NATIONAL ASSOCIATION OF Manufacturers

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Submitted via www.regulations.gov

September 28, 2017

Mr. William L. Busis
Deputy Assistant U.S. Trade Representative for Monitoring and Enforcement
Chair, Section 301 Committee
Office of the U.S. Trade Representative
600 17th Street NW
Washington, DC 20510

Re: Request for Comments on Section 301 Investigation into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property and Innovation

Dear Mr. Busis:

The National Association of Manufacturers (NAM) welcomes the opportunity to provide comments to the U.S. government on the initiation of a Section 301 investigation concerning China's policies and practices related to technology transfer, intellectual property, and innovation, pursuant to President Donald Trump's August 14, 2017 executive memorandum and in accordance with your Federal Register notice (82 Fed. Reg. 40213, Docket USTR-2017-0016).

The NAM is the largest manufacturing association in the United States, representing more than 14,000 businesses of all sizes in every industrial sector and in all 50 states. Manufacturing employs more than 12 million women and men across the country, accounting for more than three-quarters of all private-sector research and development. Manufacturing contributes nearly $2.2 trillion to the U.S. economy annually, and is the backbone of successful efforts to boost U.S. exports. U.S.-manufactured goods exports have quadrupled over the past 25 years, with major growth to our largest trading partners, including China.

China looms large for manufacturers in the U.S., both as a partner and a competitor. China stands as one of our largest economic partners, with nearly $580 billion in trade and nearly $45 billion in bilateral investment in 2016. Overall, China is the United States' largest goods trading partner, the largest source of U.S. manufactured goods imports and the third largest export market for U.S. manufactured goods. Manufacturers in the United States have seen a substantial increase in U.S. manufactured goods exports and sales to China since it joined the WTO (growing by $676 billion between 2002 and 2016), particularly as China's economy has grown and it has opened its market through implementation of WTO rules.

China is also a major challenge for manufacturers large and small, imposing a range of market-distorting and trade-limiting barriers that impact manufacturers in the United States. The

Chinese market remains one of the most frequently cited trouble spots for manufacturers in the United States, and these challenges continue to grow.

Manufacturers in the United States face a variety of market-distorting and damaging industrial policies and other measures that negatively impact them, ranging from government-fueled overcapacity to export subsidies and restraints that distort trade flows, from broad industrial policies to localization practices that promote domestic industry. More information about these concerns can be found in various NAM submissions, including our submissions for the October 2016 National Trade Estimate report, May 2017 submission for the trade deficit report and our forthcoming submission on China's WTO implementation.

Innovation and intellectual property (IP) protection have long been significant issues of concern for manufacturers in China. At home and around the world, innovation and IP are the lifeblood of manufacturers in the United States, large and small, and serve as the foundation for a competitive manufacturing base that can compete successfully against foreign competitors. Vigorous protection of IP rights at home and abroad against those who would steal innovative ideas and products is a necessity. Such protection spurs further innovation, creating greater certainty for manufacturers that their inventions will be safe and thus enabling them to build new industries and create sustainable, high-paying jobs. Strong IP protection and enforcement are also vital to promote broader U.S. interests, including consumer health and safety.[1]

China obligated itself to the baseline IP rules included in the Trade-Related Aspect of Intellectual Property (TRIPs) agreement when it joined the World Trade Organization (WTO) in 2001. In implementing its WTO commitments upon accession, China made important changes to its own rules and regulations, including major revisions to its core IP laws and regulations, that have provided some benefit to manufacturers in the United States. In recent years, as well, China has increasingly recognized the value of innovation and IP, as reflected in a greater focus on IP protection in high-level documents, revisions to its core IP laws and policies, and booming registrations of patents, trademarks and other forms of IP in China. Yet manufacturers in the United States continue to face significant IP-related challenges that stem from Chinese government policies and practices, both longstanding issues that remain unresolved and new issues related to China's increasing strategic focus on IP and technology.

This administration's efforts to prioritize the robust protection of American IP rights in China through various channels present a real opportunity to address these longstanding concerns in ways that will address concretely the issues that manufacturers face. In particular, manufacturers in the United States have long pushed for not only full implementation of robust rules to protect and enforce IP rights in China, but also the elimination of laws, regulations, policies and practices that force or effectively require companies to transfer their technology, either to their Chinese subsidiaries or to Chinese companies. Such policies and practices can take a variety of forms, including many of those discussed in the executive order and Federal Register notice.

