March–April 2009

The China Business Review

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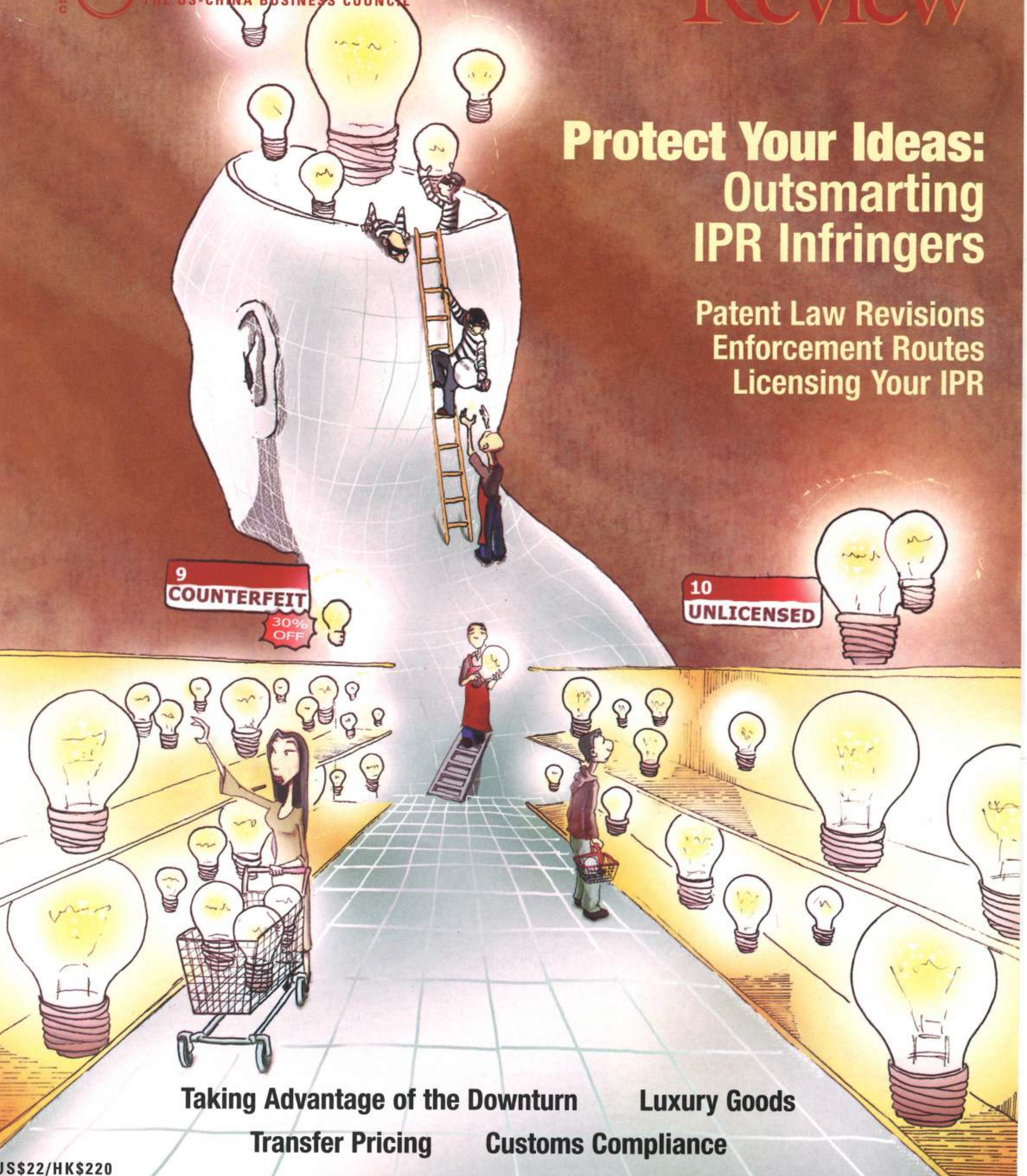

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March–April 2009 Volume 36 Number 2

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The China Business Review

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Focus: Intellectual Property

Cover design by Jason Pym

Features

Departments

Online Exclusive

How Microsoft handles its IP in China

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Letter from the Editor

This year, the *China Business Review's (CBR)* 35th anniversary, we are looking back at the magazine's first year. The March–April 1974 issue featured articles on Sino-Japanese cooperation, the Fourth Five-Year Plan (1971–75), dispute resolution, agriculture, and negotiating for bristles, as well as a table of top US imports and exports from China. (In case you were wondering "why bristles?", "materials of animal origin [primarily bristles]" was the number-two import from China in 1973.) The issue also carried practical information, such as postage rates to China, rail and airline schedules, and English-language broadcasts received in Hong Kong and Guangzhou.

Most relevant to this issue are the concerns about intellectual property (IP) raised in the article on Sino-Japanese cooperation:

> *There is also the question of patent rights. China is not party to the Paris Convention to protect industrial properties. Nevertheless, Peking has indicated readiness to negotiate a separate agreement on trademarks alone with Japan. But little progress has so far been made....*
>
> *...There have been cases...in which the Chinese were discovered to have copied machinery imported from Japan.... [S]ome Japanese manufacturers are afraid the industrial techniques they supply to China may be exported to third countries contrary to original agreements. China has a law which encourages inventions and research. But under this law, most of the benefits of these inventions and profitable research go to society. Incentives for individuals are very limited. However, China appears to be prepared to pay for the research and development efforts achieved by foreign corporations and for patented industrial techniques. Between 10 percent and 20 percent of payments for nine petrochemical plants sold by Japan to China last year represented compensation for patent rights.*
>
> *Japanese businessmen have discovered it is possible to obtain payment for patent rights involved in each plant built in China or to conclude long-term royalty agreements of five to seven years for use of patent rights. Such arrangements usually contain provisions that technological secrets must not be disclosed to third parties. However, Japan and other advanced industrial countries would like China to join international arrangements for protection of industrial property rights.*

In the intervening years, the protection of IP in China has improved immensely, but some concerns remain. China has signed the Paris Convention and many other international IP agreements. It has also built a legal framework to protect IP. On the other hand, enforcement remains weak, and companies still worry about bringing their proprietary technologies to China. In this issue, we look at the current state of IP rights in China with articles on the various options for dealing with IP violations, recent revisions to the Patent Law, provisions in the Antimonopoly Law that touch on IP, and an interview with the former IP attaché at the US Embassy in Beijing.

Virginia Hulme

Short Takes

Employment

Prompted by slow economic growth, factory closures, and worker layoffs, the PRC government recently announced plans to assist job-seeking college graduates, a demographic that is expected to grow by more than 6 million in 2009. According to Xinhua News Agency, the government will offer job training, exemptions at state-owned enterprises for job application fees, student loan-debt forgiveness for graduates who work in rural areas or join the military, and preferential loans for companies that hire new graduates and for graduates who start their own businesses. The State Council is also encouraging all levels of government to prioritize employment of laidoff and migrant workers.

The State Council has asked all cities—except Beijing, Chongqing, Shanghai, and Tianjin—to suspend residential permit (*hukou*) requirements for college graduates. The move is aimed at making it easier for graduates to find work. Shanghai and Shenzhen may revise their *hukou* systems to make it easier for long-term residents to gain resident permits.

To further slow the pace of layoffs, the State Council in February announced new requirements for enterprises that wish to reduce their workforce by more than 10 percent or by more than 20 workers. Enterprises meeting this layoff threshold must now notify all staff or report workforce-reduction plans to the local human resources and social security bureau at least 30 days before they take effect.

Trade

Total US-China trade reached $409.3 billion in 2008, up 5.8 percent over 2007. US exports to China hit $71.5 billion in 2008, up 9.5 percent from 2007, but significantly slower than in 2006 and 2007, when they grew 32.0 percent and 18.1 percent, respectively. Last year, imports rose 5.1 percent to $337.8 billion, or 7.6 percentage points less than in 2007. China now accounts for one-third of the US trade deficit.

In other noteworthy trade developments, Sino-African trade hit $106.8 billion in 2008. On average, trade between China and Africa has grown 30 percent annually since 2000, according to the PRC Ministry of Commerce. Sino-EU trade dropped 4.3 percent to $32.7 billion.

Bilateral Relations

US Secretary of State Hillary Clinton capped her first overseas visit to Asia with meetings in Beijing on February 21–22. She met with senior PRC leaders, including PRC President Hu Jintao.

During meetings, Clinton assured China's leadership of the importance of the bilateral relationship to the Obama administration. She also discussed the structure for a new bilateral dialogue, laid the groundwork for the April G-20 meetings in London, and explored opportunities for cooperation on environmental issues and climate change, which could be a central part of the secretary's China initiative.

Drought

China's worst drought in 50 years began in November 2008. The drought has affected 161 million mu (25.5 million acres) and more than 40 percent of China's wheat land, seriously damaging crops in eight northern and central provinces.

In early February, the central government declared a state of emergency and earmarked ¥400 million ($58.5 million) in drought relief to local governments. It also sought to minimize the drought's impact by subsidizing farmers' purchases of irrigation equipment, deploying soldiers to assist with irrigation, and seeding clouds with silver iodide to artificially trigger rainfall. Despite winter harvest losses, Vice Minister of Agriculture Wei Chao asserted that China had enough grain reserves to keep grain prices relatively stable.

Transportation

In January, China's domestic auto sales surpassed US auto sales for the first time. Despite a 14 percent drop in sales, China still sold 736,000 autos, according to the China Association of Automobile Manufacturers. Meanwhile, US sales plummeted 37 percent to 657,000 autos. China's auto market grew 6.7 percent in 2008, contrasting sharply with the 18 percent contraction of the US auto market last year.

To bolster transport and related sectors, the PRC government has announced several stimulus measures. The PRC Ministry of Finance recently confirmed the launch of trial programs that will subsidize government purchases of energy-saving vehicles. Moreover, Xinhua News Agency recently reported that China's farmers will receive ¥5 billion ($731 million) in subsidies to purchase minibuses with engine sizes of 1.3 liters or less. The PRC Ministry of Railways plans to spend roughly ¥1.5 trillion ($219 billion) in the next three years on railway infrastructure, and the ministry has already ordered 3.25 million tons of steel—72.9 percent more than it bought in 2008. The State Council also announced a stimulus plan for the shipbuilding industry. (For more information on China's stimulus spending projects, see p.12.)

In mid-February, AVIC Commercial Aircraft Co., Ltd. signed contracts with four other factories to begin mass production of the ARJ21-700, the country's first domestically developed regional jet. According to AVIC's website, the jet has a standard range of 2,225 km.

China Conference Calendar

China-related events near you

March–June 2009

Please confirm dates and venues with the organizer prior to attending events. To suggest an entry for the next issue, send an announcement to Jesse Marth (jmarth@uschina.org). You can also post listings and view additional entries on the *China Business Review's* website at www.chinabusinessreview.com/conference-calendar.php.

Aquatech China, June 3–5

International Medical Instruments & Equipment Exhibition

MARCH 19–21

Location: Beijing: China International Exhibition Center
Organizers: People's Liberation Army, Health Department of the General Logistics Department; China World Trade Center Co. Ltd.; Hui Tong Xing Ye International Exhibition (Beijing) Co., Ltd.; Messe Dusseldorf China Ltd.
Contact: Jiang Ling
Tel: 86-10-6505-1018
jiangling@cwtc.com
www.chinamed.net.cn/en

Trade Tech China: Institutional Equity Trading

MARCH 23

Location: Shanghai: Pudong Shangri-La
Organizer: Worldwide Business Resources
Contact: Ivy Ng
Tel: 65-6408-9207
ivy.ng@wbresearch.com
www.wbresearch.com/tradetechnorthasia

Brazil, India & China Customs Compliance

MARCH 24–26

Location: San Francisco, CA: Sheraton Fisherman's Wharf
Organizer: American Conference Institute
Contact: Virna DiPalma
Tel: 1-212-352-3220 x480
v.dipalma@americanconference.com
www.americanconference.com/globalcustoms.htm

China International Clothing & Accessories Fair

MARCH 26–29

Location: Beijing: New China International Exhibition Center
Organizers: Beijing Fashion Expo Co., Ltd; Beijing Convention & Exhibition Co.; China World Trade Center Co., Ltd.
Contact: Zeng Qi
Tel: 86-10-6505-0546
zengqi@cwtc.com
www.chiconline.com.cn/eindex.aspx

Ultra High-Rise Building Summit

MARCH 26–27

Location: Shanghai World Financial Center
Organizer: JFPS Group
Contact: Fanny Wang
Tel: 86-21-5160-8811
marketing@jfpsgroup.com.cn
www.ultrahighrisebuilding.com

Asia Pacific Business Outlook Conference

APRIL 6–7

Location: Los Angeles, CA: University of Southern California
Organizers: USC Marshall School of Business; US Department of Commerce
Contact: Eric Chow
Tel: 1-213-740-7130
ciber@usc.edu
www.apbo2009.com

Global Construction Technologies & Building Materials

APRIL 6–7

Location: Beijing: Grand Hyatt
Organizer: Marcus Evans
Contact: Cindy Cluny
Tel: 60-3-2723-6745
cindyc@marcusevanskl.com
www.marcusevans.com

Busworld Asia

APRIL 8–11

Location: Shanghai New International Expo Center
Organizers: B.A.A.V.; China Civil Engineering Society of China, Public Transport; VNU Exhibitions Asia
Contact: Isabel Hu
Tel: 86-21-6247-7668 x911
busworldasia@vnuexhibitions.com.cn
www.vnuea.com/busworld

International Solar Energy and Photovoltaic Exhibition

APRIL 13–15

Location: Shanghai International Exhibition Center
Organizer: Shanghai Newgrace Exhibition Planning Co., Ltd.
Contact: Dong Zhen
Tel: 86-21-3408-0282
nuogaisi@126.com
www.ch-solar.com

The Yangtze Business Network: The Logistics Challenges of Accessing China's Interior

APRIL 15

Location: Shanghai: Regal International East Asia Hotel
Organizers: Yangtze Business Services, Ltd.
Contact: David Lammie
Tel: 44-20-8874-3217
info@yangtzebusinessservices.com
www.yangtzebusinessservices.com/conference-2009.aspx

China Import & Export Fair

APRIL 15–MAY 7

Location: Guangzhou, Guangdong: China Import and Export Fair Complex: Phase I (Apr. 15–19), Phase II (24–28), Phase III (May 3–7)
Organizers: PRC Ministry of Commerce; China Foreign Trade Center
Tel: 86-20-2608-8888
webmaster@cantonfair.org.cn
www.cantonfair.org.cn

International Cooperation Forum on Resource and Environment

APRIL 17–18

Location: Changsha, Hunan: Tianwen Square of the Orange Isle
Organizers: PRC Ministry of Environmental Protection; All-China Federation of Industry and Commerce; China Society for Promotion of the Guangcai Program; China Enterprise Confederation; Hunan Provincial Government
Tel: 86-731-221-8125
forum@hunan.gov.cn
http://enghunan.gov.cn/forum2009

China Conference Calendar

Tianjin Investment Trade Talks & World Original Commodity Trade Fair

APRIL 18–22

Location: Tianjin: Tianjin International Exhibition Center
Organizers: Tianjin Commission of Commerce; Tianjin Foreign Economic Trade & Exhibition Co., Ltd.
Contact: Gong Jing
Tel: 86-22-2353-7159
tjzlgs@yahoo.com.cn
www.origination.org.cn/en

International Exhibition on Nuclear Power Industry

APRIL 19–22

Location: Beijing: China International Exhibition Center
Organizers: China Atomic Energy Authority; PRC Commission of Science, Technology, and Industry for National Defense; Coastal International Exhibition Co., Ltd.
Tel: 852-2827-6766
general@coastal.com.hk
www.coastal.com.hk/nuclear

Challenges and Rewards: Doing Business with China in 2009

MAY 1

Location: Schaumburg, IL: Quality Inn Schaumburg
Organizer: Artisan Business Group
Contact: Brian Su
Tel: 1-217-899-6385
info@midwestUSAChina.com
www.midwestusachina.com/master2009.htm

Qinghai Investment Fair

MAY 5–8

Location: Qinghai: Xining International Exhibition Center
Organizers: Qinghai Provincial Government; China Overseas Chinese Entrepreneurs Association
Contact: Wang Xihui
Tel: 86-971-632-1729
laoha0521@163.com
www.qhwit.gov.cn

China International Logistics Technology and Services Expo

MAY 13–15

Location: Jiangsu: Suzhou International Expo Center
Organizer: Suzhou International Expo Center Co., Ltd.
Tel: 86-512-6280-4650
zhangtj@suzhouexpo.com
www.logisticsworldexpo.com/eng/main.asp

China VOIP & Next Gen Services Conference & Expo

MAY 13–14

Location: Beijing: Presidential Plaza Hotel
Organizer: InfoEX World Services, Ltd.
Contact: Peter Lee
Tel: 852-2865-1118
peter.lee@infoexws.com
www.china-voip.com

West China Build

MAY 15–17

Location: Urumqi: Xinjiang International Exhibition Center
Organizer: ITE Group Ltd.
Contact: Kamran Mehdiyev
Tel: 44-20-7596-5004
kamran.mehdiyev@ite-exhibitions.com
www.westchinabuild.com

Power Conversion Intelligent Motion China

JUNE 2–4

Location: Shanghai: Everbright Convention & Exhibition Center
Organizers: Mesago PCIM GmbH; Shanghai Center for Scientific and Technological Exchange with Foreign Countries
Contact: Tanja Frauendorfer
Tel: 49-711-6194-6821
www.mesago.de/en/PCChina/main.htm

Aquatech China

JUNE 3–5

Location: Shanghai Exhibition Center
Organizers: CHC Expo Service (Shanghai) Co., Ltd.; Amsterdam RAI
Contact: William Wang
Tel: 86-21-6270-5336
william@chcbiz.com
www.china.aquatechtrade.com

China International Environmental Protection Exhibition and Conference

JUNE 3–6

Location: Beijing: China International Exhibition Center
Organizer: China Association of Environmental Protection Industry
Tel: 86-10-5155-5020
ciepec@163.net
www.chinaenvironment.org

China International Consumer Goods Fair

JUNE 8–12

Location: Zhejiang: Ningbo International Conference and Exhibition Center
Organizers: PRC Ministry of Commerce; Zhejiang Provincial Government
Contact: Jency Tang
Tel: 86-574-8717-8075
trade1@cicgf.com
www.cicgf.com

Asia Luxury Travel Market

JUNE 15–18

Location: Shanghai Exhibition Center
Organizer: Reed Travel Exhibitions
Contact: Stephanie Bleakley
Tel: 44-20-8910-7994
stephanie.bleakley@reedexpo
www.altm.com.cn

International Green Building & Sustainable Cities Exposition

JUNE 18–20

Location: Beijing International Exhibition Center
Organizers: China Eco Expo; PRC Ministry of Construction
Contact: Marc Merson
Tel: 1-818-906-2700
marc@ecoexpo.com
www.ecoexpo.com

Health Ingredients China, Food Ingredients Asia-China & Natural Ingredients China

JUNE 24–26

Location: Shanghai New International Expo Center
Organizer: Shanghai CMP Sinoexpo International Exhibition Co., Ltd.
Contact: Mark Nee
Tel: 86-21-6437-1178
marketing@cmpsinoexpo.com
http://asiachina2008.fi-events.com

Guangzhou International Exposition on Electricity Saving Technology and Equipment

JUNE 25–27

Location: Guangdong: Guangzhou Jinhan Exhibition Center
Organizer: Guangdong Intexpo Co., Ltd.
Tel: 86-20-8735-8971
ptdexpo@126.com
www.expo-cn.com

Expo Mobility China

JUNE 25–27

Location: Beijing: National Agriculture Exhibition Center, New Hall
Organizer: E.J. Krause & Associates, Inc.
Contact: Helen Zhao
Tel: 86-10-8451-1832
helen@ejkbeijing.com
www.expocommobile.cn

30 Find more China-business events on the *China Business Review*'s website at www.chinabusinessreview.com/conference-calendar.php.

China Tackles Economic Crisis with Fiscal Stimulus, Consumption Plans

As the global economic crisis has deepened, the PRC government has become increasingly concerned about the impact of the crisis on China's economy and has launched various efforts in response.

Central stimulus plan

The centerpiece of China's response is the massive ¥4 trillion ($585 billion) stimulus plan announced last November. Stimulus spending will focus on transportation construction, Sichuan earthquake reconstruction, rural infrastructure projects, environmental protection, housing projects, indigenous innovation (China's strategy to develop domestic innovative and technological capabilities over the next decade), and healthcare and education. Each of these broad categories conforms to a set of policy goals already outlined in China's 11th Five-Year Plan (2006–10). About ¥1.18 trillion ($263 billion) of the stimulus is slated to come directly from the central government, while the remaining funds will be provided by provincial and local governments, state-owned and private enterprises, and policy and commercial bank loans. The State Council allocated ¥120 billion ($17.5 billion) of central government funds for deployment in November and December 2008 and plans to spread the remaining stimulus spending over the next few years.

Officials at the PRC National Development and Reform Commission (NDRC), the primary agency responsible for approving stimulus package spending, said in January that it would funnel ¥100 billion ($14.6 billion) of the stimulus funds into local government projects for implementation before March, when China's National People's Congress convenes. Though NDRC retains primacy in the initial approval of stimulus projects, local ministry and provincial officials will have the final say in project implementation and execution. In general, projects worth more than ¥30 million ($4.4 million) in funding will need NDRC approval, while those over ¥200 million ($29.2 million) require NDRC and State Council approval. Recent conversations with NDRC suggest that provincial projects that do not involve national funds will not require NDRC approval, provided that the projects are not in prohibited or sensitive industries as described in NDRC's Approval and Filing catalogues.

