



Business and Industry Advisory Committee to the **OECD**

Comité Consultatif Economique et Industriel Auprès de l' **OCDE**

BIAC Discussion Paper

High-Level Workshop on IPRs and Economic Development in China, 20-23 April 2004, Beijing

The Business and Industry Advisory Committee to the OECD (BIAC) welcomes the growth of the OECD's outreach program in China in recent years and its important role in fostering an open policy dialogue with Chinese authorities. We are particularly pleased that the OECD and China have now decided to extend their cooperation to the area of protecting and enforcing intellectual property rights (IPRs). Since acceding to the World Trade Organization two years ago, China has demonstrated a growing appreciation of the importance of IPR protection for promoting innovation, social development and economic growth. At the same time, BIAC strongly believes that an effective system for protecting IPRs is critical to ensuring that our businesses can continue to contribute to China's development and capacity to benefit from integration into the global economy. We therefore share a common goal of making sure that China not only enacts IPR regulatory measures of the highest quality, but develops effective means of enforcing them as well.

To underline the importance of IPRs to our businesses and to China's future prosperity, BIAC would like to submit the following remarks to the workshop. After some general observations reflecting our experience of doing business on a global basis, we would like to stress some specific challenges investors from OECD countries face when operating in the Chinese IPR environment. We have also attached a recent BIAC discussion paper, entitled "Creativity, Innovation and Economic Growth in the 21st Century – An Affirmative Case for Intellectual Property Rights" (December 2003), which explores these issues in more detail and which we hope participants will find useful in framing the important discussion ahead.

- **Effective IPR protection helps mitigate the risks of investment**

Forward-looking intellectual property rights protection provides the incentives for firms and individuals to invest in generating new technology and new products. This is especially important where the returns from investment are longer-term, where the investment involves significant costs or risks, and where an invention or creative product is easy to copy or imitate.

- **IPRs enable technology transfer**

IPRs increasingly facilitate the operation of markets. Strong and effective intellectual property rights are an essential tool for technology transfer. They encourage private and public enterprises to transfer technology, not only through voluntary licensing and other contractual arrangements, but also through the development of innovative approaches for promoting technological development, direct investment, technology sales and dissemination, and cooperative ventures. For example, the growth of public-private partnerships and business-government-NGO collaboration to meet emerging technological or social challenges in OECD countries would often not be possible without IPRs. They provide the bridging mechanisms that make these promising collaborations work. IPRs also play a crucial role in our growing awareness of the role that diffusion of knowledge plays in the process of technological change

and economic development. A recent OECD study has shown that developing countries which depend heavily on technology and knowledge developed abroad are most in need of effective IPR policies to facilitate the inward flow of that knowledge and to foster a more competitive business climate over the long term.

• IPRs help stimulate innovation by focusing businesses on the necessity of finding legal means to “invent around” or “design around” patented inventions.

By providing exclusive rights to an invention, a properly functioning patent system frequently spurs others to innovate by developing alternative solutions to technical problems and spurring new and improved inventions. Innovators are stimulated to “invent around” or “design around” the original invention in order to avoid infringing the applicable patent(s). While this may, under some circumstances, lead to “me-too” innovation, it more often leads to the emergence of new and different technologies and competing pathways that promote competition and spur innovation. Advances resulting from innovations developed to avoid infringing existing patents yield new technological solutions that put market pressure on the exploitation of existing technologies.

Our experience also affords numerous examples of inter-industry technology “leaps.” Perfume sprayer mechanisms influenced the development of the carburetor, while various e-commerce innovations have their origins in the banking industry rather than the computer industry. Such technological convergence among industries is enabled by an intellectual property system that creates a public pool of knowledge, allowing companies to look beyond their own industry boundaries for R&D innovation.

IPR Protection in China

Since acceding to the WTO and taking on obligations in the area of intellectual property rights protection, China has made progress in combating copyright piracy and trademark counterfeiting, especially through revising its laws and providing criminal penalties for certain IPR violations. However, despite these improvements, piracy and counterfeiting at the wholesale and retail level, and over the Internet, are pervasive due to inadequate penalties, ambiguities in laws relating to criminal liability standards for IP-related offenses, uncoordinated enforcement among local, provincial and national authorities, the absence of effective mechanisms for cross-border cooperation in enforcement and the lack of transparency in China’s administrative and criminal enforcement system. With its extensive expertise in all areas of public policy and its ability to draw upon the experience of thirty member states, the OECD is well-placed to work with the Chinese to achieve progress in these areas. The international business community strongly supports these efforts and looks forward to greater assurance that its intellectual property rights in China will be enforced effectively.

Copyright Concerns

Pirated optical media products (CD, VCD and DVD) and counterfeit goods continue to be a major problem for OECD-based businesses, and the piracy rate for optical media products may well exceed 90 percent. Unauthorized use of software and other copyrighted works in business is also rampant. While recent copyright law amendments and regulations have made significant progress toward bringing Chinese law into compliance with TRIPS, the law remains deficient in several important respects, including wholly inadequate criminal liability for copyright offenses and overly broad exceptions to protection for computer software.

