

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE®



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September 22, 2010

Submitted via www.regulations.gov

Ms. Gloria Blue
Executive Secretary
Trade Policy Staff Committee (TPSC)
Office of the U.S. Trade Representative
1724 F Street, NW
Washington, D.C. 20508

Re: China's WTO Compliance: (1) Request to Testify at October 6, 2010 Hearing and (2) Notice of Testimony Regarding China's Compliance with its WTO Commitments, 75 Fed. Reg. 45693 (August 3, 2010)

Dear Ms. Blue:

The International Intellectual Property Alliance ("IIPA") hereby requests the opportunity to testify at the October 6, 2010 hearing of the TPSC regarding China's compliance with its commitments in connection with its accession to the World Trade Organization (WTO) as well as other commitments made to the United States.

REQUEST: Testifying on behalf of the IIPA will be:

Michael Schlesinger
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Washington, DC 20037
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SUMMARY OF TESTIMONY: IIPA will use its five minutes of oral testimony to mark a critical juncture in addressing the concerns of the U.S. creative industries in China, and will call for 1) meaningful, results-oriented implementation of the IPR and market access WTO cases, 2) strong WTO-consistent enforcement, including where appropriate, criminal enforcement, against all kinds of copyright piracy in China, and 3) addressing new barriers and industrial policies that threaten to impose discriminatory requirements on foreign right holders and/or deny them the exercise of their IP rights. IIPA believes that these steps are crucial components to a successful U.S. trade and economic policy with China, a policy which should focus less on one-off approaches to single issues and more on results



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such as increasing overall sales and exports to China by the creative industries, as well as fixing market access disparities and violations that put U.S. companies at a competitive disadvantage.

TESTIMONY: The text of the IIPA's prepared oral testimony is attached.

We look forward to participating in this proceeding. Thank you in advance.

Sincerely,

Michael Schlesinger

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Testimony of Michael Schlesinger International Intellectual Property Alliance (IIPA)

Public Hearing Before the Trade Policy Staff Committee Concerning China's Compliance with its WTO commitments on Copyright Law, Enforcement and Market Access

To Be Delivered October 6, 2010

Good morning. My name is Michael Schlesinger, and I appear here on behalf of the International Intellectual Property Alliance (IIPA), a coalition consisting of seven trade associations representing the U.S. copyright industries.¹ This is IIPA's tenth appearance before the TPSC, and this year marks a critical juncture in addressing the concerns of the U.S. creative industries in China.

Since China's WTO accession in 2001, IIPA has pressed for robust enforcement of IPR in the hopes that the market would improve for its members' copyright products. Unfortunately, our hopes have not been realized. Piracy of business software, piracy of music and recordings, movies and books and journals mainly in the online environment, and piracy of games in all formats, continues to dominate the marketplace in China, causing severe harm to the creative sectors and related industries in the United States,² and in some cases (e.g., illegal use of software, music services based on providing access to infringing materials, etc.) giving Chinese companies an unfair cost advantage over their American or foreign counterparts that comply with copyright laws.³ Severe and growing restrictions on market access negatively impact the creative industries and erect barriers that prevent U.S. companies from developing meaningful commercial relationships and opportunities within China. These barriers do not, however, eliminate demand for the products, a demand that is mostly filled by piracy. Lax enforcement of intellectual property rights largely prevails, including against online infringement.

These problems have consistently called into question China's WTO compliance. Recently, they have even moved several industries to urge the U.S. to bring cases before the WTO on both IPR standards and market access restrictions for publications, sound recordings and films.⁴ In both

¹ According to the latest economic reporting, the core copyright industries represented over 6% of U.S. GDP and over 4% of U.S. employment, and contributed over 22% to total real U.S. economic growth in 2007.

² The litany of piracy problems in China, many of which occur online and/or are recently emerging, are discussed in greater depth in IIPA's previous written submissions to this Committee as well as in IIPA's China country submission as part of the 2010 annual Special 301 process. See International Intellectual Property Alliance, *People's Republic of China (PRC)*, in *IIPA's 2010 Special 301 Report on Copyright Protection & Enforcement*, February 18, 2010, at <http://www.iipa.com/rbc/2010/2010SPEC301PRC.pdf>.

³ For example, China's 79 percent software infringement rate means essentially that Chinese enterprises on average pay for about 1 out of 5 copies of software they use and then compete unfairly with U.S. businesses that pay on average for about 4 out of 5 copies of the software they use to run their businesses and improve productivity.

