in order to elevate China's system to international standards and to give worldwide IPR holders a comfort level that their intellectual property interests will be respected and protected in China, and that infringing parties will be

punished. China's IPR standards and regulatory system – as a work in progress – requires strong national leadership and the dedication of capital and resources to be more effective and respected.

Thank you for this opportunity.

Notes:

1. We are pleased with Vice Premier Wu Yi's commitment, made on behalf of the Chinese government at the April 2004 Joint Commission on Commerce and Trade (JCCT) meetings, to make specific improvements in IPR laws and regulations; strengthening IPR education and enforcement; ratifying the WIPO digital treaties; establishing a joint U.S.-China IPR interagency working group to tackle enforcement issues; and promulgating the judicial interpretations on criminal liabilities standards covering prosecution, conviction, and sentences. However, the 2004 commitments have not been fulfilled and more work needs to be accomplished.
2. On January 19 2005, an AmCham delegation met with key members of the PRC Supreme Peoples Court (the "SPC") to exchange views on the Interpretation by the SPC and the Supreme People's Procuratorate (the "SPP") on Several Issues Concerning Application of Laws in Handling Criminal Cases Involving the Infringement of Intellectual Property (the "Judicial Interpretation") that was effective in December 2004. While the language of the Judicial Interpretation left much to be desired, Justice Huang Songyou, Vice President of the SPC, assured us that the Chinese government was serious about fulfilling its WTO commitments and gave priority to IPR protection. As stressed to the SPC, the key to enforcement is credible criminal sanctions that deter commercial-scale IPR counterfeiters and pirates. We believe that the SPC (the highest court in China) understands that effective action must be taken.

Excerpts of AmCham-China and AmCham-Shanghai's Draft 2005 White Paper concerning Intellectual Property Rights issues.

Central Government Resources: The Chinese leadership needs to devote more of its political capital and bureaucratic resources to shaping a national IPR strategy and putting into place an effective IPR enforcement regime. There is a need for revised laws, regulations, and policies. The most glaring deficiency in China's IPR regime at this time is in the need to revise the one key law that was not revised when China joined the WTO – its criminal code, which should be revised to provide stronger protection, enhanced penalties, and further clarification of standards. More attention is needed on the 'big impact' items to improve local enforcement, raise public awareness and strengthen intellectual property customs protection, and enhance interagency coordination.

Interagency Coordination: The lack of coordination among the many Chinese government agencies responsible IPR enforcement prevents effective enforcement. The Administrations for Industry and Commerce Trademark Divisions (AIC), AIC Economic Supervision Divisions, (Technical Supervision Bureaus (TSB), Copyright Administration offices, customs, Public Security Bureaus (PSB) Social Order Divisions, and PSB Economic Crimes Investigation Divisions (ECID), to name a few, have overlapping jurisdiction and authority. Jurisdictional issues need to be resolved and a program adopted to improve coordination.

Customs Enforcement: Since its WTO accession, China has liberalized its foreign trade regime. This is a welcome development. An unintended consequence, however, is that exports of counterfeit and pirated goods from China have increased sharply in the past two years and are now a global problem. Further liberalization contemplated by the revised Foreign Trade Law may well accelerate this trend. Although verbal assurance from the Supreme People's Court provides otherwise, there is nothing in the written laws that indicates that it is illegal to export counterfeit goods from China. This should be rectified and enforcement resources provided.

The *PRC Intellectual Property Customs Protection Regulations*, in effect from March 1, 2004, and the related implementing rules, promise to improve IPR customs enforcement. We are hopeful that Chinese customs will invest in the organizational and equipment upgrades necessary to make these regulations fully effective. This includes the purchase of a centralized computer system to enable customs officials to track the activities of counterfeiters and copyright pirates.

The regulations themselves, however, contain several weaknesses. There are no provisions to transfer suspected cases of criminal liability to the public security organs. AmCham-China and AmCham-Shanghai are also concerned about the removal of administrative penalties from the customs regulations and hope that such penalties will be reinstated. Presently, however, there appear to be no punishments for willful trade in infringing goods.