In early February, NDRC announced that it will spend ¥130 billion ($19.0 billion) more on several national projects that involve public facilities, low-income housing, infrastructure, health and education, economic restructuring, and the environment, though no timeframe was given for the spending. NDRC officials have indicated to the US-China Business Council (USCBC) that this round of stimulus spending is separate from the ¥100 billion package announced in mid-January but still a part of the ¥4 trillion announced in November. NDRC will work with various ministries on the approval and funding of central-government-sponsored projects and retain its approval authority over non-national stimulus projects.

Other policies: exports and consumption

Beyond the stimulus package, China has also taken significant steps to boost the export sector. Most important, cuts in export value-added tax (VAT) rebates made in summer 2007 have been reversed and restrictions on processing trade eased. The renminbi, which had been steadily appreciating since July 2005, has held fairly steady since July 2008. The People's Bank of China has slashed interest rates, raised lending quotas for banks, and pushed for more loans to struggling small and medium-sized enterprises.

In another move to prop up China's economy, in late December the State Council issued the Opinion on Stimulating Circulation and Expanding Consumption. Drafted mainly by the PRC Ministry of Commerce and largely a vague restatement of basic principles laid out in previous announcements, the opinion includes 20 measures to invigorate consumption. Starting in February, the Home Electronics to the Countryside program, which provides cash subsidies of 13 percent for rural residents' purchases of home appliances, was expanded to cover the entire nation. Motorcycles, water heaters, computers, and air conditioners have joined televisions, refrigerators, washing machines, and mobile phones on the list of products that may be subsidized by provincial governments. The opinion also notes the government will improve the rural logistics network and set up more rural goods distribution centers. For urban areas, the opinion contains vague provisions on improving community services to stimulate consumption and highlights potential changes to stimulate the auto sector, which has slowed significantly in recent months.

Industry-specific revitalization plans

As promised in earlier State Council documents, PRC government agencies drafted revitalization plans for several key industries. The industries are iron and steel, autos, shipbuilding, petrochemicals, textiles, light industry, nonferrous metals, equipment manufacturing, logistics, and electronics and information technology (IT). Key measures and policies in the plans include relieving the tax burden on enterprises, supporting financial credit development, launching enterprise-technology-reform projects, encouraging mergers and acquisitions to improve risk forbearance and global competitiveness, fully developing rural markets, expanding exports, and storing energy.

As *CBR* went to press, China had approved in principle plans for the industries listed above; a few details follow. The PRC government also issued plans to invest in rail construction and energy and environment projects.

■ **Steel and autos** The State Council's plans for China's steel and auto industries aim to eliminate obsolete capacity, accelerate innovation, and cut export tariffs. Some analysts note that the auto plan may favor light, efficient engines.

■ **Shipbuilding** The plan to stimulate the shipbuilding industry urges banks to boost finance for vessel exports, extends financial support for domestic buyers of oceangoing ships to 2012, encourages the replacement of outdated ships, suspends new shipyard construction, and supports technological renovation and industrial updates.

■ **Textiles** The State Council in early February announced increases in the export VAT rebate rate for textile and garment exports from 14 percent to 15 percent. Actual implementation dates remain unclear, but moves to boost textile exports and market share could meet opposition abroad.

■ **Machinery manufacturing** The State Council also approved a plan that grants heavy machinery manufacturers tax incentives, especially when they engage in research and development.

■ **Electronics and IT** According to PRC press reports, the electronics and IT industry plan, approved in mid-February, states that China will invest roughly ¥600 billion ($87.7 billion) over three years to promote third-generation communication services, digital TVs, and next-generation Internet.

■ **Light industry** The State Council's light industry plan calls for increases in export tax rebates and lending and other financial support for small and medium-sized light-industrial companies. It also aims to speed technology upgrades in certain sectors to improve energy conservation and environmental protection.

■ **Petrochemical industry** Press reports indicate that the government will likely invest ¥100 billion ($14.6 billion) in petroleum-related project upgrades in 2009 and 2010 and ¥400 billion ($58.5 billion) for construction of 20 new, large petrochemical projects; these amounts were unconfirmed as *CBR* went to press.

Foreign company opportunities

NDRC and MOFCOM officials in late January assured USCBC that foreign companies are welcome to participate in projects associated with the stimulus but provided no specifics. Companies should be aware that the majority of project contracts and licenses will be awarded at the provincial and municipal level and that opportunities vary greatly by sector. US companies that specialize in engineering, design, construction, energy, and other infrastructure services could see the best opportunities, as much of the total stimulus package targets infrastructure. National officials' growing concern about severe water shortages in and around Beijing has increased the likelihood that environmental projects in China's north—particularly water treatment plants and irrigation projects—will be a particularly high priority in the first half of 2009.

Though China plans to aid various ailing industries with increased funding for projects, the State Council has made it clear that the country could also use the economic crisis as an opportunity to encourage mergers and acquisitions among domestic enterprises to create more competitive "national champions." Foreign companies involved in or competing with sensitive, nationally controlled sectors, such as auto manufacturing, shipbuilding, or textiles, should not be surprised to see more domestic preference in 2009.

USCBC expects stimulus-related announcements to be released at a steady pace and with varying levels of detail. The March National People's Congress will bring additional focus to China's economic recovery plans. 完

This article is adapted from reports that first appeared in China Market Intelligence, *the US-China Business Council's (USCBC) members-only newsletter. To find out more about USCBC member company benefits, see www.uschina.org/benefits.html.*

Event Wrap Up

WASHINGTON

January

Potential Trade Remedies: How Companies Can Respond
Co-sponsored with the Emergency Committee for American Trade and the Retail Industry Leaders Association, this briefing featured Gary Horlick, former head of the US Department of Commerce's Import Administration.

2009 Forecast Reception and Conference
(See below)

February

New Approaches for Enforcing Intellectual Property (IP) Rights in China
Featured Xiang Wang, lead partner of Orrick, Herrington & Sutcliffe LLP's China-focused IP practice, and Ryan Ong, manager of Business Advisory Services at the US-China Business Council (USCBC).

Issues Luncheon on China's Stimulus Plan and 2009 Economic Growth Prospects
Featured Nicholas Lardy, senior fellow at the Peterson Institute for International Economics.

BEIJING

January

Human Resources Workshop on Workforce Reduction
Featured Jim Leininger, general manager, Watson Wyatt Worldwide, Inc., and Hugh Scogin, partner, Reed Smith LLP.

Breakfast Dialogue with Past US Ambassadors
Featured former US ambassadors to China Winston Lord (1985–89), James R. Sasser (1996–99), and Joseph Prueher (1999–2001), who reflected on the 30th anniversary of the normalization of US-China diplomatic relations.

SHANGHAI

January

Issues Luncheon on China's Economic Prospects in 2009
Featured Andy Xie, guest economist at *Caijing* magazine and former chief China economist at Morgan Stanley.

February

Issues Luncheon on Facility Closures and Workforce Reductions
Featured Jay Hoenig, president of Hill & Associates PRC Ltd., and Susan Munro, counsel at O'Melveny & Myers LLP.

NEW YORK

February

Business Perspectives on China in the Global Economic Crisis
Featured Bob Poole, vice president of China Operations, USCBC, and Clarence Kwan, national managing partner of Deloitte LLP's Chinese Services Group and chair of the China Committee for the United States Council for International Business, which co-hosted the event.

Upcoming Events

WASHINGTON

Issues Luncheons
March 19, 2009
April 16, 2009
May 21, 2009

36th Annual Membership Meeting
June 2, 2009
For more information, see p.9.

For more information on USCBC or its events, see www.uschina.org.

USCBC Hosts Forecast 2009 Conference, Reception

Member company executives gathered in Washington, DC, on January 29 to hear an expert lineup of speakers analyze the year ahead at the US-China Business Council's (USCBC) 28th annual Forecast Conference.

Estimating that China's gross domestic product growth in 2009 will likely slow to less than 7.5 percent, Deepak Bhattasali, lead economist, East Asia and the Pacific Region, World Bank, discussed the macroeconomic challenges and types of economic rebalancing that PRC economic planners face in 2009. He also forecast that the impacts of the PRC economic stimulus package would not become evident until the second half of the year.

Attendees heard remarks about the prospects for Congress to legislate on China in 2009. Mike Castellano, counsel and senior policy advisor, Officer of Senate Majority Leader Harry Reid, and Jason Kearns, majority trade counsel, House Committee on Ways and Means, indicated that their respective chambers would initially give the Obama administration an opportunity to take action on China in areas of perceived unfair trade practices but that Congress would move to draft legislation if the administration's efforts did not address congressional concerns.

USCBC Vice President of China Operations Bob Poole reported on the business operating challenges US companies would face in China in 2009, noting that additional details on the PRC stimulus package would likely emerge after the PRC National People's Congress convenes in March. Richard Sandor, chair and CEO of the Chicago Climate Exchange, spoke about China's prospects for managing its environmental challenges. He suggested that China's increased interest in emissions trading signals the central government's commitment to protecting the environment.

The conference concluded with a luncheon address by Kenneth Lieberthal, visiting fellow in Foreign Policy Studies at the Brookings Institution; former senior director for Asia, National Security Council; and professor at the University of Michigan. A former advisor on China to the Obama campaign, Lieberthal spoke about the Obama administration's likely policy toward China. He stressed the need for substantive, high-level dialogue to manage the significant level of distrust each side has for the other, to navigate the inevitable tensions and misunderstandings that occur when a new US administration takes office, and to address important global issues, such as the economic downturn and climate change, that are new to the bilateral relationship.

The evening before the conference, USCBC hosted a reception for member companies, US government and PRC Embassy officials, and China scholars. Attended by roughly 130 guests, the reception featured speeches by PRC Embassy Deputy Chief of Mission Xie Feng and US Representatives Rick Larsen (D-WA) and Mark Kirk (R-IL).

USCBC appreciates the support of its member companies and the speakers in making Forecast 2009 a success. Audio files of three Forecast presentations can be found at www.uschina.org.

Minister Xie Feng, deputy chief of mission, PRC Embassy; John Frisbie, USCBC president; and the Honorable Barbara Franklin, USCBC board member and president and CEO, Barbara Franklin Enterprises

US Rep. Rick Larsen (D-WA), co-chair of the US-China Working Group; Eddie Mak, director-general, Hong Kong Economic and Trade Office; and Donald Tong, Hong Kong commissioner for Economic and Trade Affairs

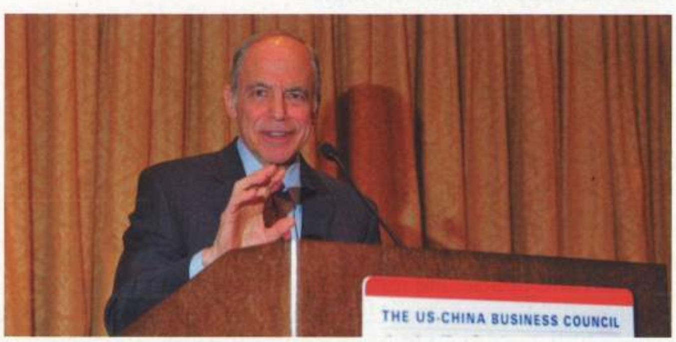
USCBC Vice President Erin Ennis and Robert Zoglman and Jeanne T. Lopatto of Westinghouse Electric Co.

US Rep. Mark Kirk (R-IL), co-chair of the US-China Working Group, and Steve Orlins, president of the National Committee on US-China Relations

Deepak Bhattasali, lead economist, East Asia & Pacific Region, the World Bank

Jennifer H. Sanford, senior manager, International Trade & Corporate Policy, Cisco Systems, Inc.

Richard Sandor, founder, chair, and CEO, Chicago Climate Exchange



Kenneth Lieberthal, visiting fellow in Foreign Policy Studies, the Brookings Institution, and professor at the University of Michigan

Transitions

Robert Poole

The year of the ox brings several transitions that will affect US business in China. One is the change of administration in the United States, which could bring revisions to trade policy for China, though it is still too early to tell. Another is the acceleration of the shift of China's economy from one that is driven largely by exports to one that is led by domestic consumption.

The year behind us

Last year might be characterized by the popping sounds of bubbles (real estate and stocks) and the shattering of crystal balls throughout China. The Shanghai Stock Exchange fell a staggering 70 percent, and real estate sales slowed after years of growth and price increases. At the beginning of 2008, I saw only two major themes—the fight against inflation (public enemy number one at the time) and the national preoccupation with the success of the Olympic Games. The subsequent run of major events surprised everyone—snowstorms, disturbances in Tibet, the calamitous earthquake in Sichuan, the national milk scandal, and the onset of the global economic crisis. Most of the news since has been the knock-on effects of the economic slowdown, particularly rising unemployment caused by slowing export industries and construction, and the need for China's leadership to steer the economy to safety.

For US-China Business Council (USCBC) member companies, the past year brought some significant regulatory changes (in labor law, new rules around favorable tax provisions for high-tech status, and changes in patent and antimonopoly laws). Many companies also participated in earthquake relief efforts, and some sponsored or otherwise supported the Olympics.

Changes

The US elections have brought some uncertainty to Chinese and foreign businesspeople, as well as to PRC government officials, who wait to see whether the new US administration or Democratic majorities in Congress will impose different requirements on China and bilateral trade and investment. The waiting period as administration posts are filled and policies are reviewed sharply lessens the amount of bilateral activity—we in USCBC's China offices are accustomed to regular US government visits and negotiations, and most of these activities slowed in early 2009.

Here in China, the larger questions revolve around the Chinese economy. Top-level economic planning in the fall of 2008 highlighted a renewed determination to include China's 700–800 million rural residents in the country's recent prosperity; the decision to allow land transfer rights for farmers was a landmark change that may have significant effects in coming years, but, as with so many Chinese policy shifts, the details remain obscure and highly contentious. The decline of industrial and consumer demand in major world markets, and resulting fall in Chinese exports, merely increased the need for domestic demand to absorb excess goods and provide employment. Finally, concern over the macro-economy prompted China's leaders to initiate an economic stimulus package of ¥4 trillion ($585 billion). Unemployment is clearly the new top concern for China's leaders.

Looking ahead

Every year, USCBC surveys its member companies on the challenges they face in China, and this year could bring changes to some of the top issues they've cited. On the positive side, the slower economy may bring some relief from the rising cost pressures of recent years (inflation fell to 1.2 percent from 9.1 percent last January), a slowdown in the turnover and costly retention of managerial talent, and some easing of licensing and approvals to expand distribution in China as officials seek to bolster business activity. Conversely, competition, overcapacity, and protectionism could worsen.

The annual National People's Congress (NPC) meeting (held in early March, after the *CBR* went to press) sets important legislative goals and other policies for China. A public poll in February showed that Chinese citizens want the government to address corruption, medical reform, employment and income distribution, fairness in education and the judiciary, and other social issues. The NPC will cover these issues and more, as the government also seeks to restore the economy and address pressing needs such as energy supply and environmental protection. For USCBC member companies, a host of related regulatory changes in these areas may bring new business opportunities.

Change is a constant companion to those of us in the China business environment, as the results of 30 years of reform unfold and a dynamic economy emerges. As ever, the challenge will be to stay abreast of developments and to capitalize on the potential opportunities for US business. 完

Robert Poole *is vice president, China Operations, at the US-China Business Council in Beijing.*

China Foto Press

Tackling Intellectual Property Infringement in China

Companies can use several official channels to deal with intellectual property rights violations

Ryan Ong

Companies face a challenging, rapidly evolving intellectual property rights (IPR) landscape in China. PRC officials are increasingly cognizant of the importance of IPR protection to an innovative economy and, as evidenced by revisions to core IPR laws and the 2008 National IPR Strategy, seek to improve the legal frameworks and channels through which companies can protect their IPR. Companies still battle regular infringement of their patents, trademarks, copyrights, and trade secrets, however, and face not only administrative hurdles—significant procedural barriers and uneven enforcement—but also commercial challenges from increasingly sophisticated counterfeiters. Companies must carefully plot their corporate strategies to navigate the terrain of China's IPR landscape successfully.

Companies can take several main steps to protect their IPR in China. First, they should establish internal controls to identify and protect IPR, factor IPR issues into their exchanges with suppliers and customers, register IPR to take advantage of PRC legal protections, and conduct surveillance and due diligence to uncover infringement (see the *CBR*, January–February 2006, p.18). If IPR infringement occurs, however, a company faces a few critical choices. It can take external action to battle IPR infringement, using either administrative or judicial channels. These channels exist for patent, trademark, copyright, and trade secret infringement, but the processes and advantages each provides differ greatly.

Administrative channels

Administrative channels are widely viewed as the quickest and least expensive way to combat IPR infringement and remain the most popular option for dealing with violations. Administrative officials can handle cases quickly, and the filing and adjudication procedures are straightforward. In addition, companies avoid the significant expenses associated with court cases. The administrative route is a good option for companies dealing with infringement cases that do not involve complex networks.

Quick Glance

- Using administrative channels to pursue intellectual property rights (IPR) infringement in China is faster and less expensive than judicial channels but tends to result in softer penalties that serve as weaker deterrents for future violations.
- Companies should consider several variables when deciding which channel to use, including enforcement goals, scope, and nature of IPR infringement.
- Judges in major cities tend to have more experience with IPR cases and are more likely to rule that IPR infringement has occurred.

Investigating IPR violations

To begin an administrative investigation, a company must first file a complaint indicating infringement of its IPR-protected products to a local administrative agency—generally at the district or county level. Depending on the type of IPR, location of the alleged infringement, and type of product, the company may choose among several administrative agencies. Though local administrations for industry and commerce (AIC) are the most common choice, other agencies—including local branches of the Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ); Customs; State Food and Drug Administration; National Copyright Administration of China; State Intellectual Property Office; and Ministry of Culture—may also play a critical role.

In addition, the local public security bureau (PSB) carries out administrative investigations for possible criminal cases. PSBs can receive cases that are transferred from administrative agencies or, if the infringement amount meets certain thresholds, the rights holder may contact the PSB directly to raise a case. If the PSB finds enough evidence to warrant a criminal case, the case is transferred to a people's prosecutor in the court system.

In some cases, local agencies may contact rights holders when they uncover instances of infringement. For example, through the recordation process, companies can register their intellectual property with national-level Customs in Beijing (see the *CBR*, November–December 2004, p.30) and train local Customs officials to spot infringing products. Private investigative firms may also contact companies when they encounter infringing goods, though companies should verify the accuracy of these notifications and check the legitimacy of these firms before contracting with them.

In most cases, however, companies must conduct their own due diligence to find infringing products. They must also gather a substantial body of evidence and present a case to local officials to convince them to carry out an official investigation.

Administrative rulings and outcomes

After a formal administrative investigation, the local agency issues a ruling. If infringement is found, the local agency can order the infringer to stop producing and selling the infringing goods, seize infringing goods and equipment used in their manufacture, and levy an administrative fine, the amount of which varies depending on the type of IPR. The rights holder or the infringer can bring an administrative suit to the Supreme People's Court (SPC) if either is unsatisfied with the local agency ruling.

In jurisdictions where agency officials have more experience working with foreign companies and better understand the importance of IPR protection, such as the developed areas of eastern China, agency officials may be more willing to pursue infringers. In recent conversations, several USCBC member companies cited cases in which local enforcement agencies were eager to pursue infringers and willing to consider a variety of punitive options.

Drawbacks of the administrative approach

Administrative channels have drawbacks, however. Administrative agencies often issue small fines that infringers view as the cost of doing business rather than as an effective deterrent. For example, fines for trademark infringement are capped at either three times the illegal revenue or ¥100,000 ($14,622), whichever is less, and most judgments issue fines of far less than the maximum amount. In some cases, goods and equipment seized during raids are not destroyed, as PRC law requires, but instead re-enter the market via auction or back channels.

Limited administrative resources also restrict local agencies' capacity to carry out investigations. Administrators must juggle various local and national priorities and may be unable or unwilling to devote staff and resources to investigate a case fully. This shortage of resources is a particular problem when a rights holder uncovers counterfeit products sold at multiple locations—for example, at multiple stalls in a wholesale market—requiring multiple investigators to conduct raids simultaneously. Local protectionism can be a factor, especially in jurisdictions that have limited experience working with foreign companies.

Other procedural hurdles may also present challenges. Local enforcement agencies often rely heavily on evidence presented in a company's initial petition, but companies and private investigators are limited in their ability to procure evidence from infringers. Some local agencies are resistant to hearing cases that are based solely on notarized purchases of infringing goods (a basic investigative technique), making it more difficult for companies to collect evidence. Companies have also experienced new difficulties regarding authorization for powers of attorney, with some local AICs demanding that "power of attorney" letters be officially notarized and legalized in China, and others requiring that each power of attorney letter be specific to a given infringement case (including explicit mention of the infringer). Meeting these requirements can cause delays.

In addition, administrative officials are often reluctant to take on cases involving counterfeiting networks that are complex in scope, structure, or geography, because these cases have a higher chance of being appealed or overturned in court. Local administrative agencies are poorly equipped to tackle such cases, especially when they involve multiple jurisdictions—for example, sales in Shanghai and Jiangsu of counterfeit goods made in Zhejiang.

Judicial channels

Companies may also look to China's courts to protect their IPR. For judicial cases, companies have two options: civil or criminal cases.

Civil cases are heard by specialized IPR tribunals, with an Intermediate People's Court typically serving as the "court of first instance" (the first court to hear a civil case). IPR tribunals exist in both Intermediate People's Courts (at the sub-provincial level) and Higher People's Courts (at the provincial level). If infringement is found, judges in civil cases can award monetary damages or injunctive relief for rights holders. Rights holders can also apply for a preliminary injunction to halt infringement prior to the final decision. After a ruling is made, either party may appeal court rulings to the civil courts at the next level (see the *CBR*, November–December 2004, p.25).

