

**INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE**  
**2005 SPECIAL 301 REPORT**  
**PEOPLE'S REPUBLIC OF CHINA (PRC)**

## **EXECUTIVE SUMMARY**

**Special 301 Recommendation:** IIPA recommends that USTR immediately request consultations with China in the World Trade Organization, and that it place China on the Priority Watch List pending an out-of-cycle review to be concluded by July 31, at which time further appropriate multilateral and bilateral action, including the possible establishment of a dispute settlement panel in the WTO, will be determined.

On February 9, 2005, IIPA submitted its comments<sup>1</sup> to USTR on China's progress in implementing the commitments it undertook under the Joint Commission on Commerce and Trade (JCCT), its WTO commitments and its 1995 and 1996 bilateral agreements and action plans to provide adequate and effective protection and enforcement for U.S. copyrighted products. These comments were part of the out-of-cycle (OCR) review process announced by USTR on May 3, 2004<sup>2</sup> and for which industry comments were sought by Federal Register Notice on December 14, 2004.<sup>3</sup> In that OCR submission, IIPA summarized the views of the copyright industries on what progress had been made since the JCCT meetings concluded. Below, we summarize IIPA and its members' findings and our conclusions:

- **Piracy levels have not been “significantly reduced” — they still are around 90% in all sectors.** China's actions in 2004 (and to date in 2005) have not produced substantial progress toward a significant reduction in copyright infringement levels, as promised by Vice Premier Wu Yi at the JCCT. China has not met its WTO TRIPS commitment to provide effective enforcement, and particularly criminal enforcement against piracy “on a commercial scale,” nor its continuing bilateral obligations reflected in the 1995-1996 bilateral agreements and action plans. On October 12, 2004, IIPA submitted its comments in connection with the TPSC's request for industry views on China's compliance with its WTO commitments and concluded that China is not living up to its international obligations, in particular by failing to amend its criminal law to bring it into compliance with Article 61 of the TRIPS Agreement, and by its failure to translate those commitments into effective, deterrent enforcement in practice.<sup>4</sup>
- **The recently-amended Supreme People's Court's “Judicial Interpretations” (hereinafter “JIs”) leave unanswered questions about China's political will to bring criminal prosecutions and impose deterrent penalties.** The new JIs make only minimal decreases in the monetary thresholds and continue to be calculated at pirate prices, but the new 1000/3000/5000 copy threshold may be helpful if implemented to bring more criminal cases against manufacturers and distributors. Online infringements that meet the thresholds are criminalized but the ability to use the new

<sup>1</sup> See [http://www.iipa.com/rbc/2005/CHINA%202005\\_Feb9\\_PRC\\_OCR\\_Submission.pdf](http://www.iipa.com/rbc/2005/CHINA%202005_Feb9_PRC_OCR_Submission.pdf).

<sup>2</sup> See [http://www.ustr.gov/Document\\_Library/Press\\_Releases/2004/May/Special\\_301\\_Report\\_Finds\\_Continued\\_Progress\\_But\\_Significant\\_Improvements\\_Needed.html](http://www.ustr.gov/Document_Library/Press_Releases/2004/May/Special_301_Report_Finds_Continued_Progress_But_Significant_Improvements_Needed.html).

<sup>3</sup> See <http://a257.g.akamaitech.net/7/257/2422/06jun20041800/edocket.access.gpo.gov/2004/pdf/04-27373.pdf>.

<sup>4</sup> See [http://www.iipa.com/rbi/2004\\_Oct12\\_IIPA\\_CHINA\\_WTO\\_TPSC\\_Submission-rev.pdf](http://www.iipa.com/rbi/2004_Oct12_IIPA_CHINA_WTO_TPSC_Submission-rev.pdf).

