

# CHINA (PRC)

## INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE (IIPA)

### 2014 SPECIAL 301 REPORT ON COPYRIGHT PROTECTION AND ENFORCEMENT

**Special 301 Recommendation:** IIPA recommends that USTR maintain China on the Priority Watch List and that China be monitored under Section 306 of the Trade Act.<sup>1</sup>

**Executive Summary:** The market in China for music, software, publications, films, and video games remains stunted by a combination of piracy and stifling market access and discriminatory barriers. At the same time, there were once again some gradual signs of progress in China during 2013. The U.S. Government has long recognized the significant harm caused by IP infringement in China,<sup>2</sup> and remains deeply engaged with the Chinese Government on intellectual property issues in various fora, including the U.S.-China Joint Commission on Commerce and Trade (JCCT) and the U.S.-China Strategic and Economic Dialogue (S&ED). These engagements have yielded progress in some areas. Recent positive developments include the 2012 U.S.-China Film Agreement, the decision to test self content-review of music in 2014 by licensed online music distributors, and the December 2013 decision to partially open the market in the Shanghai Free Trade Zone to foreign investment, which will hopefully allow the introduction of game consoles and ease restrictions on foreign online music distribution in China.

Yet many commitments made by China in the JCCT, S&ED, and the U.S.-China Film Agreement remain unfulfilled and full market opening remains elusive. For example, the Chinese commitments to promote reform in the distribution of imported films, and to actively encourage more private Chinese enterprises to be licensed by the Chinese Government to engage in the distribution of these films, have not been met. National distribution of imported films remains completely dominated by two state-owned enterprises (SOEs). The theatrical film “Master Contract,” which reportedly is under discussion between some right holders and China Film Group, remains non-transparent, unfair, and inconsistent with international best practices. Investment in music production, publication, and distribution remains limited, stunting the growth of that industry. Progress to “significantly reduce piracy” and tackle unlicensed software use, including in government agencies and SOEs, remains limited. One measure of under-performance of legitimate copyright industries is per capita spending, and the evidence is telling. Software spending per PC in China ranks among the lowest in the world, while the value of unlicensed software is estimated to be over US\$8.9 billion. The size of the legitimate music market is a fraction of what it would be in the absence of piracy and market barriers. Publishers remain hindered in their efforts to engage in core publishing activities in China, and while cooperation has been forthcoming against the piracy of online journals of scientific, technical, and medical (STM) materials, new online “sharing” services threaten the professional publishing market yet again. Other problems worsened in 2013, including unauthorized camcording; sales of hard goods pirated product, or passwords and product activation keys on online trading sites; and websites employing third parties’ peer-to-peer (P2P) and streaming client services to enable infringement by their users.

## **PRIORITY ACTIONS REQUESTED IN 2014**

### **Enforcement**

- Ensure implementation of the 2012 *Network Rules* to hold liable services encouraging or facilitating infringement.
- Halt sales of physical pirate product, passwords, and product activation keys on online trading sites and other e-commerce platforms.

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<sup>1</sup>For more details on China’s Special 301 and Section 306 monitoring history, see previous years’ reports at <http://www.iipa.com/countryreports.html>. For the history of China’s Special 301 placement, see <http://www.iipa.com/pdf/2014SPEC301HISTORICALCHART.pdf>. For a discussion of IIPA’s 2014 Key Initiatives and Challenges, see IIPA, *2014 Special 301 Submission*, at <http://www.iipa.com/pdf/2014SPEC301COVERLETTER.pdf>.

<sup>2</sup>A May 2011 United States International Trade Commission (USITC) report found that overall IP infringement (of which copyright infringement was found to be the largest part) in China costs the U.S. economy as much as \$107 billion and upwards of 2.1 million jobs. USITC, *China: Effects of Intellectual Property Infringement and Indigenous Innovation Policies on the U.S. Economy*, Investigation No. 332-519, USITC Publication 4226, May 2011, available at [www.usitc.gov/publications/332/pub4226.pdf](http://www.usitc.gov/publications/332/pub4226.pdf).



- Take effective action against websites offering infringing content, as well as those deploying non-hosted platforms such as *Xunlei* and *QVOD*.
- Have the State Administration of Press, Publication, Radio, Film and Television (SAPPRFT), the Ministry of Culture (MOC), and the Ministry of Industry and Information Technology (MIIT) revoke business licenses and halt online services of enterprises providing access to infringing materials.
- Bring targeted and deterrent actions, with transparency, against unauthorized use of software by enterprises, hard disk loading, camcording, pay TV piracy, and media box piracy.
- Allow right holders as victims to file collateral civil claims for compensation during criminal IPR trials.
- Follow through on JCCT commitments for transparent, comprehensive, and verifiable progress on government and SOE software legalization, and for strengthening IP protection in university (including library) settings.
- Ensure that SAPPRFT, theater owners, and others associated with the chain of theatrical distribution of films, make efforts to prohibit (including criminal penalties) and deter unauthorized camcording.
- Establish a central authority to compile statistics of civil, administrative, or criminal cases involving copyright; and fully implement new rules on disclosure of administrative penalties.
- Enhance “pre-release” administrative enforcement for motion pictures, sound recordings, and other works, e.g., by establishing a voluntary government-backed online copyright bulletin board.
- Expand resources at National Copyright Administration of China (NCAC), local Copyright Administrations (CAs), and Law and Cultural Enforcement Administrations (LCEAs), commensurate with the scale of piracy problems.
- Allow foreign right holder associations to increase staff and conduct anti-piracy investigations.
- Meet TRIPS obligation to fairly compensate copyright owners for public performance (including broadcast) of musical compositions.

