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ALTUM LIMITED

1 June 2005

China FTA Task Force  
Department of Foreign Affairs and Trade  
RG Casey Building  
John McEwen Crescent  
Barton ACT 0221

Dear Sir/Madam

**Proposed Australia-China Free Trade Agreement – Call for Public Submissions -  
Submission on IP Protection**

The purpose of this letter is to raise a number of issues relevant to the proposed Australia-China Free Trade Agreement.

In our submission, the lack of recognition of foreign intellectual property (or “IP”) rights by the Chinese government and Chinese industry is a key issue that should be addressed as part of any FTA with China. As you mention in the material published on the DFAT website, IP protection is one of the recognised “non-tariff” barriers to Australian companies wishing to do business in China, or indeed to companies already in business in China. Accordingly, this issue is at the heart of the success of the FTA for many industries.

It needs to be recognised that there are two distinct aspects to this problem:

- the limited IP protection currently available under Chinese law; and
- in practice, a widespread culture of infringement, both within the Chinese government and industry.

We suspect that the level of infringement is so great, that it can only be addressed by a government-to-government approach and by obtaining support within the Chinese government itself for change. The Australia-China FTA discussions represent a unique opportunity to drive this change.

We trust that this submission is of assistance to the Australia-China FTA initiative. We would welcome the opportunity to meet with you, or to provide any additional information that you may require.

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### **Background on Altium and our product**

Altium is a leading Australian developer and supplier of electronics design software for the Microsoft Windows environment. Founded in 1985, Altium released the world's first Microsoft Windows-based printed circuit board design tool in 1991 and continues to provide advanced, easy-to-use and affordable software design tools to electronics engineers, designers, and developers worldwide.

Altium is headquartered in Sydney, with sales and support offices in Australia, the United States, Japan and Europe – as well as maintaining a large reseller network in all other major markets.

Altium has a flagship electronic design product called PROTEL, that we license around the world.

PROTEL has been marketed in China since the early 1990s, and is now considered as the industry standard by the electronic design and manufacturing community in China.

A single seat licence for PROTEL at the retail level costs US\$10,000.

### **Level of infringement in China**

Independent market research conducted by the Gartner Group reports that more than 70% of electronics designers in China are using PROTEL for their design projects (see attachment). The same survey claims that the PROTEL brand is recognised by more than 90% of design engineers in China. Furthermore, the report is quoted as saying: *"Altium's revenue from China is way too small to be explained away with just the above. We suspect that software piracy has already caught up with EDA applications"*.

Altium's revenue generated from China and our database of legally obtained PROTEL licences over the past decade clearly indicates that only a small number of end users have legal PROTEL licences.

Our investigations indicate that the main infringers of PROTEL are:

- Chinese government owned and related organisations, such as the military, aerospace, government sponsored research and development centres and educational institutions;
- medium to large international Chinese enterprises (both public and private) engaged in the design and manufacture of electronic products for local consumption and for export; and
- small design bureaus working mainly as sub-contractors for medium to large sized design houses.

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In February 2004 we established a representative office in Shanghai to further support our network of newly appointed PROTEL resellers and develop a deeper understanding of the Chinese market. As the next step in Altium's commitment to the Chinese market, we are in the process of upgrading that office to a Wholly Foreign Owned Entity, so that Altium has a dedicated China subsidiary, further strengthening Altium's presence.

Our involvement in China over the past 18 months indicates that Chinese government and related organisations are the largest users of illegal PROTEL software. We have reason to believe that some government owned organisations use up to a number of hundreds of illegal licences of PROTEL for the design of electronic systems utilised in commercial, industrial and particularly for military applications.

Large corporations with well known international brands such as manufacturers of laptop computers and telecommunications equipment with revenue in excess of US\$1 billion openly use illegal PROTEL software for design and manufacturing of their products.

We understand that a pirated copy of PROTEL can be purchased for less than US\$5.00 from most electronics retail outlets in major cities in China.

It is absolutely unacceptable for this level of IP infringement to be taking place. Although this is an international, rather than a solely Australian issue, in our submission it is vital that this be addressed for the benefit of Australian companies in any FTA between Australia and China.

#### **Current IP law in China**

As you would be aware, the World Trade Organization's TRIPS Agreement (Trade Related Aspects of Intellectual Property Rights) provides minimum standards of protection for:

- copyright and related rights;
- trademarks;
- industrial designs and patents;
- integrated circuit layouts; and
- undisclosed (confidential) information.

(We understand DFAT is involved with TRIPS through its Office of Trade Negotiation, which is the coordinating body for Australia's engagement with the WTO. Within OTN, the International Intellectual Property Section has the responsibility for IP issues.)

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Foreign companies can enforce their Chinese IP rights through direct negotiation, mediation, arbitration, administrative adjudication, civil litigation and criminal prosecution, but the damages awarded are generally insufficient to compensate the loss suffered by the IP right owners. In theory, damages are awarded on the basis of the actual loss suffered by the IP right owners or illegal gain by the infringers if loss cannot be ascertained. If neither of these can be measured, a compensation of not more than RMB 500,000 will be awarded. Given the extensive IP rights infringement in the PRC, to prove actual loss and illegal gain will be a very difficult, if not impossible task.

It is perceived that the civil litigation process in China is inadequate, due to:

- lack of discovery procedures;
- lack of comprehensive evidentiary rules;
- undue delay in cases involving a foreign party;
- undue delay in cases involving complex technologies; and
- practical difficulties in enforcing judgements.