rule in practice has yet to be tested. Importing and exporting of pirate products are criminal, but not directly; liability is only under the rule governing “accomplices” — at significantly lower criminal penalties. End user software piracy appears not to have been criminalized. The rules were weakened with respect to repeat offenders. Industry is very concerned that the apparently grudging minor changes will not result in significantly more criminal cases with deterrent penalties and thus piracy levels will not be markedly affected. To the best of our knowledge, no criminal cases have yet been brought under the new JIs, so it is premature to assess whether they will make a real difference in practice in reducing piracy levels. In addition, the first line of implementation of this new interpretation will be the police (the Ministry of Public Security/Public Security Bureau or PSB). Effective enforcement will not become a reality if there is inadequate attention, investment and training by the PSB. However, police resources for this purpose have not been increased nor, to the best of our knowledge, were they involved in drafting the JIs. More importantly, that part of the PSB reportedly directly responsible for copyright enforcement has been uninterested in bringing criminal cases against copyright piracy and has so informed the U.S. Government. There needs to be a mandate for the PSB to treat criminal investigation and enforcement of IPR offenses as a top priority. Finally, criminal enforcement of copyright piracy continues to be burdened by the fact that Articles 217 and 218 of China’s criminal code requires a demonstration that piracy is occurring for the purpose of making a profit, something very difficult to demonstrate, particularly in the online environment. TRIPS requires criminalization of “copyright piracy on a commercial scale” — not just piracy for the purpose of making a profit.

- **However, raiding activity has increased for most sectors.** As a result of Vice Premier Wu Yi’s leadership at the JCCT and, in August 2004, in forming the National IPR Protection Working Group (which she heads as Group Leader) and the National IPR Protection Office (NIPO), a one year national anti-piracy campaign was kicked off in September 2004. These actions, and prior actions taken immediately following the JCCT meeting, have given rise to increased raiding activity (though almost entirely at the administrative level), to higher seizures of pirate product, and what would appear, at this early stage, to be better coordination of administrative enforcement in the regions. Nevertheless, despite Wu Yi’s singular efforts, IIPA members report no meaningful decrease in the national piracy rates, which still are estimated to be around 90% in all copyright sectors.

## **Actions to be Taken by the Chinese Government**

To redeem its JCCT commitments and to meet its TRIPS obligations, the Chinese authorities must take the following further steps immediately and through July 31, 2005:

- Commence criminal prosecutions using both the monetary and new copy thresholds and carry these forward promptly to impose deterrent penalties. The Economic Crime Division of the PSB should be made responsible for all criminal copyright enforcement and be provided sufficient resources and training to very substantially increase criminal enforcement under the new JIs.
- Under the leadership of Vice Premier Wu Yi, constitute a single interagency authority at the national and provincial/local levels to undertake administrative enforcement against piracy of all works. This authority would have the responsibilities similar to those formerly exercised by the National Anti-Pornography and Piracy Working Group (NAPPWC)<sup>5</sup> for audiovisual works and would have the full authority to administer fines

<sup>5</sup> Due to the re-organization of the functions of the NAPPWC in 2005, that body will now only focus on major pornography/piracy cases. NAPPWC’s coordination function has been withdrawn and provincial offices are to be closed down early in 2005.

and to refer cases to the Ministry of Public Security and the Supreme People's Procuratorate for criminal prosecution, under referral guidelines that are equal to or better than the JIs. Such authority must have the full backing of the Party Central Committee and the State Council. Far greater resources must be provided to this enforcement authority. All administrative enforcement, and enforcement by Customs at the border, must be significantly strengthened.<sup>6</sup>

- Issue a final set of comprehensive and transparent regulations governing enforcement on the Internet, including the liability of Internet Service Providers, which follow the recommendations made in this submission, and including effective “notice and takedown” mechanisms and without unreasonable administrative evidentiary burdens. Establish within this single interagency authority described above special units (at the national, provincial and local levels), whose purpose is to enforce the law and these new regulations against piracy on the Internet.
- Amend the Criminal Law to comply with the TRIPS Article 61 requirement to make criminal all acts of “copyright piracy on a commercial scale.” These must include infringing acts not currently covered, such as end user software piracy and Internet offenses conducted without a profit motive.
- Amend the new JIs to ensure that sound recordings are fully covered.
- Significantly increase administrative penalties/remedies, including shop closures, and monetary fines and impose them at deterrent levels.
- Fully implement China's WTO market access commitments and begin now to liberalize its market access rules and overall business climate to permit effective operations by all copyright industries.
- Permit private companies and trade associations to undertake anti-piracy investigations on the same basis as local companies and trade associations.