### **Legislation and Related Matters**

- Include intellectual property provisions in the Criminal Law reform consistent with this filing.
- Consider and enact comprehensive copyright law reform as “first tier” legislation, incorporating changes recommended by IIPA and member associations in various past filings.
- Ensure criminalization of: 1) unauthorized use of software by enterprises; 2) hard disk loading; 3) Internet piracy; and 4) circumvention of TPMs and trafficking in circumvention technologies, software, devices, components, and services, including the sale of passwords and product activation keys.
- Specify and lower proof requirements for evidence preservation orders and civil injunctions.
- Make it a violation of law to use, or attempt to use, an audiovisual recording device to make or transmit a copy, in whole or in part, of a cinematographic/audiovisual work, from a performance in an exhibition facility.
- Lower the threshold for criminal enforcement actions to be taken against infringers, including Internet infringers, and including infringements undertaken for purposes other than commercial gain.
- Clarify that administrative transfers of cases for criminal prosecution are required upon “reasonable suspicion” that the criminal thresholds are met.

### **Market Access**

- Ensure full implementation of the U.S.-China Film Agreement:
  - Ensure the promotion and licensing of private Chinese enterprise to engage in national distribution in competition with China Film Group and Huaxia.
  - For “Revenue Sharing Films,” ensure that all terms of the Master Contract for theatrical film distribution comply with the U.S.-China Film Agreement.
  - For “Other Than Revenue-Sharing Films,” ensure that the terms of Chinese SOE contracts comply with the Agreement and are transparent to the industry at large, including private Chinese Enterprises which may act as intermediaries in the importation and national distribution chain.
- Meaningfully implement the WTO cases to further open the market for publishing, online music distribution, and theatrical film distribution.
- Formally revoke the requirement to appoint an exclusive licensee for online music distribution, consistent with verbal assurances of the same.

- Ensure market access is not conditioned on local ownership or local development of the IP of a service or product, and does not compel the transfer of foreign IP and R&D to China, including information security software and cloud products.
- Revise new software procurement rules that impose price controls and licensing terms that discriminate against the procurement of foreign software brands.

## **PIRACY AND ENFORCEMENT UPDATES IN CHINA**

Prior IIPA submissions in the Special 301 docket, as well as IIPA filings in WTO compliance reviews and other fora, have provided detailed accounts of the many piracy and enforcement challenges and issues in China. This year's filing serves as a supplement to those, and is not meant as an exhaustive review of all issues.<sup>3</sup>

**The Continuing Challenge of Addressing Online/Mobile Piracy in China:** Online piracy remains a major challenge in China.<sup>4</sup> Prior filings document the rapid growth of online access, broadband, and mobile penetration in China. With this, China is fast becoming the largest potential market in the world, and while some progress has been made to license services in China, the challenge of online infringement and illegal web and mobile services harming right holders in (and outside of) China has grown faster than the legitimate market.<sup>5</sup> Some services previously noted, like *Xunlei's GouGou* service, have ceased to operate; however, *Xunlei* remains a concern, and was nominated by IIPA as a "notorious market" in IIPA's October 2013 filing,<sup>6</sup> for its hosted *Xunlei Kuaichuan* service and its proprietary, high speed non-hosted P2P file sharing system that facilitates the distribution of unauthorized copies of motion picture and television content. *QVOD* is also noted in that October 2013 filing as a P2P protocol software used by Chinese linking sites to distribute infringing copies of copyright materials. *Xunlei* and *QVOD* are deployed on third-party websites but are responsible for massive amounts of infringement. Stakeholders from both the foreign and domestic film and television industries have identified such piracy sites/services as the biggest threat to the development of the legitimate online video industry in China.

Another major Internet piracy problem involves the unauthorized sale of physical pirate and counterfeit product on e-commerce sites. *Taobao* has demonstrated major improvements in cooperation and coordination with some right holders in recent years (mainly through MOUs), and the Motion Picture Association of America reports exemplary cooperation. Unfortunately, the software, music, and publishing industries all report continuing problems on *Taobao* and other e-commerce sites. The software industry is deeply concerned about tremendous losses resulting from the sale of unlicensed software and software product activation codes and keys via *Taobao* and other auction sites, where these materials are available for very nominal fees. The music industry similarly notes that, notwithstanding greater cooperation with *Taobao*, infringing music remains widely available on the site, as well as on other e-commerce sites. The publishing industry, while noting *Taobao's* willingness to cooperate, continues to have concerns over entities that traffic in login credentials through the *Taobao* platform.

The music industry notes the rampant rise of mobile piracy and the rapid proliferation and worsening of pirate mobile apps. Publishers have noted continuing concerns with unauthorized online distribution of copies of STM

<sup>3</sup>See, e.g., IIPA, *China*, 2013 Special 301 Report, February 8, 2013, at <http://www.iipa.com/rbc/2013/2013SPEC301CHINA.PDF>; IIPA, *China's WTO Compliance - Notification of Intent to Testify and Testimony Re: "Request for Comments and Notice of Public Hearing Concerning China's Compliance With WTO Commitments"* (78 Fed. Reg. 49787, August 15, 2013), September 20, 2013, at [http://www.iipa.com/pdf/2013\\_Sep20\\_China\\_WTO\\_Compliance.PDF](http://www.iipa.com/pdf/2013_Sep20_China_WTO_Compliance.PDF).

<sup>4</sup>The record industry reports, for example, that the total number of cease and desist notices sent to infringing websites increased from 8,692 (2012) to 11,671 (2013).

<sup>5</sup>Some music sites in China have been licensed (for example *kugou*, *baidu*, *kuwo*, *duomi*, and *xiami*), although many smaller websites remain unlicensed, those that are licensed may not cover all rights (for example, some licenses only extend to streaming), and the licenses are restricted to the territory of China. Unfortunately, *kuwo.cn* is accessible from Hong Kong, Singapore, and Taiwan; *xiami.com* is accessible from Singapore, Malaysia, and Taiwan; and *yinyuetai.com* is accessible from Hong Kong, Singapore, Malaysia, and Taiwan). The Chinese Government should apply pressure to rectify these problems. The licensed site *baidu* also remains problematic for the music industry as it operates a cyberlocker *pan.baidu.com* which hosts infringing content. The music industry sent over 2,000 notices to *pan.baidu.com* with a takedown rate of only 42%.