⁴ Both WTO cases brought by the U.S. government were litigated with the background support of the China Copyright Alliance (CCA), a coalition of some, but not all, IIPA members. IIPA did not participate in these cases.



cases brought in 2007, the United States largely prevailed, with WTO panels concluding that China's laws were not in compliance with WTO standards.

We believe that in the short term, 1) seeking meaningful, results-oriented implementation of the IPR and market access WTO cases, 2) continuing to press for strong WTO-consistent enforcement, including where appropriate, criminal enforcement, against all kinds of copyright piracy, and 3) addressing barriers and industrial policies that impose discriminatory requirements on foreign right holders and/or deny them the exercise of their IP rights, are keys to improving the lot of U.S. creative companies in China. We also believe these steps are crucial components to a successful U.S. trade and economic policy with China, a policy which should focus less on one-off commitments made at annual ministerial meetings and more on tangible results such as increasing overall sales and exports to China by the creative industries, as well as fixing market access disparities and violations that put U.S. companies at a competitive disadvantage.

While time does not permit a full litany of the issues here, the following are some key points of concern in this docket.⁵

The WTO Cases

The dominance of piracy and the unwillingness of the Chinese government to alter the rules to ease access to the market (exacerbating the piracy dilemma), led certain industries to conclude that the best alternative to seek redress was through the WTO dispute settlement process. As a result, two WTO cases, one focused on IPR inadequacies, and one focused on deficiencies in China's compliance with its WTO commitments on market access for published materials and audio and audiovisual entertainment products, were launched in 2007. In 2009, both cases concluded, with a WTO dispute settlement Panel rendering its decision in the IPR case in January 2009, and with the WTO Appellate Body rendering its decision in the market access case in December 2009. In both cases, the U.S. largely prevailed on many key issues, but evaluation of success will be in the details of implementation.

In the IPR case (DS 362 – report issued January 26, 2009), the WTO panel ruled on three claims. In arguably the most significant claim, the U.S. challenged China's high "thresholds" for criminal liability (including the present 500 copy threshold). Those "thresholds" provide a large "safe harbor" for commercial activities for which pirates can operate with no risk of criminal prosecution, leaving only small administrative fines or short-term store closures as remedies. The WTO Panel set out a comprehensive market-based test for what constitutes "piracy on a commercial scale" which must be subject to criminal penalties under TRIPS. The Panel provided a detailed discussion and definition for the phrase "on a commercial scale," which it indicated would "depend on the magnitude or extent that is typical or usual with respect to [a particular product] in [a particular market], which may be small or large." While the Panel concluded that the U.S. had not introduced sufficient probative evidence for it to determine whether China's thresholds covered

⁵ A more comprehensive discussion of WTO-related issues in China appears in IIPA's China country submission as part of the 2010 annual Special 301 process. *See supra* note 2.



“all” copyright piracy on a commercial scale, we believe the market-based test set out by the Panel, if properly applied by China, requires it to lower its thresholds in order to criminalize all commercial scale piracy. We believe that China does not meet the Panel’s test and that China should review and significantly lower its existing thresholds.⁶

In the landmark market access case (DS 363), the United States prevailed on many claims against China’s regime restricting the importation (trading rights) and distribution of publications, sound recordings, audiovisual home entertainment, and films for theatrical release. As a result, China must undertake the following:

1) **China must allow U.S. companies to import freely into China** (without going through the government monopoly) films for theatrical release, DVDs, sound recordings, and books, newspapers, and periodicals. This is a significant market opening result.

2) **China must provide market access to, and not discriminate against, foreign companies wishing to distribute their products in China.** Specifically, China must fix its measures in ways which will: open its market to wholesale, master distribution (exclusive sale) of books and periodicals, as well as electronic publications, by foreign-invested companies including U.S. companies; permit sound recording distribution services, including electronic distribution, by Chinese-foreign contractual joint ventures, including majority foreign-owned joint ventures; allow the participation of foreign capital in a contractual joint venture engaged in the distribution of reading materials or audiovisual home entertainment products; ease commercial presence requirements for the distribution of DVDs; and do away with China’s 15-year operating term limitation on foreign joint ventures.