IPR criminal cases are heard first by Criminal Tribunals in the People's Court with jurisdiction over the location of criminal activity; courts at the sub-provincial level typically serve as the court of first instance. Cases are generally initiated by the people's prosecutors after an initial PSB investigation. Rights holders may also initiate private prosecution proceedings in court, though the process is rarely used. A finding of criminal liability can result in fines as well as sentences of up to seven years, depending on the value of the infringed products. Subsequent appeals are heard by criminal courts at the next level.

Advantages and risks of the judicial approach

The main advantage of judicial channels is that they offer stronger penalties, and thus a stronger deterrent, than administrative cases. Though only civil cases provide rights holders with the opportunity to claim monetary damages for the loss of market share and for lost revenue caused by infringement, criminal cases provide opportunities for criminal sentences, in addition to larger fines. The court system's procedures for collecting, presenting, discussing, and weighing evidence also make it better suited for complex cases. Rights holders have a chance to present evidence to the presiding judge and respond to questions, a process that allows them to better explain and illustrate complex areas of IPR.

Despite court cases' advantages, however, they are far more costly and time-consuming than administrative cases. Whereas administrative cases can reach resolution in just a few weeks, court cases can easily take a year or longer and often involve the time and expense of using committed outside counsel. Local protectionism and low transparency remain a concern in court cases, especially in jurisdictions outside China's major cities. A September 2007 decision in Wenzhou, Zhejiang, provides a cautionary tale. In July 2006, Chint Group Corp. filed suit in its home courts in Wenzhou against French company Schneider Electric SA's joint venture, Schneider Electric Low Voltage (Tianjin) Co., Ltd., claiming that five Schneider circuit breaker products infringed upon Chint's patents. The presiding judge ruled that Schneider had infringed Chint's patents, ordered Schneider to halt sales of five products, and awarded unprecedented damages to Chint: ¥334.8 million ($49 million). This amount far exceeds the typical award in such patent cases; when a Chinese company is the defendant, damages rarely exceed a few million renminbi.

China's relatively small number of IPR-related judicial cases means that many judges have limited experience in IPR cases, especially complex cases. The Beijing Number One Intermediate People's Court is widely viewed as the best in China in terms of experience and expertise, and other courts in major cities—including Beijing, Shanghai, and Guangzhou and Shenzhen, Guangdong—are also quite experienced. Courts in other jurisdictions have much less experience, though these courts are improving

The main advantage of judicial channels is that they offer stronger penalties and thus a stronger deterrent.

because of more cases and an influx of trained judges. Inexperience also tends to make judges more uncertain and conservative in their judgments, meaning they are less likely to rule that IPR infringement has occurred. The SPC is working to give more guidance to lower courts—for example, by sharing model rulings and judicial interpretations on key issues—but this process is slow. Many companies try to avoid inexperienced courts by seeking to place cases in courts in "safer" cities.

A number of procedural challenges also remain. As in other court cases, the burden of proof in a patent infringement suit lies with the plaintiff, in this case the rights holder. Yet there is no formal discovery process, making it difficult for plaintiffs to obtain evidence from the infringer. In addition, evidence must be notarized and admitted to the court, a time-consuming process that can take even longer if the evidence was produced overseas or is in the category of "company literature," which includes advertisements and pamphlets. Judges also often rely on the opinions of outside experts or panels to understand the IPR and products in question. It remains unclear how these experts are chosen and how applicable their expertise is to the cases they address. Finally, monetary damages are difficult to collect, and non-monetary punishments, including injunctions and limits on business activity, are even tougher to impose.

On the criminal side, simply getting a criminal case on the docket is a major challenge. To be eligible for a criminal case, an act of IPR infringement must meet a minimum value threshold for infringing goods. Although the SPC lowered the value thresholds in a December 2004 judicial interpretation, the values still remain high. The threshold for trademark counterfeiting cases is ¥50,000 ($7,311) for the value of the infringing products or ¥30,000 ($4,387) in illegal income; for patents, the amounts are ¥200,000 ($29,243) and ¥100,000 ($14,622), respectively. High thresholds prevent many criminal cases from making it to court.

What to consider when choosing a strategy

For a company facing IPR infringement, deciding which channel or combination of channels to pursue can be complicated. Though administrative enforcement is preferred for its speed and low cost, foreign companies are beginning to recognize that judicial channels are a viable alternative. Before planning an enforcement strategy, an IPR holder should consider several factors:

- **Company resources** Companies should be realistic from the outset about the resources they are willing and able to devote to IPR enforcement. Judicial cases require greater funding and attention because the process is longer and more complex, and requires more documents and input from the company.
- **Company enforcement goals** Executives should be clear what the goal of their enforcement action is—stopping infringement as quickly as possible or deterring future infringement. Companies may prefer to deal with infringers via administrative channels as they pop up, a strategy that requires fewer resources but continued diligence—and may ultimately fail to deter infringers. Alternatively, companies could use judicial channels to set an example and deter infringers or to attack a counterfeiting network.

> Despite court cases' advantages, they are far more costly and time-consuming than administrative cases.

- **Type of IPR involved** China's administrative agencies and courts have varying levels of experience with patents, trademarks, copyrights, and trade secrets. Trademark and copyright infringement tend to be simpler, and local officials have more experience working with these forms of IPR. Patents are well-protected under PRC law but often involve a level of technical complexity that requires time and expertise to understand. Trade secrets are still a developing area of PRC law in which both administrative officials and judges have little experience.
- **Nature of infringement** If a company discovers infringement by one or a small group of infringers, an administrative action may be sufficient to tackle the problem. If the company confronts a larger, more sophisticated counterfeiter or a counterfeiting network, however, small-scale raids and low-level fines may be ineffective. In these more complex cases, judicial channels, which offer the possibility of damages or criminal sentences, may be more effective.
- **Government actors** Companies should carefully weigh the resources, staffing, and level of expertise of the actors who would handle their cases. This includes considering not only administrative actors versus their judicial counterparts but the range of possible administrative actors that could tackle a case. For example, a company that learns of large numbers of counterfeit goods being sold under its trademark could go through the local AIC or PSB; alternatively, if it suspects that the counterfeit products are below quality standards, it can approach the local branch of AQSIQ.
- **Location of infringement** As noted earlier, administrative and judicial authorities in larger cities and more developed areas tend to have greater expertise and a better reputation for dealing with IPR issues than their counterparts in less-developed areas. The gap in experience is especially large on the judicial side. For IPR infringement

in less-developed areas, administrative channels are usually more effective. Depending on the nature of infringement and how evidence is collected, companies may be able to select an appropriate jurisdiction in which to file a case. For example, many companies that face widespread counterfeiting make notarized purchases in Beijing and Shanghai to establish standing before IPR courts in those locations.

A collaborative, organized effort

Though the above list is not exhaustive, companies that consider these factors should be better positioned to tackle IPR infringement in China. Pushing for a civil case while allocating limited resources to the effort will only result in frustration when more money is needed; using administrative enforcement to battle a large counterfeiting network may prove ineffective. A well-developed plan of attack against IPR infringement, combined with strong internal controls, should provide companies with a multifaceted strategy to help them navigate China's challenging IPR landscape. 完

Ryan Ong *is manager, Business Advisory Services, at the US-China Business Council in Washington, DC.*

China's IPR Enforcement Agencies

Different administrative agencies are responsible for various aspects of administrative intellectual property rights (IPR) enforcement and present possible avenues for companies wanting to file complaints.

The PRC government maintains a website that includes links to many helpful IPR-related agencies at http://english.ipr.gov.cn/en/organizations.shtml.

Administration for Quality Supervision, Inspection, and Quarantine (AQSIQ)

Through its local representatives, China inspection and quarantine bureaus (CIQs) and technology supervision bureaus (TSBs), AQSIQ is a possible avenue for trademark infringement cases when counterfeit products are of poor quality.

Director: Wang Yong
9 Madian Donglu, Haidian Qu
Beijing 100088
86-10-8226-0001
www.aqsiq.gov.cn

State Administration for Industry and Commerce (SAIC)

SAIC regulates domestic commercial activity, giving it a broad mandate that touches on many areas of company operations. On intellectual property issues, SAIC oversees the China Trademark Office and, through its own provincial and local offices, can investigate and determine cases of trademark infringement. SAIC's Antimonopoly and Anti-Unfair Competition Bureau (formerly the Fair Trade Bureau) oversees trade secrets disputes under the Anti-Unfair Competition Law.

Director: Zhou Bohua
8 Sanlihe Donglu, Xicheng Qu
Beijing 100820
86-10-8865-0000
www.saic.gov.cn

Antimonopoly and Anti-Unfair Competition Bureau
Director General: Ning Wanglu
www.saic.gov.cn/zwxxq/zzjg/zgsz/t20060112_2946.htm

China Trademark Office
Director: Li Jianchang
86-10-6802-7820
www.ctmo.gov.cn

State Intellectual Property Office (SIPO)

SIPO examines and issues patents at the national level and oversees reviews and invalidation proceedings. SIPO's provincial offices handle administrative reviews and enforcement of patent infringement cases.

Commissioner: Tian Lipu
6 Xitucheng Lu, Jimenqiao, Haidian Qu
Beijing 100088
86-10-6208-3114
www.sipo.gov.cn

National Copyright Administration of China (NCAC)

NCAC is broadly responsible for copyright policy, registration, administration, and enforcement. It also handles national copyright activities, including investigations and campaigns to fight copyright infringement. NCAC offers administrative remedies for copyright infringement, but because it has a small number of Beijing staff, NCAC encourages companies to seek redress through the court system.

Director: Liu Binjie
40 Xuanwumenwai Dajie, Xuanwu Qu
Beijing 100052
86-10-8313-8735
www.ncac.gov.cn

General Administration of Customs

Customs is responsible for monitoring and investigating counterfeit goods that cross China's borders. Companies must record their IPR through the Customs recordation process—registering with national-level Customs and training local level inspectors—to ensure that Customs searches for infringing goods during its normal border inspections.

Director: Sheng Guangzu
6 Jianguomennei Dajie
Beijing 100730
86-10-6519-4114
www.customs.gov.cn

For a complete list of China's IPR enforcement agencies, their responsibilities, and contact information, see www.chinabusinessreview.com.

China Foto Press

Mark Cohen on Intellectual Property

China's IP legal framework has grown more sophisticated, but companies must still aggressively register and protect their IP

***Mark Cohen** is of counsel at Jones Day in Beijing and was senior intellectual property (IP) attaché at the US Embassy in Beijing from 2004 to 2008. He recently spoke with* CBR *Editor Virginia Hulme about IP issues in China.*

CBR: What improvements have you seen in IP protection and awareness in China in the last 5–10 years? What and who is driving these improvements?

Cohen: Changes surrounding IP in China are currently driven by the Chinese economy. Chinese officials are painfully aware that China is a manufacturing center for the world but not an innovation center. China can remain a low-cost manufacturing center for only so long. Eventually, those jobs will migrate out. The way to move up the value chain is by harnessing their own R&D [research and development] talent and entrepreneurial instincts, developing brands that have worldwide repute, filing patents, and commercializing technology. The way to accomplish that is by developing confidence in the IP system.

Over the last 10 years, the IP environment has become more complex. There is a greater need for companies to strategize, plan, and acclimate their approach to IP to the different rights, remedies, and problems that exist within China.

There are a number of people in China today who not only understand IP, but are using the system in a way that, to many of us, looks unfair. For instance, foreigners can find that someone has filed a patent on their design or technology, and they now have to invalidate those patents. Similar things happen with trademarks and domain names. The US system affords many protections to ensure the fair use of rights, including granting trademarks based on use, not on registration, protecting patents based on first to file—all these things that give you rights, even without applying. By contrast, in China, as in many countries, there is a race to the registration office.

CBR: If companies find that their patents and trademarks have already been taken, what can they do about it? How successful have foreign companies been in regaining their trademark and patent rights?


Mark Cohen

Cohen: It's not only an issue for foreign companies; it affects Chinese companies, too. In many cases they have been successful, sometimes at great cost. The global trademark system works mostly on a first-to-file basis, and if someone files before you without any proven ill intent, they could have the right to use the mark. This problem is especially acute for many SMEs [small and medium-sized enterprises]. Some companies may not even have a physical presence in China but find when they open up a factory or a representative office that others have secured rights they thought they had owned simply by reason of prior use.

CBR: How has China's legal and regulatory landscape for IP changed? What do you see as the most significant legal developments?

Cohen: There have been three predominant phases of IP development in China during the past 20 years. During the first phase the US government was a significant source of pressure for IP reform. The United States has had a history of encouraging China to accelerate developments in its IP system. The second phase was in response to WTO [World Trade Organization] accession, and the need to bring Chinese laws into compliance with WTO requirements. The third and current phase is IP for China's own development. China's 15-year science and technology plan, National IP Rights Strategy, and recent amendments to the Patent Law are all part of this process. Issues that were not under consideration at the time of China's WTO accession are now appearing, such as protection of folklore, genetic resources, or traditional Chinese medicine. China is also interested in the relationship between standards and patents, the role of antitrust law in IP protection, the economic impact of IP rights enforcement and protection, the balance between private and public interests in IP, and other complex IP policy issues. These are hot international issues that China is now looking at for its own development interests.

China also shares some challenges with the United States as its economy develops. In 2008, China overtook the United States as the country with the most Internet users in the world—it now has nearly 300 million Internet users. Protecting copyright in the Internet environment has become a great concern to many Chinese officials. As another example: The explosive growth in China's patent and trademark offices, including increasingly sophisticated patent applications, has brought challenges that are similar to those in the United States.

Another major change of the past 10 years is the development of a pool of sophisticated IP professionals in China. China has sent officials, scientists, businesspeople, and lawyers to the United States, Europe, and Japan to study IP. The Chinese patent office has sent many of its officials to universities overseas. The European Community is implementing "IPR-2," its large IP rights technical assistance program. The US government is also active. This is all making an impact. Admittedly more capacity building is still needed, but it is not unusual to find individuals in most Chinese ministries today who have PhDs in relevant IP fields and to find many knowledgeable officials at the local government levels. As another example, in the view of most foreign and Chinese observers, the judges in the IP courts are the best educated in China.

We should not think that many of the officials and lawyers we deal with don't understand our system well. Developments in the United States that have redirected policy—and there have been several over the past few years—are carefully analyzed in China. If, for example, the FTC [Federal Trade Commission] criticizes aspects of the US patent system and its effects on innovation, China looks at this carefully and frequently considers and implements similar policies.

CBR: Are there any areas related to IP protection that have gotten worse? What challenges still remain?

Cohen: Continuing growth in seizures of counterfeit goods made in China overseas is a problem (see p.34). It's been growing for many years in both absolute numbers and as a proportion of total seizures. The widespread growth of the Internet and difficulties enforcing IP rights is another area.

Innovative pharmaceutical companies find continuing problems. The protection of clinical data exclusivity, which China was obligated to provide as part of its WTO accession, hasn't occurred as expected.

The other area where there has been some decline is product safety and quality. Substandard products are usually regulated and enforced by agencies such as AQSIQ [Administration for Quality Supervision, Inspection, and

Quarantine] and SFDA [State Food and Drug Administration], as well as SAIC [State Administration for Industry and Commerce] under its consumer protection mandate. There is a clear overlap in authority over many counterfeit and substandard products. In some instances, more serious penalties may be imposed for "fake and shoddy goods" or "illegal business operations" than for IP infringements. There is administrative enforcement in these areas, but as with IP, there are concerns over exports of shoddy products, local protectionism, weak civil remedies, and weak interagency coordination.

Another emerging trend that may be of concern involves large awards in cases where foreigners are named as defendants. In the Schneider case, the Chinese plaintiff won a ¥334.8 million ($49 million) judgment, which was many times larger than the next largest civil judgment of any kind. If the system is supposed to be fair, why have foreign plaintiffs generally received very low levels of damages, while Chinese plaintiffs with a home court advantage are getting very favorable outcomes?

So there are still concerns about transparency, and national treatment concerns remain, particularly at a local level. Local funding of courts and enforcement agencies remain key problems, which are now further magnified by local government subsidies for local companies to file patents and trademarks.

CBR: As you noted earlier, the latest developments in IP are aimed at promoting innovation in China and protecting China's own IP. What implications does China's drive for innovation have for IP protection in China?

Cohen: The drive for innovation means that there will be more patent filings by Chinese companies, both within China and overseas. More attention will be focused on aspects of IP that are closely related to technological innovation, namely patents, and some other rights like plant variety protection. There may be more opportunities for foreign-invested R&D in China, yet a more nationalistic interest will be associated with the fruits of that R&D. There may be more problems with government procurement that favors Chinese innovation or the transfer of technology from foreign-invested R&D in China to overseas. The government may subsidize certain types of R&D and projects and may try to create winners in certain technical areas through national standards, export controls, or other policies, which may tilt the playing field unfairly. But opportunities to engage with the Chinese government also exist. The question is whether China will get the mix right so that foreigners feel they are being treated fairly. The very term, indigenous innovation, gives many people cause for concern.

> The bottom line: have a strategy, secure your rights, adjust your strategy to the Chinese market.

CBR: What are some of the emerging issues in IP protection, especially for foreign companies in China?

Cohen: There are three main issues: global enforcement, increasingly sophisticated counterfeiters, and local Chinese companies as rights holders. To give an example of the scope of the problem—a company could seize Chinese counterfeit goods in a Gulf state bound for Africa or Europe. A company may have a criminal case in one country, a customs matter in another, and a civil case in a third country. The challenges of dealing with the problem's criminal or quasi-criminal nature have become increasingly globalized.

CBR: What are some of the most important IP issues facing US companies in China today?

Cohen: Enforcement is still top of the list and has been for years. For the copyright industries, enforcement issues are also linked to market access issues. For the pharmaceutical industries, IPR issues rank closely with reimbursement and pricing issues for innovative products. Even though it's not strictly an IP issue, market access is critical in many sectors. If you don't have market access, illegitimate goods enter the market, and your problems multiply with less revenue available to address them. There are issues with the Internet, such as the unauthorized webcasting of sporting programs that was encountered during the Olympics. Many companies are also concerned about industrial policy linkages to IP, or about threats of compulsory licensing in a variety of areas.

CBR: Given everything going on in IP in China today and the difficulties companies have enforcing their IP, what advice would you give to US companies in China, or that are thinking about going to China, in terms of IP protection?

Cohen: Too many companies go to China without having secured the trademarks or applied for appropriate patent protection. They may thereafter complain that their rights have been stolen. However, they may not have a legal claim, and certainly there is not much the US government can do if they didn't try to obtain and enforce their rights at the outset.

Companies have to secure their rights, and do it strategically. They need to have a plan, so they know what their expenses will be and the approximate value it will bring.

The other part of securing rights is that companies have to adjust their strategy to China. They can't just secure the same rights that they do in the United States, use the same procedures, and think that will work the same way in China. China does many things differently. In some cases, it has procedures or rights that are not available in the United States. And some of them are not expensive. Design patents and utility model patents are relatively inexpensive, as is administrative enforcement. China has customs remedies against exports. The United States does not have such an administrative system. The bottom line: have a strategy, secure your rights, adjust what you're doing to the Chinese market. Those remain the three key things that companies have to do.

Companies should also incorporate a government relations strategy into their IP approach. Multinationals may need to work more closely with their local corporate security personnel, who may be concerned about brand integrity and theft of trade secret information. Corporate security can help vet employees and support vigorous steps to control the supply chain. Companies also need to work with their PR [public relations] people. If a case is resolved in your favor, thank the Chinese government. If you have a problem you think the government is unaware of, bring it to their attention through government and media relations. All of these things build a more comprehensive approach that can be very different than what companies use in the United States.

CBR: What role should the US government play in improving the IP environment for US companies in China? What advice would you give to the new administration to improve the current approach?

Cohen: The Bush administration, including Commerce Secretary Carlos Guttierez, Ambassador Clark Randt, and Patent and Trademark Office Director Jon Dudas were very active and concerned about IP issues. They placed me in the embassy in Beijing, and when I left I had a staff of about 12 people, which was the largest presence of the US government on IP overseas. Sister agencies that also have a stake in the IP system have a presence in China and other markets.