<sup>6</sup>IIPA, *IIPA Written Submission Re: 2013 Special 301 Out-of-Cycle Review of Notorious Markets: Request for Public Comments*, 78 Fed. Reg. 57924 (September 20, 2013), 78 Fed. Reg. 60367 (October 1, 2013) (Extending Deadline), October 25, 2013, available at [http://www.iipa.com/pdf/2013\\_Oct25\\_Notorious\\_Markets.pdf](http://www.iipa.com/pdf/2013_Oct25_Notorious_Markets.pdf). Chinese-based sites noted in that filing include: *QVOD*, *xunlei*, *xiami.com*, *sina.com.cn*, *wenku.baidu.com*, *docin.com*, *yyets.com*, *eachnet.com*, and *taobao*.

journal articles,<sup>7</sup> as well as the rise of new “sharing services,” which are open online platforms where users can upload and share documents. These services, such as *Baidu Wenku*, *Sina*, and *Docin*, employ “digital coin” systems, whereby coins earned through uploading documents may be used to “purchase” English language and Chinese translations of trade books, textbooks, and journals for download. These sharing services have ineffective notice and takedown processes for reporting and addressing infringements. Other online services provide unauthorized access to proprietary databases through the sale of login credentials or information from the databases.

Enforcement against online piracy in China over the past year has been mixed. The Chinese Government has brought several criminal actions. The continuation of the special campaign “Operation Sword Net” organized by NCAC, MPS and MIIT also demonstrates positive government commitment. IIPA members report continued cooperation with authorities and some ISPs to engage in self-help to defeat or remove piracy from rogue or notorious sites. For example, the music industry reported 437 websites to NCAC and MOC in 2013. Of these, 96 websites removed alleged infringing links, 109 were closed by the copyright bureaus and cultural enforcement agencies, and 5 no longer contain music. The other websites apparently still remain operational. The motion picture industry reports cooperation directly with many ISPs and services, with some notable exceptions (e.g., *Xunlei*).

Court cases and administrative enforcement seem to be making an impact. In November 2013, pursuant to a complaint filed by the recording industry, the founder of the *Zyin* service was convicted and sentenced to 15 months imprisonment, fined RMB50,000 (roughly US\$6,000), and subject to confiscation of illegal income of RMB100,000 (roughly US\$12,000), and the operator/owner of the website was sentenced to one year imprisonment, fined RMB40,000 (roughly US\$5,000), and subject to confiscation of the hard disks involved. In addition, in November 2013, the major Chinese site *Sohu* and several other websites sued *Baidu Player* (*v.baidu.com*) and *QVOD* for hosting P2P networks with widespread infringing content. On December 30, 2013, NCAC, together with State Internet Information Office, MIIT, and MPS, jointly held a press conference to announce the results of the “2013 Special Campaign for the Crackdown on Internet Piracy.” *Baidu* and *QVOD* were ordered to immediately cease facilitation of copyright infringement and penalties of RMB250,000 (US\$41,000), the maximum administrative fine under the law, were assessed to each service. In December 2013, IIPA further welcomed the decisions of the Beijing No. 1 Intermediate People’s Court holding liable P2P streaming video network and video on demand (VOD) company Beijing Funshion Online Technology Co., Ltd., owners of the website *Funshion.com*. This site has caused significant harm throughout Greater China, including Taiwan, as well as Hong Kong and Singapore. The total award was RMB470,875 (US\$77,647) in respect of nine civil actions filed, although the site appears to remain operational with a server location in Inner Mongolia.

Combating copyright infringement on the Internet must remain a top priority for the Chinese Government.<sup>8</sup> Full and proper implementation of the 2012 *Network Rules* is critical to hold liable websites and online and mobile services that encourage infringement. Unfortunately, rights holders indicate that promulgation of the *Network Rules* has yet to have a meaningful impact. Full implementation of the *Network Rules* is necessary for ensuring that service providers are: 1) subject to clear secondary liability rules, including in cases of wilful blindness; 2) obligated to respond in a timely manner to takedown notices; and 3) incentivized to take action against repeat infringers. While NCAC has been cooperative on the administrative side, the Supreme People’s Procuratorate remains reluctant to prosecute due to concerns about adequacy of evidence to meet the thresholds for criminal liability (i.e., they cite the lack of hard evidence on ISP servers related to P2P streaming). Thus, there remains a need to address thresholds so that non-hosted online services such as P2P streaming services can no longer escape liability. One step IIPA has noted would be helpful is the establishment of a voluntary government-backed online copyright bulletin board to enhance “pre-release” administrative enforcement for motion pictures, sound recordings, and other works.

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<sup>7</sup>Problems remain with online journal piracy in China, including a service that offers for purchase, and delivery by e-mail, articles from a massive database of journals. The site is currently down and under investigation, but unless and until there is a final conviction and the service is permanently dismantled, other potential similar services will not be deterred. While there has certainly been progress, it has come slowly, since it is now more than two and a half years since the original complaint was filed.

<sup>8</sup>Industry notes the growth of the Internet and mobile piracy problem in particular in Zhejiang, Guangdong, and Shanghai.

**Camcording Worsened in 2013 and Must Be Addressed Forthwith:** Unauthorized camcording of movies – a key source for online audiovisual infringements – has reemerged, particularly in southern China, with a number of illegal camcording incidents detected in Guangzhou city in 2013. The motion picture industry has raised this issue with relevant Chinese Government agencies, e.g., NCAC, NAPP, and SAPPRFT, and with the China Film Distribution and Exhibition Association. The Chinese Government must swiftly enact reforms to make it a violation of law to use, or attempt to use, an audiovisual recording device to make or transmit a copy, in whole or in part, of a cinematographic/audiovisual work, from a performance in an exhibition facility. While awaiting this legislative change, the Chinese Government, theater owners, and others associated with the chain of theatrical distribution of films should take stronger efforts to deter unauthorized camcording.