As USTR conducts its investigation, manufacturers strongly encourage the review to focus on clear, specific policies and documentable practices that directly impact manufacturers in the United States across sectors that own and use the technology and intellectual property in question and on which the United States can monitor China's actions. Such a focused approach

[1] White House Office of the Intellectual Property Enforcement Coordinator, "Supporting Innovation, Creativity & Enterprise: Charting a Path Ahead: U.S. Joint Strategic Plan on Intellectual Property Enforcement, FY 2017-2019," December 2016.

is more likely to yield concrete solutions that will directly impact manufacturers in the United States. At the same time, manufacturers encourage USTR to ensure that its work on a Section 301 investigation is part of a coherent strategy to address not just the specific policies and practices identified in the investigation, but broader issues that limit the ability of IP-intensive industries to compete in the Chinese market, including market access barriers. This strategy should be fully consistent with U.S. WTO obligations. Such a strategy and focus will not only provide the most benefit for manufacturers and workers in the United States that face these challenges, but also will best ensure consistency with international trading obligations.

Policies and practices that promote unreasonable or unwarranted technology transfer cited most frequently by manufacturers include areas such as:

- Investment restrictions and government-run licensing and approval processes: Manufacturers have long faced investment caps in China under the Catalogue Guiding Foreign Investment in key manufacturing sectors such as agricultural processing, automotive, and telecommunications that force them to form joint ventures with domestic companies. This system, which persists despite various initiatives by China's central government to open investment, provides leeway for government and company stakeholders to request concessions, such as technology transfer, from foreign companies during negotiations.

  This tilting of the playing field leaves manufacturers with untenable choices: they must either transfer their technology to the new China-based joint venture, or they must cede the world's fastest-growing market to foreign competitors, thus harming both their short-term growth and their long-term competitiveness. Eliminating these types of joint venture requirements would alleviate this harmful dynamic, allowing manufacturers to leverage the full value of their IP and determine when and where to use it based on market grounds, not market-distorting government rules.

- Government-led industrial plans, policies and practices that promote technology localization: In recent years, China has released a range of policies designed to promote development of strategic industries, technologies and sectors that promote domestic technology development, technology acquisition, and technology transfer. For manufacturers, the Made in China 2025 initiative is a leading example. This ambitious ten-year plan to upgrade China's manufacturing economy sets specific targets for domestic manufacturing and technology, such as 40 percent domestic content in core components and materials by 2020 and 70 percent by 2025. Additionally, the plan identifies ten priority technology-intensive manufacturing sectors, such as information technology, new-energy vehicles, agricultural equipment and robotics. The plan's focus on building globally competitive Chinese companies through significant government policy and financial support that can be used to develop and acquire technologies raises significant questions about technology transfer and the ability of foreign companies to compete and utilize their IP fairly in China and around the world, given the global ambition of China's plan to build internationally competitive players.

  In addition to broad policies such as the Made in China 2025 plan, manufacturers face a range of industry-specific policies that encourage technology localization, including longstanding efforts to eliminate provincial and local "indigenous innovation" product catalogues, policies mandating local testing and certification for information technology and medical device products, policies offering expedited approvals or other financial benefits for locally created products and technologies in sectors such as medical

devices, and policies requiring companies to use "secure and controllable" technologies or to store China-generated data only on local servers (see below).

- Cybersecurity-related laws and measures that encourage transfer of technology and restrict cross-border data flows: China has taken steps in recent years to tighten its cybersecurity environment in ways that create trade barriers, block market access and forcing companies to use local technologies, promote inappropriate technology transfer and restrict cross-border data flows. A series of Chinese regulations issued in recent years have mandated the use of "secure and controllable" technology and software, a term that requires foreign products to disclose source code and other sensitive and proprietary information to the Chinese government. Such policies include the Cybersecurity Law, National Security Law, Counterterrorism Law, August 2016 opinions on strengthening the standardization of national cybersecurity and sector-specific provisions in banking and insurance. The Cybersecurity Law also requires foreign companies to store data collected in China on local servers and prevents them from transmitting such data outside of China. This has spurred other proposed or widely discussed measures to extend these requirements through a broad definition of critical information infrastructure that would include cloud computing, big data and other areas. Such technologies and the data flows they depend on are critical in the deployment of machine-to-machine and Internet of Things technologies that are increasingly used by manufacturers to improve their products and manage their operations.

