

Industry Comments on the Draft Notice Launching the National Indigenous Innovation Product Accreditation Work for 2010

May 10, 2010

Summary

The signatory organizations listed below welcome the opportunity to comment on China's Draft Notice Launching the National Indigenous Innovation Product Accreditation Work for 2010 ("the Draft Notice"). As organizations representing thousands of companies, many with deep and longstanding engagement in the Chinese market, we welcome China's efforts to strengthen its innovative capacity, to which our companies have already made great contributions through their R&D and other investments in China.

We appreciate the Chinese Government's efforts to address some of the most troubling aspects of the national indigenous innovation product accreditation system detailed in the November 2009 Circular No. 618 and accompanying Instructions ("the 2009 Notice"). However, the business community still has many remaining concerns with these measures.

While we support and encourage innovation in China, and look forward to working with the Chinese Government to promote an environment that enhances opportunities for innovation in China, we believe that the Draft Notice and the many related policies would actually decrease, not increase, innovation in China. These related policies, broadly linked to indigenous innovation, limit the types of products that are developed and used in China and exclude some of the most innovative suppliers, the associated R&D, and resulting innovation benefits to the Chinese market.

We look forward to working with the Chinese government to encourage an environment that enhances opportunities for innovation in China.

To do so effectively, we respectfully urge MOST, NDRC and MOF not to publish the indigenous innovation product list and not to carry forward this program.

We also urge China to proceed with an ongoing dialogue with stakeholders on best policies and practices that promote innovation and do not discriminate against foreign firms' investments in and exports to the Chinese market. In that regard, as an essential first step, the Chinese government should undertake an immediate review of all innovation policies to ensure they do not discriminate between foreign and domestic suppliers and achieve the goal of the opening China's market wider to foreign investment and exports promised by President Hu and Premier Wen.

We strongly believe that the best ways for China to further enhance its innovative capacity are to:

(1) further open its markets to foreign investment, to enable China to obtain the full benefits of foreign technology and know-how;

(2) provide incentives to innovate by: ensuring full respect for intellectual property rights including patents, copyrights and trademarks; avoiding policies which establish preferences based on nationality of the owners of the intellectual property rights; and acting forcefully and promptly to prevent misappropriation of such rights;

(3) promote full and open competition, so that Chinese consumers and companies have access to the best technologies, resources, and products at competitive prices; and

(4) adopt non-discriminatory, merit-based and transparent procurement policies and practices that allow all innovators to compete on an equal footing.

In addition to adopting the above basic policy framework to promote innovation, China should actively consider added positive, non-discriminatory steps to build its innovative capacity, such as increasing government funding for research, expanding university research programs, providing incentives for private sector research and development, improving science and engineering education, promoting entrepreneurship and fostering innovation clusters.

We would welcome the opportunity to engage in such a dialogue and share best practices. China, along with other G5 and G8 countries, “acknowledge[d] the need to conduct a constructive dialogue in order to address contentious issues in a manner which would assist in the promotion and protection of innovation and intellectual property rights (IPRs) to the benefit of all economies.”¹ In this regard, it is important for China to consider changes to its broader set of policies related to innovation that affect the ability of non-Chinese companies to compete in China.

Finally, given China’s commitments in its WTO accession document as well as recent Strategic and Economic Dialogue commitments, we urge China to ensure that any new laws or regulations it implements are consistent with the policies and spirit of the WTO’s Government Procurement Agreement, and to move its policies in a direction consistent with eventual accession to that Code.

¹ Concluding Report of the Heiligendamm Process (G8 Summit 2009), Par. 23.

Comments

A. Overarching Issues

The signatory organizations listed below welcome the opportunity to comment on China's Draft Notice Launching the National Indigenous Innovation Product Accreditation Work for 2010 and appreciate the Chinese Government's revisions of the national indigenous innovation product accreditation system detailed in the November 2009 Circular No. 618 and accompanying Instructions (2009 Measures).