**Software Piracy Updates:** Chinese private enterprises, state-owned enterprises and government agencies continue to use high levels of unlicensed software. The commercial value of unlicensed software in China was \$8.9 billion in 2011 – an amount that has more than doubled since 2005. This figure represents nearly half the value of all unlicensed software in the Asia-Pacific region. The piracy rate in 2011 was 77%, well above the global average of 42% and the Asia-Pacific average of 60%.<sup>9</sup> Piracy of U.S. software in China diminishes sales and exports for U.S. software companies. It also provides an unfair competitive advantage to Chinese firms that use this unlicensed software. Namely, Chinese firms get a free ride on their software and produce products coming into the U.S. market, which then compete against U.S.-made goods produced by firms that legitimately pay for their software.

As detailed in prior filings, there are significant hurdles to effectively dealing with enterprise end-user piracy in China. These include: 1) the lack of criminal remedies against this form of software piracy; 2) ineffective civil enforcement procedures; and 3) inadequate administrative enforcement. With regard to civil cases, several critical improvements are needed. The courts must relax excessively high burdens for granting evidence preservation orders and need to increase the amount of damages awarded against end-user pirates. In 2013, more local judges granted evidence preservation orders, but this process remains unpredictable, with some judges rejecting applications or causing undue delays. While some courts have increased the amount of damages, others, when facing similar infringement situations, grant much smaller “statutory damages” in lieu of a proper compensatory award. This problem highlights the need to significantly increase statutory damages beyond those currently laid out in the third draft Copyright Law revision. Finally, in cases in which a civil order is issued, right holders and authorities often face on-site resistance against evidence preservation and have only a limited amount of time to conduct software infringement inspections.

Another major issue is the lack of progress on software legalization in Chinese Government agencies and SOEs despite numerous specific commitments by the Chinese Government to tackle this problem in the JCCT and S&ED. Reports by U.S. software companies of little to no progress on these issues clearly indicate that software legalization programs are not being implemented in a comprehensive manner. To follow through on its software legalization commitments, the Chinese Government needs to implement comprehensive legalization programs for the Chinese Government and SOEs that include: 1) audits, certification and other credible processes to verify software license compliance; 2) software asset management (SAM) best practices; 3) sufficient budgets to purchase legal software; 4) performance indicators to hold government and SOE officials accountable for ensuring measurable progress on software legalization; and 5) a prohibition on mandates or preferences for the purchase of domestic software brands as part of the legalization process.

**Physical Piracy Abates, But Hard Disk Loading, High-Quality Counterfeits, Exports, and Manufacture of Circumvention Devices, Remain Problematic:** While many companies report an overall reduction in the impact of physical piracy, hard disk loading of software and other copyright materials remains an acute problem in China,

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<sup>9</sup>Data on software piracy rates and commercial values are taken from the 2011 BSA Global Software Piracy Study at [www.bsa.org/globalstudy/](http://www.bsa.org/globalstudy/). This study assesses piracy rates and the commercial value of unlicensed software installed on personal computers during 2011 in more than 100 markets. The study includes a detailed discussion of the methodology used. BSA plans to release an updated study in the second quarter of 2014.

including at *BuyNow PC Malls* as indicated in IIPA's October 2013 "Notorious Markets" filing to USTR.<sup>10</sup> High-quality counterfeit discs continue to be manufactured in China and sold in domestic markets or exported (including to the U.S., Australia, and Europe). *Hua Qiang Bei Market* (华强北) in Shenzhen, also mentioned in IIPA's October 2013 filing, is a central point from which counterfeit software is distributed to other regions in China and exported. Several criminal counterfeit software cases in China have involved distributors operating out of this market, and while the market has been subject to several sweeps during special enforcement campaigns, the situation has not improved in any meaningful way. Publishers continue to note physical piracy, for example, in the form of English language textbooks, but this is not as substantial a problem as print piracy of trade books. Reports indicate pirate books printed in and exported from China are showing up in parts of Africa. While university-sanctioned piracy has declined over the years, the Ministry of Education should be more involved in fighting piracy on campuses and educating librarians and students. The Ministry of Science & Technology (MOST) should also become more proactive to address pirate document delivery services, and the Chinese Academy of Sciences (CAS) should do more to educate information officers/librarians of the 100 research institutes in China.

Media box piracy, as documented in prior IIPA reports, remains a serious issue and since China is the main source of this problem spreading across Asia, the Chinese Government should take immediate actions against manufacturers and key distribution points for this illegal business model.<sup>11</sup> Finally, as documented in prior IIPA reports, China remains a hub for manufacture and distribution of technologies and devices used around the world to circumvent access controls employed by copyright owners to manage access to their works and services. The reluctance of the Chinese Government to bring criminal actions against manufacturers and distributors of these circumvention technologies and devices remains deeply troubling.

**Next-Generation Pay TV Signal Theft:** IIPA has documented in prior reports not only the increasing incidence of pay TV piracy in China but China's role as the manufacturing and export/distribution hub for pay TV circumvention devices and services. It is believed that pay TV piracy has widened in China's second and third tier markets in recent years. In addition, concerns have been raised about the deployment of services providing unauthorized retransmission (including over the Internet) of digital pay TV services. The film and TV industries are still learning about the size and scope of the problem, but the emergence of this next-generation digital pay TV is certainly a cause for concern.

**Continued Need for Enhanced Chinese Government Resources to Tackle Piracy:** IIPA has long argued that the disproportionately small amount of resources devoted to fighting piracy in China, when compared, for example, with those deployed to stop counterfeiting, creates a recipe for failure. For example, the software industry continues to report that the only avenues they have for seeking redress for unauthorized use of software by enterprises are the administrative and civil systems, which are under-funded and under-resourced, and which generally result in non-deterrent penalties. The same story plays out for other industries, which report that civil enforcement efforts are plagued by non-deterrent remedies (e.g., low damages and limited injunctive relief) and overly burdensome procedures (e.g., extensive documentation and legalization requirements). As such, IIPA continues to urge the Chinese Government to expand resources at NCAC, local CAs, and LCEAs, commensurate with the scale of the piracy problem. Given the ongoing prohibition on foreign right holder investigations into piracy, it becomes even more incumbent upon the Chinese Government to enhance its own resources.