  These provisions pressure foreign companies into transferring key technologies and data to China, including critical source code, and limit the ability of manufacturers to use increasingly important digital solutions such as cloud computing and big data analytics in China. As manufacturers increasingly rely on digital technologies and connectivity to operate, maintain and service their products globally, China's expanding restrictions on the outward flow of data represent a significant trade barrier that will negatively impact the ability of companies fully employ digital technologies to compete in that market while forcing transfer of technologies and operations to China in order to remain competitive.

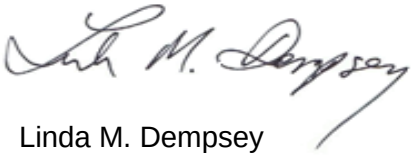
- Policies and enforcement practices in IP-related areas such as standards-setting and competition that undermine the effective value of foreign IP: Manufacturers concerned about IP and technology transfer are increasingly monitoring efforts by Chinese government agencies in broader areas such as standards and competition that impact their ability to use their IP effectively by undermining its value. For example, China has released a number of regulations over the last several years, starting with the 2007 Antimonopoly Law and including a range of guidelines from various Chinese agencies,. Manufacturers are seeking to ensure that China's competition enforcement will be fair, objective, transparent, and non-discriminatory, particularly as regulators evaluate whether the existence of IP can be considered as "market dominance" and whether officials take appropriate, internationally tested approaches to patent royalties in the competition and standards contexts.

Conclusion

As USTR conducts this investigation, the NAM urges it to consult actively and regularly with industry stakeholders. Given the potential implications of a Section 301 investigation, including both potential benefits and implications for manufacturers and their workers operating both in the United States and in China, such consultation is critical to the success of any determination made and remedies taken.

The NAM looks forward to working with USTR and your colleagues across the administration as you work to resolve concrete market-distorting actions such as forced technology transfer and other areas of IP theft. Please do not hesitate to contact either me or our lead contact on China issues, Ryan Ong (rong@nam.org), as desired to discuss these issues further. I am attaching additional NAM materials that provide greater detail on IP issues facing manufacturers in China.

Respectfully,



Linda M. Dempsey

Attachments:

- China Section of NAM 2017 Submission to USTR's Special 301 Process
- IP Section of NAM's September 2017 submission on China's WTO implementation

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China Section, National Association of Manufacturers' 2017 Submission to USTR's Special 301 Process[2]

China's increased recognition of the value of innovation and intellectual property, as reflected in high-level documents such as the 13th Five-Year Plan, has fostered more attention on IP at home and progress on IP issues in bilateral dialogues such as the 2016 Strategic and Economic Dialogue (S&ED) and Joint Commission on Commerce and Trade (JCCT). In 2016, for example, that included commitments to eliminate persistent indigenous innovation requirements in government procurement policy, address security-related IP issues in information technology policies, and cooperation on technology licensing, and addressing IP infringement over e-commerce platforms.[3] The NAM supports these outcomes and USTR efforts to ensure robust implementation of Chinese commitments related to intellectual property.

Yet there is a clear reason why China has remained on the Priority Watch List of the Special 301 report year after year: manufacturers in the United States continue to face significant IP-related challenges that stem from Chinese government policies and practices. The United States must continue to urge China to do more to create a fair innovation environment. Such an environment would allow foreign companies to develop, register, and protect IP in China on a non-discriminatory basis, while not providing unfair advantages to domestic firms or requiring them to localize their R&D or technology in China. Examples of discriminatory or otherwise harmful IP policies include China's continued position as a hub for global counterfeiting and piracy, lack of effective trade secret protection and protection for confidential business information, continued weaknesses and implementation questions on core IP laws, and indigenous innovation and industry development policies that protect domestic IP-intensive industries, and structural barriers that hinder effective enforcement of IP rights.

Counterfeiting and **piracy** remain rampant in China, which continues to be the leading source of counterfeit and pirated goods traded around the world. In 2014, 87 percent of the $1.35 billion in counterfeit goods seized at U.S. borders were from China (52 percent) or Hong Kong (35 percent).[4] Major categories of counterfeit products included medicines, consumer electronics, toys, computer accessories and other goods that could pose serious health and safety risks. IP theft in China is a serious concern for manufacturers of all sizes, but can pose an insurmountable challenge for small businesses. These firms often do not have in-house IP experts or investigators. They do not have the resources to track down and prosecute counterfeiters and pirates, and are particularly reliant on government actions to stop international counterfeiting and piracy and trade in fakes.

