

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE



1747 PENNSYLVANIA AVENUE, NW • SUITE 825 • WASHINGTON, DC • 20006-4637 • TEL (202) 833-4198 • FAX (202) 872-0546 • WWW.IIPA.COM • EMAIL: INFO@IIPA.COM

September 1, 2005

By E-MAIL to FR0437@ustr.eop.gov
Ms. Gloria Blue
Executive Secretary
Trade Policy Staff Committee (TPSC)
Office of the U.S. Trade Representative
1724 F Street, N.W.
Washington, D.C. 20508

Re: China WTO Compliance: (1) Request to Testify at September 14, 2005 Hearing and (2) Notice of Testimony Regarding Copyright Protection and Services/Market Access in China in response to the Request for Comments and Notice of Public Hearing Concerning China's Compliance with WTO Commitments, 70 Fed. Reg. 44715 (August 3, 2005)

Dear Ms. Blue:

The International Intellectual Property Alliance ("IIPA") hereby requests the opportunity to testify at the September 14, 2005 hearing the TPSC will hold regarding China's compliance with the commitments it made in connection with its accession to the World Trade Organization (WTO) as well as other commitments made to the United States.

REQUEST: Testifying for the IIPA will be
Mr. Eric H. Smith
President, International Intellectual Property Alliance (IIPA)
1747 Pennsylvania Avenue NW, Suite 825
Washington, DC 20006
Tel: 202 833 4198

SUMMARY OF TESTIMONY: IIPA will testify regarding issues related to copyright law and enforcement in China, including China's obligations under the WTO TRIPS Agreement as well as bilateral obligations China has made to the U.S. Our 3-paragraph summary follows:

China's potential market and demand for U.S. copyright products is huge, but that market is virtually closed to U.S. companies. Onerous market access barriers and a staggering 90% piracy rate, affecting virtually all copyright industries, are cheating the U.S. economy of potentially billions of dollars annually. Losses to these industries exceeded an estimated \$2.5 billion in 2004 and are growing. As the



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result of market access barriers and rampant piracy, the Chinese market is more closed to the copyright industries than almost any other U.S. business sector, denying the U.S. a major trade comparative advantage. With respect to piracy, China, despite many promises from high government officials, continues to fail to bring criminal actions against piracy of U.S. copyright products. Taking effective criminal action against piracy is a key WTO TRIPS requirement and likewise key to China reducing the staggering piracy rates and create a market both for U.S. and local right holders. Criminalizing all acts of “copyright piracy on a commercial scale” and taking effective criminal action against such acts are key WTO TRIPS requirements and are the only way that China will be able to reduce its staggering piracy rates and create a market both for U.S. and local right holders.

With respect to market access, China also has failed to implement timely its WTO market access commitments with respect to trading rights for the book publishing industry. Other market access barriers, while permitted under China’s WTO accession terms, continue to produce almost insurmountable barriers to legitimate market entry for U.S. and foreign rightsholders, thus contributing to the continued existence of a pirate marketplace.

U.S. government efforts, in April 2004, to engage the Chinese government in a heightened dialogue, through the Joint Commission on Commerce and Trade (JCCT), two and one-half years after China’s WTO accession, resulted in a commitment by China to “significantly reduce IPR infringements.” More than a year later, however, piracy rates remain at virtually the same levels, the market has only very marginally improved for some industries, if at all, and worsened for others. IIPA supports a new and tougher dialogue with China to deal both with rampant piracy and oppressive market access barriers.

TESTIMONY: The text of Mr. Smith’s prepared testimony is attached. The brevity of the testimony is dictated by the 5-minute limitation the TPSC has placed on witnesses.

WRITTEN COMMENTS: Please know that IIPA aims to file comprehensive written comments in this docket by the TPSC’s September 6, 2005 deadline.

We look forward to participating in this proceeding. Thank you for your attention.

Sincerely,

Eric H. Smith
President
International Intellectual Property Alliance

Testimony Attached



[As Prepared for Delivery, Limited to 5 Minutes]

**Proposed Testimony of
Eric H. Smith
President, International Intellectual Property Alliance (IIPA)
on
China's WTO and Bilateral Commitments
on Copyright Law, Enforcement and Market Access**

My name is Eric H. Smith, and I am President of the International Intellectual Property Alliance (IIPA), a coalition consisting of seven trade associations representing the U.S. copyright industries. I am pleased to have this opportunity to share with you the perspectives of the U.S. creative industries on China's WTO compliance. IIPA has also submitted separate, more comprehensive comments in this proceeding.