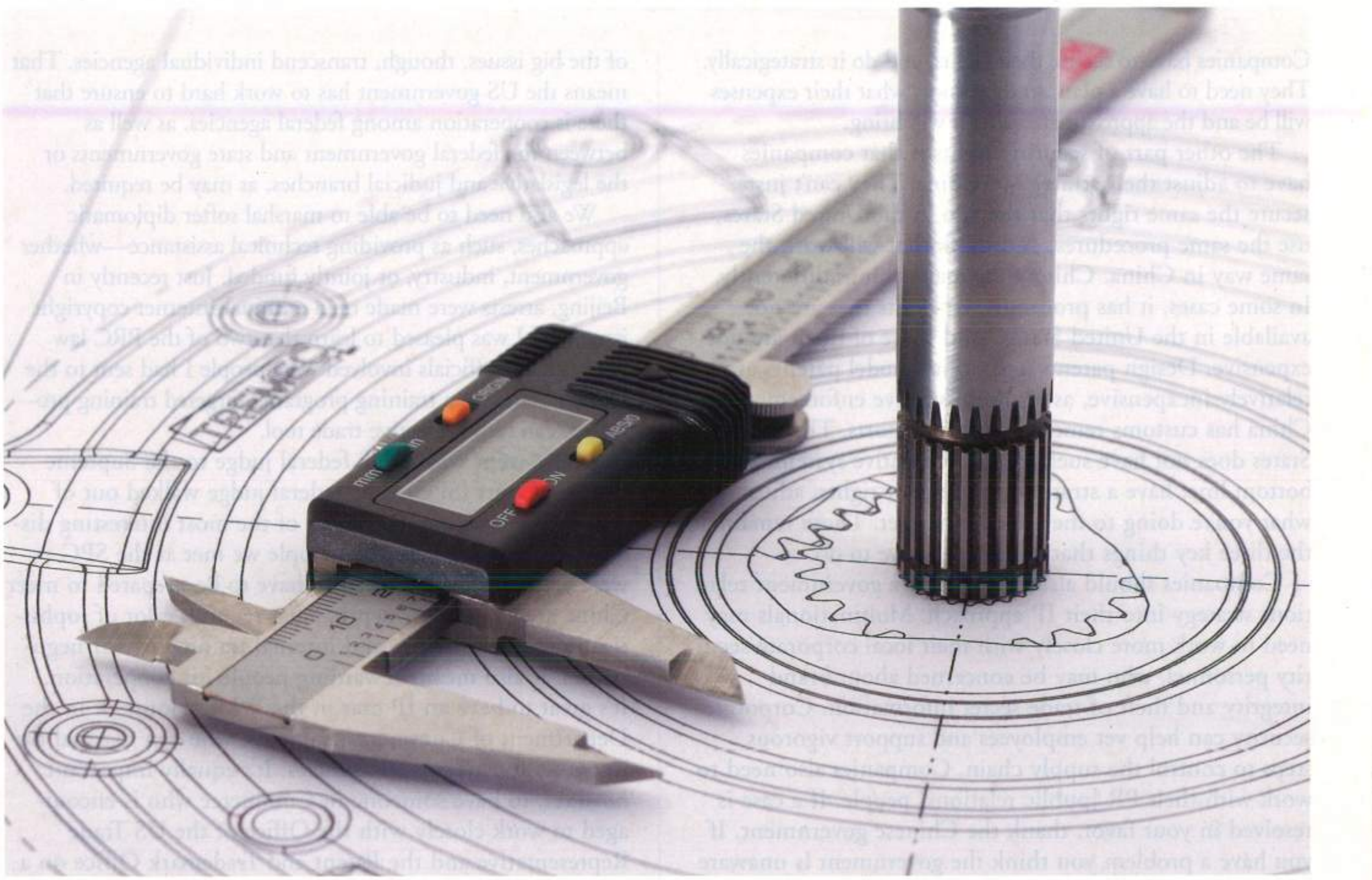
Our government's challenge is coordination. Currently in the United States, we have cooperative MOUs [memoranda of understanding] with China: patent office to patent office, trademark office to trademark office, copyright to copyright, law enforcement to law enforcement, customs to customs. Multiple avenues exist for cooperation and exchange. Most of the big issues, though, transcend individual agencies. That means the US government has to work hard to ensure that there is cooperation among federal agencies, as well as between the federal government and state governments or the legislative and judicial branches, as may be required.

We also need to be able to marshal softer diplomatic approaches, such as providing technical assistance—whether government, industry, or jointly funded. Just recently in Beijing, arrests were made on a criminal Internet copyright issue, and I was pleased to learn that two of the PRC law enforcement officials involved were people I had sent to the United States on a training program. Targeted training programs, can be an effective trade tool.

I once went with a US federal judge to the Supreme People's Court (SPC). The federal judge walked out of that meeting saying it was one of the most interesting discussions he's ever had. The people we met at the SPC were very knowledgeable. You have to be prepared to meet China at that level of depth. That requires a lot of sophistication, coordination, and internal training of our negotiators. It also means rewarding people for cooperation. It's great to have an IP czar in the White House or in the Department of Commerce, someone who can marshal the resources for individual agencies. It's equally important, however, to have someone in Commerce who is encouraged to work closely with the Office of the US Trade Representative and the Patent and Trademark Office on a particular training issue. We have to find ways to reward people for dealing with an issue that transcends agencies, that sometimes transcends the executive branch as well.

That's where industry—including associations—can play a vital role. We should be giving the US government a road map. We should be saying, to give a hypothetical example: "We have a huge problem with copyright in China. We think you should focus on the Internet. We think a good way of focusing on the Internet is to get joint criminal cases. We want to be able to support training programs in this province and that province—they're our priorities. We understand the civil system is weak in this city. We think you should consider a visit." For example, we might encourage the Obama administration to go more often to Guangdong and not initially focus on just Beijing and Shanghai. We should be telling the US government: "This is where the problems are." This is especially critical in light of the current financial crisis, when resources have to be marshaled more efficiently.

Ultimately, though, IP is a private property right. It's very important for businesses to put together the right team in China to protect their rights and to recognize that even in the best of circumstances, the government can't do everything. You have to protect yourself. 完



A New Era of Intellectual Property Rights Licensing

Multinationals should be aware of licensing pitfalls and diminished bargaining power

Esther H. Lim and Srikala P. Atluri

Despite China's intention to balance domestic industry growth and foreign investment priorities through its recently enacted Antimonopoly Law (AML), many multinational corporations (MNCs) believe that certain provisions of the law, specifically Article 55, which relates to intellectual property rights (IPR), may have a disproportionately negative effect on them. As a result, foreign entities that seek to exploit IPR in China, particularly through licensing agreements, would be wise to tread carefully in China's new regulatory landscape. These MNCs should recognize their diminished bargaining power in view of China's compulsory licensing provisions. In addition, they should be aware of patent pools and package licenses and, as always, review all licensing terms and conditions thoroughly.

Article 55

The AML's controversial Article 55 states, "This law does not govern the conduct of business operators to exercise their IPR under laws and relevant administrative regulations on IPR; however, business operators' conduct to eliminate or restrict market competition by abusing IPR shall be governed by this law." Though PRC officials are quick to assert that only an abuse of IPR will trigger this provision, what constitutes abuse, as well as the legal consequences of such abuse, remains unclear. Without clarification, intellectual property owners fear that even the legitimate use of IPR may result in the forfeiture of their intellectual property, imposition of compulsory licensing, monetary sanctions, or other negative consequences. Indeed, one PRC official, Wu Zhenguo, the deputy director of the Treaty and Law Department and Antimonopoly Office in the Ministry of Commerce, disclosed that common abuses may involve practices not necessarily considered abuses in the United States and Europe. Specifically, Wu mentioned package licensing, meaning the licensing of a group of patents that generally relate to one product; compulsory licensing (explained below); "supplemental irrational conditions in licensing contracts"; and the "collection of irrational license fees." Because there has been little clarification, some fear that China will apply Article 55 to what it deems "irrational" (or unfair), though such terms and conditions may not be considered unfair or "irrational" outside of China. Furthermore, Article 55 does not clarify whether an entity must have monopoly power or dominant market position to be considered abusing IPR.

MNCs are also concerned that enforcement authorities could exploit the ambiguity of Article 55 to protect local interests over their IPR. In fact, even before its enactment, the AML garnered wide support among members of the PRC business community as a means of protecting local entities and interests against what they viewed as unfair and unrestrained foreign competition. MNCs worry that enforcement authorities, under pressure from local businesses and the community, will force MNCs to cede their IPR.

Beware of diminished bargaining power

A compulsory license forces an IPR owner to grant the use of those rights to a third party. The Trade-Related Aspects of IPR (TRIPS) Agreement, to which China is a signatory, allows for compulsory licenses under certain circumstances. Consistent with TRIPS, China allows compulsory licenses in the case of a national emergency and when a party has unsuccessfully sought to license a patent from a patentee on reasonable terms and conditions over a significant period of time. Going one step further, China allows a compulsory license for an important technical advance that is predicated on or requires the exploitation of another patent. Notably, China recently amended its Patent Law to include further grounds on which a compulsory license may be justified. The revised Patent Law allows for a compulsory license if the patent owner, without justification, has failed to "sufficiently" exploit patent rights three years after their grant or if the patent owner uses the rights in a manner that eliminates or restricts competition (see p.30).

Quick Glance

- Recent changes to China's intellectual property rights (IPR) licensing regime could create new challenges for foreign multinational corporations, especially in the areas of compulsory licensing, patent pools, and package licenses.
- Recent comments by a senior PRC official suggest that some IPR practices considered common in the United States and Europe may be considered abuses in China.
- Taiwan's granting of compulsory licenses provides clues about how China might proceed in this area.

Because Taiwan allows the grant of a compulsory license to counteract anticompetitive activity and it shares similar concerns with mainland China about the protection of local businesses and the dominance of MNCs in the marketplace, the circumstances under which Taiwan has granted compulsory licenses may shed light on those under which the Mainland may grant compulsory licenses. In 2005, Taiwan's Intellectual Property Office granted Gigastorage Corp., a Taiwan compact disc (CD) manufacturer, a compulsory license to use Royal Philips Electronics' CD technology. Six years earlier, Gigastorage had agreed to a royalty rate of the higher of 3 percent or 10 Japanese yen per CD for the use of Philips' CD technology. By 2002, however, 10 yen was more than 40 percent of the price of a CD, and Gigastorage attempted to renegotiate a 2–5 percent royalty with Philips. Failing to renegotiate the licensing contract, Gigastorage stopped its royalty payments and applied for a compulsory license. The Intellectual Property Office found that Philips had competed unfairly and based its grant of a compulsory license on Gigastorage's inability to obtain a license from Philips on reasonable terms and conditions after a significant period of time. Philips filed suit before the Taipei High Administrative Court, which ultimately reversed the Intellectual Property Office's decision, stating that it had failed to properly determine what constitutes reasonable terms and conditions. The Taipei High Administrative Court, however, left untouched the office's conclusion that Philips had engaged in anticompetitive behavior.

The decisions of the Intellectual Property Office, and even the Taipei High Administrative Court, illustrate the potential consequences of refusing to license or of negotiating IPR license contracts too aggressively. The recently revised PRC Patent Law goes even further, allowing compulsory licenses when a company has exploited its IPR but has not *sufficiently* exploited those rights. What constitutes sufficient exploitation remains unclear, but MNCs hoping to develop their intellectual property in China must recognize their diminished bargaining position.

lack of clarity and the general sentiment it reflects are cause for concern.

Taiwan's courts, applying antitrust laws similar to China's, have ruled that such licensing schemes may constitute an abuse of IPR. In the late 1990s, Philips, Sony Corp., and Taiyo Yuden Co., Ltd. pooled essential and nonessential patents related to CD technology. They licensed the patents in a package at a fixed price regardless of how many patents the licensee used or desired. A number of Taiwan CD manufacturers filed a complaint with Taiwan's Fair Trade Commission challenging the patent pool and package license. Taiwan's Fair Trade Commission concluded that the patentees violated Taiwan's Fair Trade Act through their patent pool because they had a monopoly on the CD market and abused their monopoly power by demanding excessive royalties, fixing prices, and tying nonessential patents to essential patents. On appeal, the High Administrative Court and the Supreme Administrative Court reversed, finding the patents to be essential and complementary to each other, rather than substitutable, and thus not an abuse of monopoly power. Even so, foreign entities planning to use their IPR via patent pools or package licenses in China should consider alternate licensing strategies, such as the use of multiple licenses, when possible.

Foreign entities planning to use their IPR via patent pools or package licenses in China should consider alternate strategies, such as the use of multiple licenses.

Refrain from patent pools and package licenses when possible

MNCs in China should be wary of entering into patent pools or engaging in package licensing. (A patent pool is a group of companies that combine their patents relating to a particular technology for licensing together by one of the companies or an agent for the group of companies. In a package license, several patents, related or not, are licensed together.) These types of licensing arrangements are generally allowable in the United States and Europe and are even thought to have positive effects on competition. But, as noted earlier, at least one high-ranking PRC official, Wu Zhenguo, has highlighted such practices as common abuses of IPR. The official prepared comments that listed, without further explanation, common abuses of intellectual property holders as limiting "competition and seek[ing] monopolies by means of a package of compulsory licensing, placement of supplementary irrational conditions in licensing contracts and collection of irrational license fees by making use of their dominant market positions." This statement's

Antimonopoly Enforcement Agencies

The three Antimonopoly Law enforcement authorities are the PRC Ministry of Commerce (MOFCOM), National Development and Reform Commission (NDRC), and State Administration for Industry and Commerce (SAIC). MOFCOM handles merger notifications and review. NDRC handles price abuses, and SAIC deals with prohibitions against monopoly agreements and abuses of market dominance. Though SAIC also has responsibility for registering and enforcing trademarks, the State Intellectual Property Office (SIPO), a separate government agency, deals with patents. It is unclear whether SIPO will be formally involved in AML enforcement, though it will likely be involved in some way because none of the other agencies has patent experience.

—Esther H. Lim and Srikala P. Atluri

Pay close attention to all licensing terms and conditions

MNCs seeking to use their IPR in China should engage in the same safe business practices they would use elsewhere in the world. Companies should develop and maintain good relationships with the relevant authorities at the local and national levels, thoroughly vet potential licensees, and build necessary protections into their licensing agreements. In addition, MNCs should be aware that licensing IPR in China requires an additional level of scrutiny that, at minimum, involves paying close attention to dealings with local businesses. For example, the State Administration for Industry and Commerce, one of the three AML enforcement authorities (see Box), released a report in May 2004 that singled out at least one large MNC for refusing to license its patents and trade secrets, which it stated resulted in technology and market barriers, such as prohibitively expensive licensing fees and research and development costs associated with "designing around" intellectual property that MNCs have refused to license.

Though no compulsory license was issued in this case, the report at least reflects the PRC government's view of refusals to license.

Unlike their counterparts in the United States and Europe, where refusal to license patents generally does not constitute IPR abuse and refusal to license trade secrets almost never constitutes abuse, PRC officials seem to have taken a different stance. With China's revised Patent Law allowing compulsory licenses to be granted to PRC companies in cases where a rights holder has insufficiently exploited its intellectual property, foreign entities must use caution when licensing their IPR in China.

Terms and conditions considered to be standard in many licenses in the United States and Europe also warrant special attention. In one instance, the Taipei High Administrative Court found that conditions requiring licensees to withdraw validity challenges to a licensed patent may be an abuse of monopoly power. (Except in litigation settlements, provisions that prevent validity challenges are unenforceable in the United States and European Union.) In another instance, Taiwan's Fair Trade Commission found that conditions in a licensing agreement requiring the licensee to provide information such as its inventory at manufacturing facilities, operational costs, production capacity, and client lists were unfair and anticompetitive conduct. The licensor was ordered to cease its requests and pay a fine. Though it is still unclear what licensing conditions will be considered "supplemental irrational conditions" by PRC courts, such findings in Taiwan should at least give MNCs in the Mainland pause before including them in their own licenses.

> Terms and conditions considered standard in the United States and Europe may also warrant special attention.

The enactment of the AML provides great promise for a freer, more innovative market structure in China that is more conducive to competition. Nonetheless, certain provisions, such as Article 55, may require more attention from MNCs until clarifying implementing guidelines are released or the passage of time reveals otherwise. 完

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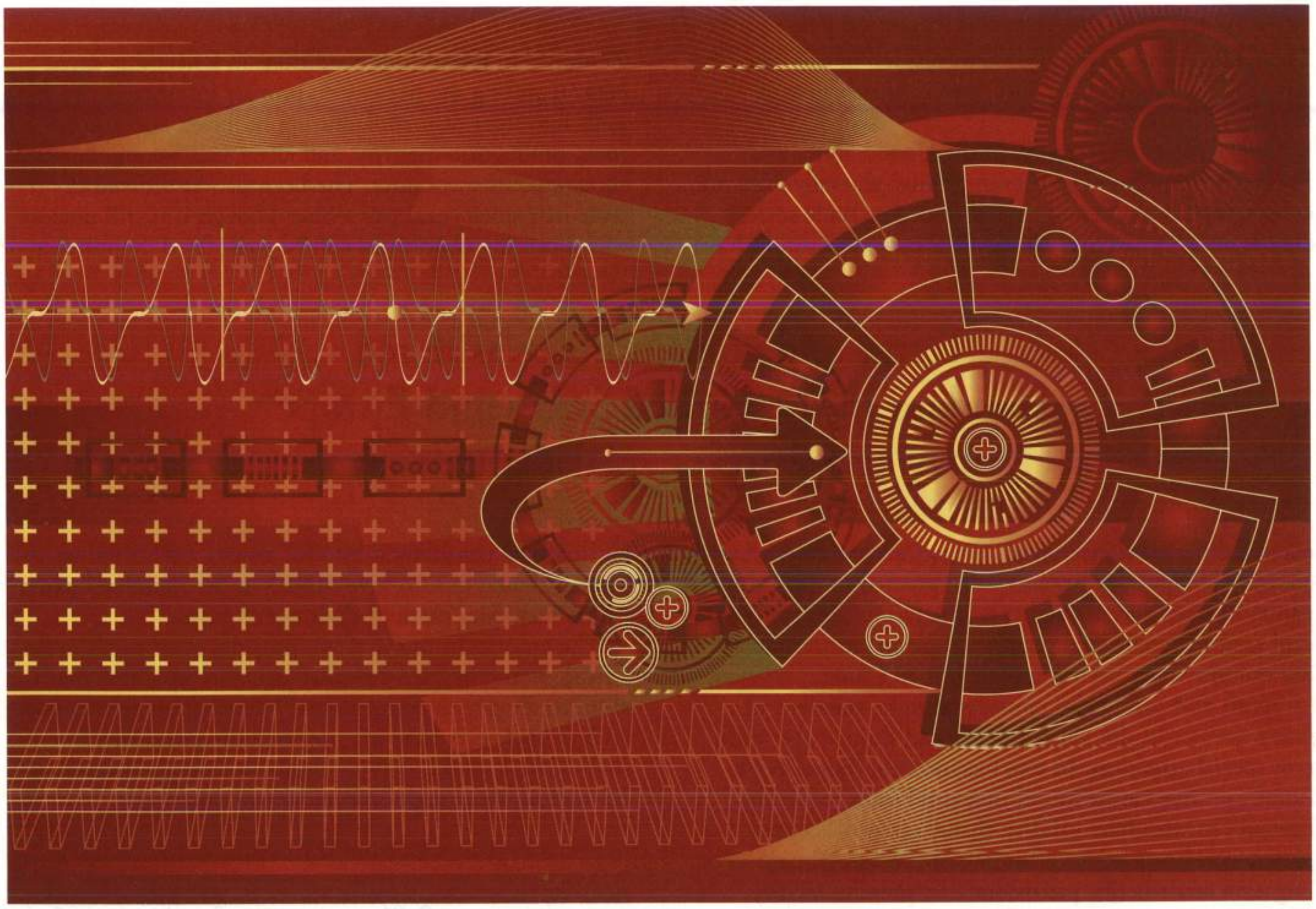

Changes to China's Patent Law and Practice

The revised Patent Law brings the country closer to international standards but leaves room for further improvement

Thomas T. Moga

The National People's Congress Standing Committee in late December 2008 approved amendments to China's Patent Law for the third time since enacting the law in 1985. Set to take effect October 1, 2009, the revised law contains a curious mix of practical fine-tuning and political alignment with other developing countries.

China's National Intellectual Property Rights (IPR) Strategy, issued in June 2008, emphasized the importance of promoting "China's capacity in creation, utilization, protection, and administration of intellectual property" to help improve China's capacity for independent innovation. The revised law will be one tool—albeit an imperfect one—to help China in its ambition to progress from being the "world's factory" to a leader in innovation. The revised law helps to improve patent protection in China through higher standards, but some of its language is vague and some of its provisions, such as those on compulsory licensing, are cause for concern.

Obtaining patent rights

Modified novelty standard

As a condition of patentability, an invention must possess novelty, which under the current law means that no identical invention or utility model has been made public anywhere in the world or used in China. The current law's definition of novelty is a "mixed" or "relative" standard. Article 22 of the revised law, by contrast, articulates an "absolute" novelty standard that is more in line with other countries' standards. In the revised law, "prior art" refers to "any technology known to the public in [China] or abroad before the date of filing." As a consequence of this change, all applicants intent on seeking patent protection in China will need to file a patent application somewhere in the world before the invention is known publicly, either inside or outside China. Importantly, the revised law adds that offering to sell a product whose patent has been granted to another person or entity is prohibited without the authorization of the patent holder.

Quick Glance

- As part of its effort to spur innovation through better intellectual property protection, China recently revised its Patent Law.
- Though some new provisions help align China's patent regime with international practice, others—especially those dealing with genetic resources and compulsory licensing—are cause for concern.
- Changes to China's patent enforcement regime are positive developments.

Design patent changes

An applicant for patent protection in China may obtain any of three different types of patents: invention, utility model, or design. According to the revised Article 2, "invention" refers to "any new technical solution relating to a product, process, or an improvement thereof"; "utility model" refers to "any new technical solution relating to a product's shape, structure, or combination thereof"; and "design" refers to "any new design of a product's shape, pattern, or combination thereof, or the combination of its color and shape or pattern, that creates an aesthetic feeling and is fit for industrial application." Foreign applicants seeking to build a strong patent portfolio have only recently begun to understand the value of design patent protection in China. The revised law makes several changes in the area of design patent protection, though design patent applications will still not undergo substantive examination.

Article 23 extends the "absolute novelty" standard to patentable designs by defining "prior design" as "any design known to the public in this country or abroad before the date of filing." This article also articulates that the design must be "obviously different from the prior design or a combination of features of the prior design."