## **COPYRIGHT AND RELATED LAWS AND REGULATIONS UPDATE**

Prior IIPA filings have documented in detail developments in the Chinese legal system for the protection of copyright, including Copyright and Criminal Law reform efforts. Last year's major development was the entry into

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<sup>10</sup>Buynow (百脑汇) PC Mall (China, various locations) is a very large personal computer mall chain in China, operating 22 stores across the country, leasing space to sellers of electronics equipment, software, games and accessories. Many of these sellers offer pirated operating systems and software, which they will install directly onto their customers' hard disks.

<sup>11</sup>"Media box" piracy consists of hardware sold that facilitates remote access to music videos, karaoke, audiovisual, and other creative materials. These boxes are being manufactured in China and exported to overseas markets throughout Asia. This next generation piracy threatens not only the Chinese market for content but is exported from China, harming other markets.

force on January 1, 2013 of a 2012 set of *Network Rules* to address online infringements.<sup>12</sup> These revision processes provide important opportunities to update the legal regime in China for more effective copyright protection and enforcement. IIPA also notes the commencement of official operations of the National Leading Group (NLG) in July 2013. While the key work plan of the NLG remains unclear, one important item on its agenda should be to ensure the Copyright and Criminal Law reform processes move forward and result in updated laws that adopt copyright protection and enforcement best practices, as IIPA and many IIPA member associations have recommended in numerous submissions to the Chinese Government. In 2013, *Regulations for the Implementation of the Copyright Law of the People's Republic of China* were issued (January 30); the *Regulations* confirm increased maximum administrative penalties.<sup>13</sup> Meanwhile, several other draft measures were released for comment, including: *NCAC Measures on the Supervision and Administration of the Copyright of Film and Television Works Disseminated via Internet* (March 2013);<sup>14</sup> *Rules of Administration of Network Publication Services* (January 2013);<sup>15</sup> and *Draft Measures for Online Trading and Related Services* (September 2013).<sup>16</sup> None of these measures seems to have fully recognized the seriousness and scope of online piracy and counterfeiting. For example, the *Draft Measures for Online Trading and Related Services* simply defers the IP infringement issues to the existing Tort Law without imposing any meaningful duty over online trading platforms. If the *Draft Measures* are issued as is, China will have missed an opportunity to reform its regime of online enforcement to the benefit of creators.

**Copyright Law Reform Not Fast-Tracked:** IIPA has provided several sets of comments on the draft amendments to the Copyright Law, and IIPA's specific comments and remaining issues have been communicated to the Chinese Government. Beyond those already discussed, additional issues raised with the Chinese Government by industry most recently include:

- the proposal by the Chinese Government of possibly overly restrictive collective management provisions;
- problematic default presumptions of ownership in the draft as to audiovisual works and works for hire;
- the re-introduction of an over-broad statutory license for broadcast of certain "published works";
- concerns over the way the draft attempts to address protection and use of "orphan works"; and
- the need to ensure that: 1) evidence preservation orders would issue within 48 hours of receipt of the application; 2) written decisions on applications for such orders are provided; 3) an opportunity to appeal denials of such orders is afforded; and 4) evidence preservation provisions otherwise conform to China's TRIPS obligations.

The third NCAC draft now sits with the State Council Legislative Affairs Office, where it is reportedly not considered "first tier" legislation, meaning it may not be considered by the National People's Congress in 2014 with priority. This is unfortunate. Given the proliferation of copyright piracy in China, including illegal online services, there is an urgent need for China to update and modernize its copyright law. This includes adequate remedies in the online environment and for ISP cooperation to tackle online piracy. In the absence of Copyright Law reform, the 2012 *Network Rules* on liability (i.e., the "necessary measures" to be taken by ISPs to avoid liability) will continue to govern.

**Criminal Code Reform Should Include Intellectual Property:** Unlike Copyright Law reform which appears stalled, Criminal Law reform appears to be fast-tracked. While to IIPA's knowledge no set of comprehensive amendments has emerged, the latest information suggests changes to the intellectual property provisions of the

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<sup>12</sup>*Judicial Rules on Several Issues concerning the application of Law in Hearing Civil Dispute Cases Involving Infringement of the Right to Network Dissemination of Information*, Approved at No. 1561 Meeting of the Supreme People's Court Adjudication Commission held on November 26, 2012. These *Rules* replaced the 2006 *Regulations on the Protection of the Right of Communication through Information Networks*.

<sup>13</sup>For example, the maximum compensation for infringing related rights of sound recording producers will be increased to RMB250,000 (US\$41,000).

<sup>14</sup>The music industry suggested that cinematographic works and works created in a way similar to cinematography as well as music videos should be covered in these measures.

<sup>15</sup>The music industry recommended that: 1) the draft rules should clarify that foreign invested entities may participate in network distribution service for music; 2) online music should be subject to only one content examination procedure; 3) copyright infringement should be expressly indicated as a "prohibited" action; and 4) consequences should be clearly stated if an ISP does not strictly observe its obligations under the Rules.

<sup>16</sup>The music industry suggested that: 1) copyright and rights related to copyright should be covered; 2) a "Publication Business Permit" should be obtained and shown in order to sell audio and video products; and 3) third party trading platform service providers and related service providers should have obligations to protect copyright and rights related to copyright.

Criminal Law (e.g., Articles 217 and 218 and accompanying JIs) and other related provisions may not be considered. This would be a major missed opportunity, and we urge the Chinese Government to reconsider this decision. As IIPA has noted above and in many prior filings and in informal consultations, a credible criminal remedy in China is needed to effectively curtail piracy and related violations in all their forms. Remaining gaps include:

- Thresholds that are too high (in the case of illegal income) or unclear (e.g., in the case of the copy threshold).
- Leaving some critical commercial scale infringements without a criminal remedy because of the requirement to show that the infringement is carried out “for the purpose of making profits,” an undefined phrase. It is often difficult for law enforcement authorities or right holders to prove that the infringer is operating for the purpose of making profits in cases of Internet piracy, enterprise end-user software piracy, or hard disk loading piracy cases.
- Failure to cover all acts of piracy on a commercial scale as required by TRIPS Article 61. For example, acts that Chinese law fails to expressly criminalize include: infringement of the communication to the public or the making available right of any work/related right; satellite, cable and broadcast piracy; trafficking in bootleg recordings; and other acts of infringement even when they are “on a commercial scale.”
- Failure to separately define criminal violations related to the WCT and WPPT, for example, circumvention of technological protection measures, trafficking in circumvention technologies, software, devices, components, and services, including in particular the unauthorized sales of passwords or product activation codes or keys over the Internet.
- Limited criminal accomplice liability with respect to imports and exports (with lower penalties available).
- Uncertainties with respect to increased penalties against repeat offenders.