Our organizations bring together thousands of companies, many of which have deep and longstanding engagement in the Chinese market and many more that will likely participate in an open innovation regime in China. We welcome China's efforts to strengthen its innovative capacity, which already has been greatly advanced through the R&D and other investments our companies have made in China.

Innovation is occurring at ever-increasing rates, is increasingly interdisciplinary, technologically complex, collaborative and global.² Our own experience in many countries around the world is that an open, collaborative and non-discriminatory approach that respects intellectual property rights is the fastest and most effective way to promote innovation. Indeed, "[b]oth experience and research have shown that the best way to encourage competition, promote efficiency, and spur innovation is through adherence to principles that allow market forces to determine the availability, commercialization, deployment, and use of technologies."³

The real benefit of innovation to a society comes from the application of innovative technologies throughout all industry sectors. This creates far greater economic growth than the initial development of the technology in a particular company or industry. Government policies should thus promote the rapid adoption and diffusion of innovative technologies throughout the economy, regardless of the source of the innovation.

We strongly believe that the best ways for China to further enhance its innovative capacity are to:

- (1) further open its markets to foreign investment, to enable China to obtain the full benefits of foreign technology and know-how;

² *Innovate America*, Council on Competitiveness. 2004. As the G5 and G8 countries have noted: "the flow of ideas around the world has changed the way innovation is generated," which is "manifested in the digitalisation of the economy, the internationalisation of research and development networks, industrial design, and the development of open innovation. . . ." Concluding Report of the Heiligendamm Process (G8 Summit 2009), Par. 24 & 26.

³ APEC Digital Prosperity Checklist, Section IV Innovation: Creative Industries/Individuals Principle No. 1 (November 2008).

(2) provide incentives to innovate by: ensuring full respect for intellectual property rights including patents, copyrights and trademarks; avoiding policies which establish preferences based on nationality of the owners of the intellectual property rights; and acting forcefully and promptly to prevent misappropriation of such rights;

(3) promote full and open competition, so that Chinese consumers and companies have access to the best technologies, resources, and products at competitive prices; and

(4) adopt non-discriminatory, merit-based and transparent procurement policies and practices that allow all innovators to compete on an equal footing.

Although the 2010 Draft Measures address some of the concerns previously expressed regarding the eligibility of products for accreditation, we continue to have serious concerns about the approach of the Draft Measures.

Preference policies that favor one technology or product over another, including specific lists or catalogues of designated products, are counterproductive to promoting long-term successful innovation. Such lists create a significant potential for uneven treatment and cumbersome management, and risk being easily outdated as soon as issued, particularly given the innovative nature of the products the catalogues are designed to spur.

China should also remove indigenous innovation procurement preferences from China's draft Government Procurement Law Implementing Regulations and elsewhere, as these same problems will occur in any instance that such a list is used. For similar reasons, China should eliminate the use of product catalogues at the local and provincial level, where explicit references to import substitution and domestic intellectual property ownership remain. Without clarification from the central government that the use of product lists is unacceptable at any level of government, discrimination against foreign companies will continue, and innovation will be hindered.

Many concerns remain about the Draft Measures themselves and the challenges posed by the many policies issued by various national and local government authorities that encompass China's indigenous innovation drive. These policies represent a structural issue with direct consequences for market access and the ability for foreign firms to compete on a level playing field in China.

Procurement practices should be non-discriminatory, merit-based, and transparent, allowing all innovators to compete on equal footing with full protection of their intellectual property.

Our concerns with the 2010 Draft Measures are heightened given other policies related to innovation and procurement adopted by the Chinese Government. These other policies are identified more specifically below.

For all of these reasons, we respectfully urge MOST, NDRC and MOF not to publish the indigenous innovation product list and not carry forward this program.

