

Concerns of Intellectual Property (IP) theft are no small matter for industry

The allure of heady revenues has drawn many manufacturers to China, which in 2009 drew total investments by U.S. multinationals worth \$49 billion, up 66% from 2007, per a report from the U.S. Department of Commerce. The potential is great but it does not come without the possibility of a downside.

One company that has experienced both the highs and lows is U.S.-based American Superconductor Corporation (AMSC), which for years had struggled to turn a profit from sales of its superconductor technology but found instead stunning success from selling its technology for wind turbines to Sinovel, a major Chinese supplier of such turbines. In a relatively short time, Sinovel became AMSC's largest single customer, representing more than 70% of its 2010 revenues. AMSC was so confident that it reported early in 2011 that it expected to meet its goal of 2015 revenues of \$1 billion a full year earlier.

The success story soured in a surprisingly short time when in April AMSC reported that Sinovel refused to accept shipment of ordered components. AMSC saw its stock price plummet from \$25 a share by more than half in April, a trend that was fed by bad news about Sinovel and related earning report problems. AMSC filed a lawsuit in Beijing's High Court against Sinovel.

"Based in part upon evidence obtained through the investigations, AMSC believes that Sinovel illegally obtained and used AMSC's intellectual property to upgrade its 1.5 megawatt wind turbines in the field to meet proposed Chinese grid codes and to potentially allow for the use of core electrical components from other manufacturers," a press release said. AMSC wants Sinovel to honor its IP, to pay for its past orders, its related economic losses and to accept all contracted but not yet delivered orders.

Sinovel filed a counterclaim to the Beijing Arbitration Commission basically saying that it was AMSC that was at fault. It claimed that AMSC's electronic control components that Sinovel used to produce its SL1500 and SL3000 wind turbines were rejected "because they fail to meet contract requirements in technologies and quality." It is asking for AMSC to pay Sinovel \$12 million for economic losses from breach of eight contracts from May 2008 to January 2011. Sinovel reported that the arbitration tribunal has accepted the counterclaim and will try the case along with the AMSC arbitration application.

This case has drawn much interest because the issue of IP is a major concern to manufacturers. A report by the U.S. International Trade Commission (USITC) estimates that U.S. firms lost approximately \$48 billion in 2009 due to infringement of IP rights by China, with some \$36.6

billion, nearly 80%, from lost sales, the remainder from lost royalty and license payments as well as other unspecified losses.

Both parties claim the other violated the multi-year supply agreement, and an Austrian court ruled that an AMSC wind technician had illegally sold software codes to Sinovel, and sentenced him to one year in jail.

One person who has commented on the topic is Lou Schwartz, a lawyer and China specialist who focuses on the energy and metals sectors. In a piece published in *Renewable Energy World*, he put the case in context.

"So where does the truth reside? Is it a classic case of a Chinese company expropriating one of the quickly dwindling comparative advantages the U.S. continues to maintain? There certainly is precedent for Chinese companies not respecting and not paying for foreign intellectual property. And given the cutthroat nature of competition among Chinese turbine manufacturers, it is quite possible that Sinovel saw a ready place to reduce costs.

"Or is it, as Sinovel contends, that AMSC has failed to make the technological improvements to its products that were promised, forcing Sinovel to develop its own solutions? Is there anything to the charge by Sinovel that AMSC failed to develop a robust system to handle after-sales maintenance, repairs and equipment upgrades?

"Perhaps this is just another ordinary case of Chinese companies steadily occupying the manufacturing space of foreign companies. The Chinese regularly do trumpet their success with import substitution, developing industries that manufacture products previously only available through imports. Indeed, Sinovel has 'localized' production of a growing list of turbine parts (blades, gears, bearings, generators and frequency regulators), and is proud of how indigenous manufacturing of key wind turbine components has



American Superconductor Corporation has experienced the highs and lows of marketing its technology in China.

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helped them reduce costs, increase profits and enhance the company's competitiveness.

"It was once said (in the context of the Japanese) that the Americans are like baseball sluggers who swing for the fences, as contrasted with the Japanese who score their runs through a combination of singles, bunts and the occasional stolen base. It's an interesting analogy in part because baseball is a quintessential American game and the implication was that the Japanese were beating us at our own game by playing it differently. Similarly in the second decade of the 21st Century, there is a prevailing view that the Chinese are beating us at our own game: the Communists are out-performing the Capitalists at capitalism.

"As we lament losing out to the Chinese on our 'home field,' there also is that unsettling feeling that some of those losses are not a result of the Chinese simply outthrusting us, but that they are playing by a different set of rules. Is it that the Chinese are more driven than us or because the Yuan doesn't float freely? Do their much lower labor rates give them the flexibility to undersell the market or is the 'China Price' in part due to shortcuts that aren't permitted according to our rulebook, e.g., lead in paint, melamine in milk or toxic waste from PV manufacturing dumped in rivers? Do the Chinese succeed because they are investing far more than us in infrastructure and human capital or because they beg, borrow and steal the intellectual property of innovation economies such as ours?

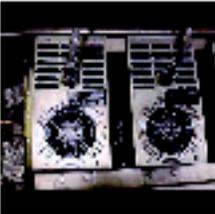
"We should be able to accept the results when the runs pile up from a well-executed series of singles, bunts and even stolen bases; but if the win comes from balks and stolen signs, it's not surprising that we then question the score. The truth lies somewhere at the intersection of all these crosscurrents, which makes it more imperative than ever for both the Chinese and the U.S. to carry out honest assessments of what are the new rules of the road. The AMSC/Sinovel relationship would be as good a place as any to start."

Lou Schwartz is a principal of China Strategies, LLC, Pittsburgh, Pennsylvania, USA. The company provides clients research and analysis, due diligence, merger and acquisition, private equity investment and other support for trade and investment in China. He holds degrees in East Asian Studies from the University of Michigan and Harvard University, where he studied Chinese language and literature, economics and law, among other disciplines. He also earned a J.D. from George Washington University Law School. He has taught at the University of Pittsburgh School of Law and its College of Arts and Sciences, and Carnegie-Mellon University, including law and development in China, Chinese for Lawyers and Technology and Development in India and China. He can be reached at lou@chinastrategiesllc.com. ■



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