3) **China must discard discriminatory commercial hurdles** for imported reading materials, sound recordings intended for electronic distribution, and films for theatrical release. For example, China must not improperly and discriminatorily limit distribution for imported newspapers and periodicals to “subscriptions,” and must not limit such materials and other reading materials to Chinese wholly state-owned enterprises, and may not limit the distributor of such reading materials to a State-owned publication import entity particularly designated by a Government agency. Finally, China may not prohibit foreign-invested enterprises from engaging in the distribution of imported reading materials. The WTO Panel and Appellate Body, in a technical finding, concluded that they lacked sufficient information to determine whether China’s discriminatory censorship regime for online music violated China’s WTO commitments. However, this was not a “green light” for the Chinese to continue their discriminatory censorship practices.

⁶ The U.S. challenged two other measures and prevailed on both claims. The U.S. challenged China’s copyright law which denied copyright protection for content deemed objectionable by the government and which was prohibited from being distributed within China. The Panel ruled this measure, codified in old Article 4 of China’s Copyright Act, to be inconsistent with China’s WTO obligations. The Panel decision made clear that China must protect all works regardless of content including, in particular, works which are pending censorship review and which were banned from distribution pending conclusion of such review. The U.S. finally challenged several of China’s Customs rules for releasing into the marketplace counterfeit goods once the infringing mark has been removed. The Panel found this default rule to be inconsistent with Articles 46 and 59 of the TRIPS Agreement. China implemented the Panel finding related to Article 4 by amending its Copyright Law in March 2010, and implemented the Panel finding related to the Customs rules by amending its Customs Regulations in April 2010.



China's discriminatory regime is both unfair and highly suspect under WTO rules. China further complicated an already unsatisfactory situation by issuing the September 2009 Circular on Strengthening and Improving Online Music Content Examination (issued while the WTO case was being adjudicated and therefore not the direct subject of any Panel ruling). This Circular puts into place a censorship review process premised on an architecture already determined to violate China's GATS commitments—by allowing only wholly-owned Chinese digital distribution enterprises to submit recordings for required censorship approval. When China joined the WTO, it agreed to allow foreign investment in *all* music distribution ventures, on a non-discriminatory basis. That includes online music distribution. By excluding foreign-invested enterprises (FIEs) from submitting imported music for censorship review, the Circular denies bargained-for market access and discriminates against FIEs thereby violating China's national treatment obligations. It violates China's accession commitments under the General Agreement on Trade in Services (GATS) and the General Agreement on Tariffs and Trade 1994 (GATT); it also violates China's Accession Protocol commitment to authorize trade in goods by any entity or individual. China must revoke or modify the Circular to fix these problems.

While the U.S. had alleged that certain Chinese measures indicated that imported films for theatrical release can only be distributed by two state-controlled enterprises (China Film and Huaxia), whereas domestic films for theatrical release can be distributed by other distributors in China, the WTO Panel (upheld by the Appellate Body) concluded that the duopoly did not constitute a "measure," and cited the lack of any evidence that a third distributor had been denied upon an application from operating in the Chinese market. Were there to be a *de facto* duopoly as to foreign films only that was enforceable by a measure, the Panel and AB reports confirm that China would be in violation of its WTO obligations. The industries view this decision as confirming that, to be consistent with what the Panel and AB reports have said, China must approve applications for other theatrical film distributors in China, a step which would significantly open up this market to competition, and additionally, would open up to competition and negotiation the underlying agreements upon which foreign films are now distributed in China.

The market access Appellate Body report was adopted by the Dispute Settlement Body on January 19, 2010, and the parties in consultation came to an agreement of 14 months for implementation of the report, so the expiration date for China to implement the market access decision is March 19, 2011. IIPA views it as a critical part of this docket for the U.S. government to consider how it can take a robust and active approach to pressing the Chinese government to implement its commitments arising from the market access case, and to addressing the two very important issues noted above related to discrimination of foreigners in the distribution of music online and breaking the duopoly for foreign theatrical film distribution in China. We would note that, without immediate and intensified engagement by the U.S. government, it is likely the Chinese government will attempt to implement the case in the narrowest possible terms. With proper engagement, it may be possible to make broad gains in bringing U.S. creative industries' products to market in China.