In China, these problems are fueled by structural policy barriers, including insufficient coordination among different agencies and levels of government, insufficient political will by officials to tackle the problem, and inadequate resources and capacity to address IP infringement. Specific value thresholds prevent criminal prosecution for IP infringement in most

[2] Full text of NAM submission is available at http://documents.nam.org/IEA/NAM_2017_Special_301_Comments.pdf.
[3] Office of the U.S. Trade Representative, "U.S. Fact Sheet for the 27th U.S.-China Joint Commission on Commerce and Trade," November 2016.
[4] Office of Trade, U.S. Customs and Border Protection, "Intellectual Property Rights: Fiscal Year 2015 Seizure Statistics," April 2016.

cases, and low administrative fines and civil damages provide little deterrence as counterfeiters and pirates often see fines merely as a cost of doing business.

While U.S. federal agencies are taking important and meaningful steps to stop international counterfeiting and piracy, including new tools provided by the Trade Facilitation and Trade Enforcement Act of 2015, those officials face a huge challenge in trying to address counterfeiting and piracy in China. Chinese counterfeiting and piracy have a broad impact here in the United States: exposing U.S. consumers to illegal or even hazardous imported products and putting critical U.S.-developed technologies at risk. For some, that risk is just too high. Smaller manufacturers, in particular, often are reluctant to or decide not to export to China for fear of losing their IP, thus cutting them out of one of the world's largest markets. The United States cannot afford to accept weak IP enforcement in China that prevents small businesses from exporting to one of the world's largest and fastest growing markets.

Fighting counterfeiting and piracy in China must not only tackle traditional physical counterfeiting markets and cross-border transit routes, but all means by which counterfeit products are circulating, including online auction sites in China such as Alibaba and Taobao that have pledged actions but have yet to address concerns for many brand-owners facing rampant counterfeiting via their platforms. Other means that must be tackled include transit of counterfeit products via inadequately policed free trade zones in markets around the world, and illegal use by overseas rogue sites and remote sellers of international mail services and airmail such as the China-based express mail service of the China Post.

Trade secret theft also remains a challenge in China, though companies have seen some positive steps, including a handful of trade secrets cases in which courts granted preliminary injunctions. China's new and specialized IP courts were created to facilitate better management of complex IP matters, including providing consistent, streamlined opportunities for IP litigants, but remain limited in terms of their scope and jurisdiction. Current actions, however, are not doing enough to help companies protect critical know-how. China must take steps to boost trade secrets enforcement, addressing evidentiary burdens and other practical barriers such as the difficulty of using judicial tools such as preliminary injunctions that in practice prevent companies from enforcing their trade secrets through China's courts. Additionally, damage awards have not adequately compensated trade secret owners against losses. A strong enforcement system is critical to deterring trade secret misappropriation and demonstrating to innovators that China takes protecting IP seriously.

Previous rounds of the Joint Commission on Commerce and Trade (JCCT) included Chinese commitments on these areas, including revisions to its Anti-Unfair Competition Law, issuance of issue model or guiding court cases, and clarification of rules on preliminary injunctions, evidence preservation orders, and damages.[5] Indeed, China's State Administration of Industry and Commerce (SAIC) in February 2016 released a draft of the AUCL for public comment that included some positive changes, including increasing administrative fines for trade secret infringement and allowing a company bringing a trade secret case to shift the burden of proof to a defendant once they can establish that infringement has probably occurred. Yet the law did not fully address other challenging areas of trade secret protection, including high evidentiary burdens, low damage awards, and limited use of judicial tools such as preliminary injunctions, and is not yet final. The NAM encourages the U.S. government to work with China to meet its

[5] U.S. Department of Commerce Office of Public Affairs, "U.S. Fact Sheet: 26th U.S.-China Joint Commission on Commerce and Trade," November 2015; Office of the U.S. Trade Representative, "U.S. Fact Sheet for the 27th U.S.-China Joint Commission on Commerce and Trade," November 2016.

JCCT commitments related to trade secrets, and to continue encouraging China to move beyond those commitments to consider legal and judicial reforms that extend beyond the confines of the Anti-Unfair Competition Law, which contains only a portion of the relevant legal provisions dealing with trade secrets issues.

