

**Testimony of the Honorable Dave McCurdy,
President and CEO, Electronic Industries Alliance
before the
U.S.-China Economic & Security Review Commission**

**Hearing on
China's Enforcement of Intellectual Property Rights;
and the Dangers of the Movement of Counterfeited and Pirated Goods
into the United States**

June 8, 2006

Thank you, Mr. Chairman, Commissioner Houston and members of the Commission. I am appearing before you today as the President and Chief Executive Officer of the Electronic Industries Alliance (EIA), which is an alliance of several trade associations representing nearly 1,300 companies from the full spectrum of U.S. technology manufacturers. Our member companies' products and services range from the smallest electronic components to the most complex systems used by defense, space and industry, including consumer electronics and telecommunications equipment.

I appreciate the opportunity to come before you to discuss the issue of intellectual property protection in China. I know the Commission is aware of what a growing problem this is. China is now our third-largest trading partner. Last year American firms exported \$42 billion in goods and services to China, and exports rose 40% in the first quarter of this year, with high-tech products such as medical and scientific equipment and semiconductors among the fastest-rising major products.

But for firms that, fundamentally, trade not in tangible things but in innovation, China can be a risky place to do business. China's share of infringing goods seized at the U.S. border is more

than 10 times greater than that of any other U.S. trading partner – and that doesn't even reflect the goods that never leave the country.

We have seen some small indications that the Chinese government is taking intellectual property more seriously. There has been progress – a very tiny amount – but not nearly enough. The truth is that China has no strong tradition of protecting intellectual property rights. Until it does, the abundant rewards of trade with China will always be tempered by equally abundant risks.

The concerted effort begun by the Chinese government in recent months to encourage homegrown innovation and lessen the country's economic development reliance on imported technology is in some ways a double-edged sword. On one hand, it is encouraging that the government wants China to develop its own commercial technologies, because the most effective way to foster true enforcement of IPR protection is for domestic entrepreneurs and small businesses to have a real stake in the system. It is impossible for someone to take enforcement seriously if they have nothing of their own to protect. Encouraging innovation rather than mandating technology and standards is a definite step in the right direction of lowering non-tariff trade barriers.

On the other hand, the pressure from the government for researchers and technology developers to produce the demanded domestic successes has led to at least one alarming scandal uncovered just a few weeks ago, in which the dean of a leading university's Microelectronics School falsely claimed to have developed a "domestic" computer chip. In fact, the research behind the series of digital signals processing chips he introduced was allegedly faked, and the chips were revealed to be those of Freescale Semiconductor – an EIA member company – from which the trademarks had been scrubbed and replaced. The good news is that Shanghai's Jiaotong University dealt

quickly and severely with the situation, firing the dean, ordering him to pay back research funds he had received, and banning him from future state research projects. But the fact that domestic scientists are under such intense pressure to demonstrate China's domestic capability quickly is cause for some concern and something we must monitor.

Later this year, Research in Motion will launch its BlackBerry service in China, after two years of negotiation, bureaucracy and red tape from the state. Two years, as it turns out, was long enough for China Unicom, a state-controlled telecommunications company, to come out with its own "push-mail" service. They launched it in April. They call it the RedBerry. Never let it be said that the Chinese don't have a sense of humor.

RIM, which is another EIA member, did everything right. They worked with the Chinese government and they worked within the rules. They also knew that, despite all their efforts, they were taking a risk.

What exactly happened is not clear. But this case will not help the perception that the Chinese government bends and contorts the rules to support local and sometimes state-owned companies. The last few years have brought major reform to China's intellectual property laws. But China is still not enforcing these laws consistently.

Another of our members had a worse experience. After acquiring a high-end audio equipment manufacturer, the company began production in China. It also started registering its trademark internationally. But in China, Korea and Thailand it found that the trademark had already been registered. It soon discovered that another company was producing counterfeit products using its trademark.

The company found out the hard way about China's "first-to-file" trademark system. It also found out how difficult it can be to prosecute intellectual property infringement in China. It was advised that it would take at least three years to have the mark cancelled, and as much as five if the counterfeiter appealed. It was also informed that in order to proceed with administrative action, it would have to disclose its Chinese manufacturing partner. When it did, the Chinese manufacturer would be subject to an injunction from the counterfeiter.

Two years later, the U.S.-based company has not made much progress. The counterfeiter, on the other hand, has expanded into Singapore and Malaysia, even though in these countries the U.S. company has registration rights.

Let me say that I believe very strongly in the rewards of trading with China. When we combine Chinese markets with American innovation, the result is better, cheaper products for American consumers. In fact, with China's market liberalization, it means better, cheaper products for new Chinese consumers too. And history has shown us that economic liberalization is often the first step to political liberalization.

Obviously, we cannot simply ignore a country that has more than a sixth of the world's potential consumers. But even if we could, the opportunities of greater access to the Chinese market are proving themselves day after day.

Yet many companies are learning that the opportunities in China go hand in hand with certain risks. U.S. firms must do business within a complicated and sometimes unpredictable legal framework. A sound, transparent legal system is perhaps the most important ingredient of a flourishing free market. Until people feel they can count on their legal system, they will not be willing to make the investments that a vibrant market demands.

In China, they have made some strides toward this ideal – some of them remarkable strides, considering the country’s history. But they still have a long way to go. Nowhere is this more apparent than in the realm of intellectual property rights.

As the Chinese say, one cannot refuse to eat just because there is a chance of being choked.

While the opportunities found in China are abundant, many firms have indeed been choked there – by regulation, by state bureaucrats, by uneven application of the law or simply by an unfamiliar legal system and customs.