One undesirable new requirement is that a brief description of the design, optional under the current law, will be compulsory under the revised law. The revised Article 27 specifies that applicants must submit "a brief explanation of the design." As judges or administrative authorities may use the brief description "to interpret the product protected by design patent shown in the drawings or photographs," applicants should not take this requirement lightly. Some observers have expressed concern that the brief description requirement will force the applicant to make a statement that may prove limiting and thus disadvantageous in the event of future patent infringement litigation.

Though the design application may include drawings or photographs, dotted, broken, or shadow lines remain unacceptable, so an applicant will still find it difficult to designate unimportant or minor features he or she does not intend to claim. A single design patent application, however, may include "two or more similar designs for the same product," in which case one design must be appointed the "basic design" in the brief explanation.

Double patenting

Applicants often simultaneously file invention and utility model patent applications. Authorities typically grant the utility model application, which is not substantively examined, eight to ten months after filing, long before the grant of the invention patent. Meanwhile, during the substantive examination of the invention patent, the examiner will ordinarily identify the previously issued utility model patent and require the applicant to choose between the two. The revised law codifies this practice in Article 9.

Genetic resources

Many of the law's revisions were clearly made for practical reasons, but others suggest a change in attitude in Beijing. The most notable of these is the requirement under Article 26 that states, "for an invention-creation, the completion of which depends on genetic resources, the applicant shall indicate the direct source and original source of said genetic resources in the application documents; the applicant shall state reasons if the original source of said genetic resources cannot be indicated." Though consistent with the current practice of a handful of countries, including Brazil, India, and Peru, the genetic resources requirement is not the norm in international practice. Patent holders' main concern with this practice is how commercial benefits would be shared.

Relying upon vague phrases such as "the completion of which depends on genetic resources" does a disservice to applicants, whether domestic or foreign. The ambiguity of such phrases makes it difficult to ascertain what might not be patentable and makes it potentially impossible for an applicant to comply with the procedures of the revised law. The lack of clarity also appears to violate Article 62.1 of the World Trade Organization Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement, which mandates that governments provide "reasonable procedures and formalities" for the acquisition and maintenance of IPR. In addition, the disclosure requirement—limited to genetic resources—adds a new substantive requirement to patentability that exceeds the requirements of Article 29 of TRIPS and Article 5 of the Patent Cooperation Treaty, to which China is a signatory. Furthermore, the genetic resources disclosure requirement may conflict with Article 27.1 of the TRIPS agreement, which specifies that the conditions of patentability be "nondiscriminatory" for different technical fields.

Software

Aware of the consistently high levels of software piracy in China, foreign and domestic industries have long called for the inclusion of patent protection for software. China's protection for this technology, currently available under China's copyright laws, is limited and difficult to enforce. Regrettably, the revised law does not include software as patentable subject matter.

Foreign filing

China's current law requires a PRC entity or individual seeking to file a patent application in a foreign country for an invention created in China to first file in China. This has deterred many foreign companies from undertaking research and development in China. Under Article 20 of the revised law, "any entity or individual may file an application in a foreign country for an invention-creation completed in China, subject to a prior security examination by the Patent Administration Department under the State Council." This is consistent with practice in the United States, where a person may not file abroad within six months of filing a US patent application "for the registration of a utility model, industrial design, or model in respect of an invention made in [the United States]." The only exception is when the US Patent and Trademark Office has granted the applicant a license to do so. Those who fail to seek foreign filing authorization in China may be subject to disciplinary sanction or convicted of a crime if the foreign filing divulges state secrets, as outlined in Article 71 of the revised law.

Ownership and enforcement of patent rights

Compulsory licensing

One of the most controversial aspects of the revised law is compulsory licensing. To date, no compulsory license has

Exceptions to Infringement

China's revised Patent Law outlines several instances in which unauthorized use of a patent would not result in infringement.

Medication and medical apparatus for administrative approval

Article 69 of the revised Patent Law exempts the manufacture of a patented medication or medical apparatus "solely for the purposes of providing information needed for administrative approval" from infringement. This approach is similar to the Bolar exemption, which allows for the use of a patented invention without the permission of the patent rights holder if the use is related to providing information required to obtain regulatory approval. Under this exception, generic drug makers in the United States can manufacture a patented drug before the patent expires to prepare the generic drug for regulatory approval so that the manufacturer can sell it soon after the patent expires.

The Bolar exemption is the result of a balance of interests under which both the patent holder and the generic drug maker benefit. A critical balance is that the generic drug maker can begin to manufacture before the patent expires, and the patent holder's rights are extended, in certain circumstances, for time that the patent holder loses as the third party seeks regulatory approval. (The use of an invention by a third party to obtain regulatory approval without the patent holder's permission is considered to shorten the term of the patent.) The revised law does not require a generic drug to be withheld until the original patent expires and thus does not adequately protect the patent holder.

Patent exhaustion

Another exemption to patent infringement arises under Article 69 of the revised law, which states that there is no infringement "[w]here, after the sale of a patented product that was made by the patentee or an entity or individual with the authorization of the patentee, or of a product that was directly obtained by using the patented process by the patentee or an [authorized] entity or individual ... any other person uses, offers to sell, sells, or imports that product...." This causes difficulty in situations in which a product is patented in China and the patent holder sells the patented product outside China, after which the product is imported into China by another person. The original manufacturer does not intend the sale of such grey market goods and cannot warrant or support products sold in this manner. Ultimately, such activity erodes consumer confidence and damages brand integrity.

—Thomas T. Moga

been granted in China, but certain sectors, particularly the pharmaceutical industry, are concerned that the revised law and China's Antimonopoly Law (AML) could be setting the stage for the granting of compulsory licenses. Under the current law, the government may grant a compulsory license to exploit an invention patent or a utility model patent, and the use of a compulsory license to exploit a patent is permitted in the event of a national emergency or if "any extraordinary state of affairs occurs or where the public interest so requires."

Under the revised law, any entity or individual capable of exploiting the patented invention may request the grant of a compulsory license under either of two conditions outlined in Article 48: first, where the patentee has not "exploited the patent or has not sufficiently exploited the patent without any justified reason" in the three years following grant; or second, where a court or an administrative body determines that the "patentee's exercise of the patent right thereof is an act of eliminating or restricting competition." The second condition is generally based on Article 31(k) of the TRIPS agreement.

The Patent Law's draft revised implementing regulations (which have not yet been passed) define insufficient exploitation as "the situation where the patentee or the licensee exploits the patent in a manner or on a scale that does not meet the domestic demands on the patented product or method" (Rule 80), but the language of the first condition is broad and vague. In addition, the condition is inconsistent with Article 5 of the Paris Convention for the Protection of Industrial Property (to which China is a signatory), which provides for a period of four years from the date of patent application filing or three years from patent grant, "whichever expires last." With regard to the second condition, Article 31(k) of TRIPS indicates that a practice must be found anticompetitive through the judicial or administrative process before compulsory licensing may be authorized. That process is embodied in China's new and substantially unproven AML. Article 55 of the AML states that the law does not apply to the exercise of "legitimate" IPR but does apply to the conduct of business operators that eliminates or restricts market competition through the abuse of those rights. Thus, the AML should be considered in any determination of whether a compulsory license should be granted under the revised Patent Law's Article 48 (2). Given the absence of specific guidelines in the revised law and AML's relative newness, there is considerable concern about how compulsory licensing will be implemented (see p.26).

Article 50 of the revised law for the first time allows the grant of a compulsory license to manufacture medicine that has been granted patent rights in China and export it to countries or regions that conform to relevant treaties to which China is a signatory. Rule 80 of the Patent Law draft revised implementing regulations defines a patented medication as "any patented product or any product obtained by a patented method" that includes "active ingredients for the manufacture of the product and diagnostics for the employment of the product, which are needed in the medical field for the purpose of public health." This is generally consistent with provisions of the Doha Declaration on the TRIPS Agreement and Public Health. Another new addition, Article 53, states that beyond this exception and the exception on granting compulsory licenses for national emergencies or for the public interest provided in Article 49, compulsory licenses may be granted mainly to supply the domestic market.

Enforcement

The revised law embodies important changes to China's patent enforcement regime. Some of these changes represent new practices, while some of them simply codify prior practice.

The revisions give both new and expanded authority to the patent office in resolving disputes, including broad investigative power as set forth in the new Article 64. The revised law also introduces a provision that enables determination of compensation when it is "difficult to determine the losses of the patent holder." In such a case, the court can peg compensation between ¥10,000 ($1,462) and ¥1 million ($146,216), "based on the type of patent, and nature and circumstances of the infringement." This raises the scope of statutory damages from its current range of ¥5,000 ($731) to ¥500,000 ($73,108). Nevertheless, the Intellectual Property Owners Association, a US-based trade association, argued that the upper limit should be left undefined, as "the amount of damages and compensation should always take into account market factors which may be far greater than ¥1 million." Also in the revised law, the amount of compensation due for an act of infringement may be supplemented by "reasonable expenses the patentee has incurred in order to stop the infringing act."

Still room for improvement

China should be commended on the opportunities given to foreign governments and private enterprises to comment on the Patent Law amendments. Many of these changes, perhaps even most of them, are an improvement over the current law. Yet concerns remain about the treatment of compulsory licensing, design patents, and genetic resources. The international patent community remains hopeful that China's revised Patent Law will encourage innovation and portfolio development rather than deterring it. 完

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Patents, Enforce

Patent applications and approvals hit new highs in 2008, boosted by a surge in domestic applications.

Patent Applications and Approvals in China, 2007–08

	2007	2008	% increase	% of total
Patent applications	**694,153**	**828,328**	**19.3**	**—**
Total domestic	586,734	717,144	22.2	86.6
Total foreign	107,419	111,184	3.5	13.4
Invention	**245,161**	**289,838**	**18.2**	**35.0**
Domestic	153,060	194,579	27.1	67.1
Foreign	92,101	95,259	3.4	32.9
Utility model	**181,324**	**225,586**	**24.4**	**27.2**
Domestic	179,999	223,945	24.4	99.3
Foreign	1,325	1,641	23.8	0.7
Design	**267,668**	**312,904**	**16.9**	**37.8**
Domestic	253,675	298,620	17.7	95.4
Foreign	13,993	14,284	2.1	4.6
Patent approvals	**351,782**	**411,982**	**17.1**	
Total domestic	301,632	352,406	16.8	85.5
Total foreign	50,150	59,576	18.8	14.5
Invention	**67,948**	**93,706**	**37.9**	**22.7**
Domestic	31,945	46,590	45.8	49.7
Foreign	36,003	47,116	30.9	50.3
Utility model	**150,036**	**176,675**	**17.8**	**42.9**
Domestic	148,391	175,169	18.0	99.1
Foreign	1,645	1,506	-8.4	0.9
Design	**133,798**	**141,601**	**5.8**	**34.4**
Domestic	121,296	130,647	7.7	92.3
Foreign	12,502	10,954	-12.4	7.7

Note: Percentages calculated by *CBR*.
Source: PRC State Intellectual Property Office (SIPO)

Software Copyright

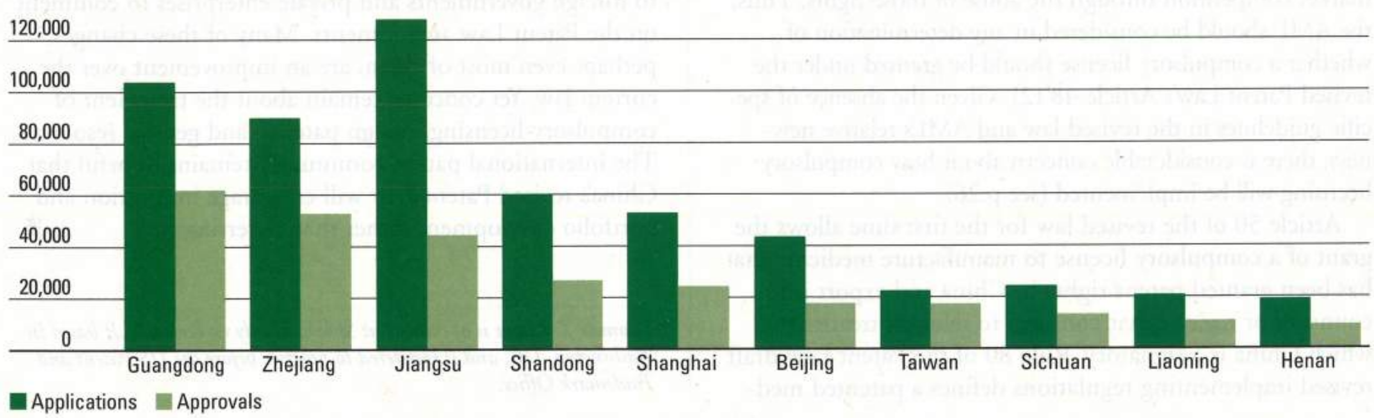
25,666: The number of software registrations in China in 2007, up 15.9 percent over 2006. Of these, 24,518 were registered for copyrights.

8,666: The number of software copyright registrations in Beijing, the city that registered the most copyrights in China in 2007, up 7 percent over 2006.

3,269: The number of software copyright registrations in Guangdong, the city with the second-most registrations in 2007, up 24.6 percent over 2006.

In terms of geographical distribution, Guangdong leads in patent approvals, followed by Zhejiang and Jiangsu.

Top 10 Provinces with the Most Domestic Patent Applications and Approvals, 2008



Notes: Domestic applications and approvals are ranked by total number of patent approvals; SIPO considers Taiwan a province in its rankings.
Source: SIPO

nent, and Seizures

Trademark applications and approvals fell slightly from 2006 to 2007.

Trademark Applications and Approvals, 2006–07

	2006	2007	% change
Applications	766,000	708,000	-7.6
Approvals	275,641	263,000	-4.6

Source: SIPO

Only a small percentage of cases were transferred to courts and public security bureaus

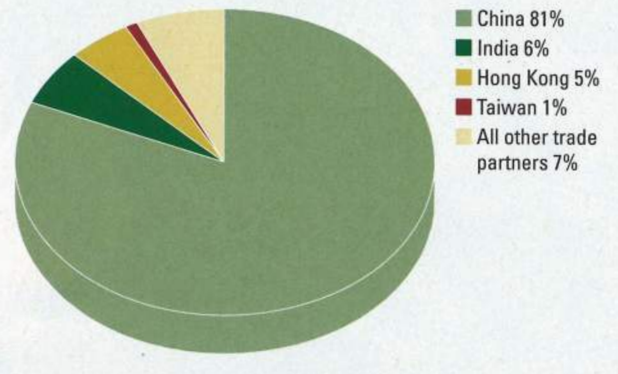
Intellectual Property Rights Enforcement, 2006–07

	2006	2007	% change
Administrative enforcement			
Trademark cases investigated	50,534	50,318	-0.4
Cases involving foreign trademarks	9,562	10,320	7.9
Fines imposed (¥ million)	398	418	5.0
Cases transferred to courts	252	229	-9.1
Criminal suspects	263	228	-13.3
Copyright cases received	10,559	NA	NA
Cases in which administrative sanctions were imposed	8,524	9,816	15.2
Confiscated products (million)	73	76	4.1
Cases transferred to courts	235	268	14.0
Patent cases received	1,227	986	-19.6
Cases transferred to PSBs	12	NA	NA
Civil enforcement			
First-instance civil cases concluded	14,056	17,395	23.8
First-instance cases concluded involving foreign parties	353	668	89.2
Criminal enforcement			
Criminal cases concluded	2,277	2,684	17.9
Defendants found guilty	3,507	4,322	23.2

Notes: PSB = public security bureaus; percent change calculated by *CBR*.
Source: SIPO

The vast majority of infringing goods seized in the United States last year came from China.

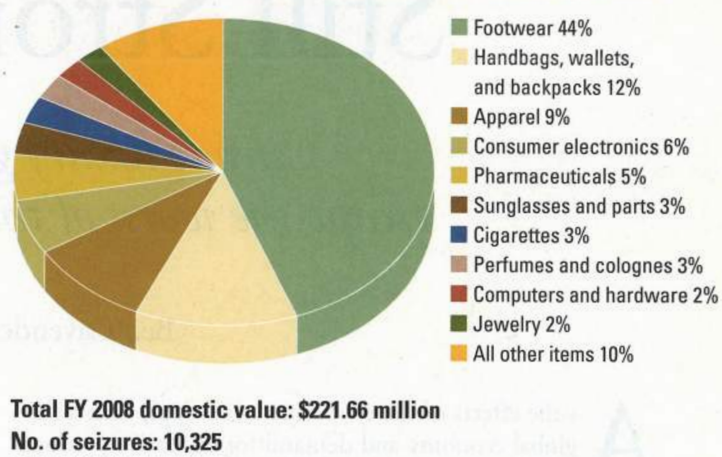
US Top Trading Partners for IPR Seizures, FY 2008



Total FY 2008 domestic value: $272.73 million
No. of seizures: 14,992

Footwear was the top counterfeit good seized from China, followed by bags and wallets.

US Customs IPR Seizures of Goods from China, FY 2008



Total FY 2008 domestic value: $221.66 million
No. of seizures: 10,325

Notes: The US government's 2008 fiscal year (FY) ran from October 1, 2007 to September 30, 2008. "Domestic value" is the cost of the seized goods, plus the cost of shipping and importing the goods into the United States, and an amount for profit.
Source: US Department of Homeland Security US Customs and Border Protection

China Foto Press

Luxury Goods: Still Strong Sellers

China's luxury goods market may escape the worst of the global economic crisis

Ben Cavender and Shaun Rein

As the effects of the economic crisis ripple across the global economy and demand for expensive products plummets, luxury brands face gloomy prospects in North America and Europe. Except in China, consumer spending is in sharp decline, and 2009 does not present much hope for a rebound. Global luxury spending rose 6.5 percent in 2007 before slowing to 3 percent growth in 2008, according to a Bain & Co. report. Indicators from mature markets such as Europe, Japan, and the United States suggest flat or negative growth in 2009.

In the face of reduced demand, luxury brands are turning to China as a potential stronghold for consumer spending in 2009. Like the rest of the world, China is feeling the effects of the economic crisis, and real estate, stock markets, and exports have all taken a beating. But consumer spending in China remains strong. In 2007, retail spending hit ¥8.9 trillion ($1.3 trillion), up 17 percent over 2006, and 2008 retail sales reached ¥10.9 trillion ($1.6 trillion), up 21.6 percent year on year, according to the PRC Ministry of Commerce. Growth in Chinese consumer spending will likely slow during the first half of 2009 but will remain fairly strong. China's comparatively strong economic growth and government policies designed to encourage consumption will also help maintain luxury sales. If luxury brands focus on the desires of Chinese consumers, they may be able to use China as a haven even as other markets falter.

Successful luxury players

Many key luxury players reported strong sales performance in China in 2008, despite the global downturn. For example, LVMH Moet Hennessy Louis Vuitton SA reported "very dynamic" growth in China, led by strong numbers from its leading brand, Louis Vuitton. According to LVMH's 2008 Annual Report, worldwide, China became the second-largest customer base for Louis Vuitton. In addition, LVMH's wine and spirits brands, which have been struggling in other markets, enjoyed "exceptional" growth in China last year, with particularly strong performance from cognac maker Hennessey. China was the largest market for Hennessy cognac last year. Furthermore, in November 2008, LVMH reported that Parfums Christian Dior experienced "excellent" double-digit growth in China through the third quarter. And in its selective retail division, LVMH attributed the recent strong performance of duty-free retailer DFS Group LP to continued expansion of Chinese clientele.

Giancarlo Di Risio, CEO of Gianni Versace SpA, reported last November that Versace does not expect to be heavily affected by the economic downturn because of its high position in the luxury market and superrich clientele. Di Risio is particularly optimistic about China and has remarked that even if China's economic growth slows to 8 percent, it is still good news for the luxury industry. Versace is also optimistic about China's prospects and is focusing efforts on China growth in the coming months, including by opening new boutiques in China in 2009. The company expects Asia to surpass the United States as its second-largest market in 2009, driven largely by growth in China.

China sales also boost the Gucci Group. Gucci Group's global 2008 sales were up about 8 percent over 2007, with the highest growth rates coming from Asia and led by China. According to a 2008 annual report, Gucci's sales in Greater China grew 42 percent over 2007. Last fall, the company said it expected steady consumption growth in China and other emerging markets and would likely continue to prioritize these areas.

Quick Glance

- Though growth in Chinese consumer spending will likely slow during the first half of 2009, it should remain strong enough to support the luxury goods market.
- Consumer optimism, a growing middle class, superrich that are still willing to spend, and government efforts to boost the economy will all contribute to growing demand for luxury goods.
- To succeed in China, luxury retailers should prepare to serve a wider range of customers, offer lower-priced and higher-priced items, improve their service, and educate customers.

Reasons for luxury's success

Consumer spending—and demand for luxury goods—has remained strong in China for several reasons.

Consumer optimism

First, Chinese consumers—especially consumers in their mid-twenties to mid-thirties—are optimistic. In January 2009, the China Market Research Group (CMR) interviewed several hundred consumers in Beijing; Chengdu, Sichuan; Fuzhou, Fujian; Guangzhou, Guangdong; Shanghai; and Xi'an, Shaanxi, about how they have adjusted or are planning to adjust their spending because of the economic crisis. The consumers said that they will spend as planned, with the exception of purchases within the auto and real estate sectors.

A middle class that wants to spend

China's young, emerging middle class is beginning to equate accumulation of possessions and leisure opportunities with quality of life, and it is this group that is largely responsible for China's falling savings rates and rising consumption rates, especially in major cities. Consumers in this group have also been instrumental in driving the growth of the luxury market within China as they try to display their success and status with luxury hand bags and high-end mobile phones, such as those made by UK-based luxury phone maker Vertu (a Nokia subsidiary). This group remains optimistic about its future, despite the drop in China's stock market and falling real estate prices. (Much of China's middle class has little to no stock market exposure, and those with experience expect that the market will rise again.) The group also expects 10–15 percent annual salary increases and strong economic growth over the long term. In the CMR interviews conducted in January, 60 percent of respondents predicted that they would spend more money in 2009 than 2008. Consumer confidence is likely to ebb during the first half of 2009, since companies have been cautious with bonuses and hiring, but consumers are generally maintaining an optimistic outlook for the economy.