The NAM welcomes efforts by China to address foreign company concerns about **indigenous innovation initiatives**, including steps to limit the use of indigenous innovation policies in government procurement, to clarify that foreign companies are eligible to participate in innovation-related government such as its semiconductor development plan. In the run-up to the 2016 JCCT, the State Council issued a formal document requiring local governments and agencies to eliminate provisions linking indigenous innovation to government procurement preferences, reaffirming a commitment made by former president Hu Jintao in 2011 and addressing one area of discriminatory treatment for innovative foreign products.[6] As with the 2011 commitment, full and robust implementation and monitoring will be key to address manufacturer concerns. Despite these developments, NAM members are monitoring closely to ensure that policies at the central and provincial level, such as the Made in China 2025 policy framework, do not unfairly protect domestic business at the expense of innovative foreign manufacturers.

China's patent system also has issues with **patent quality**, due to the lack of substantive examination for utility model and design patents. The quality of these unexamined assets is largely unknown, regularly resulting in the granting of "junk patents" that enjoy a high level of protection but often carry a low level of inventiveness. Though these patents may not have been granted if fully examined, they still carry full patent rights, allowing those who hold them to assert these junk patents against genuine innovators. The vast majority of these unexamined rights are held by Chinese domestic companies and individuals. Since no substantive review of unexamined assets is required prior to their assertion, they can represent a significant business risk to innovation-driven U.S. and Chinese companies. The NAM believes China's patent system should be reformed to address these concerns. Possible reforms could include:

- Requiring the preparation of an evaluation report for utility model patents before issuing the patent;
- Encouraging the preparation of an evaluation report for utility model patents to accompany a cease and desist letter on a utility model patent, or requiring such an evaluation report prior to filing a complaint
- Requiring the patent applicant to pay the fee for a substantive examination, regardless of who requests the examination
- Impose meaningful penalties for companies operating in bad faith by threatening competitors or customers with unexamined or rejected utility model patents.

Manufacturers in the United States are also closely watching the **ongoing revisions to key areas of the IP legal framework**, such as the Patent Law and the Copyright Law, which may impact the ability of manufacturers to register and protect their IP in China. With the Patent Law, for example, a number of outstanding questions remain related to administrative patent enforcement authority, the role of local patent authorities in enforcement, and vague language related to IP abuse that could pose challenges for companies to exercise their patent rights.

Other legal revisions already completed, such as the **Trademark Law** and its implementing regulations, continue to increase the risk that brand owners will be held hostage to pirates

[6] US-China Business Council, Update: China's Innovation & Government Procurement Policies, May 2015

registering marks in bad faith or to other parties infringing upon their legitimate trademarks. For example, if a trademark owner opposes a third-party application to register a mark and loses, they cannot appeal that decision under the new Trademark Law, and the registration is granted. The trademark owner must then go through another timely and costly proceeding to seek invalidation of that mark, and if the registered mark is identical to the trademark owner's prior yet unregistered mark, the owner must either halt its use of the mark or risk an enforcement action. Other trademark issues facing manufacturers remain unaddressed by the latest revised law, including persistent issues of trademark squatting in China. This is a longstanding challenge for manufacturers, particularly SMMs, exacerbated by China's "first to file" system (which prevents consideration of prior unregistered use of a trademark) and a high standards for well-known trademarks (requiring the mark to be well-known to the average consumer across China) that often serves as a *de facto* bar for many foreign companies.

Manufacturers are also closely monitoring China's increasing incorporation of IP rules into other areas of regulation, sometimes in ways that raise significant concerns for manufacturers and questions about their consistency with WTO obligations. For example, China continues to give special, unwarranted attention to **IP in the context of competition**, with a number of outstanding guidelines designed to regulate "IP abuse," including draft Anti-Monopoly Guidelines on Abuse of IP Rights released by the State Council Anti-Monopoly Commission and the National Development and Reform Commission.[7] These policies raise concerns about how Chinese regulators may treat the legitimate exercise of IP in consideration of competition concerns. These regulations should align with international best practices and with specific Chinese commitments made in bilateral dialogues to ensure that competition enforcement is "fair, objective, transparent, and non-discriminatory." China should explicitly recognize that the existence of IP does not equate to market power. In instances where competitive concerns may genuinely be raised by bad behavior, the appropriate remedy should be to address that behavior, not to curtail IP.