There are two approaches that EIA is taking to help more firms succeed and thrive in the Chinese market. The first is self-help. U.S. companies must learn to navigate the Chinese legal system and local customs to protect their intellectual property. The second is encouraging the U.S. government to continue putting pressure on China to reform its laws and enforce them transparently and consistently.

Let me start by talking about how companies can learn to help themselves. According to another Chinese proverb, experience is a comb that nature gives to men when they are bald. By now, thousands of U.S. firms have had experiences in China – many good, some bad. EIA is working to ensure that more companies receive the benefit of that experience before – as the proverb has it – they go bald.

To this end, EIA published in April a best practices guide entitled *Protecting Intellectual Property Rights in China* and sent it to senior executives at each of our nearly 1,300 member companies. The guide was a collaboration between EIA and the China Alliance, which is a partnership of four North American law firms: Armstrong Teasdale of Missouri, Blake Cassels &

Graydon of Canada, Butzel Long of Michigan and Michael Best & Friedrich of Wisconsin with a collective team of legal experts on China.

The best practices guide was produced under the supervision of Charles Freeman, the China Alliance's managing director. The Commission is no doubt very familiar with Mr. Freeman from his previous role as the Assistant U.S. Trade Representative for China Affairs; he knows the issues U.S. companies face there. We're very proud of the guide and I feel confident that many small and mid-sized U.S. businesses will benefit from the wisdom and experience found in its pages.

I would like to briefly take you through some of the recommendations in the best practices guide because they illustrate the challenges high-tech firms face when they do business in China. Many of these measures would be unnecessary – perhaps even unthinkable – in the U.S. or other developed markets. I think the most important message of the guide, though, is that in many ways there are *no* markets like China. The companies that have been the most successful are those that have anticipated the immense legal, political and cultural differences between China and the U.S..

The first challenge is that counterfeiters and pirates do not honor borders. For this reason, any business may be at risk from China's ineffective intellectual property protections, whether they interact with the Chinese market directly or not. In a global world, intellectual property piracy is a global problem. This is why the U.S. and other countries pursue global solutions – global solutions that China often implements half-heartedly if at all. Until China can be considered a full partner in intellectual property protection, all businesses will have to factor it in to their plans. Trade with China is optional; planning for China is not.

For those companies that do decide to do business in China, the unfortunate reality is that they all must expect intellectual problems eventually. The problem may originate from suppliers or other Chinese manufacturers. It may come from former employees.

It may even come from state-sponsored reverse-engineering programs. In March, China's railway ministry proudly announced two new, high-speed railway lines. Government officials announced that the new railways would use only Chinese technology. How did China achieve this Great Leap Forward in transportation technology? Railroad minister Liu Zhijun explained it to the Chinese press: "Our technology is a re-innovation on the basis of assimilating advanced technologies of foreign countries."

"Re-innovation," whether by the state or by other local businesses, is a fact of life in today's China. As EIA's guide recommends, companies must expect and plan for the worst, even as they hope to be pleasantly surprised.

Many of the measures that our guide recommends have little to do with Chinese law. No matter what part of the world you're talking about, it makes sense to try to ensure that no one has the full picture of a company's valuable intellectual property. Companies should keep their IP on a need-to-know basis. They should also ensure that one direct company employee is on site at all times. Finally, when there are problems, businesses will be more likely to secure favorable outcomes if they are known in China to be good corporate citizens.

So businesses that choose to produce or sell in China must protect themselves against intellectual property theft. But we believe that self-help is not enough. That's why we are asking Congress and the Administration to continue putting pressure on the Chinese government.

As a new market and an ever more important trading partner, China holds great promise. But there are still many challenges that U.S. companies face in doing business there. Sometimes the opportunities outweigh the risks; other times, firms run into serious trouble in China. In every case, the Chinese market will never meet its full potential until it is governed by a sound and transparent legal system, particularly in terms of intellectual property rights. Congress and the Administration have a great opportunity now to put pressure on the Chinese government to reform its intellectual property laws and enforce them more vigorously and consistently. Once that happens, the benefits to the American economy and indeed the Chinese economy will be immense.

The recent announcement in USTR's annual Special 301 report that it will begin a provincial-level review of China's IPR protection and enforcements efforts is a welcome one. I can relate from personal experience just how apt is the saying "The mountains are high, and the Emperor is far away." On one of my trips to China, I had the chance to sit in on a speech made by a local Qingdao official of the State Intellectual Property Office. Since he was speaking to an auditorium of local businessmen and Chinese government officials, perhaps I should have expected the candor with which he spoke, but my jaw still dropped when I heard off-message rhetoric that enforcement of trademark, patent and copyright laws could lead to monopolies by foreign multinationals, that different economic development levels call for different standards of enforcement, and that better enforcement could not come at the expense of domestic innovators. That is certainly not the language we hear from Vice Minister Wu Yi and other Beijing officials working to improve China's record. I believe in the sincerity of the people at the top, but it is clear that there is a great deal of work to be done at the local and provincial level, and we appreciate USTR's recognition of this fact.

EIA has placed the issue of intellectual property rights in China at the top of its priority list, and we coordinate on a regular basis with Chris Israel, Tim Stratford and other officials at the Commerce Dept., USTR, the Patent & Trademark Office and other agencies working to further this cause. We are actively engaged in the industry-led Coalition Against Counterfeiting and Piracy, which is doing excellent work to develop best practices, pool corporate resources, coordinate with the Administration and lobby Congress for new, effective legislation on the IPR front.

I am grateful for the opportunity to present EIA's perspective on this critical issue to the Commission, and on behalf of all of our member companies, thank you.