IIPA and its members have been working to improve copyright laws, piracy, enforcement and market access issues in China for well over a decade. From the 1992 IPR Memorandum of Understanding, to the 1995 and 1996 IPR negotiations and agreements and action plans (settling at that time a U.S. Section 301 action), and China's WTO accession in 2001, IIPA has greeted each of these milestones with hope that the market would improve for its members' copyright products. The combination of debilitating levels of piracy, resulting in huge economic losses to America's creative industries, and severe market access restrictions create an insuperable barrier to realizing the vast potential of the Chinese market for products in which the U.S. is the world leader.

WTO COMPLIANCE ISSUES

IIPA again reports to the TSPC, for the fourth year in a row, that two primary problems have kept China's market largely closed, preventing copyright owners from benefiting from China's accession to the WTO. The first is copyright piracy, which dominates the local market for copyrighted materials and is beginning to become an export problem again. The second is market access restrictions that prevent



meaningful entry into the local market for most of our industries, thereby exacerbating the piracy problem by restricting the availability of legitimate products.

It is only through commencing coordinated and aggressive criminal prosecutions and convictions (with deterrent penalties) against all forms of piracy – combined with steps to open the Chinese market, that China can comply with its WTO commitments. My testimony today will focus on how China has fared with respect to these two key issues.

COPYRIGHT PIRACY AND INEFFECTIVE ENFORCEMENT

Widespread copyright piracy in China harms the markets for every copyright sector, including movies, recorded music, business software, entertainment software, and book publishing. Piracy levels (which reflect the percentage of product sold in a market that is illegal) were in the 85-95% range for 2004 for all copyright industries reporting piracy rates. The Chinese enforcement system has failed to lower significantly such piracy levels, and therefore, does not provide adequate procedures and effective legal remedies to protect copyright, as is required by the TRIPS enforcement provisions. Estimated losses due to piracy of copyrighted materials were over \$2.5 billion dollars in 2004.

Continuing hard goods piracy – videos, records, books, videogames, software – remains widespread. Optical media plants in China continue to produce pirate CDs, VCDs and DVDs, and there is increasing evidence, including one of the only criminal convictions for export piracy – the Guthrie case – from 2005, that pirate producers in China have once again begun exporting product. While most pirate products in the Chinese market are produced in China, imports of pirate product from other countries in Asia is also a problem. Internet piracy is an ever-growing phenomenon in China today, including so called peer to peer (P2P) piracy, unauthorized or pirate servers for entertainment software, and piracy in Internet cafes.

The lowering of the criminal thresholds in 2004 was publicized by the Chinese governments as being responsive to China's April 2004 JCCT commitments but the reality, at least so far, is that these thresholds are still too high and other barriers to their proper application still too onerous. Moreover, the



Chinese Criminal Code fails to criminalize all acts of “copyright piracy on a commercial scale.
Article 61 of TRIPS requires that criminal procedures be available (both on the books and in practice) at least against copyright piracy “on a commercial scale.” Article 41 of TRIPS requires countries to provide “effective action” against infringements that actually creates a “deterrent to further infringements.” There have been few criminal copyright infringement prosecutions brought under the Criminal Code and virtually all of these involve Chinese right holders and local copyright product. Because of the continued high thresholds in the Criminal Code, the failure to criminalize some acts of commercial scale piracy, and a lack of prosecutions in-practice, it is clear that foreign right holders do not enjoy a WTO-compatible criminal remedy in China.

Anti-piracy enforcement in China for foreign rightsholders has continued to involve only administrative enforcement actions, chiefly aimed at seizing infringing materials. Administrative enforcement, however, has been an ineffective avenue for deterring piracy in China, since administrative cases result in notoriously low fines and no imprisonment. There has been almost no effective administrative enforcement system against end-user piracy of software and other copyrighted materials in China; only in this year’s JCCT “outcomes” has this been recognized as a problem that the Chinese are now willing to correct, including criminalizing such acts of piracy. This will be a new and welcome development, if prosecutions are actually brought, leading to a measurable decline in piracy and a measurable increase in legitimate software sales.

MARKET ACCESS RESTRICTIONS

Providing market access to allow more legitimate product into China is an essential element of an effective anti-piracy strategy in the country. It is significant that China, through its WTO commitments, has agreed to open its market in various ways to different copyright industry sectors.

For example, it is noteworthy that China has agreed to open its market to wholesale and retail distribution by foreign book publishers. Other commitments, particularly in the audio and audiovisual sectors, are less helpful, but since they are minimum commitments, it is possible for China to effectuate further market opening at any time.