China's **IP-related standard-setting practices** continue to cause significant concern. As part of its National Intellectual Property Strategy, China has focused on improving its standards-related policies. China moved in that direction in 2013 with revised Regulatory Measures on National Standards Involving Patents that removed some problematic language related to the handling of IP in standard-setting processes. Participation in standard-setting activities, however, remains a question for some companies: manufacturers still can only participate in China's standard setting processes by invitation, putting them at a disadvantage relative to their Chinese competitors.[8] These gaps are particularly noticeable in areas of manufacturing such as information technology.

IP licensing also remains an issue for many companies, due to challenges they face licensing technology into China even to their own subsidiaries. In a move clearly aimed at encouraging businesses to develop technology locally, China's 2001 Technology Import-Export Administrative Regulations impose greater risks and liabilities on overseas technology licensors than on domestic licensors. For example, unlike a domestic licensor, an overseas licensor is liable for infringing a third party's rights due to the licensee's use of the licensed technology, and also could not own technology improvements developed by the licensee. This puts

[7] These rules follow similar IP abuse rules already formulated and finalized by the State Administration of Industry and Commerce in April 2015.
[8] This is particularly significant as the draft Rules limit the ways patents that relate to standards can be used, regardless of participating in the relevant standard body. See State Administration of Industry and Commerce of China, Regulations on the Prohibition of Abuse of Intellectual Property Rights to Eliminate and Restrict Competition (IP Abuse Rules), June 2014.

manufacturers based abroad at a significant competitive disadvantage. China at the 2016 JCCT stated that they are actively researching potential revisions to these regulations to address U.S. concerns, and plans to convene a joint seminar with the United States in the first quarter of 2017. The NAM encourages the U.S. government to hold China to that commitment.

Protection of sensitive business information is also a question for many NAM members operating in China. Similarly, companies report instances in which customs officials in **China** press importers of certain chemical formulations to supply proprietary information, including the name and percentage of each specific monomer as a condition of customs clearance.

China continues to draft a new regulation on "**service inventions**" that are created during an inventor's employment, though there have been no new updates in several months. If passed, the regulation could damage the ability of manufacturers to make commercial choices about how best to exploit IP derived from inventions in China, and increase not only legal and financial risks but the cost of research and development operations in China, making China a less attractive location for manufacturing R&D. Progress was made last year, however, with revisions that mean the regulations would no longer apply to technical secrets.

The United States and China made important commitments at the December 2014 JCCT related to **geographical indications (GIs)**, an important area of IP protected as a trademark broadly around the world, including in the United States. Those pledges covered the importance of relationships between GIs and trademarks, recognition that generic terms are not eligible for GI protection, and the importance of GI opposition and cancellation proceedings, and a commitment to further dialogue on these issues. The United States and China should continue to engage actively on these issues both in bilateral discussions and as the two countries engage with other trading partners.

Finally, patent filers in the pharmaceutical industry continue to face patentability and patent invalidation issues related to ongoing restrictions on submitting **supplemental data**. China's State Intellectual Property Office does not consistently accept data generated after a patent is filed during patent prosecution to describe inventions or satisfy inventive step requirements. Such a practice deviates from the world's other busiest patent offices, including patent offices in the United States, Europe, Japan and Korea: meaning that patents accepted in these locations can experience problems in China. China's State Intellectual Property Office in 2016 issued draft Patent Examination Guidelines that would require examiners to consider post-filing experimental data – a shift that appears intended to implement its December 2013 U.S.-China Joint Commission on Commerce and Trade (JCCT) commitment to allow patent applicants to submit additional data after filing patent applications. The NAM hopes that the final guidelines, when released, reflect this change as well as other feedback received from industry groups.

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Intellectual Property Section, National Association of Manufacturers' 2017 Submission on China's Implementation of its World Trade Organization (WTO) Commitments[9]

China has recognized the vital role that innovation and IP protection play in economic development and encouraging more foreign investment, with strong language on innovation in key high-level documents such as the December 2014 National IP Rights Strategy (2014-2020), the 2015 13th Five-Year Plan (2015-2020) and the 2015 State Council *Opinions on Accelerating the Construction of a Strong IP Country under a New Situation*. China's position as the world's top patent office in terms of number of patent applications and patent grants also reflects growing interest in intellectual property. Yet while China's increased recognition of the value of innovation has fostered progress on IP issues in recent bilateral dialogues, the United States must continue to urge China to do more to create a fair innovation environment. Such an environment would allow foreign companies to develop, register and protect IP in China on a non-discriminatory basis, while not providing unfair advantages to firms that develop IP in China.