Superrich still spend on luxury

Global slowdown in demand and slowing exports from China are unlikely to change the lifestyles of China's superrich, another key consumer group for the luxury market. Versace is counting on this, as described above, as is high-end luxury retailer Hermès. Hermès has seen sales drop in Japan, where many of its customers are middle class. In China, where Hermès customers mainly come from the superrich consumer group, sales have not shown any impact of the downturn thus far. The Asian region, excluding Japan, posted 21 percent growth through the third quarter primarily because of increased demand in China. Hermès is bullish on China and last September announced plans to open three to four more stores in China each year for the next three years.

Trust in the government

In general, Chinese consumers trust the PRC government to make sound policy decisions regarding the economy. Whereas in the United States there is little faith that Congress will respond adequately to the economic crisis, Chinese consumers are extremely confident in the government's ability to respond to economic strain and stimulate growth. In fact, 80 percent of consumers CMR interviewed say that they trust the PRC government and believe it will ensure economic growth in China even during the current global downturn.

Even if sales dip in the short term, China will likely be a major long-term growth engine for the global luxury market.

Economic stimulus plan

In November 2008, the PRC government announced a ¥4 trillion ($585 billion) spending plan to help keep China's growth on track (see p.12). The plan will serve as a direct stimulus to the economy and a signal to Chinese consumers that the government will be quick to act with a "heavy hand," in the words of the State Council, to keep China's economic growth strong. The government hopes the move will instill confidence in consumers and keep spending high so that consumption will help cushion the economy as export demand falls.

Strategies for success in luxury goods

The strong growth reported by luxury heavyweights LVMH, Gucci Group, Versace, and Hermès, combined with the factors above, are reasons luxury retailers can be cautiously optimistic about the China market. Even if sales dip in the short term, China will likely be a major long-term growth engine for the global luxury market. Meanwhile, luxury retailers should consider the following strategies to improve the luxury shopping experience in China, secure the loyalty of Chinese consumers, help weather a sales slump if one occurs, and be well-positioned for stronger growth when demand picks up again.

Prepare to serve a wide range of customers

Luxury retailers on the mainland must be able to serve a wide range of consumers, from the first-time luxury purchaser to the superrich. Salespeople must be able to provide guidance and education to newer entrants to the luxury market, especially for fashion items. According to CMR research, women are generally interested in learning how to apply cosmetics and about the most recent fashion trends, and men are interested in learning how to match items, such as suits with shirts and ties, and choose gifts for wives, girlfriends, and clients or business partners.

Improve service

In CMR interviews with new luxury shoppers, many respondents have described mainland luxury retail salespeople as unhelpful, intimidating, and sometimes rude. Salespeople must be trained well to make shopping a pleasant and luxurious experience and represent their brands' lifestyle to shoppers.

Offer lower-priced luxury items

New luxury shoppers also need access to starter luxury items, including signature accessories—such as belts and key chains—and lower-priced bags and wallets. CMR research shows that shoppers want to touch and try these items in the store before purchasing them. Retailers should accommodate these needs by making such items easily accessible.

Offer top-of-the line items too

In addition to starter items for new luxury shoppers, mainland luxury retailers must offer the newest, top-of-the-line items to satisfy China's seasoned superrich—shoppers who are typically looking for items that will make them feel special and stand out. According to CMR research, many of these experienced luxury shoppers are unable to find the newest products and brands they want on the Mainland. Many have been going to Hong Kong, and the superrich have been traveling to the United States and Europe, to gain access to the latest fashion items.

Educate consumers about the brand

Besides educating consumers about products and fashion, luxury retailers need to educate consumers about what their brands represent. Versace communicated its high-culture,

China's High Net Worth Individuals (HNWI)

Year	HNWI	% increase year on year
2005	320,000	6.7
2006	345,000	7.8
2007	415,000	20.3

Note: HNWIs hold at least $1 million in financial assets, excluding collectibles, consumables, consumer durables, and primary residences. Numbers for 2008 were unavailable as *CBR* went to press.
Source: Merrill Lynch and Capgemini 2008 *Asia-Pacific Wealth Report*

high-fashion image well in its first fashion show in China, held in November 2008. Versace chose Beijing's new Legation Quarter—a new "lifestyle development project" near Tiananmen Square and the Forbidden City—for the show's location. Local elites and celebrities such as Jet Li attended the event, which included a dinner and auction to raise money for victims of the May 2008 Sichuan earthquake.

Though Versace's fashion show communicated its brand image to those in China's super-elite ranks well, next year Versace and companies like it should also communicate to those who aspire to join those ranks. For example, when Salvatore Ferragamo Italia SpA chose Shanghai as the venue for its eightieth anniversary celebration, in addition to hosting fashion shows and parties for the city's elite, it erected a giant replica of its famous rainbow-cork-wedge sandal outside its Shanghai location to be viewed by the masses. Given that the number of millionaires in China in 2007 rose about 20 percent over 2006, according to a Merrill Lynch and Capgemini estimate, companies must target China's aspiring middle class today to reach next year's millionaires (see Table).

Cautious optimism

Because China is an integrated part of the world economy, growth in Chinese demand for certain luxury products and brands may slow as a result of the current downturn. But considering strong numbers from key players thus far, government initiatives, and existing trends in the Chinese economy, such as record-high growth in retail sales, CMR remains cautiously optimistic that China will remain a strong growth source for luxury brands. Luxury brands should continue to prioritize China as a key driver of global growth in the coming months. 完

> Luxury retailers on the mainland must be able to serve a wide range of consumers, from the first-time luxury purchaser to the superrich.

Ben Cavender is senior analyst, and Shaun Rein is managing director, at China Market Research Group (CMR), a strategic market intelligence firm headquartered in Shanghai.

Converting the Downturn to Advantage

In tough times, the best strategy is to push forward

Francis Bassolino, Michael Deering, and Lyuba Tovbina

For the past five years, many international companies have experienced rapid growth in market share and profits in China and have generated savings by improving supply chain effectiveness and efficiency, but at the end of 2008, when the economic crisis deepened, they were having a hard time finalizing budgets that could justify additional investments in China. Earlier in 2008, companies had been planning to add staff and expand revenue and cost-optimizing programs. But the mood has changed dramatically, and it seems profane to push for further investment when serious trouble looms at home.

Nevertheless, operating executives and board members at some major consumer goods companies, including Siemens AG and Kimberly-Clark Corp., have chosen to turn the downturn to their own benefit. In 2009, they are pushing forward with a combination of growth initiatives and cost reduction strategies. In a *China Daily* article, Stephen Shao, president of Kimberly-Clark (China) Co. Ltd. said, "Under the economic gloom, if you spend ¥1 on branding, the effect may be the same as if you spend ¥10 during prosperous times." The leaders of these firms recognize that although this year will cause some pain for domestic and international companies, an overly defensive or flat-footed stance will only result in missed opportunities—during and after the downturn.

Understand the economic climate

China's economy expanded by only 6.8 percent in the last quarter of 2008 compared to the same period in 2007. Starting in November, monthly exports declined year on year for the first time in seven years, and imports plummeted as manufacturers purchased fewer foreign production inputs. The trade numbers continued deteriorating into 2009, with exports and imports plunging 17.5 percent and 43.1 percent, respectively, in January. Foreign direct investment (FDI) into China dropped 36.5 percent in November, 5.7 percent in December, and 32.6 percent in January, compared to the same periods in the previous year. On the ground, factory closures spiked in December and January, resulting in a rise in lawsuits and unemployment. In February, China announced that 20 million migrant workers, or 15.4 percent of the total, were unemployed.

As a result of slowing domestic and international demand, inflation slipped to 1 percent in January, with the price level of non-food goods and services falling by 0.6 and 0.8 percent, respectively, signaling the strong possibility of a deflationary period in the following months. Major economic indicators imply that in 2009 the Chinese economy may fail to meet the government growth target of 8 percent for the first time since 1999. By the end of January, UBS AG had revised its forecast for 2009 gross domestic product (GDP) growth in China to 6.5 percent, and Morgan Stanley had cut its estimate to an even grimmer 5.5 percent. In either case, the global slowdown in demand will be quite painful for the Chinese economy.

Yet in China this downturn is more of a cyclical trough than a sign of structural weakness. Falling exports are not an easy pill to swallow, but it is important to remember that the dependence of the Chinese economy on foreign trade is often overstated. According to a 2007 estimate by Jonathan Anderson, an economist at UBS Investment Research, exports account for less than 10 percent of China's GDP. Dragonomics Advisory Services Ltd. research estimates that net trade contributed about 21 percent of GDP growth over the past three years. China is not Hong Kong or Japan—it is a large continental economy, which affords it a degree of independence from global cycles. Even if the global malaise persists and exports continue to suffer, China can revitalize its economic growth through other means.

Encouraging investment and consumption growth

Over the past five years, investment and consumption contributed about 9 percent of China's GDP growth annually, and in the second half of 2008, the PRC government took several important measures to boost both. The People's Bank of China cut interest rates five times, bringing the benchmark one-year lending rate down to 5.31 percent. In addition, bank reserve requirements were lowered by 250 basis points, loan quotas were abolished, and banks were asked (or rather, strongly advised) to increase lending activity. The result was an immediate surge in bank lending, with loans worth ¥1.62 trillion ($236.9 billion) distributed in January—a single-month record and almost double the amount lent in January 2008.

> **Quick Glance**
>
> ■ Firms that use China as a supply base and those that target the evolving Chinese consumer and industrial markets can find ways to benefit from the downturn, especially when they employ cost-cutting strategies.
>
> ■ In any plan to expand in China, companies should balance the country's favorable government policies, relatively accommodating suppliers, abundant labor, and acquisition opportunities against risks such as economic nationalism.

To encourage lending to small and medium-sized enterprises (SMEs)—a difficult mission given the banking system's tradition of serving state-owned giants—the China Banking Regulatory Commission (CBRC) issued a directive that encourages commercial banks to establish special service desks for SME clients. One major obstacle is that lending to smaller clients requires resources and processes that are in short supply at most PRC banks. To encourage more risk tolerance in the banking system, local governments in areas with high concentrations of SMEs—including Dongguan, Guangdong, and Shangyu, Zhejiang—have allocated funding to provide interest subsidies to SME borrowers and partial repayment guarantees to lending banks. In response to the early success of these policy experiments, the PRC Ministry of Finance has pledged to furnish ¥1.8 billion ($263.2 million) to support local efforts. These steps, as well as positive signs of the development of a corporate bond market, are particularly important in a country where SME owners must often reach into their own pockets to solve enterprise cash flow problems. They may also boost investment spending, which would bolster GDP growth.

In a move to stimulate domestic consumption, the Chinese Communist Party leadership in December 2008 pledged to increase urban and rural incomes significantly over the next three years. Urban incomes could benefit from higher personal income tax thresholds, but given Chinese households' high savings rate, the government will likely channel the cash into government spending instead. Rural incomes will be raised through price controls on agricultural products and oil. Nationwide subsidies of 13 percent of total cost for rural purchases of certain large-ticket items, such as motorcycles and refrigerators, will help boost rural spending.

The government has also made serious attempts to reinvigorate the residential property market. Untimely government policies aimed at tightening the booming property market in the first half of 2008 contributed to an unexpectedly drastic contraction, which in turn exacerbated China's economic slowdown. To increase demand and address the oversupply of high-end property, the government has pushed for more investment in affordable housing projects. Minimum down payments to purchase a home have been reduced from 30–40 percent of total value to 20 percent. The transaction tax has been waived for acquisition of properties intended for long-term use. The restoration of the property market is an essential step in ensuring the speedy recovery of the economy as a whole.

An increase in government spending

To show that new policies will be backed with funds, the PRC government has announced a significant fiscal program in hope that more government spending will pick up the slack for declining export growth. The ¥4 trillion ($585 billion) stimulus package rolled out on November 9, 2008 received mixed reviews from the international community, but there is more to it than meets the eye.

First, analysts estimate that infrastructure spending (which accounts for roughly 80 percent of the stimulus budget) could contribute 2–3 percent to GDP growth in 2009, while indirect benefits, including job creation and better access to inland areas, will provide an additional boost. Second, the national stimulus will act as a top-down directive for local governments to launch their own spending packages. According to the Economist Intelligence Unit, "local governments across China have rolled out some ¥25 trillion [$3.7 trillion] worth of projects to 'supplement' the central government's effort." With the CBRC encouraging banks to support local projects despite the risks, even the poorest provinces will be able to obtain the necessary loan funding to bring a good portion of the plans to fruition. Finally, the stimulus can be viewed as a confidence-building tactic. In a nation where faith in government power remains strong, such a gesture can boost consumer expectations, thereby raising domestic demand.

Seize the day

It is a good time to push cost-optimizing agendas such as strategic sourcing and loan programs. A temporary downturn is unavoidable and will be reflected in slower revenue growth for many firms. But with the exception of export-dependent regions such as Guangdong, where fundamental changes to the dynamics of the market are severe, this downturn is cyclical, not structural. In fact, the downturn can bring a number of benefits to firms that use China as a supply base and those that target the evolving Chinese consumer and industrial markets. This is the right time for firms to expand market share through acquisition, brand development, or aggressive organic growth.

■ **Favorable government policies** Companies that stay in China during the downturn can take advantage of favorable government policies intended to keep them from leaving. The government has provided some breathing room for exporters in the form of higher value-added tax (VAT) rebates on a wide range of products, and anecdotal evidence indicates relaxed enforcement of environmental regulations. For companies looking to invest in additional facilities or equipment, VAT credits on fixed-asset investment will offer substantial opportunities for tax deductions this year. According to Robin Ye, chief of the China Finance Executive Council, "VAT reform ... will make it 13–17 percent cheaper to set up manufacturing operations in China from January 1, 2009 [compared to] 2008." Expanded borrowing opportunities and lower interest rates will also encourage investment, and the government's employment goals will make it a more accommodating host.

Regional governments will implement friendly policies toward companies that stay, as evidenced by Dongguan's recent invitation of major companies in its jurisdiction to a meeting about steps the government could take to create more favorable business conditions. Dongguan has also extended an invitation to build an additional factory at close to zero cost to a large consumer packaging firm and has probably extended similar offers to other large companies operating in the region. On the other hand, companies that decide to leave or downsize will face more hurdles, as governments could reject liquidation requests and fine employers that implement aggressive layoffs.

■ **More accommodating suppliers** After years of rising goods and labor costs, companies that expand in China in

Spark Plug Joint Venture

Expansion during a downturn is risky, but companies willing to take risks in the short run are most likely to claim the prize of China's domestic demand in the long run and to lock in capacity at better vendors. This was certainly the case with Die Bosch Gruppe, a German firm that formed a joint venture with Nanjing Huade Spark Plug Co., Ltd. in 1989, when China's economic growth slipped to about 4 percent. While competitors made drastic budget cuts or pulled out of China completely, Bosch was able to build up its brand name and increase market share. After the economy recovered, Bosch became a market leader, and its competitors were unable to regain lost ground.

The current downturn is likely to speed up the Darwinian process of creative destruction by perpetuating the wave of consolidations that has already washed through some Chinese industries. Thus, foreign firms that stay in China and expand market share during the rainy season will discover themselves, when the sky clears, at the head of healthier, more consolidated industries and facing less price-based competition.

—Francis Bassolino, Michael Deering, and Lyuba Tovbina

2009 will enjoy a buyer's market. In the face of plummeting orders from major clients, some Chinese suppliers will be more flexible. This is the time for foreign firms to reexamine the supply chain, renegotiate contracts, and ask for greater cooperation from Chinese suppliers. But a word of warning is in order. In industries with historically razor-thin margins, mounting losses may not allow for further price cuts. Instead of demanding lower prices, which could drive suppliers out of business, buyers may want to concentrate on acquiring less tangible advantages. These might include better service, more supply-chain and cost information, and long-term cooperation commitments.

■ **Availablity of good workers** As unemployment rises, new graduates and laid-off workers are having trouble finding jobs. Though the new Labor Contract Law took effect in January 2008, selective enforcement of labor regulations will likely become more common as concerns over unemployment grow, especially in traditional export-oriented manufacturing hubs such as Guangdong. Officials will probably crack down on firms that terminate contracts but simultaneously relax temporary labor restrictions and wage controls. Enforcement of labor laws will be inconsistent, and staying in the government's good graces will require knowledge and finesse.

For foreign firms with long-term ambitions in China, the growing pool of available labor presents the opportunity to reshuffle existing human resources and hire better-qualified workers at a lower cost. Since Chinese workers have become adept at job hopping, firms should also reevaluate employee loyalty programs to ensure that quality labor hired during the downturn stays after the economy improves.

■ **Acquisition opportunities** For firms that have held on to a significant amount of cash in the recent boom years, the downturn will offer a host of growth opportunities, including acquisition of assets, competitors, and new product lines. Indeed, in an environment of mounting losses and factory closures, many business owners in China will need to sell, and valuations will be much lower than they were just a few months ago. Financial and operational due diligence will be as tricky as ever, but opportunities to capture market share, extend product lines, and acquire capacity will present themselves in abundance.

In addition, the CBRC in December 2008 issued guidelines for commercial banks to provide loans for mergers and acquisitions (M&A) of both public and private firms. These guidelines effectively changed the government position on M&A lending from "restricted" to "encouraged," making way for the state-owned Industrial and Commercial Bank of China to become the country's first M&A lender by signing an agreement on January 6 to provide loan funding for Beijing Capital Co.'s future acquisition projects. Although all companies registered under PRC law, including wholly foreign-owned enterprises and joint ventures, can in theory take advantage of these loans, it will take time for this type of lending to transition from policy-centric to strictly commercially motivated. Still, the change is likely to lead to more M&A activity, strengthening the Chinese economy in the medium term.

Risks to consider

Although companies will likely benefit from maintaining a firm course in China, there are several short- and long-term risks in the current economic environment. In a country with an immature legal infrastructure and underdeveloped rule of law, an economic downturn often leads to a spike in illegal and unethical practices. Therefore, it becomes even more critical to perform thorough due diligence when evaluating potential suppliers or acquisition targets and to keep a close eye on existing suppliers and partners. To avoid losing important assets and being confronted with disgruntled workers, increased vigilance is prudent. Companies should also diversify their supplier network to insure against supply disruptions.

Continued on page 54

The Tale of Two Vendors

In the years that preceded the recent economic downturn, the rapid growth of exports and domestic demand in China created an environment that allowed many firms to grow rapidly. Some companies built stronger, more focused organizations, while others expanded well beyond their core. This the story of Mr. Hubris and Mr. Steady.

Vendor 1: Mr. Hubris

Mr. Hubris experienced strong export growth from 1999 until the economic crisis began. Riding a wave of success, he began to diversify into real estate, stock trading, initial public offerings, and capital investment. He now sits on a stock portfolio worth significantly less than he expected, a real estate portfolio either just finishing completion or experiencing reduced rents, and a weak export book.

If Mr. Hubris is your supplier, do not put all your eggs in his basket. If you are looking for an acquisition target, Mr. Hubris might be a good bet.

Vendor 2: Mr. Steady

Mr. Steady stuck to his core business. He refused to be lured into expanding into commercial property and chose not to raise money in the public equity markets. He built up efficiencies in his manufacturing operations and is now sitting on a bundle of cash. Mr. Steady is poised to become the largest maker of a commodity and is considering acquiring global brands and building domestic channels for their products.

If Mr. Steady is your supplier, be careful not to lose bargaining power. If he is your competitor, have a strategic plan ready.

—Francis Bassolino, Michael Deering, and Lyuba Tovbina

China's Special Tax Adjustment Regulations: An Action Plan

China's new transfer pricing regime raises documentation costs but presents opportunities for cost sharing

Glenn DeSouza

More than 50 percent of the world's trade involves transfer pricing—the pricing of transactions that occur between subsidiaries of the same group. Transfer pricing can also mask what has become the most significant form of global tax evasion; simply put, multinational corporations (MNCs) can use transfer pricing to shift profits out of one country by overpaying affiliates in other countries for products purchased and undercharging for products sold. Because transfer pricing evasions are so hard to detect, tax authorities around the world have begun to demand that MNCs prepare specific documentation for transfer pricing purposes, which is an expensive burden.

A significant recent change to the global transfer pricing landscape is the release of the Implementing Measures for Special Tax Adjustments (the measures), which include new transfer pricing regulations. The PRC State Administration of Taxation (SAT) finally released the measures on January 9, 2009, and they take effect retroactively to cover all transactions in 2008. Two aspects of the measures are important for MNCs: the significant compliance burden of the new transfer pricing documentation requirements and the opportunities provided by cost sharing.

The implementing measures provide the details necessary to implement the transfer pricing provisions of China's Enterprise Income Tax (EIT) Law, which took effect January 1, 2008. To help monitor transfer pricing compliance, the law requires entities to prepare, keep, and—at the request of the tax authorities—submit contemporaneous documentation to demonstrate that their intercompany pricing is fair and reasonable, or comparable to what a third party would pay. The EIT Law, however, does not provide details on who should prepare documentation and in what format; these questions are addressed in the Implementing Measures for Special Tax Adjustments.