B. Concerns with Specific Elements of the Draft Notice

Although the Draft Notice address some of the concerns previously expressed regarding the eligibility of products for accreditation for government procurement, several key questions remain on the specific requirements for accreditation and how this program would be implemented. There are several elements of the Draft Notice that are unclear and which continue to generate significant concern among our members. Among them:

- The link between procurement preferences and products and services included in the NIIP Catalogue. The Draft Notice provides that accredited products will be included in the NIIP Catalogue and “receive support in accordance with the PRC Law on Science and Technology Progress and other relevant state regulations.” The Draft Notice does not, however, specify what this “support” entails – and most importantly, whether and what procurement preferences will be awarded to innovation products. We urge the Chinese Government to sever the link between the Catalogue and government procurement, and instead to endorse a policy of merit-based procurement with decisions made on the basis of whether a product is best suited to the needs of the procuring authority, regardless of whether that product is or is not included in the Catalogue. We note that a number of Chinese policy makers have suggested that the NIIP is not about government procurement. This action would reinforce the statements already made.
- The requirement that products comply with “national industrial and technology policies” (Accreditation Condition (1)). With the exception of Accreditation Condition (5) – which requires that products that are subject to compulsory certification regimes must be certified in order to be eligible for accreditation – the Draft Notice do not specify the “national industrial and technology policies” with which products must comply. To the extent that these policies include IPR requirements or other restrictions on market access, we encourage the Government to modify and clarify these policies and to eliminate all market access barriers to foreign companies. The Draft Notice should specify the nature and scope of such policies so that it avoids enabling the creation of additional market barriers.
- The requirement that a product be locally researched and developed (Accreditation Condition (2)). Accreditation Condition (2) requires that the applicant “owns the intellectual property (IP) rights in China or licensed IP usage rights in China of products it has researched and developed” The Draft Notice also requires that applicants have Chinese legal status. Taken together—and reinforced by requirements in the application itself—these requirements could be read to mean that in order for a product to be eligible for inclusion in the NIIP Catalogue, the R&D must have been led by a Chinese entity in China. Most foreign firms, some joint ventures between foreign and PRC companies which don’t have Chinese legal status

under China's Company Law and Civil Law, and even some Chinese firms (particularly those with foreign research or development centers) will be unable to satisfy this requirement. As noted in the Summary, in today's global economy, product design and development may be performed in many different countries, including but not limited to China. Conditioning market access on the place of development or locus of IP ownership distorts competition and distorts the market-based incentives that should drive innovation. We encourage the Chinese Government to delete this language from Accreditation Condition (2). (We note that we have not yet seen the 2010 application form, which may help to clarify this point.)

- The requirement that the IP in the product “does not have any disputes or controversies with other products’ IP” (Accreditation Condition (2)). This language is vague and could result in a product being excluded from eligibility simply because a third party, including a competitor, asserts an IP infringement claim against the applicant, or seeks invalidity of the IP rights for abusive or anticompetitive purposes – even if that claim is meritless. The impact could be especially severe for Chinese holders of utility model and design patents (who hold over 90% of such patents), which are not examined for substance over prior art. There are numerous other reasons the language is flawed. The language also fails to distinguish an IP “right” from an IP “claim” that may read on a particular product. Moreover, patentees from time to time may seek to bring re-examination proceedings against patents in order to further strengthen their claims. In certain areas, such as information technology—which are patent-intensive, it will be difficult to find a product that is completely free of patent claims of one kind or another, in China or overseas. If such a provision is deemed necessary, the sentence should be revised to state that products may be excluded from the NIIP Catalogue only where the applicant is found by the State Intellectual Property Office not to own the relevant IP claims or have legal authorisation to use it and a court has made a determination that the claims relevant to the product are invalid or do not read on the product.
- The requirement that a product's technology be “advanced” (Accreditation Condition (4)). The Draft Notice indicates that a product can be considered “advanced” where it has “substantively improved upon the original product in terms of its structure, quality, material and craftsmanship, and demonstrates a clear improvement in product performance.” We are concerned that these terms are highly subjective and susceptible to divergent and inconsistent interpretations by those applying them (presumably the experts designated by the various central, regional, provincial and municipal Science and Technology Units). We also know from experience that such subjective criteria can sometimes be used to mask biases in favor of certain suppliers based on factors other than merit. We encourage the Chinese Government to delete these requirements and focus on whether the product meets or exceeds the needs of the procuring authority.
- The requirement that a product have “potential economic benefits and bright market prospects” (Accreditation Condition (6)). These terms are nowhere defined,