In addition to expanding the scope of IP criminal liability, the law should also be amended to lift the jurisdictional bar limiting foreign right holders from commencing a private “civil claim” against those being prosecuted for copyright crimes in local district courts.

**Possible New Levels of Transparency in Case Law and Administrative Enforcement:** The SPC issued a Decision, *Supreme People’s Court Decision on Publishing Written Judgment of People’s Court on the Internet*,<sup>17</sup> effective January 1, 2014, requiring all judicial opinions to be published on the Internet within seven days. The increased transparency directly corresponds to what is called for by the Resolution of Third Plenum, demanding consistency and uniformity in the court adjudication process, including those adjudicated in the IP system. On November 21, 2013 the State Council issued its *Opinion on Disclosure of Information on Administrative Sanctions against IP Piracy*. The *Opinion* indicates that, except for business confidential and private information, administrative sanctions against IP piracy shall be disclosed to the public. These are generally considered positive developments.<sup>18</sup> We hope that full implementation of these measures, as well as the establishment of a central authority to provide information on and compile statistics for civil, administrative, or criminal cases involving copyright, will usher in a new era of transparency in the Chinese enforcement system.

**TRIPS/Berne Obligation to Pay Fairly for Public Performances (Including Broadcasts) of Musical Compositions:** IIPA continues to maintain that China violates its TRIPS/Berne Convention obligation to compensate copyright owners for the broadcast of musical compositions, both for failure to pay retroactively to China’s entry into the WTO, and for an ongoing violation of establishing a payment scheme that is clearly tens of millions of dollars below what would be a fair rate. The Chinese Government has never followed through on the agreement to “hold government/industry roundtables in China to discuss online copyright protection and enforcement, including library copyright protection.” This issue should remain a top priority in bilateral discussions.

**Administrative Criminal Transfer Regulations Need Significant Improvements:** The amended *Criminal Transfer Regulations* are well intentioned but do not adequately address existing challenges to the effective transfer

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<sup>17</sup>*Supreme People’s Court Decision on Publishing Written Judgment of People’s Court on the Internet* (最高人民法院关于人民法院在互联网公布裁判文书的规定), effective January 1, 2014.

<sup>18</sup>There are genuine concerns, however, based on some recent decisions, that the arbitrary deadline may short-circuit some judges’ processes in achieving full, reasoned decisions.

of administrative cases to criminal investigation and prosecution. The *Regulations* leave unclear whether transfers are required upon “reasonable suspicion” that the criminal thresholds have been met, and thus, some enforcement authorities believe “reasonable suspicion” is insufficient to result in a transfer, requiring proof of illegal proceeds. However, administrative authorities do not employ investigative powers to ascertain such proof. The “reasonable suspicion” rule should be expressly included in amended transfer regulations. There is apparently also some reluctance about transferring cases due to administrative authorities’ wish to retain the potential financial reward for successful enforcement actions, although questions also remain about who bears the costs for storage of contraband and other expenses associated with the handling of cases.<sup>19</sup>

## **MARKET ACCESS UPDATES AND RELATED ISSUES**

IIPA has consistently stressed the direct relationship between the fight against piracy in China and the need for liberalized market access to supply legitimate product, both foreign and domestic, to Chinese consumers. Many past IIPA submissions on China have detailed key market access barriers, such as:

- investment prohibitions or restrictions on core copyright businesses, such as production (including signing musicians and recording them), publication, duplication/replication, and distribution of audiovisual (music and film/TV) and published materials;
- restrictions on “exclusive licenses” of online music services;
- the lack of competition with incumbent SOEs for national distribution of imported films, and the lack of encouragement of other private Chinese entities to participate in national distribution of imported films without interference;
- the to-date non-transparent and non-negotiable Master Contract for theatrical distribution;
- import and export restrictions;
- discriminatory, arbitrary, and opaque censorship and release processes and timelines;
- the ban on importation or distribution of videogame consoles (which may be partially lifted due to market opening in the Shanghai Free Trade Zone); and
- measures that have the effect of discriminating against foreign software and other technology products, or compelling transfers of technology and intellectual property to China in order to access the market.

While many of these restrictions remain, some of the copyright sectors have seen limited progress in the past two years toward expanded market access. For example, the December 2011 amendment to the *Catalog of Foreign Investment Guidelines* promised to open the market for several creative product categories, creating new opportunities for foreign right holders. We are also encouraged by recent high-level political pronouncements which seem to indicate a policy shift toward viewing IP overall as an important Chinese interest. In November 2013, the Chinese Communist Party issued a decision on major issues concerning comprehensive major reforms, which stated that “China will strengthen protection of intellectual property rights, improve the mechanism to encourage innovation, and explore ways of setting up an IPR court.” The reform document also mentions improving the cultural management system and developing a modern cultural market. This would include improving entry and exit mechanisms into the cultural market and the development of non-state owned cultural enterprises. The document also mentions promoting Chinese culture to the world while actively absorbing all outstanding cultural achievements from abroad. These high-level policy directives to guide the Chinese Government over the next decade seem to represent a positive policy shift, although given the industry’s experience with, e.g., indigenous innovation and concerns over strategic emerging industries (SEIs) and possible discriminatory or protectionist effect, we must urge the U.S. Government to continue to monitor this trend carefully.