IP protection in China is a priority for manufacturers of all sizes. Among the primary issues that manufacturers in the United States face are troubling IP-related policy developments and inadequate IP enforcement. These problems are particularly acute for small and medium-sized manufacturers that lack the resources to track down and prosecute counterfeiters and pirates and often do not have in-house IP experts or investigators.

Core Legal Framework

China's overall legal framework for IP protection and enforcement is fairly robust, and comprehensively covers core areas of IP, such as patents, trademarks, copyrights and trade secrets. Yet China's core IP laws and regulations still contain key weaknesses, and the spread of IP into other areas of law (such as competition and standards) have raised critical questions for manufacturers in a variety of areas.

Trade secrets reflects one are of weakness in China's laws and regulations. Trade secrets remain under the Anti-Unfair Competition Law (AUCL), last revised in 1993. In February 2016, after years of efforts by the U.S. government and others to encourage China to draft an updated, standalone trade secrets law, the State Administration of Industry and Commerce (SAIC) finally decided to act, releasing a draft of the AUCL for public comment. Those revisions have continued to evolve, with the NPC releasing the latest draft for public comment in September 2017.

The latest draft of the AUCL proposes some positive changes, including increasing administrative fines for trade secret infringement and expanding the scope of trade secret protection to include behaviors by current and former employees, and removes some earlier problematic language on issues such as abuse of a company's dominant market position. Yet manufacturers continue to have questions about various provisions and whether the draft will

[9] Full text of NAM submission is available at http://documents.nam.org/IEA/NAM_2017_Submission_on_China_WTO_Compliance.pdf.

address effectively problematic areas of trade secrets enforcement, such as high evidentiary burdens, low damage awards and limited use of judicial tools such as preliminary injunctions. The United States should continue to engage China to improve effective protection for trade secrets through multiple means, including improving judicial practices and advancing legal reforms that include not only the AUCL but also other laws and regulations that also impact trade secrets enforcement. Additionally, China must take additional steps to address concerns about regulator requests for trade secrets and confidential business information, including limiting requests to legitimate regulatory purposes and providing clear protection for any such data required by regulators.

The most recent version of the Trademark Law and its implementing regulations have also raised concerns for companies, as they increase the risk that brand owners will be held hostage to pirates registering marks in bad faith or to other parties infringing upon their legitimate trademarks. For example, if a trademark owner opposes a third-party application to register a mark and loses, they cannot appeal that decision under the new Trademark Law, and the registration is granted. The trademark owner must then go through another timely and costly proceeding to seek invalidation of that mark, and if the registered mark is identical to the trademark owner's prior yet unregistered mark, the owner must either halt its use of the mark or risk an enforcement action. Other trademark issues facing manufacturers remain unaddressed by the latest revised law, including persistent issues of trademark squatting in China. This is a longstanding challenge for manufacturers, particularly SMMs, exacerbated by China's "first to file" system (which prevents consideration of prior unregistered use of a trademark) and high standards for well-known trademarks (requiring the mark to be well-known to the average consumer across China) that often serves as a *de facto* bar for many foreign companies.

Manufacturers in the United States are also closely watching the ongoing revisions to other core IP laws, such as the Patent Law and the Copyright Law, which may impact the ability of manufacturers to register and protect their IP in China. With the Patent Law, for example, a number of outstanding questions remain related to administrative patent enforcement authority, the role of local patent authorities in enforcement, and vague language related to IP abuse that could pose challenges for companies to exercise their patent rights.

Similarly, manufacturers are monitoring implementation of Chinese commitments made through bilateral dialogue on trademark-related areas such as geographical indications (GIs), including mutual pledges on the importance of relationships between GIs and trademarks, recognition that generic terms are not eligible for GI protection and the importance of GI opposition and cancellation proceedings. Monitoring of the latter is particularly important given European Union efforts to negotiate a new trade agreement with China.

Other IP-Related Legal and Regulatory Areas of Concern

Manufacturers are also closely monitoring China's increasing incorporation of IP rules into other areas of regulation, sometimes in ways that raise significant concerns for manufacturers and questions about their consistency with WTO obligations. Such areas include standards, competition and industry development.