Chinese regulations require IPR owners to carry a heavy burden for protecting their intellectual property. For example, companies must provide customs officials with precise information as to which port(s) counterfeit goods will be going through, even though such information is very difficult to obtain. IPR owners also are required to post bonds to cover the risk of counterclaims in the event that a court finds the detained goods are not counterfeit. The procedures and amounts are unreasonably burdensome, especially because the courts

require a separate bond in the event that a seizure leads to litigation. We believe IPR owners should be allowed to post a single bond at the China Customs in Beijing covering the risk of counterclaims for all customs branches.

Criminal Enforcement: The AmCham welcomes the release of the Judicial Interpretation on Issues Concerning Application of Laws in Handling Criminal Cases Involving the Infringement of Intellectual Property, effective in December 2004. While the Judicial Interpretation significantly reduces the numerical thresholds to trigger criminal IPR prosecutions, we are disappointed that the Judicial Interpretation fails to include language concerning, among other things, the criminal liability for exporters of counterfeits and organizational end-users (and specifically with respect to the misuse of software products); methods for calculating value of semi-finished infringing products; enhanced penalties for repeated offenders, violations of health and safety, and other aggravating circumstances; and a clear definition of “illegal business income” which appears to allow the use of the infringing party’s prices and not the actual loss by the genuine owner of the IPR. Moreover, the distinction between individual and corporate infringing activity (with the threshold for unit or corporate activity being significantly higher than for individual activity) is unfortunate since it will simply encourage criminals to incorporate to avoid criminal liability. In the end, the true test of effectiveness of the Judicial Interpretation – and the resulting work of the courts and prosecutors – will be whether it is effective in deterring the rampant infringement of IPR in China and in bringing more criminal prosecutions and convictions in IP cases.

Administrative Enforcement: The existing system for administrative enforcement of regulations against piracy and counterfeiting needs to be improved. The AIC and the TSBs are key agencies providing support to intellectual property rights holders, but their effectiveness is limited by policy and legal problems. For example, there are no minimum standards for administrative fines; only a maximum standard. Consequently, our members report the amount and scope of administrative fines is dropping. We encourage the government to unify standards at the local level, combat local protectionism, and enhance interagency coordination.

Administrative Fines for Trademark Infringement: The State Council issued implementing regulations for the PRC Trademark Law, which entered into effect on September 15, 2002. These regulations provide, inter alia, for a dramatic increase in the maximum administrative fines that may be imposed on counterfeiters, from the prior 50 percent of turnover to the current 300 percent. Unfortunately, these increases in maximum potential fines have yet to result in a significant increase in actual penalties imposed. This is mainly due to the lack of guidelines from the State Council and the Trademark Office of the SAIC as to how fines should be calculated.

Administrative Enforcement of Software Copyright: Copyright authorities at the local level are crippled by inadequate manpower, training, and resources. Appropriate steps should be taken to ensure that the National Copyright Administration (NCA) and their local offices responsible for enforcing copyrights are adequately supported, such that rights holders can have reliable access to administrative and civil remedies provided under relevant laws against end-user and other copyright pirates. Effective coordination needs to be established with the SAIC to increase the enforcement capability of the local Copyright Administration offices. There must be reliable administrative enforcement coupled with deterrent penalties to prove that corporate end-user piracy bears administrative liability. We look forward to the prompt enactment of administrative rules by the NCA and the Ministry of Information Industry (MII) to deal with Internet piracy, takedown notice procedure and ISP liability.

The following issues related to the *Computer Software Protection Regulations* (issued by the State Council on June 4, 1991 and amended on December 20, 2001) should be addressed: (1) the regulations should be modified to clarify that temporary copies of software are protected; (2) the exception under Article 17 – which allows for the unlimited use of any software for the purposes of learning and studying the design – should be amended since it goes well beyond what is permitted under the Berne Convention and the TRIPS Agreement; (3) the exception under Article 30 of the Regulations – which creates a significant loophole in the liability of corporate end-user pirates by allowing an exception to liability in cases where a party is deemed to have acted without knowledge – should also be amended as inconsistent with international standards; and (4) the requirement under Article 30 that allows for a compulsory license in situations if destruction of the illegally used software would bring great loss to the infringer – should be deleted or amended as it is vague and goes beyond the exceptions and limitations permitted by the TRIPS Agreement.