The book publishing industry reports overdue WTO commitments. First, it is our understanding that China, through its WTO commitments, has agreed that foreign companies are to be afforded full trading rights – the right to freely import directly into China – with respect to books, newspapers and magazines. Contrary to China's obligation, the latest Foreign Investment Guidelines expressly state that "importation" of books, newspapers and magazines is prohibited, which would apparently place China in violation of its WTO commitments. Second, while the latest Guidelines confirm China's commitments with respect to wholesale and retail distribution, they fail to confirm that foreign entities may engage in commission agents' services, franchise services and the like as required under the WTO. Third, the latest Guidelines do not confirm that foreign entities can partake in many subordinated services including "sales promotion [and] advertising," again, as required under the WTO. In addition to the WTO issues, continued severe restrictions on activities of paramount importance to U.S. publishers, such as printing (which is "restricted"), and failure to define key activities which are prohibited, for example, "master issuing" and "producing" cast doubt on whether China is meeting its WTO obligations.

Other industries continue to suffer market access restrictions. The filmed entertainment industry continues to suffer from policies such as China's WTO commitment to allow in a minimum of 20 foreign films annually under discriminatory standard commercial terms (and fixed terms for revenue sharing); this essentially provides pirates with a monopoly in the Chinese market for an up to six-months between theatrical release of a motion picture and the release of the product in home video formats. If delays are permitted to occur in the censorship process for home video entertainment, then pirates have an even longer period in which they can operate before legitimate product enters the market.

The record industry faces serious market access hurdles for every essential activity to their business in China. Wholesale and retail distribution, the signing of recording artists, artist management, the production and publication of sound recordings, are all off limits for U.S. enterprises. Chinese guidelines make it clear that "publishing, producing, master issuing and importing" of records in China are prohibited foreign investment activities, as is broadcasting, while distributing and selling records is a "restricted" activity. These restrictions effectively limit the availability of legitimate recordings, thereby leaving the entirety of the market to the pirates. Failure to open the Chinese market to those with the bulk



of the wherewithal and know-how to make records makes it impossible for the vast majority of record producers worldwide to bring local Chinese content to the Chinese people and to make those artists and the music known to the world.

With respect to business software in China, IIPA and BSA are encouraged by the recent commitments by the Chinese to ensure fair, open and nondiscriminatory government procurement procedures for technology products. Specifically, we are heartened that China will not issue software procurement regulations pending further work with industry and governments, and are also encouraged by China's commitment to hasten its efforts to join the WTO Government Procurement Agreement (GPA). IIPA and BSA believe this is a very important step to ensure open and fair access to government markets for all software makers. To be successful in eradicating piracy in government agencies and enterprises, China must ultimately allocate resources to the procurement of legitimate software products.

Entertainment software companies remain concerned about the timeliness in the approval process for entertainment software titles. Online versions of games go through an approval process at the Chinese Ministry of Culture before distribution is allowed, while hard goods versions go through an approval process with the General Administration for Press & Publication (GAPP). For entertainment software products, in many instances, the approval process takes several weeks to several months to complete. Given the prevalence of piracy, it is important that any content review process be undertaken in as expeditious a manner as possible. It is also important that the review process be streamlined and lodged with only one agency to avoid a bifurcated process that can only add to the delay in the approval process.

The IIPA and its members have been supportive of the JCCT process, and we continue to look for concrete results which lower piracy and improve market access. At the 2004 JCCT, Vice Premier Wu Yi said that the Chinese government was committed to "significantly reduce IPR infringements" by taking a number of tough enforcement and regulatory measures. In 2005, the Chinese had failed to change piracy rates significantly, but made a number of additional commitments (including that referred to above for the business software sector), including most importantly, increasing the number of criminal prosecutions



against copyright piracy. Only time and further experience will tell if activity will increase in the criminal enforcement arena and if foreign rightsholders will begin to benefit from such increase.

CONCLUSION

I conclude by noting that China must immediately bring its enforcement regime into compliance with its TRIPS obligations by undertaking a significant number of criminal prosecutions resulting in real deterrent penalties and significantly increasing administrative fines imposed on pirates. Second, piracy in China cannot be defeated or effectively deterred by enforcement alone – it must be accompanied by significant market-opening measures. The time is now for the Chinese government to acknowledge the nexus between practicable market access and the ability to effectively fight piracy. China must revise its market access regime to afford effective access to the Chinese market and remove all existing (and withdraw all threatened) barriers which discriminate against U.S. businesses. The continuous vacuum left by China's closed market will always be filled by pirates who do not adhere to legitimate market rules.

Thank you for giving us the opportunity to share the copyright industries' experiences in China. I'd be happy to answer any questions.