**Self-Censorship of Foreign Entity Music Introduced:** On August 12, 2013, the *Administrative Measures on Content Self-Censorship of Internet Cultural Operating Units of MOC* were issued (entering into force December

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<sup>19</sup>The bottom line is that the structures in place should encourage administrative authorities and police to cooperate in seeking positive outcomes in piracy cases.

2013).<sup>20</sup> Under the *Administrative Measures*, the Ministry of Culture will not need to censor or examine either the imported or domestic music repertoire of foreign entities after self-censorship by the Internet cultural operating units. This self-censorship is considered as a pilot project until November 2014, after which time MOC will decide whether or not to extend or expand it. IIPA and members have been pressing for years for a change to the current discriminatory system, and we hope to see it implemented in a way which will provide equal treatment to both imported and domestic music. In addition, the Chinese Government has verbally indicated that it is no longer necessary to appoint an exclusive licensee for online music distribution. However, to avoid any uncertainty, it is recommended that the Chinese Government formally revoke this requirement.

**Shanghai Free Trade Zone Opens Online Music Sector (and Perhaps Consoles) to Foreign Investment, But Leaves Others Out:** In September 2013, China officially launched the pilot free trade zone in Shanghai (“Shanghai FTZ”). Foreign investment in all sectors is allowed in the Shanghai FTZ unless listed under a published *Negative List*. The *List* does not prohibit investment in internet services for “music,” so foreign record companies should be able to start online music businesses in the Shanghai FTZ. Unfortunately, the *List* expressly prohibits investment in “online audio and video programs,” as well as so-called “Internet cultural business.” In addition, I64, category 4, indicates, “Foreign investors are forbidden to be engaged or involved in operation of online games directly or indirectly.” Further, even for music, it is unclear whether music videos can be included, and whether such a foreign company established in the Shanghai FTZ could make music available throughout China. One potential breakthrough includes the ban on importing or distributing consoles in China. Since there is no express prohibition on consoles in the *List*, presumably, that market is now apparently permitted for foreign investment in the Shanghai FTZ.

**Review of the “Master Contract”:** The Master Contract governs the relationship between China Film Group and foreign producers who secure a quota slot, which are primarily major motion picture studios. This Contract, which unfairly restricts terms such as revenue-sharing percentage, is reportedly being re-negotiated. This is an extremely important development. IIPA requests that the U.S. Government make this review a priority issue, as we can expect that China Film Group may try to negotiate as few changes as possible. To the extent the Master Contract becomes the subject of bilateral discussions between U.S. Government and its counterparts at the Chinese Ministry of Commerce (MOFCOM), all industry stakeholders are prepared to work with the U.S. Government to get the most they can out of this discussion and negotiation. The financial and standard terms of the Master Contract must be transparent with the effect of the Chinese Government signaling to the marketplace that reforms to comply with the U.S.-China Film Agreement are well underway. Other private Chinese enterprises will then understand the terms on which China Film Group imports and distributes quota films so that they can finally engage in the national distribution of imported films.

**U.S.-China Film Agreement Implementation – Next Stages:** The February 2012 U.S.-China Film Agreement has had the positive result in increasing revenue sharing participation to 25% of box office revenue for up to 34 films (14 of which enter the Chinese market in enhanced formats). This change has already resulted in increased revenues for films that are able to secure the increased quota slots and share in box office revenue. This progress is tempered by the fact that so few imported films are able to secure quota slots, and films that do not share in the box office revenue still meet insurmountable boundaries and lack of distribution options due to the dominant incumbent SOEs in the market, China Film Group and Huaxia. Until the U.S.-China Film Agreement is robustly and fully implemented, and national distribution can be conducted by private Chinese enterprises in competition with the dominant incumbents, the majority of film producers will have very limited export opportunities in China.<sup>21</sup> Access

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<sup>20</sup>Before this occurred, IIPA and its members had been concerned about the 2012 draft *Network Publishing Service Management Regulations (Opinion-Seeking Revision Draft)*, but the new *Administrative Measures* appear, at least for the moment, to have overtaken those concerns.

<sup>21</sup>The independent film industry which produces the majority of U.S. films continues to experience limited access to the Chinese marketplace and is only able to secure a very limited number of revenue sharing quota slots. Most independent films are still imported and theatrically distributed in China on a non-revenue share basis and suffer from lack of distribution options and below-market commercial terms. Both the financial return and the license fees for the underlying films are massively eroded by the lack of qualified theatrical distributors who can adequately support a nationwide theatrical release, and by a relatively non-competitive and non-transparent marketplace. The lack of legitimate distribution opportunities for independent films make these films particularly vulnerable to piracy as Chinese consumers struggle or are unable to find the content they want through legitimate channels.

they do have will be through intermediaries that must navigate a non-transparent marketplace. In order to promote a level the playing field for all imported films seeking distribution opportunities in China, the PRC should immediately:

- begin to actively promote and approve Chinese companies to engage in national distribution of theatrical films. This includes promulgating transparent business practices in which the incumbents would work transparently with private Chinese enterprise to coordinate importation of films (both revenue sharing and non-revenue sharing films) so that those private companies could engage unfettered in the national distribution of imported films as envisioned in Paragraphs 4 through 8 of the Agreement;
- provide for transparency in the censorship process for films;<sup>22</sup>
- eliminate arbitrarily declared special periods of protection for domestic films that interfere with the marketing and distribution of imported and local films alike, so as to permit imported films to be released and scheduled according to commercial contracts and without Government interference (permitting both the Chinese distributor and the producer to achieve maximum commercial benefits);<sup>23</sup> and
- cease other actions taken by the Government and SOEs (formal or otherwise) which have a discriminatory impact on foreign film and television producers.

A newly proposed centralized ticketing system may create more transparency, but also may be a new cause of concern for the strengthening of the Chinese Government's influence on the theatrical marketplace. Developments must be closely monitored to ensure the Chinese Government's full compliance with the U.S.-China Film Agreement.