Documentation

An important aspect of the measures was the transfer pricing documentation requirements and the threshold level at which documentation would be required (see Table). Under Article 14, non-exempt entities (entities that exceed the thresholds) must prepare contemporaneous documentation for five areas: organizational structure, business operations, related-party transactions (see p.46 for definition of related parties), comparable analysis, and selection and application of transfer pricing methods. The deadline to complete the preparation of contemporaneous documentation for the 2008 tax year is December 31, 2009. Article 11 of the measures requires all entities to submit nine transfer pricing disclosure forms by May 31, 2009 as part of their annual EIT filing. The raising of these thresholds shows that SAT, alarmed by the economic crisis, has scaled back the requirements in response to investor concerns. The documentation requirement is still a staggering burden, however, and comes as companies are slashing tax consulting budgets and instituting hiring freezes. To make matters worse, documentation is on a by-entity basis and must be filed in Chinese. (Most MNCs have multiple legal entities in China, because entities formed there have narrowly defined business scopes. MNCs that pursue different businesses must operate many entities.)

Quick Glance

- China's Implementing Measures for Special Tax Adjustments contain important information for transfer pricing compliance and cost-sharing opportunities.
- A multinational corporation's entities that operate in China must file disclosure forms on related-party transactions and, if their activities exceed new thresholds, submit contemporaneous documentation.
- Using appropriate functional, financial, and comparable company analyses—and in-sourcing when possible—can cut costs and reduce the likelihood of an audit.

Risks of not filing

Entities may incur several penalties if they fail to submit documentation.

- **Fines** The fine for failure to prepare documentation is ¥2,000–¥10,000 ($292–$1,462) and can rise to ¥50,000 ($7,311) if the taxpayer "refuses" to provide this information.
- **Interest penalties** If the taxpayer provides no documentation, it will be subject to a 5 percent interest penalty on the amount of tax adjustments in addition to the normal People's Bank of China lending rate.
- **Deemed profit** According to Article 115 of the Implementing Regulations of the EIT Law, if the taxpayer has not provided contemporaneous documentation, the tax bureau may apply the deemed profit method and levy tax accordingly.
- **Audit** Article 29 of the measures states that "enterprises that fail to prepare contemporaneous documentation should be selected for audit."

Strategies for documentation

The most important aspects of contemporaneous documentation are the functional analysis, financial analysis, and comparable company analysis. Determining the allocation of functions and risks among related parties is at the heart of any transfer pricing analysis. The more functions performed (in terms of quantity and importance), the higher the expectation of profits. The measures emphasize the importance of functional analysis by requiring taxpayers to complete a "Functional and Risk Analysis" form as part of the contemporaneous documents.

SAT also requires each non-exempt entity to prepare a "segmented financial analysis form of annual related-party and third-party transactions." This analysis requires firms to allocate selling and administrative expenses appropriately, as SAT will likely assess whether net profit on related-party transactions is less than that on third-party transactions.

Use Chinese comparable companies

Whether PRC authorities view a company's transfer pricing as legitimate often comes down to whether the company uses comparable company data to support the position that profits in China are reasonable. The quality of comparable studies done in China varies widely, however. (Comparable studies analyze similar transactions by entities of a similar size in a similar industry, preferably in the same country.) Often, a comparables search of China's market is done in the United States using a generic type of database or by someone unfamiliar with the Chinese market. Given the peculiarities of the Chinese stock market and the fact that annual reports are usually available only in Chinese, the results of such studies are frequently unsatisfactory. At their most basic level, comparables need to be reasonable from an intelligent layman's perspective. The local PRC tax authorities tend to reject studies they cannot understand or find unpersuasive because the comparable study uses data from a different industry or country. Comparable data should also be technically sound and based on correct statistical principles, because provincial- and central-level authorities are well-versed in comparable company analysis and will throw out comparables that are unreliable or appear to have been selected to support an entity's case.

Given recent economic conditions, the typical three-year comparable companies analysis that compares a company to the 2005–07 average of comparables will often result in a company being measured against an unrealistic benchmark. Instead, when submitting comparables, companies should

- Update and extrapolate the comparable companies' data to reflect the most recent and anticipated developments;
- Present internal group information to show that Chinese subsidiaries are making greater profits than their corporate headquarters or other subsidiaries; and
- Identify negative industry developments, such as bankruptcies and sales declines.

Minimize compliance costs

In this era of frozen budgets, companies need to think creatively. A traditional interview-based, prose document will only waste time and money. Excessive or incorrect information can be costly, time-consuming, and may prompt an investigation.

- **Match effort to level of risk** The amount of resources spent on documentation should be consistent with the level of exposure. If the entity has low audit detection risk (it is unlikely to be asked to submit contemporaneous documentation) and low adjustment risk (it is small and profitable), it should spend only a modest amount on preparation.
- **Use a tabular approach** To reduce translation and updating costs, preparers should use data tables rather than prose descriptions.

A notable, positive feature of the measures is that they allow intercompany cost sharing.

- **Apply China master files** Where entities perform the same function, the benchmark results and functional analysis should be shared across the group to ensure consistency and enhance efficiency.
- **Use technology** Take advantage of transfer pricing software, templates, and other tools to streamline the documentation process. For example, for detailed information on PRC companies, entities may consider a China-specific comparables database system.
- **In-source where possible** Given that consultant billing rates in China are higher than in most countries, including the United States, it makes sense to perform as many tasks as possible in-house, especially with regard to data collection, functional analysis, and updating. Through in-sourcing, companies may also capitalize on in-house experience and institutional knowledge.
- **Use SAT formats** Companies should avoid using a global template. SAT has prescribed specific forms and checklists that are unique to China. These requirements should be honored to enhance the likelihood that the local tax officer

Defining "Related Party" in PRC Law

The Implementing Measures for Special Tax Adjustments outline eight kinds of related-party relationships:

- One party directly or indirectly owns 25 percent or more of the other party or 25 percent or more of both parties are commonly owned directly or indirectly by a third party; where one party owns shares of the other party through an intermediary and owns 25 percent or more of the intermediary, the percentage held indirectly is the percentage of the other party's shares owned by the intermediary.
- Debt provided to one party (except to independent financial institutions) by the other party accounts for 50 percent or more of the debtor's paid-in capital or 10 percent or more of one party's debt is guaranteed by the other party.
- 50 percent or more of one party's high-level management (for example, directors and managers), or at least one senior director who is in a position to control the board of directors is appointed by the other party, or the above-mentioned personnel of both parties are appointed by a third party.
- 50 percent or more of one party's high-level management is also the high-level management of the other party, or at least one senior director of one party who is in a position to control the board of directors is also a senior director of the board of directors of the other party.
- Business operations of one party rely on the industrial patent, technological know-how, or other licensed intangible property provided by the other party.
- Buy-sell transactions of one party are primarily controlled by the other party.
- Receipt or provision of services of one party is primarily controlled by the other party.
- Other situations where one party has effective control over the other party's business operations and transactions or other relationships arising from mutual interests, such as relationships where the majority shareholder of both parties enjoy basically the same economic benefits and family relationships.

—Glenn DeSouza

accepts the transfer pricing documentation and the information and analysis it contains. A global template will likely create resistance, generate confusion, and invite questions.

Cost sharing

A notable, positive feature of the measures is that they allow intercompany cost sharing. Though cost-sharing arrangements are restricted in certain areas—for example, sharing intercompany services is limited to marketing and procurement arrangements—they can generally be used for intangibles, typically the research and development of intellectual property. MNCs that operate at a loss in their home markets but are profitable in China could minimize global taxes through these measures by, for instance, having their China entities buy into the multinational's preexisting intellectual property under an internationally recognized cost-sharing arrangement. This would provide a way to shift profits and cash out of China and back home.

Another common complaint among global tax directors is that service fees that China-based entities pay out of China are subject to taxes. The measures allow cost sharing for group marketing and procurement services but, unfortunately, this provision cannot be fully utilized with certainty until one crucial area is clarified—namely, the business tax and corporate income tax treatment associated with service cost-sharing payments. Service fees paid out of China are subject to withholding taxes if a permanent establishment exists in China. Whether a cost sharing payment would be exempt from such taxes is unclear, and MNCs should watch for further developments in this area.

Thin capitalization

Thin capitalization rules have become an important element in the corporate tax systems of developed countries as a way to counter the abusive use of loan-financing to reduce the taxable income of the borrowing enterprise. In its evolution toward an increasingly sophisticated tax regime, China introduced a thin capitalization requirement in the EIT Law. The measures (together with Caishui [2008] No. 121) address thin capitalization and set the allowable debt-to-equity ratio for financial enterprises at 5:1, and at 2:1 for other enterprises. Any interest paid on debt to related parties that exceeds the ratio shall be non-deductible. Transfer Pricing Management Consulting experience indicates that this circular may allow many MNCs to reduce the marginal effective tax rate of their subsidiaries in China through debt push-down (adding more debt and getting a larger interest deduction); conversely, some entities will face the risk that interest expenses will be disallowed.

China's tax regime in transition

The measures come as China needs taxes to pay for its ¥4 trillion ($585 billion) economic stimulus plan. At the same time, senior PRC leaders are emphasizing that job creation and continued economic growth remain the main priorities. Transfer Pricing Management Consulting believes that China will maintain its investor-friendly attitude and that tax inspectors will take a balanced and reasonable approach. The measures impose significant burdens on MNCs, but these burdens can and should be handled in a practical and cost-effective manner. On balance, the measures are a necessary step forward and signal that China's economy is becoming more developed and complex. 完

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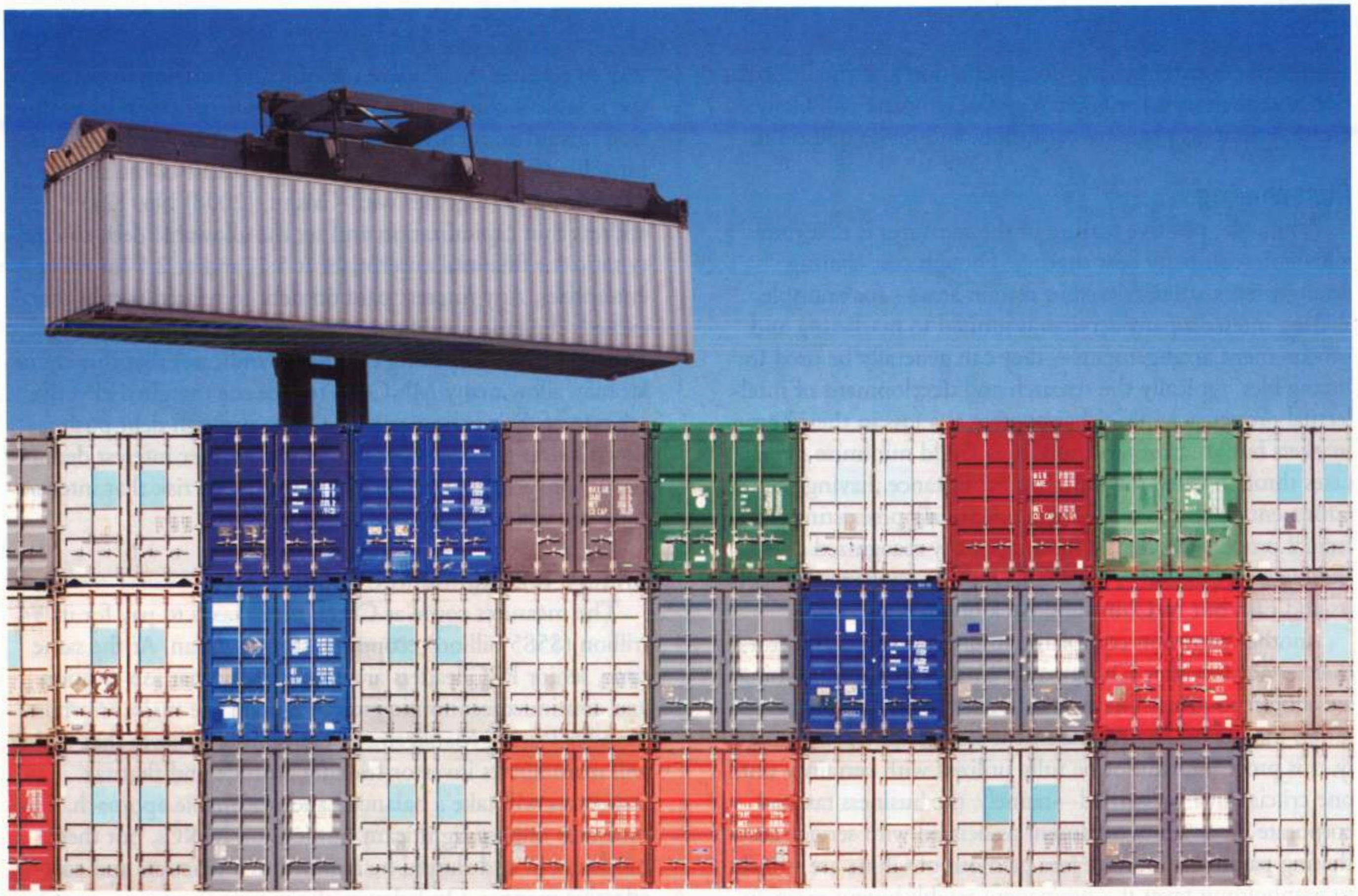
China's Transfer Pricing Documentation Requirements

Compliance obligation	Content	Who should file	2008 documentation due date
Disclosure forms	■ Related-Party Relationships: List of Associated Parties ■ Summary of Intercompany Transactions ■ Related-Party Transactions: Purchases and Sales ■ Related-Party Transactions: Services ■ Related-Party Transactions: Intangible-Assets Transfers ■ Related-Party Transactions: Fixed-Assets Transfers ■ Related-Party Transactions: Financing ■ Report of Outbound Investments ■ Related-Party Transactions: Offshore Remittances	All entities	May 31, 2009
Contemoraneous documentation	■ Organizational structure ■ Business operations ■ Related-party transactions ■ Comparable analysis ■ Selection and application of transfer pricing methods	Entities with annual related-party sales and purchases totaling at least ¥200 million ($29.2 million) or with other related party transactions totaling at least ¥40 million ($5.8 million)	December 31, 2009

Source: Implementing Measures for Special Tax Adjustments



Ramping Up Customs Compliance Reviews

Companies must create strong compliance teams and comprehensive checklists to stay on the right side of the law

Tony Kerr

During the past few years, little has been more bewildering, frustrating, and costly for companies than new government requirements for compliance in almost every area of business. In addition to requirements under the 2002 Sarbanes-Oxley Act, companies face new security, health, and quality requirements, some of which apply to the cross-border movement of goods.

Customs compliance requirements have been affecting a growing number of businesses involved in the cross-border movement of goods and the manufacture of goods under bonded conditions. Free-trade agreements have also added customs requirements, because the agreements often contain provisions for the sharing and disclosure of companies' information with other customs authorities or for audits by teams from an importing country's customs service.

To ensure full compliance with complex and changing customs requirements, companies should take a holistic approach. Any company that uses a myopic or piecemeal approach is likely to overlook potentially serious problems in its business transactions that may be found during a customs audit. Having a sound, efficient, and effective customs compliance review program in place will certainly pay dividends.

China's customs environment

Since China's World Trade Organization (WTO) entry in 2001, the PRC General Administration of Customs has made significant strides toward becoming a modern and transparent authority. Though the abilities of China's customs officials have improved enormously over the last decade, China's customs regime still faces many transparency issues and differences in interpretation among regional offices. As a result, companies must be fully aware of statutory and regulatory requirements from a cross-border perspective.

Changes that have affected the country's economic and industrial environment include the rapid development of free-trade zones, export-processing zones, bonded logistics parks and centers, and bonded harbors, all of which are supervised by Customs. Despite their advantages for companies and localities, these areas have introduced new difficulties that Customs officials have sought to resolve. For instance, authorities in local free-trade and bonded zones often provided incentives that pushed legal boundaries to entice investors to establish their business within a particular zone. Some practices allowed the storage of non-bonded goods within a bonded area or allowed major processing in areas that only legally permitted minor processing. In addition, some customs offices in these zones allowed transactions between related parties that did not comply with customs valuation rules under the WTO and PRC customs laws. This practice grew considerably until a few years ago, when Customs and the State Administration of Taxation realized how much revenue was being lost and how much noncompliance in these areas had grown.

Customs has begun slowly taking steps to correct these practices. For example, Customs is monitoring processing-trade enterprises better and is using independent third-party auditors to perform compliance audits. It has also introduced new laws to make it clearer to processing-trade enterprises that they must obtain Customs approval before moving goods to other manufacturers. With these changes, many companies that have benefited from noncompliant practices will find becoming fully compliant an expensive exercise.

The importance of customs compliance

Companies should be aware that major noncompliance with customs requirements could bring a significant part of their business to a halt, especially if China is a key part of a company's supply chain and their China supply chain is noncompliant. The impact of noncompliance on a flourishing business cannot be underestimated, though the risks depend upon the severity of the noncompliance. For example, Customs can downgrade a company's customs status, resulting in clearance and approval delays. It can also inflict heavy penalties and collect revenue retroactively. For serious noncompliance, the legal representative of the China entity can face questioning, travel restrictions, or detainment pending the outcome of an investigation. Moreover, companies that fail to comply with PRC Customs and are publicly listed in the United States may face criminal charges in China and suffer the economic, legal, and reputational effects that such charges can have on a company and its board of directors.

Quick Glance

- Companies should take a holistic approach to ensure full compliance with China's complex and changing customs requirements.
- At minimum, companies involved in cross-border trade or manufacturing under bonded conditions should complete a full customs compliance review of their operations once a year.
- They must also decide whether to set up an in-house customs compliance team or hire an external service provider to conduct reviews.

Find compliance problems—and fix them

When China entered the WTO, it enticed foreign companies with its large, low-cost workforce and generally lower business costs. In their rush to enter China, however, many of these new investors failed to conduct the all-important planning, due diligence, risk assessment, and implementation of quality- and internal-control systems required for sound investment.

A key part of planning is conducting a risk assessment of a country's regulatory climate and, for import-export and manufacturing companies, an in-depth analysis of its customs regime and other border-agency requirements. Companies that do not conduct adequate risk management in their early ventures often face costly and complex customs problems as a result. And if they have a weak network of contacts and lack knowledge of customs requirements, they often experience lengthy delays and high costs when resolving customs problems. Some of the steps taken to resolve these matters can cause other noncompliance issues beyond customs. For example, new problems can arise if an individual within a company attempts to fix a problem on his or her own and inadvertently puts the company in breach of its obligations under the US Foreign Corrupt Practices Act (FCPA).

Today, China is more transparent and has new laws that more closely reflect the global trading environment. There are more avenues available to address concerns legitimately and a greater openness to discuss and resolve issues. In addition, several well-established business associations, such as the US-China Business Council (publisher of the *CBR*) and American Chamber of Commerce, provide useful information on regulatory changes and their potential impact on business and assist companies through a network of business and government contacts.

Yet even in this improved environment, some companies fail to establish customs compliance programs or conduct a complete and systematic compliance review that would allow them to identify and quantify any potential exposure. At minimum, every company involved in cross-border trade or manufacturing under bonded conditions should complete a full customs compliance review of each of their operations once a year (see Table). The review can be conducted by internal customs and trade specialists or by a third party.

Compliance teams—internal or external?

Each company must decide whether to set up an in-house customs compliance team or hire an external service provider to conduct its reviews. Most companies conclude that maintaining an in-house customs compliance team is the most cost-effective solution, even though its cost can be substantial.

To develop an effective internal customs team, companies must hire sufficient personnel with advanced customs and trade skills and give them the full support of all business units within the company and of all levels of management. The team must also have an adequate budget and resources for it to function effectively. In addition, it should have an excellent network of contacts in PRC and US customs and other government departments with whom team members can liaise to keep up-to-date on the latest legal changes that affect their industry. In a small- to medium-sized operation, a two-person team for each region should be enough, while a larger operation will need at least three to five people per country, depending on the number of entities the company has within that country.

An external service provider would have a team of customs and international trade experts that can normally function as a company's global service provider. Though costs would likely be higher for the first full compliance review, follow-up reviews during the course of a year should cost much less.

Whether a company uses an internal customs team or an external service provider, the team or service provider must follow the requirements of the US FCPA, PRC anticorruption laws, and similar legislation in discussions with PRC government authorities and local bodies. (China has not yet implemented a comprehensive anticorruption law, but government agencies have their own provisions relating to payments, entertainment, and gifts.) For US-based companies, it is important that all staff, including a company's internal cus-

Key Areas to Include in Customs Compliance Programs

Compliance area	Comments
Pre-shipment inspection and license requirements	These inspections and requirements particularly affect used and refurbished products, medical devices, pharmaceuticals, and agricultural and food products. Products that have been repaired and are being imported as "replenishment stock" for use in after-sales servicing are considered used and require pre-shipment approval for their import. Such products cannot be stored within bonded facilities in China.
Harmonized System of tariff classification	Incorrect classification affects duty rates, value-added tax rates, origin, labeling, permit requirements, license requirements, export controls, and import-export prohibitions and restrictions.
Customs value	Related parties are subject to valuation checks, and a transfer price that complies with Organization for Economic Cooperation and Development guidelines will not be accepted for customs purposes (see p.44). If royalties, distribution fees, and franchise fees are applicable, they may be added into the value by PRC Customs.
Certificate of origin	Companies should ensure they have correct documentation that is fully certified by the approved issuing authority in the country of manufacture.
Customs licenses and approvals; business licenses	Companies should confirm that ■ They comply with processing trade approvals and associated manuals; ■ Their business complies with acquired approvals; and ■ Their business licenses comply with the approved scope and any other requirements.
Entities in bonded locations	Companies should ■ Monitor the bonded zone's customs requirements and comply with them; ■ Confirm that controls on the movement of goods within and outside of a bonded facility are in place and effective; ■ Comply fully with processing-trade export requirements (if a processing-trade entity), and obtain the appropriate approvals (if importing finished products); and ■ Review security and inventory controls.
Customs brokers and logistics service providers	Companies must set controls to monitor the work that third parties do on their behalf. The acts performed by third parties regarding a company's goods are legally the acts of the principal.
Employees	Companies should ensure they have good job descriptions and training for staff. Companies should also be aware that disgruntled employees could divulge company information to authorities.
Foreign Corrupt Practices Act (FCPA) and similar legislation	Companies must provide good FCPA-related training and awareness programs to all employees and third-party service providers. They must also have effective controls on discussions with government authorities and any proposed entertainment of these authorities.
Export control legislation	Companies should classify their products correctly within US export control legislation to ensure they have the correct instructions for their products.
Document retention	PRC Customs, State Administration of Taxation, and business registration laws all require some form of document retention. Companies need to understand what each document is and in what format it can be retained.
Finance	Companies should record inward and outward revenue and ensure that the recording of payments made or received and their associated orders or purchase agreements are accurate, complete, and properly authorized.
Internal logistics	Companies should also verify that the actions that personnel in this area take comply fully with Customs and other cross-border requirements.