Local Standards and Local Protectionism: There is significant variation among localities for interpreting liability thresholds. Currently, the provinces and municipalities have very different thresholds for determining copyright infringement. For example, the Shanghai PSB has issued its own IPR crime arrest and investigation guidelines, but we are not aware of any current efforts to provide nationwide standards. In many cases, local protectionism renders administrative enforcement ineffective. After raiding counterfeiters, trademark owners too often encounter local AICs that are reluctant (delays are often more than six months, and sometimes more than a year) to release the official administrative penalty decision letters. This has seriously hindered trademark owners' efforts to recover damages from counterfeiters in court. We welcome steps to bring cases against administrative authorities for abuse of their authority in rendering insignificant fines. We also believe that administrative authorities should be encouraged to make their decisions publicly available to ensure the system is fully transparent and in accordance with the law.

Patent and Trademark Registration and Protection: Improving the trademark registration process would help deter counterfeiters who preemptively register well-known trademarks, trademark imitations, and even blatant copies of the trade dress of others. Unfortunately, the China Trademark Review and Adjudication Board (TRAB) and Chinese courts do not take bad faith into consideration in cases of preemptive trademark registration, trademark imitation, and trade dress infringement. There is also considerable delays with respect to trademark invalidation petitions before the Trademark Office, which reportedly has 20,000 undecided cases pending with some disputes filed in 1999 remain undecided.

Similarly, the China Patent Reexamination Board (PRB) and the Chinese courts rarely take bad faith into consideration when reviewing preemptive patent filing at either the invalidation process with the PRB or infringement suits in court. Currently, a legitimate rights owner has little recourse against counterfeiters that file utility and design patents, knowing that such filings lack novelty.

Delays in receiving patents or being granted market access are another problem. SIPO is understaffed to handle the large volume of applications. With the resulting backlog of patent applications, it can take up to five years to receive a patent.

The thin legal grounds underlying the State Patent Office's decision to invalidate the use-patent for Viagra represent a step backwards. In its decision to invalidate the patent, SIPO relied on new guidelines issued after the patent had been granted, and then did not allow the patentee the opportunity to meet the revised data

provision standard of the new guidelines. The SIPO decision has been appealed to the courts and at this writing is still in litigation. Although we are most concerned with SIPO's rationale and procedure in invalidating this patent, which set an unfortunate precedent, we also note that the patent did not protect that legal producer. Domestic pharmaceutical companies widely copied the product and sold it through a variety of legal and illegal channels.

Patents and Standards: The intellectual property policies of the standards working groups in China do not conform to international practices. International standards organizations have an intellectual property policy that defines how intellectual property is contributed and made available for implementation of standards. Generally, Chinese standards groups in high tech areas (Advanced Visual Standard (AVS), Radio Frequency Identification (RFID), Linux, Intelligent Grouping and Resource Sharing (IGRS), etc.) either have no such policy, or an unreasonable policy requiring mandatory patent pool participation, unreasonable disclosure, and compulsory licensing.

The common practice is to require members of standards working groups to place all related patents in the patent pool and to entrust only the standards group to license the technology. In addition to creating monopolistic control, mandatory patent pool participation devalues patents in subsequent negotiations, cross licensing, and defense of intellectual property. Patent disclosure obligations in working groups typically apply to the entire company rather than the individual representing the company, and cover not only patents necessary to the standard in question, but all related patents, including third party patents and patent applications. Such disclosure standards are overly broad and impractical. This is compounded by rules in some working groups that non-disclosed patents must be licensed royalty free or not asserted.

The AVS Working Group is making an effort to cooperate with international standards experts to develop an appropriate IPR policy and related legal documentation. We recommend that relevant agencies and other Chinese standards organizations study this example.

Patent Protection for Computer Software: Patent examination guidelines and practices only allow patenting software-related inventions in the form of the computer that executes software (apparatus claims) or methods for operating computers using software (process claims). Protection is not allowed for computer readable media claims or programs that cause a computer to implement an innovative process (program product claims). As a result, the only one likely to be a direct infringer is the end-user who actually uses the software. This limits the use of software-related patents to protect the intellectual property of the industry. Many governments, such as the U.S., Germany, Japan, and Korea have already recognized program product claims. China's failure to do so is not only discouraging to foreign companies, but also denies protection to Chinese software enterprises at home and leaves them facing an unfamiliar environment in international markets full of competitors seasoned in patent protection of program products. We recommend revision of the patent examination guidelines to accept program products claims.