One key example is China's drive to promote economic development through "indigenous innovation," which is often interpreted as innovation by Chinese firms in China, at the expense of foreign companies, products and technologies. The United States and other national governments have pushed back repeatedly to halt or force revisions to discriminatory innovation policies, including incentives provided under China's Strategic and Emerging Industries (SEIs)

program and efforts to create a national catalogue of indigenous innovation products that would be eligible for various government incentives. Despite these efforts, manufacturers in the United States continue to face problematic indigenous innovation policies, including language in policies discussed in the "Localization Policies" section such as "Made in China 2025," the Cybersecurity Law, and others, and provincial and local catalogues of indigenous innovation products that largely exclude foreign products.

Additionally, China has released a flurry of recent draft regulations, including draft guidelines from the State Council Anti-Monopoly Commission, National Development and Reform Commission and State Administration of Industry and Commerce, that raise concerns about how Chinese regulators may treat the legitimate exercise of IP in relation to competition. Manufacturers in the United States are concerned with whether China will ensure that competition enforcement will be "fair, objective, transparent and non-discriminatory," and that regulators do not interpret inappropriately the existence of IP as market dominance that is subject to competition to proceedings.

The NAM also encourages U.S. government officials to consider other priority issues raised in the NAM's Special 301 submission for their WTO relevance, including IP licensing, China's draft "service invention" regulations, issues related to patent quality and acceptance of supplemental data for pharmaceutical patents. The NAM additionally notes that while China's current regulatory data protection system is ineffective and has certain limitations, the China Food and Drug Administration (CFDA)'s May 2017 draft *Policies Related to Encouraging Innovator Rights and Interests in Drug and Medical Device Innovation Protection* (Circular 55) proposes a new structure for regulatory data exclusivity that could address certain issues. Manufacturers in the health industry are watching closely for additional details from CFDA.

IP Enforcement

Counterfeiting and piracy remain rampant in China, which continues to be the leading source of counterfeit and pirated goods traded around the world. In 2014, 87 percent of the $1.35 billion in counterfeit goods seized at U.S. borders were from China (52 percent) or Hong Kong (35 percent).[10] Moreover, many U.S. manufacturers report challenges with Chinese suppliers or companies copying their products and designs to manufacture and sell virtually identical versions of their products in China and third-party markets under their own brand names.

IP theft in China is a serious concern for manufacturers of all sizes, but can pose an insurmountable challenge for small businesses. These firms often do not have in-house IP experts or investigators. They do not have the resources to track down and prosecute counterfeiters and pirates, and are particularly reliant on government actions to stop international counterfeiting and piracy and trade in fakes. Many of these members often are reluctant to or decide not to export to China for fear of losing their IP, thus cutting them out of one of the world's largest markets.

In China, these problems are fueled by structural policy barriers, including insufficient coordination among different agencies and levels of government, insufficient political will by officials to tackle the problem and inadequate resources and capacity to address IP infringement. Specific value thresholds prevent criminal prosecution for IP infringement in most cases and low administrative fines and civil damages provide little deterrence as counterfeiters

[10] Office of Trade, U.S. Customs and Border Protection, "Intellectual Property Rights: Fiscal Year 2015 Seizure Statistics," April 2016.

and pirates often see fines merely as a cost of doing business. Other specific legal changes that could tackle counterfeiting, such as broadening the definition of “bad faith” trademark filings to include efforts to register a trademark knowingly being used by a competitor, remain unaddressed.

Fighting counterfeiting and piracy in China must not only tackle traditional physical counterfeiting markets and cross-border transit routes, but all means by which counterfeit products are circulating, including online auction sites in China such as Alibaba and Taobao that have pledged actions but have yet to address concerns for many brand-owners facing rampant counterfeiting via their platforms. Other means that must be tackled include transit of counterfeit products via inadequately policed free trade zones in markets around the world, and illegal use by overseas rogue sites and remote sellers of international mail services and airmail such as the China-based express mail service of the China Post.

Companies also face challenges with patent and trade secret enforcement. China’s specialized IP courts were created to facilitate better management of complex IP matters, including providing consistent, streamlined opportunities for IP litigants, but remain limited in terms of their scope and jurisdiction. Through both legal reforms (see “Core IP Laws and Regulations”) and changes to practice, China must take steps to boost patent and trade secret enforcement, addressing evidentiary burdens and other practical barriers, structural challenges that limit damages and remedies and boost access to judicial tools such as preliminary injunctions. A strong enforcement system is critical to deterring trade secret misappropriation and demonstrating to innovators that China takes protecting their intellectual property seriously.