Other WTO Concerns Related to Piracy and Enforcement Deficiencies in China

IIPA has reported to this Committee in many past proceedings a range of deficiencies in the Chinese statutory and enforcement system for protection of intellectual property rights that are incompatible with China's WTO TRIPS obligations. The WTO cases discussed above did not cover all the statutory TRIPS deficiencies that exist in the Chinese enforcement system. For example, China's Criminal Law fails to subject to criminal liability the infringement of some exclusive rights⁷ which constitute "copyright piracy on a commercial scale," all in violation of Articles 41 and 61 of the TRIPS Agreement. China has also never brought a criminal case against the unauthorized use (usually involving reproduction, distribution, or both) of business software in a business setting, so-called end-user piracy of software, even in egregious cases involving many computers being used in a commercial enterprise for business profits. In this regard, the Supreme People's Court and the Supreme People's Procuratorate (SPP) need to issue a Judicial Interpretation clarifying that end-user piracy of software is subject to criminal penalties and make corresponding amendments to the Criminal Code and Copyright Law, and case referral rules for the Ministry of Public Security and SPP as needed.

The overriding problem in China remains the failure to provide effective and deterrent enforcement required under Article 41 and 61 of TRIPS. In some cases, this is the result of Chinese reliance on administrative enforcement measures which are non-deterrent—e.g., against commercial pirates that have no legitimate business enterprise and who have no assets. In other cases, and quite ironically, it is the result of the Chinese government's failure to employ available administrative measures with respect to infringers for whom administrative measures might be effective—e.g. against "legitimate" companies like Baidu's music service and other services based on providing access to infringing materials.

We urge the Chinese government to develop a TRIPS compatible anti-piracy enforcement regime that employs both administrative and criminal measures where appropriate in order to create meaningful deterrence. We note that there have been some minimal gains that have resulted from the administrative system in certain sectors. For example, the GAPP and the NCAC, in cooperation with local enforcement authorities, have made some efforts to tackle the problem of unauthorized copying of books and journals by university textbook centers, and administrative decisions issued after raids have included fines, which have had some deterrent effect in this sector.

Other Issues

IIPA members have identified several other issues involving industrial policies that threaten to impose discriminatory requirements on foreign right holders and/or deny them the exercise of their IP rights. Each of these issues undermine the ability of U.S. creative companies to operate in China and may invoke China's WTO obligations.

⁷ For example, China fails to criminalize satellite, cable and broadcast piracy, bootlegging and a number of other acts of piracy when they are "on a commercial scale."



For example, entertainment software companies continue to face lengthy delays – weeks or sometimes even months – in the GAPP censorship approval process, wiping out the already-shorter window for legitimate distribution of entertainment software products. Meanwhile, the Chinese government does not immediately seize infringing copies of titles intended for release as packaged product and which are still undergoing censorship review, resulting in inadequate protection and enforcement. The entertainment software industry is also harmed by China's ban on video game consoles. The current ban on the manufacture, sale and importation of electronic gaming devices (i.e., video game consoles), in effect since a 2000 *Opinion on the Special Administration of Electronic Gaming Operating Venues*, stymies the growth of the entertainment software sector in China. The ban even extends to development kits used in the creations and development of video games. The ban impacts not only foreign game publishers, but also domestic Chinese developers, who are unable to obtain such kits given the prohibition on their importation. The Chinese government should be encouraged to eliminate this ban, on both video game consoles and on development kits. Maintaining the ban not only impedes access to the market for foreign publishers but also hinders the fledging Chinese game industry's access to game development technology — a policy seemingly at odds with the government's interest in spurring the growth of this dynamic sector.

The business software industry reports that Chinese government efforts to legalize software use in enterprises have often gone hand in hand with preferences favoring the acquisition of Chinese software over non-Chinese software, which would be inconsistent with China's commitment in its WTO working party report that the government “would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including the quantity, value or country of origin of any goods purchased or sold . . . ,” and its JCCT commitment that software purchases by all Chinese private and state-owned enterprises will be based solely on market terms without government direction. The Chinese government should, consistent with its WTO and JCCT obligations, refrain from instructing or encouraging state-owned enterprises to implement preferences for Chinese software in carrying out its legalization efforts, and should communicate this policy to relevant government agencies at the central, provincial and local levels.