and again are vague and susceptible to subjective and diverging interpretations by those applying them. We encourage the Chinese Government to delete these requirements. Again, the focus should be on merit-based procurement that meets the needs of the procuring authority rather than anticipated commercial demand. Government and commercial needs often differ significantly.

- The apparent requirement that in the case of joint ventures, the percentage of Chinese investment in the applicant must exceed 50%. The Draft Notice states that “any product manufacturing unit in China that has acquired Chinese legal status” can apply to be accredited. While we have not seen the 2010 application for accreditation, the 2009 application required applicants to disclose their equity structure (including the proportion of Chinese and foreign investment, the name of the largest shareholder, and the proportion of that shareholder’s equity). We understood that to qualify for accreditation, the percentage of Chinese investment in the applicant had to exceed 50%. While we have not seen the 2010 application for accreditation, to the extent that it includes the same requirement, we encourage the Chinese Government to refrain from using equity ownership requirements as a tool to restrict eligibility for benefits under government policies.
- The content of the application itself – and more specifically whether it would impose any further requirements for eligibility on top of those set forth in the Draft Notice itself. The Draft Notice does not include examples of the application form. Instead, the Draft Notice simply states those applicants will be required to complete a product declaration form and submit it “along with other supporting documents.” We encourage the Ministry of Science and Technology (MOST) to publish the application form for comment, as well as a list of required supporting documents required and, to the extent those documents include confidential company information, a description of what measures will be taken by the Government to protect that information from disclosure or misuse. It is imperative that the application forms mirror the criteria in the Draft Notice and not introduce new conditions for eligibility.
- The composition of the expert panels that will conduct product accreditation reviews and the rules that govern their work. The Draft Notice indicate that the central, regional, provincial and municipal Science and Technology Units will appoint “experts” to assess products and recommend which products satisfy the accreditation conditions; MOST, in conjunction with the National Development and Reform Commission (NDRC) and Ministry of Finance (MOF), will also appoint experts to assist in compiling the final NIIP Catalogue. The Draft Notice do not specify how these experts are to be selected, what qualifications the experts will be expected to hold, or how the expert groups will make their decisions. We encourage the Chinese Government to develop transparent procedures for the selection and supervision of these groups if the decision is made to continue the catalogues.

Given broad concerns about the absence of clarity around so many provisions in the Draft Notice, we respectfully urge MOST, NDRC and MOF not to publish the indigenous innovation product list and not carry forward this program.

C. Further Concerns on Related Policies

There exists general concern of Chinese policies with overlapping and unclear application aimed at promoting innovation that we believe would deny market access or other commercial benefits to non-Chinese firms, impair the flow of technology and potentially hinder China's efforts to develop its innovative capacity. Our organizations would like to work with your government to address these concerns as well.

In addition to the Draft Notice, our organizations remain concerned about other Chinese innovation-related policies that hinder foreign-invested enterprises from participating fully in China's marketplace for goods and services or otherwise impede market access. As detailed below, many of these measures either

(1) encourage or mandate procurement from domestic Chinese suppliers;

(2) extend monetary or other benefits only to Chinese suppliers; or

(3) provide preferences to products including "Chinese" IP, or compel the transfer of or otherwise fail to adequately protect IP in non-Chinese products.

Each of these policies also raises potential questions about China's compliance with its obligations under existing international trade disciplines and its pledges to reject protectionism and not to discriminate against foreign invested enterprises for procurement purposes.