**Addressing Indigenous Innovation, Procurement Preferences, and Local IP Ownership Requirements for Information Security Products Including Software:** The Chinese Government must continue to address other market access barriers and industrial policies, including indigenous innovation policies, that impose discriminatory requirements on foreign right holders and/or deny them the exercise of their IP rights.<sup>24</sup>

**Indigenous Innovation:** Over the past several years, China has rolled out a series of policies aimed at promoting "indigenous innovation." The apparent goal of many of these policies is to develop national champions, but raising some concerns that the implementation of such policies may discriminate against foreign companies and compel transfers of technology. Of particular concern are policies that condition market access on local ownership or development of a service's or product's intellectual property, or that aim to compel transfers of foreign intellectual property and research and development to China.

For example, in 2012, the Chinese Government announced they would be investing US\$1.7 trillion over the next five years in designated Strategic Emerging Industries (SEIs). This initiative, in addition to a SPC Opinion on IP released in mid-December 2011 which seemed to instruct lower courts to make decisions that assist domestic "cultural" industries, could effectively promote the implementation of discriminatory policies. In 2011, China committed to eliminate catalogues or other measures by provincial and municipal governments and autonomous regions linking innovation policies to government procurement preferences. This followed previous Chinese commitments to "delink" innovation policies from government procurement. At the 2012 S&ED, China made a broader commitment to treat IPR owned or developed in other countries on the same basis as IPR owned or developed in China. These commitments must be fully satisfied to give software developers and other copyright industries fair access to China's vast procurement market.

**Software Preferences:** The software industry remains concerned that the Chinese Government is adopting mandates or preferences for domestic software brands as part of its legalization programs for government agencies

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<sup>22</sup>The lack of certainty in China's censorship process for films causes unstable commercial transactions and poses a market access barrier to independent film producers. For example, local distributors report they cannot obtain official written responses from the censorship authorities, and some continue to use a film's censorship rejection as a way to avoid payment of license fees.

<sup>23</sup>Uncertainty regarding the release of foreign and domestic films in China negatively impacts all independent film producers and their local Chinese distribution partners.

<sup>24</sup>For more market access related concerns for the software industry, please see the China section (pages 3-5) of the BSA submission for the National Trade Estimate (NTE) to USTR, at <http://www.bsa.org/~media/Files/Policy/Trade/BSASubmissionfor2013NTEFINAL10152012.ashx>.

and SOEs. This is inconsistent both with China's efforts to join the WTO's Government Procurement Agreement, and 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 ... ."

In May 2013, China's Ministry of Finance (MOF) issued new rules on software procurement, the *Notice on Generic Software Assets Allocation Standards in Government Agencies* (MOF Decree). The MOF Decree imposes price controls and preferred licensing terms (e.g., site-licenses) on procurement of software that favor local brands and significantly restrict market access for foreign brands. Moreover, the MOF Decree focuses on the procurement of only certain types of software – operating systems, office productivity software, and anti-virus software – suggesting that procurement may not be authorized or, at a minimum, that budgets will not be made available for other types of software. This directive does not comport with best practices for software procurement, does not adequately take into account the speed with which software products and services are developing, and puts in place *de facto* preferences for procuring domestic software products and services that are not in keeping with China's JCCT and S&ED commitments to avoid discrimination against products with foreign-owned or foreign-developed IP in its government procurement and its WTO accession obligations to refrain from imposing price controls.

Additionally, China has provided similar MOF guidance to the SOEs. This guidance has been provided directly, as well as on State-owned Assets Supervision and Administration Commission (SASAC) hosted SOE product legalization websites. This guidance: 1) creates a preference to purchase domestic-brand software; 2) erects artificial barriers that impede market access by suggesting that products are comparable when they are not (e.g., business productivity software versus basic word processing software); and 3) presses entities to support, encourage, and ensure the fast growth of the domestic software industry.

To address this situation, the Chinese Government should:

- withdraw the MOF Decree and address its discriminatory elements, including by removing the price controls and site-license preference, and refrain from adopting or implementing any other measure that would have the effect of excluding foreign software or favoring domestic software in government procurement;
- consistent with its WTO obligations and its JCCT and S&ED commitments, affirmatively declare: 1) that it will not influence, either formally or informally, the software purchasing decisions of SOEs in any way (whether through the MOF Decree or otherwise); and 2) that it will take affirmative steps to clarify to all SOEs that they remain free to make software purchasing decisions based on commercial considerations irrespective of the origin of the software or the nationality of the supplier.

In keeping with these commitments, China should remove all instances of such discriminatory guidance from all government websites directed at SOEs.

**Local IP Ownership Requirements for Information Security Products Including Software:** China's "Multi Level Protection Scheme" (MLPS) imposes significant restrictions on procurement of information security products for an overly broad range of information systems the government considers sensitive. Among other requirements, procurements of such products are limited to those with IP rights owned in China. This applies to procurements by the Chinese Government and increasingly to procurements by SOEs and others in the private sector. This results in an undue and discriminatory market access restriction for foreign information security products and will in many cases prevent information systems in China from procuring the most effective security tools to meet their needs. We welcome the commitment made by China in the 2012 JCCT that it will review and revise the MLPS rules through a process that will seek the views of all parties, including through dialogue with U.S. parties, and urge that China use this process to remove requirements that discriminate against products that are foreign-owned or have foreign-owned IP.

**Patent Law Reform:** The Chinese Government is currently undertaking a process to amend the Patent Law, led by the State Intellectual Property Office (SIPO). Among other things, the proposed amendments would give expanded enforcement powers to SIPO, who may be able to conduct *ex officio* raids and enforcement actions

against ill-defined “market-disruptive” patent infringement activities, and award fines as well as compensatory and punitive damages. This creates enormous risks for foreign patent holders in China. The Chinese judicial system is the proper forum to adjudicate patent infringement and damages, and it does not make sense to vest that same authority in administrative agencies as well. The proposed empowerment of SIPO and hundreds of local intellectual property offices (IPOs) in enforcing patents will dramatically change the current enforcement landscape, creating the potential for substantial confusion and duplication of the role that courts now play. The envisioned role for SIPO and IPOs as patent enforcement authorities is, based on our research, without analogue in any other national law.