## **By the end of 2005, China must**

- Through amended copyright legislation or regulations, correct the deficiencies in China's implementation of the WCT and WPPT, and ratify the two treaties.
- Significantly ease evidentiary burdens in civil cases, including establishing a presumption with respect to subsistence and ownership of copyright and, ideally, permitting use of a U.S. copyright certificate, and ensure that evidentiary requirements are consistently applied by judges and are available in a transparent manner to litigants.

Each of the measures noted above is necessary to strengthen China's intellectual property enforcement regime. The true test, however, is the impact of China's actions and policies on U.S. sales and exports of copyrighted works. A piracy rate hovering around 90 percent has denied the U.S. copyright industries and our national economy what should have been a long-standing trade surplus in American music, movies, books and software. It is essential that China rectify this imbalance between its widespread use of U.S. copyrighted works and its negligible trade in legitimate products. It is not enough for China to introduce new copyright laws or to temporarily escalate enforcement activity, if such actions do nothing to increase sales of legitimate U.S. products or halt the production and use of illegal copies. Similarly, intellectual property reforms are of little value to U.S. right holders if China persists in maintaining and erecting other trade barriers that limit or foreclose access to the Chinese market. If markets for U.S. copyrighted products are closed or market access severely restricted, intellectual property rights are of limited value. IIPA thus recommends that USTR also measure China's progress

<sup>6</sup> In the area of trademark enforcement undertaken by one ESA member company and involving handheld and cartridge based games, the new JIs are unclear on whether the authorities are able to seize components and parts that make up the counterfeit products. This is essential and must be clarified.

according to additional benchmarks that signify meaningful gains and opportunities for U.S. copyright owners. IIPA looks forward to working with USTR on developing these additional benchmarks.

<b>PEOPLE'S REPUBLIC OF CHINA</b> <b>Estimated Trade Losses Due to Copyright Piracy</b> <i>(in millions of U.S. dollars)</i> <b>and Levels of Piracy: 2000-2004<sup>7</sup></b>										
INDUSTRY	2004		2003		2002		2001		2000	
	Loss	Level								
Motion Pictures	280.0	95%	178.0	95%	168.0	91%	160.0	88%	120.0	90%
Records & Music <sup>8</sup>	202.9	85%	286.0	90%	48.0	90%	47.0	90%	70.0	93%
Business Software <sup>9</sup>	1465.0	90%	1787.0	92%	1637.3	92%	1140.2	92%	765.1	94%
Entertainment Software <sup>10</sup>	510.0	NA	568.2	96%	NA	96%	455.0	92%	NA	99%
Books	50.0	NA	40.0	NA	40.0	NA	130.0	NA	130.0	NA
<b>TOTALS</b>	2507.9		2859.2		1893.3		1932.5		1085.1	

## **THE STATE OF COPYRIGHT PIRACY AND ENFORCEMENT IN CHINA**

### **Piracy Continues at Unacceptably High Levels Despite China's JCCT and Other International and Bilateral Commitments**

Several of IIPA's members have undertaken surveys of the market since the summer of 2004 in an effort to measure progress in reducing piracy levels. These surveys, which were provided to USTR on a business confidential basis, provided a detailed review of piracy at the retail level and provided data on seizures from destination countries of pirate DVDs. Other data provided to USTR covered enforcement actions in which either those industries were involved or for which the data was provided by the Chinese government. Because of the lack of transparency in the administrative and criminal enforcement system and the inability to compile meaningful statistics directly, as opposed to relying on Chinese government information (which is rarely sufficiently granular to draw meaningful conclusions), the data presented in these surveys and in this submission are incomplete at best. While certain selected information is available, like, in some cases, what shops, distribution centers or factories were raided (and such data was provided, where available, to USTR), a meaningful picture of the scope of the

<sup>7</sup> The methodology used by IIPA member associations to calculate these estimated piracy levels and losses is described in IIPA's 2005 Special 301 submission at [www.iipa.com/pdf/2005spec301methodology.pdf](http://www.iipa.com/pdf/2005spec301methodology.pdf).