We believe that greater clarity is needed as to how the Draft Notice fits into the broader set of measures that comprise China's innovation policy, and whether a product or service that is eligible for inclusion in the Accreditation Catalogue must nonetheless satisfy the requirements established in these other measures. To better understand the impact of the accreditation process laid out in the Draft Notice, we would respectfully request more detailed information on how the policies detailed below apply to accredited products.

Further, we believe that to the extent any of these measures extend to the purchasing decisions of state-owned enterprises (SOEs), they are inconsistent with China's clear commitments in its WTO Accession Agreement that SOEs engaged in commercial activity would make procurement decisions solely in accordance with commercial considerations.⁴

Examples of such policies include:

⁴ See Report of the Working Party on the Accession of China, **WT/MIN(01)/3**⁴ 10 November 2001, Par. 45-47.

- Import substitution policies, such as the Guiding Catalogue of Major Indigenous Innovative Technologies and Equipment 2009, which specify import substitution in its criteria.
- Government procurement policies such as the Government Procurement Law (GPL), which states that the government “shall procure domestic goods, construction and services,” and the proposed GPL Implementation Rules, which establish narrow standards for determining when a good or service qualifies as “domestic” and discourage the procurement of imported products.
- Central and provincial government measures extending discriminatory preferences to “indigenous innovation,” such as the December 2009 MIIT/SASAC/MOST/MOF Guiding Catalogue for Indigenous Innovation of Major Technical Equipment (which establishes preferences for “indigenous innovation” certified products in 18 sectors and sets forth as an objective substituting domestic products for imported ones).
- Standards mandates, such as the 2009 MIIT requirements that Chinese WLAN Authentication and Privacy Infrastructure (WAPI) standard be included with any Wi-Fi enabled mobile device and several 2008-09 Requests for Proposal (RFPs) from China’s state-owned telecommunications carriers requiring WAPI in wireless access points..
- National laws that effectively weaken intellectual property rights, such as the 2008 amendments to China’s Patent Law which expand the grounds for the issuance of compulsory licenses and require foreign companies in China to undergo security examinations by Chinese authorities before filing patents abroad.
- Efforts by the Standardization Administration of China (SAC) to develop Standardization Rules that could lead to below market licensing or the use of compulsory licensing of foreign technologies used in “mandatory national standards.”

This universe of policies run counter to China’s commitment at the time of its WTO accession to join the Government Procurement Agreement. These policies are also inconsistent with the commitments by World Leaders in the G-20, including Chinese President Hu Jintao, to reject protectionism. We believe innovation is best served by practices that are non-discriminatory, merit-based, and transparent, allowing all innovators to compete on equal footing.

We appreciate MOST’s willingness to release the Draft Notice and solicit comment. We note that the deadline for filing comments on the Draft Notice and the first date to file an application for accreditation coincide (on 10 May 2010). We nonetheless hope that the

Government will take our input, and that of other stakeholders, into account before finalizing the Draft Notice.

We look forward to working with the Chinese government to encourage an environment that enhances opportunities for innovation in China.

To do so effectively, we respectfully urge MOST, NDRC and MOF not to publish the indigenous innovation product list and not carry forward this program.

We also urge China to proceed with an ongoing dialogue with industry stakeholders on best policies and practices that promote innovation and do not discriminate against foreign firms participation in the Chinese market. In that regard, as an essential first step, the Chinese government should undertake an immediate review of all innovation policies to ensure they do not discriminate between foreign and domestic suppliers.

American Chamber of Commerce in China
American Chamber of Commerce in Shanghai
American Chamber of Commerce in South China
Association of Equipment Manufacturers
BUSINESSEUROPE
Business Roundtable
Business Software Alliance
Canadian Manufacturers & Exporters
Coalition of Service Industries
Consumer Electronics Association
DIGITALEUROPE
Emergency Committee for American Trade
European Services Forum
Information Technology Industry Council
National Association of Manufacturers
National Foreign Trade Council
Semiconductor Industry Association
Software & Information Industry Association
TechAmerica
Telecommunications Industry Association
The International Anticounterfeiting Coalition
U.S. Chamber of Commerce
US-China Business Council