Criminal prosecution is also not an ideal deterrent to IP infringement. Despite the rapid increase in the number of severe counterfeiting and pirate infringements of IP rights, fairly small numbers of criminal cases of IP violations eventually go to judicial procedures. Elements contributing to this situation include a weak sense of using legal measures for the protection of IP rights in law enforcement officials, local protectionism and the high threshold for criminal convictions. Even though the latest interpretation issued by the Supreme People's Court of the PRC and the Supreme People's Procuratorate in 2004 have tried to lower the threshold of criminal prosecution, other systemic problems remain.

Microsoft's case (which was elected as one of the ten biggest IP cases in 2004 in the PRC) against two PRC compact disc manufacturing companies reflects the inadequacy of the legal enforcement in the PRC. In that case, Microsoft software was illegally copied by two PRC companies. About 60,000 unauthorised copies were made and the illegal gain of the two companies recovered by Microsoft was only about RMB 10,000. The companies were also fined a total amount of about RMB 90,000.

The persons involved were convicted and sentenced to 6-12 months imprisonment and ordered to pay a small fine.

The large number of unauthorised software copies could not be traced. Having said that, this case is still considered as successful, as it sent a message to the public that not only end users of illegal softwares will be prosecuted, producers of fake copies will also be punished.

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We would be pleased to provide further information about issues with current Chinese IP law, if you are interested.

**Impact on our global business**

Unlicensed usage of our products in China has a direct and significant financial impact on our business, not only in China, but as we are now seeing, affecting our business in the US and Europe, through international Chinese enterprises operating abroad.

Altium competes effectively and successfully at a global level with its American, European and Japanese competitors by offering superior products and technologies to those markets at an affordable price. We see that our efforts have been greatly undermined by wide usage of the illegal copies of our products in China.

One of the key principles behind the Australia-US Free Trade Agreement was fair competition and ensuring a level playing field. In our view, the illegal use of PROTEL software puts the Chinese electronic design and manufacturing industry in an unfair competitive position.

Consumer electronic markets are flooded by unrealistically low priced products due to the disregard of intellectual property rights of companies and countries with a commitment to investing in research and development. For example, in our submission selling DVD players for less than \$100 is not due to cheap labour or clever technology, but rather to minimal investment in research and development, and to unlicensed use of intellectual property.

**What have we done to date to address this problem?**

For the last 12 months, we have been endeavouring to raise this issue with Chinese government and public organisations, but have been frustrated by our inability to reach the appropriate authorities.

In July/August 2004, Altium introduced its "Preferred Customer Program" designed to provide incentives to companies who we believe were users of Protel to purchase licences at favourable prices. Initially 22 medium to large public and state owned enterprises were contacted in a trial program that yielded disappointing results.

Our experience in China has demonstrated that our resources are by no means sufficient to effectively engage with the Chinese government bureaucracy. We believe that illegal use of intellectual property by government organisations would be more effectively dealt with at a government-to-government level, rather than at a private sector company-to-government level.

This is borne out by the experience of other companies in this industry dealing in China. The scale of the problem is illustrated by the attached copies of articles on Chinese IP infringement of the following leading IT companies' products: (some key quotations and comments from these articles are extracted below)

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- Autodesk - "You can't change China, so you have to change your business". Autodesk has also taken civil action against a corporate end user in China;
- Business Software Alliance - "more than 90 percent of China's software is pirated". You may also wish to refer to the Business Software Alliance's global piracy study at [www.bsa.org/globalstudy](http://www.bsa.org/globalstudy);
- Cadence - is also undertaking training and sponsorship programs in China, in an effort to attract users to legitimate use of software. The CEO of Cadence recently called on China to start recognising the value of IP protection, as it becomes more established in the global electronics industry;
- Microsoft - is mounting a major anti-piracy promotion in China, including substantially reducing prices to attract customers, and requiring customers wishing to download upgrades to verify that their software is under genuine licence;
- Adobe, Oracle and Sun Microsystems - have also had difficulties in China;
- Cisco - has also taken legal action in China.

The International Intellectual Property Alliance stated in February 2004 - "The largest software piracy losses occur in China, where entertainment software alone was pirated to the value of \$568 million last year". We enclose a copy of the IIPA's 2005 report on IP infringement in China. The report concludes:

- "Piracy levels have not been 'significantly reduced' - they still are around 90% in all sectors" (page 183);
- "The software industry's ability to increase exports to China - and recoup billions of dollars in piracy-related losses - is severely limited by China's failure to take the steps necessary to create a fair and level playing field for U.S. software developers and other IT companies" (page 215).

It seems to us that, unless the Chinese government leads the way in enforcement of IP protection law, Chinese enterprises which are engaged in the export of electronics equipment will have no interest in observing the intellectual property rights of the international business community.

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**Our proposed solution**

We do not believe that the depth and breadth of unlicensed usage of PROTEL software by Chinese government agencies has been fully recognised and appreciated by the Chinese authorities.


We hope that once the appropriate government authorities are made aware of this matter, they will take action to rectify the situation, given the sensitivity and comparatively small amount of investment that is required to resolve this issue.

However, we need the help and support of the Australian government to elevate these concerns to the appropriate Chinese government authorities. The proposed Australia-China Free Trade Agreement represents a unique opportunity to raise this issue to the right level, and to have genuine consideration given to it by the Chinese authorities in the context of the FTA.

It is also in China's long-term interest to obtain legal licences to PROTEL and other Australian products, as otherwise they do not have access to up-to-date documentation, technical support, ongoing fixes and upgrades and training, which are generally regarded as of great value by our legitimate clients and by the clients of other Australian companies.

Quite apart from the impact on Australian companies, in our submission the Chinese government needs to address these issues if it is to trade credibly on the world stage, and participate in international trade arrangements such as the proposed Free Trade Agreement.

Yours sincerely

  
Kayvan Oboudiyar  
Executive Vice Chairman