In addition, fair and non-discriminatory access to China's vast government procurement market is a critical issue for the IIPA. China has repeatedly committed to join the WTO's Government Procurement Agreement (GPA) yet has been slow to move this process along. This past July, China released a Revised Offer to join the GPA that, while improving somewhat on prior offers, has significant shortcomings that will not make it an effective agreement for ensuring meaningful market access for our members and many other U.S. industries. The deficiencies include: (1) the lack of express coverage for software and related services; (2) monetary thresholds that would be too high to reach a significant share of procurements; (3) an unacceptably long transition period for full commitments to take effect (i.e., a five year stand-still followed by a five-year transition period); (4) limitations on coverage of central government agencies and an absence of coverage for “sub-central” agencies; (5) lack of clarity regarding coverage of state-owned enterprises; (6) a broad, undefined exception for “national policy objectives,” and (6) the ability to



require domestic content, offset procurement and transfers of technology. We also believe that China's GPA offer should include a provision reaffirming its commitment to ensure that government agencies use legal software and that government contractors use only legal software as well. We urge the U.S. government to raise these concerns with China and press the Chinese government to develop an improved GPA offer on an expedited basis.

The music industry has long noted the intolerable levels of music piracy in the Chinese market and the various market access restrictions which prevent a meaningful presence. Internet piracy of music is estimated at an astonishing 99%, fueled primarily by deep-linking services, the most prominent of which is operated by NASDAQ-traded Baidu. China boasts the highest broadband penetration and mobile phone ownership in the world, yet the value of total digital sales in 2009 was \$94 million, and total revenue (both physical and digital) was a mere \$124 million. This compares to \$7.9 billion in the U.S., \$285 million in South Korea and \$142 million in Thailand — a country with less than 5% of China's population and with a roughly equivalent per capita GDP. The Thai number is particularly interesting given the fact that GDP is roughly equivalent, and that Thailand also suffers from high piracy levels. If Chinese sales were equivalent to Thailand's on a per capita basis, present music sales would be US \$2.8 billion. And that would represent under-performance and reflect significant losses to piracy. Indeed, it is fair to say that China's lack of enforcement against music piracy—particularly on the internet, amounts to more than US \$2 billion in subsidies to Chinese internet companies who can provide their users to access to music without negotiating licenses therefore. In other words, policies promoting "indigenous innovation" through the denial of copyright protection are hardly a new phenomenon.

Another interesting point of comparison is with Japan. China has approximately six times as many mobile users than Japan (634 million to 110 million). Japan's digital market, comprised primarily of revenue generated from mobile platforms, was worth US\$ 1.2 billion in 2009. If Chinese revenue were to approximate Japan's on a per capita basis, the Chinese digital market would have been worth over US\$7 billion in 2009, mostly driven by mobile delivery. In similar fashion, 2009 digital revenue in South Korea was US\$ 285 million. South Korea has a population less than 5% of China's. Were China to match South Korea's performance, the 2009 Chinese digital music marketplace would have been valued at US\$ 6 billion. While we would not expect per capita consumption in China to presently rival that in Japan or Korea, these figures provide a very interesting and stark background for consideration of China's present performance in the digital realm where total revenue was a paltry US\$94 million.

Over the past several years, China has been rolling out a series of policies aimed at promoting "indigenous innovation." The apparent goal of many of these policies is to develop national champions by discriminating against foreign companies and compelling transfers of technology. Of particular concern are policies that condition market access on local ownership or development of a service or product's intellectual property or aim to compel transfers of foreign intellectual property and research and development to China. A broad array of U.S. and international industry groups have raised serious concerns that these policies will effectively shut them out of the rapidly growing Chinese market and are out of step with international best practices



for promoting innovation. IIPA shares these concerns and strongly believes that the best ways for China to further enhance its innovative capacity are to: further open its markets to foreign investment; provide incentives to innovate by ensuring full respect for intellectual property rights including patents, copyrights and trademarks; avoid policies which establish preferences based on nationality of the owners of the intellectual property rights; and act forcefully and promptly to prevent misappropriation of such rights. It is noteworthy that these recent Chinese policies directly counter repeated pledges by the Chinese government to avoid protectionism, including the joint commitment of President Hu and President Obama at their summit in November 2009 to pursue open trade and investment. They also are counter to China's commitments in the JCCT and the U.S.-China Strategic and Economic Dialogue (S&ED) to keep government procurement open to foreign-invested enterprises (FIEs) and to China's efforts to join the WTO's Government Procurement Agreement (GPA).

Thank you for the opportunity to share the copyright industries' experiences in China. I would be pleased to answer any questions you may have.