Source: Bryan Cave International Trade LLC toms team, are fully aware of FCPA provisions and PRC anti-corruption legislation. Companies should also ensure that the consultancy or legal firm they have retained is fully conversant in these types of legislation and practices full compliance.

General customs requirements

Companies reviewing their customs compliance in China should initially think about three things: the valuation of their products, especially products traded between related entities; the classification of the product under the Harmonized System of tariff classification; and the origin of goods from a preferential tariff and a labeling perspective.

Companies should also review their compliance with other requirements that could affect Customs' clearance of their goods. Such requirements may include PRC Administration of Quality Supervision, Inspection, and Quarantine approvals; laws and regulations related to approved processing-trade entities (bonded manufacturing entities); laws and regulations related to entities in free-trade zones and other bonded areas or facilities; PRC export control regulations; foreign corrupt practices legislation or similar legislation; and record retention laws of Customs and SAT, as well as those under companies' business license approvals. Companies with ties to the United States must also comply with US export control laws.

Another important area for companies to check is the compliance of any third party that interfaces with Customs on their behalf. This should be a standard check when a company first hires its customs broker or similar third-party service provider and on a regular basis thereafter. The compliance review of a customs broker or agent should identify the processes that it uses to represent the client company at Customs. It should also confirm that the broker or agent classifies goods correctly under the Harmonized System and understands customs valuation well. To ensure that its interests are not compromised, a company should also investigate the relationships its service providers have with Customs and other government officials. In particular, companies should regularly check the accounts they receive to confirm that the fees being charged are in accordance with what they have negotiated. They should question any extra fees and ask for evidence to support the fee. In addition, companies should speak with their service providers' staff to understand how they interact with government officials—including whether they entertain officials or provide other services. A company should also investigate if it imports products it knows should have some restrictions or inspections, yet the goods arrive without delays or inspections.

Processing trade requirements

Entities that are approved by Customs to import raw materials without paying customs duty and value-added tax are known as either bonded manufacturers or Customs-approved processing-trade entities. Bryan Cave International Trade LLC has observed that many of these companies tend to have poor inventory controls in place on raw-material use and finished-goods production. It has also noted that processing-trade entities frequently move goods to other manufacturing entities when they have no further capacity to manufacture, often without Customs approval. Again, effective internal control procedures should be in place to ensure good inventory control and to ensure that appropriate approvals are sought.

Major noncompliance with customs requirements could bring a significant part of a business to a halt.

Merger, acquisition, and joint venture requirements

Companies often overlook customs compliance verification when considering mergers, acquisitions, and joint ventures. When companies seek to acquire another company or to enter into a joint venture agreement, their auditors or legal representatives, either in-house or external, usually conduct legal and financial due diligence reviews of the target entity, but often fail to include full customs and trade due diligence. When the target entity is a trading or manufacturing entity that has been importing and exporting goods, the acquiring company can be held accountable for the target company's noncompliance if revenue authorities conduct an audit. (Though there is a limit on the pursuit of shareholders in these instances, Customs can claim revenue, impose penalties, and disrupt operations because of past offenses by the previous company.)

Don't miss your annual check-up

A regular compliance program is like a regular health exam—people need a yearly check-up, but they must decide whether to visit and pay for a family doctor or a team of specialists. Whether a company has in-house personnel to undertake this compliance function or hires external consultants is a business decision that should be based on getting the best professionals to do the work. The discussion above lists just a few of the areas in which noncompliance can occur. As China tightens customs enforcement, companies can only benefit from getting their own house in order and fully complying with the letter of the law. 完

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Sales and Investment

January 2009

The following listings contain information from recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by the *CBR*. Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in the *CBR* by sending the information to the attention of the editor (publications@uschina.org).

Compiled by Nicholas Chu, Arie Eernisse, and Daniel Strouhal

Accounting

OTHER

Qiao Xing Mobile Communication Co., Ltd. (Beijing)
Hired US-based Crowe Horwath LLP as its independent registered public accounting firm.

Renhuang Pharmaceuticals, Inc. (Heilongjiang)
Hired US-based Moore Stephens, PC as its independent auditor.

Advertising, Marketing & Public Relations

OTHER

ANTA Sports Products Ltd. (Fujian)
Signed three-year sponsorship contract with Serbian tennis player Jelena Jankovic.

Automotive

INVESTMENTS IN CHINA

BorgWarner Inc. (US)/China Automobile Development United Investment Co., Ltd., a consortium of 12 PRC automakers
Signed contract to form JV, BorgWarner United Transmission Systems, to produce dual-clutch transmission modules in Dalian, Liaoning, starting in 2011. (US:66%-PRC:34%).

Daimler AG (Germany)/Beiqi Foton Motor Co., Ltd. (Beijing)
Will establish JV, Beijing Foton Daimler Automotive Co., to start producing diesel engines in 2011 and trucks in 2012. (Germany: 50%-PRC:50%). $929 million.

Ford Motor Co. (US)
Won MOFCOM approval to set up Greenway (Taicang) Auto Sales Co. Ltd. in Jiangsu.

Aviation/Aerospace

INVESTMENTS IN CHINA

Airbus China, a subsidiary of Airbus SAS (France)/Hafei Aviation Industry Co. Ltd. (Heilongjiang), AviChina Industry and Technology Co. Ltd. (Beijing), Harbin Development Zone Heli Infrastructure Development Co. Ltd. (Heilongjiang), and Harbin Aircraft Industry (Group) Co., a subsidiary of AVIC
Signed agreement to build a factory in Heilongjiang to jointly produce composite materials and components for the A350 aircraft. (France:20%-PRC:80%).

OTHER

China Southern Airlines Co., Ltd. (Guangzhou)
Opened a representative office in Taiwan.

FedEx Corp. (US)
Terminated contract with Tianjin-based Okay Airways Corp. Ltd. after Okay suspended flights because of financial difficulty.

Banking & Finance

INVESTMENTS IN CHINA

UBS AG (Switzerland)
Increased its stake in Guangdong-based China Merchants Bank from 7.95% to 8.15%. $9.7 million.

OTHER

Bank of America Corp. (US)
Sold 5.62 billion shares in Beijing-based CCB. $2.8 billion.

Citibank (China) Co., Ltd., a unit of Citigroup Inc. (US)
Won CBRC approval to establish a company, Dalian Wafangdian Citi Lending Co., Ltd., in Liaoning.

Deutsche Bank AG (Germany)/ Shanxi Securities Co.
Won CSRC approval to establish a securities JV, Zhong De Securities Co. (Germany:33.3%-PRC:66.7%).

Royal Bank of Scotland plc
Sold 10.8 billion shares in Beijing-based BOC. $2.3 billion.

Education

OTHER

Microsoft Asia Pacific & Greater China Customer Service and Support, a unit of Microsoft Corp. (US)
Signed MOU with Shanghai-based East China Normal University and Tongji University's School of Software Engineering to establish a center to train at least 30 technical support and service personnel each year.

The Symbio Group (US)
Signed agreement with Beijing Jiaotong University School of Software Engineering for educational collaboration.

Electronics, Hardware & Software

CHINA'S IMPORTS

AU Optronics Corp., Chi Mei Optoelectronics Corp. (Taiwan)
Signed deal with nine PRC television set producers to supply 120 million liquid crystal display panels. $2.19 billion.

INVESTMENTS IN CHINA

Fujitsu Quality Laboratory Ltd., a wholly owned subsidiary of Fujitsu Ltd. (Japan)
Established subsidiary in Jiangsu, Fujitsu Quality Laboratory (Suzhou) Ltd., that will offer local quality and environmental assurance services for electronic components procured from China by Japanese manufacturers.

GE Transportation, a unit of General Electric Co. (US)
Signed two letters of intent with Liaoning-based A-Power Energy Generation Systems Ltd. to supply A-Power with 900 2.7 MW wind-turbine gearboxes and establish a joint partnership to build those gearboxes in China.

IBM Corp. (US)
Acquired 1.56% stake in Sichuan Changhong Electric Co., an electronic products manufacturer. $15.8 million.

Shanghai Epic Music Manufacturing Operations, a JV between Sony Music Entertainment Inc. (Japan), Shanghai Synergy Group, and Shanghai Jingwen Investment
Will build a Blu-ray Disc production line with monthly capacity of 500,000 discs in Shanghai.

Energy & Electric Power

CHINA'S IMPORTS

Invensys Process Systems, a unit of Invensys plc (UK)
Won contract to supply China Nuclear Power Engineering Corp., a unit of Beijing-based China National Nuclear Corp., with four fully digitalized control rooms for two nuclear plants in Fujian and Zhejiang. $250 million.

SPX Corp. (US)
Won two contracts to provide dry cooling systems for power plants in Shanxi and Inner Mongolia. $51 million.

Environmental Equipment & Technology

CHINA'S EXPORTS

ET Solar Group Corp. (Jiangsu)
Signed sales agreement with Germany-based USE GmbH to supply 13 MW of high-efficiency solar modules.

ReneSola Ltd. (Zhejiang)
Will supply BP Solar International Inc., a unit of UK-based BP plc, with 120 MW of monocrystalline and multicrystalline solar wafers.

Suntech Power Holdings Co., Ltd. (Jiangsu)
Supplied 5 MW of solar panels for a 10 MW solar electricity system in Abu Dhabi, UAE.

OTHER

Sembawang Engineers and Constructors, a subsidiary of Punj Lloyd Ltd. (India)
Signed MOU with Sino-Singapore Tianjin Eco-city to study the feasibility of building a $1 billion solar polysilicon production plant.

Food & Food Processing

INVESTMENTS IN CHINA

Asahi Breweries, Ltd. (Japan)
Will increase its stake in Shandong-based Tsingtao Brewery Co. Ltd. to 31% by acquiring 19.9% stake from Belgium-based Anheuser-Busch InBev. $667 million.

OTHER

Starbucks Corp. (US)
Will sign framework agreement with Yunnan provincial government to help upgrade the quality of local coffee beans.

Media, Publishing & Entertainment

CHINA'S IMPORTS

Strong Westrex Co., a subsidiary of Ballantyne of Omaha, Inc. (US)
Will provide and install 100 NEC STARUS NC1600 digital cinema projectors for China Film Group Corp.

Medical Equipment & Devices

INVESTMENTS IN CHINA

Sichuan Joint-Wit Medical & Pharmaceutical Industry Co. Ltd./SU BioMedicine BV, a subsidiary of TNO Bedrijven BV (the Netherlands)
Will form JV, Chengdu Zhonghe Huicheng Biopharmaceutical Co. Ltd., in Sichuan for cooperation on R&D, manufacturing, and marketing. (the Netherlands: 50%-PRC:50%). $1.46 million.

Metals, Minerals & Mining

OTHER

Image Resource NL (Australia)/Hainan Provincial Bureau of Geological Exploration
Signed MOU to release composite samples of Hainan's North Perth Basin to facilitate negotiations on the commercialization of basin resources.

Miscellaneous

CHINA'S INVESTMENTS ABROAD

Markor International Furniture Co., Ltd. (Xinjiang)
Acquired US-based Schnadig Corp. $8.94 million.

OTHER

Government of Germany/ Government of PRC
Signed six agreements on energy, environmental protection, biochemical, infrastructure, transport, logistics, financial services, and creative industries protection cooperation.

Petroleum, Natural Gas & Related Equipment

CHINA'S INVESTMENTS ABROAD

National Iranian Oil Co./ CNPC (Beijing)
Signed deal for the development of Iran's North Azadegan oil field. $1.76 billion.

OTHER

Norwegian Ministry of Petroleum and Energy/NDRC
Signed MOU to enhance economic cooperation in the petroleum sector.

Vietnam Oil and Gas Corp./ XinAo Group Co. Ltd. (Hebei)
Signed MOU on energy cooperation.

Rail

CHINA'S EXPORTS

China Civil Engineering Construction Corp., a unit of China Railway Construction Corp. (Beijing)
Signed construction agreement with the Libyan railway authority to build a 172 km section of a railway in Libya. $805 million.

Dongfang Electric Corp. (Sichuan)
Signed contract to provide Pakistan Railways with 75 locomotives. $51 million.

CHINA'S IMPORTS

ThyssenKrupp AG (Germany)/ Shanghai Maglev Transportation Development Co., Ltd.
Signed MOU on transferring parts technology for the Transrapid magnetic high-speed rail project.

INVESTMENTS IN CHINA

MTR Corp. Ltd. (Hong Kong)/ Hangzhou Metro Group Co., Ltd. (Zhejiang)
Will form JV to jointly develop and operate a mass transit rail line in Hangzhou, Zhejiang. (Hong Kong:49%-PRC:51%). $3.2 billion.

Raw Materials

INVESTMENTS IN CHINA

CRH plc (Ireland)
Acquired 26% stake in Yatai Cement, a subsidiary of Jilin Yatai (Group) Co., Ltd. $311 million.

Real Estate & Land

INVESTMENTS IN CHINA

The Bank of East Asia, Ltd. (Hong Kong)
Purchased a 10-story A-class office building in Shanghai.

Research & Development

CHINA'S INVESTMENTS ABROAD

Government of the PRC
Established third research station in Antarctica.

Abbreviations used throughout text: ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; ATM: automated teller machine; AVIC I and II: China Aviation Industry Corp. I and II; BOC: Bank of China; CAAC: Civil Aviation Administration of China; CATV: cable television; CBRC: China Banking Regulatory Commision; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum Corp.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; DSL: digital subscriber line; ETDZ: economic and technological development zone; GSM: global system for mobile communication; GPS: global positioning system: ICBC: Industrial and Commercial Bank of China; IP: Internet protocol; IT: information technology; JV: joint venture; LNG: liquefied natural gas; LOI: Letter of intent; MIIT: Ministry of Industry and Information Technology; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; NORINCO: China North Industries Corp.; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; R&D: research and development; SARFT: State Administration of Radio, Film, and Television; SASAC: State Assets Supervision and Administration Commission; SEZ: special economic zone; Sinopec: China Petroleum & Chemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; Wi-Fi: wireless fidelity; WFOE: wholly foreign-owned enterprise.

Retail/Wholesale

INVESTMENTS IN CHINA

Beijing Huadesheng Property Management Co., Ltd., a wholly owned subsidiary of Parkson Retail Group Ltd. (Hong Kong)
Signed agreement with Beijing Suntrans Real Estate Development Co., Ltd. to acquire land-use and building-ownership rights for 51,120 sq m of retail space in Beijing. $165.2 million.

Carrefour SA (France)
Will open 28 stores in China this year.

Telecommunications

CHINA'S IMPORTS

Amdocs Ltd. (US)
Implemented a business support system for Tianjin Telecom and Jilin Telecom, subsidiaries of Beijing-based China Telecom.

CHINA'S INVESTMENTS ABROAD

Huawei Technologies Co., Ltd. (Guangdong)
Won contract from Costa Rica-based Grupo ICE to install a third-generation mobile phone network in Costa Rica. $235 million.

INVESTMENTS IN CHINA

Canpex Group (India)
Formed new subsidiary, Byond Tech, which will manufacture mobile handsets in Shenzhen, Guangdong.

OTHER

Qualcomm Inc. (US)/LT Mobile Communication Co., Ltd. (Guangdong)
Signed CDMA subscriber unit license agreement that grants LT Mobile a patent license to develop, manufacture, and sell the CDMA2000 standard.

Tourism & Hotels

OTHER

Dalian Wanda Group Corp. Ltd. (Liaoning)
Signed agreement to manage five new luxury hotels owned by US-based Hilton Hotels Corp.

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Converting the Downturn to Advantage

Continued from page 43

From a macroeconomic perspective, despite government efforts to stimulate the economy, a slowdown in domestic demand is possible, particularly through the second quarter, while people wait to see whether global and domestic markets have bottomed out. Indeed, faced with tenuous employment prospects, workers are likely to save even more than their current 25 percent. And as long as the savings rate is driven by a lack of state protection from the financial burdens of job loss, healthcare, education, and retirement, measures to stimulate household consumption will have a muted effect. The medical reform plan that passed in January earmarked ¥850 billion ($124.3 billion) to be spent by 2011 on the provision of affordable universal medical care. This is a welcome step, but long-term effort is required to alleviate China's many healthcare-related shortfalls and inspire citizens' confidence in the medical system.

Another potential hurdle on the path to economic recovery is misplaced nationalism and protectionism, in China and globally. In 2009, nationalism and a lack of enlightened leadership on the business and political fronts could be disruptive in certain sectors. A recent example is the 87 percent tariff the European Union placed on fastener imports in December 2008. In China, this protectionist move will likely result in factory closures, an estimated loss of €400 million ($305.5 million) of annual revenue, the loss of tens of thousands of jobs, and a corresponding fall in consumer spending. With all major national economies interconnected in a global web, it is important for political leaders to recognize the impact of protectionist decisions not only on the targeted country but also on the global economy.

The final and most worrisome issue has to do with the relationship between the current downturn and China's long-term development. In the second half of 2008, the PRC government reversed or undermined several policies it had pursued earlier in the year that sought to move industries up the value chain.

Specifically, enforcement of labor and environmental regulations seems to have been relaxed. This attitude may provide benefits in the short run, but the long-term costs to the economy, the environment, and the rule of law could be significant. Likewise, renminbi appreciation has come to a halt, which will help exporters but hurt Chinese investors and consumers.

Now is the time

Despite some concerns, China has the potential to emerge from the crisis in better shape than before. With the appropriate strategic planning on the part of business leaders and apt use of the policy arsenal on the part of the PRC government—neither of which is guaranteed—the country could experience healthier development, consolidate fragmented industries, build a more mature financial system, and expand domestic demand. Companies should take advantage of the current economic environment and find ways to benefit from favorable government policies, more accommodating suppliers, availability of skilled workers, and M&A opportunities. Capitalizing on these advantages to reduce costs and expand market share may well be the key to surviving the downturn. 完

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News of China-related educational, cultural, and charitable projects

US companies participate in a broad range of programs that benefit the people of China and strengthen the bonds of US-China friendship beyond the commercial realm. *Opportunities* aims to help companies identify programs that merit their assistance. The materials contained in *Opportunities* are condensed. For more detailed information, interested companies should contact the programs directly. (Note: Neither the US-China Business Council nor the *CBR* is a sponsor of any project listed in *Opportunities* and makes no recommendation with regard to corporate assistance to any specific project.)

Institution: The China Education Initiative (CEI)
Project Description: To improve educational opportunities in low-income Chinese communities and promote awareness of China's educational and developmental challenges

CEI is recruiting top graduates from PRC and US universities to serve together in one-year teaching posts at hard-to-staff schools in China. CEI seeks funding from corporations and individuals interested in helping to support its teaching fellows; it is also looking for companies that can develop its volunteers' professional and leadership potential. The deadline to sponsor CEI's first teacher corps is April 10, 2009.

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US Institution: The Yao Ming Foundation
PRC Institution: The China Youth Development Fund (CYDF)
Project Description: To build earthquake-resistant schools in China's 2008 Sichuan earthquake region

The Yao Ming Foundation, established in June 2008 by Houston Rockets star Yao Ming, and CYDF have committed to rebuilding five schools destroyed by the May 2008 Sichuan earthquake. The new earthquake-resistant schools will provide education and, in some cases, housing to more than 1,000 students. CYDF will distribute the funds and oversee the projects. The foundation also plans additional support for improvements to rural schools throughout China.

Schools that receive funds from the foundation and CYDF will receive matching contributions from local governments to ensure community support. The foundation is seeking corporate sponsorship.

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Tel: 310-649-5222 Fax: 310-649-5070
www.theyaomingfoundation.org

US Institution: Meridian International Center
PRC Institutions: The Embassy of the People's Republic of China in Washington, DC; the National Art Museum of China; and the PRC Ministry of Culture
Project Description: To share Chinese artists' reflections on contemporary urban life in China with Americans

The Meridian International Center will mark the 30th anniversary of the normalization of US-China diplomatic relations with a groundbreaking contemporary art exhibition. *Metropolis Now! Chinese Contemporary Artists Reflect on City Life and Globalization* exhibits famous Chinese artists' portrayal of transformations of lifestyles, generational differences, and the effects of globalization on long-standing traditions.

The exhibition will open on March 25, 2009 in Washington, DC. A symposium on March 26 will discuss the effect of urbanization and globalization on the people of China and the United States. PRC Ambassador to the United States Zhou Wenzhong will attend the opening and a related dinner on March 23 that honors exhibit supporters. Meridian is seeking corporate sponsorship.

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