There is still need for better coordination between agencies and between administrative and criminal measures. There have been some successes in bringing civil actions, but deterrent sentencing in criminal courts continues to be largely ineffective. China’s criminal law has rarely been used to prosecute piracy because of the high thresholds for criminal liability established by the People’s Supreme Court in its interpretations of the criminal copyright provisions. Moreover,

administrative enforcement is slow, cumbersome and rarely results in deterrent fines, in part because of the lack of resources or political mandate of local copyright authorities. Although Chinese authorities have undertaken some administrative enforcement actions against pirates, the government's refusal to share information about the activities of CD plants or the ultimate outcomes of these actions makes it very difficult for rightholders to assess the deterrent impact of China's enforcement efforts. Cooperation between copyright authorities and local and provincial Offices of the Administration for Industry and Commerce (AICs) exists for some types of copyright infringement, but expanding this to all types of infringement (e.g. corporate end user piracy) should be seriously considered. Overall, the issue of IPR protection is marked by a readiness at the central government level to make strides to address the problem while implementation at local levels of government continues to leave much to be desired. We would therefore welcome the involvement of local and provincial authorities in all IPR activities organized by the OECD in China as a means of encouraging more effective coordination with their counterparts at the national level.

Patent Concerns

Although the legal and regulatory system covering both invention patents and design patents in China is now substantially in compliance with TRIPs, BIAAC members continue to encounter serious problems stemming from inadequate implementation and enforcement. Local officials sometimes evince a stronger interest in protecting their local economy than in policing IPRs and have been known to act uncooperatively in patent infringement suits.

Attempts to enforce patent rights through patent administrative departments are largely ineffective because the administrative agencies only have the power to stop infringements in their local territories and because they act slowly, cannot collect damages and suffer from a lack of transparency. Enforcement actions through the court system are generally more effective, but damages are not calculated in such a way as to compensate all the actual expenses of a rightholder in stopping infringing acts. Procedures for evidence exchange where trade secrets are alleged are not fully defined, and courts have referred matters to appraisal panels without input from the parties involved. This is despite the clear TRIPs mandate that parties are entitled to see any evidence used to determine their rights. The practices in Europe, US, Japan, and elsewhere regarding protective orders and the like provide a good model for handling such issues. Moreover, a 2003 Chinese Supreme Court case overturning a high court decision related to an appraisal conclusion based on evidence withheld from the plaintiff, and holding that parties must have the opportunity to review and challenge relevant underlying evidence, may improve the situation. Finally, while less expensive than in a number of Western countries, it is costly to bring litigation to enforce patents in China, outcomes can be highly unpredictable, local protectionism is sometimes still evident, and damages are low even when the patentholder is successful.

While patent infringement is decided through the judicial process, patent validity is decided at the Patent Reexamination Board (PRB) of the State Intellectual Property Office (SIPO), although the PRB's decision is subject to court review. While many countries separate the infringement and validity determinations in a similar way, the PRB in China has accepted challenges to validity based on arguments already decided during the original patent examination process, and has permitted multiple, simultaneous challenges by the same party, making enforcement and defense of valid patent rights difficult. Thus, we recommend that, as in other jurisdictions, validity issues should be consolidated, and rules relating to *res judicata* should be applied (i.e. challengers should not be permitted to raise issues which have already been decided.)

As for design patents, some infringers often obtain a design patent registration which is based on a copy product designed by utilizing the non-substantive examination system in China, and insist on the legality of their infringing conduct based on such invalid design patent rights notwithstanding the existing procedures available to invalidate such design patents. In regulated product areas, such as pharmaceuticals, there is no linkage between the regulatory agency and the enforcement of patents. Thus, the State Food and Drug Agency (SFDA) approves generic versions of patented medicines without regard to the patent protection which covers the product.

What is needed is a process whereby the SFDA will withhold approval of generic versions of products until the patent issues are resolved, preventing market disruption and patient confusion. In addition, as trade in manufacturing technology and process is becoming increasingly important in China, the protection of trade secrets in the manufacturing process technology requires particular attention. Effective regulatory and legal measures to protect trade secrets will be necessary for increased investment and trade in technology in China.

Finally, the judicial enforcement system lacks transparency. All courts should follow the same rules and guidelines, and decisions should be published so that companies can learn how the rules and guidelines are implemented. BIAC encourages the OECD to continue to work with Chinese authorities to stress the importance of enforcing patent rights to the business community and work with them to inject greater transparency throughout the system.

Trademark and Counterfeiting Concerns

For branded products, trademark protection is crucial to maintaining high-quality goods and services in order to build and strengthen customer loyalty. Counterfeiting, however, can severely damage the reputation of our companies; compromise the safety and quality of products with tragic consequences for Chinese and foreign consumers alike; result in serious losses of tax revenue to the government; provide a lucrative source of illicit income for organized crime organizations and harm China's reputation among foreign companies as a desirable place to do business. Representatives of the Chinese private sector attending these workshops surely recognize the potential pitfalls for the growth of their own businesses as well.

In addition to an appropriate legal regime that guarantees trademark integrity, an adequate IPR system must include an effective enforcement mechanism. Transparency is a vital component of this mechanism and adequate resources for police officials charged with investigating these offenses. Transparency not only increases the confidence that business has in the viability of the Chinese market, but it also decreases the opportunities for corruption. In this connection, BIAC appreciates the OECD's work with Chinese authorities on fostering greater transparency throughout the Chinese system, as well as its recent seminar on fighting corruption in the public service, attended by 130 chief-prosecutors or their deputies from throughout China. Reconvening such a distinguished group to focus on better enforcement of IPRs in China would be a welcome next stage in this dialogue.

Conclusion

A ready measure of the success of the IPR workshops will be the degree to which they form a solid basis for further IPR related cooperation with China to the general benefit of all involved. BIAC stands ready to work with the OECD and Chinese authorities on these and other issues of mutual importance in the days ahead.

Annex: BIAC Discussion paper on Creativity, Innovation and Economic Growth in the 21st Century – An affirmative case for intellectual property rights