<sup>8</sup> The estimated losses to the sound recording/music industry due to domestic piracy are US\$202.9 million for 2004, and exclude any losses on sales of exported discs. This number is also based on a "displaced sales" methodology.

<sup>9</sup> BSA's final 2003 figures represent the U.S. software publisher's share of software piracy losses in China, as compiled in October 2004 (based on a BSA/IDC July 2004 worldwide study, found at <http://www.bsa.org/globalstudy/>). In prior years, the "global" figures did not include certain computer applications such as operating systems, or consumer applications such as PC gaming, personal finance, and reference software. These software applications are now included in the estimated 2003 losses resulting in a significantly higher loss estimate (\$3.82 billion) than was reported in prior years. The preliminary 2003 losses which had appeared in previously released IIPA charts were based on the older methodology, which is why they differ from the 2003 numbers in this report.

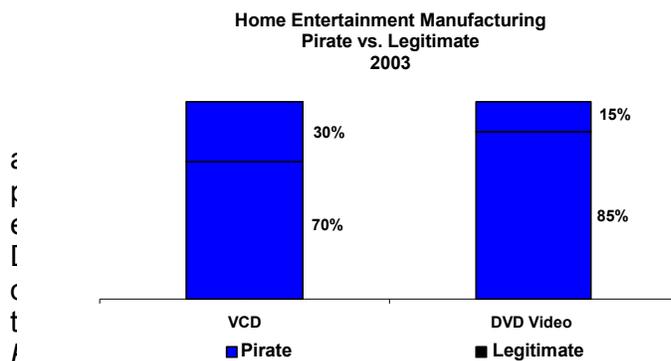
<sup>10</sup> ESA's reported dollar figures are preliminary and reflect the value of pirate product present in the marketplace as distinguished from definitive industry "losses." The methodology used by the ESA is further described in Appendix B of this report.

piracy problem must be drawn from the gross statistics available primarily from the Chinese government, supplemented by industry-generated statistics. What follows, first, is a description of the current, updated, piracy situation facing the copyright industries in China and, second, 2004 enforcement information that is available to those industries.

**Piracy in the home video and the audiovisual market generally:** MPA reports that, in 2004, China Customs claimed to have seized approximately 79.6 million optical discs which were intended to be smuggled into China. At the same time, the NAPPWC reported seizing a staggering 165 million discs during this same period in the domestic market. These numbers (a total of over 244 million pirate discs in 2004) exceed any data that IIPA has seen from prior years and is indicative of the continuing vast scope of the piracy problem.<sup>11</sup> In 2003, NAPPWC seizures were down to 64 million disks (reportedly due primarily to complications of the SARS epidemic), compared to the 78.8 million discs seized in all of 2002. This also serves as evidence of stepped up enforcement which most IIPA members have reported following the JCCT announcements. However, based on these new market surveys (which are only a partial look at best), the percentage of pirate product available in the marketplace continues to support the piracy level estimates we provide in this submission.

In 2004 there were reportedly 83 licensed plants in China, with 765 operating production lines. This is up from 71 plants and 569 lines reported for 2003. 152 of these lines are dedicated to producing DVDs. Total capacity, excluding the production of blank CD-Rs, is now 2.67 billion units annually — a staggering figure when viewed in conjunction with the prevailing 90% piracy rates. These above numbers do not count underground plants, whose locations have increasingly been dispersed to more rural areas in China. Reports emanate from China regularly about raids on such plants, but we are unable to ascertain, in almost all cases, the disposition of any enforcement actions against their owners. Because industry is forbidden from conducting investigations, only Chinese authorities have any ability to identify and raid these underground factories.

China is one of the leading global manufacturers of pirate product. *Understanding and Solutions* estimates that in 2003, 69% of the VCD and 85% of the DVD discs manufactured in China were pirate product.



Source: *Understanding & Solutions*

pronounced. *Infoma Media* reports that ... as a direct result of piracy. Part of the ... than cinema tickets. According to market ... to \$1.20 and \$2.00 to \$2.50 for a pirate ... ost of a movie ticket in Beijing.<sup>13</sup> Further, ... available in the pirate market long before ... a. Pirate videos of *Harry Potter and the ... ter Tomorrow* — with Chinese subtitles — ... release, reportedly for \$1.00 per copy.

<sup>11</sup> In evaluating these seizure statistics provided by Chinese authorities, it must be kept in mind that (a) seizures of pirate product involving U.S. copyrighted material is not broken out, (b) it is not known how many of the discs seized contained pornographic or otherwise politically unacceptable material or involved legal violations other than copyright piracy. The lack of transparency makes it difficult therefore to ascertain a true picture of the anti-piracy enforcement situation in China.

<sup>12</sup> Motion Picture Association, April 2004.

Another measure of the level of piracy is the sale of VCD and DVD players. The VCD and DVD player dominate the Chinese home entertainment market. In 2003, *Screen Digest* estimated that 84.4 million, or 24% of television households had a VCD player, whereas 26.4 million, or 8% of television households had a DVD player. The DVD player has recently seen explosive growth in China. Between 2000 and 2002, the number of DVD households grew by 23.4 million, or 867%.

At the same time the number of legitimate DVD discs sold to consumers in China grew at a much slower pace. In fact, in 2003 the number of DVD discs sold to consumers was a mere 0.3 per DVD household. This is inconsistent with the trends seen in Hong Kong, a similar market, which is dominated by the VCD player. In 2003, the average DVD household in Hong Kong made 4.3 DVD disc purchases. Clearly, economic circumstances influence buying patterns of consumers, but the discrepancy between these two markets is in large part due to the piracy epidemic within China. It is unlikely that Chinese consumers are investing in DVD players only to leave them gathering dust in their living rooms; more likely is that consumers are investing in pirate film collections.

**Export piracy:** MPA has also been experiencing a marked increase in exports of DVDs from China to the U.S., the UK and other countries and has provided USTR with charts showing destination countries and some information on the Customs seizures themselves.<sup>14</sup> Exports have been steadily increasing over the last three years and show no signs of abating. In addition, exports of pirated music sound recordings have been found in several Southeast Asian countries. It is the hope that the new anti-piracy campaign announced in August 2004 will reduce this problem, which, as we know, slowed to a mere trickle in 1996-97 following the Chinese government's decision to avoid U.S. government trade retaliation by shutting down the export trade in pirate video and audio product. (Exports of very high quality counterfeit software continued throughout this period, however.)

**Internet piracy:** With respect to Internet piracy generally, it continues to grow rapidly in China and the problem is discussed in the sections devoted to each industry sector. In 2003, we reported that 78 million people were then on line (up from 58 million users in 2002 and 33.7 million in 2001). In 2004, that number has jumped to 94 million, making China the largest user of Internet facilities in the world.

Specifically, for audiovisual works, this piracy, which is also increasing, involves the sale of "hard goods" (VCDs and DVDs—all formats) as well as the illegal streaming of films. As discussed below, MPA's attempts to enforce against piracy have significantly increased but with only some success. As detailed in the enforcement section, in 2004, MPA sent out 3,905 cease and desist letters. As the majority of these were sent to P2P targets it is not possible to determine the compliance rate. Where cease and desist letters were sent to other than P2P targets (mostly streaming sites), the compliance rate was a very disappointing 17%.

**Broadcast, Cable and Public Performance Piracy:** Other types of audiovisual piracy also continue in China, including the unauthorized public performance of U.S. motion picture product, which continues mostly unchecked in hotels, clubs, mini-theaters and even government facilities; television piracy, particularly at the provincial and local level; and cable piracy (over 1,500 registered systems) which routinely pirate U.S. product.

<sup>13</sup> *Informa Media Group*, "Global Film: Exhibition & Distribution", 2003.

<sup>14</sup> MPA reports that there is evidence of Chinese DVD exports to Australia, Belgium, Hong Kong, Japan, Sweden, the U.K. (185,000 disks seized from January-September 2004), UAE and the U.S.

**Piracy in the Market for Sound Recordings:** As IIPA reported last year and as is reflected in the submissions made by RIAA during the OCR pendency, the crisis in the local and international music industry continues for a fifth year in a row. Losses, under the new methodology begun in last year's submission which counts displaced sales are estimated at \$202.9, a decrease from an estimated \$289 million in 2003. The estimated national piracy rate is 85%, down from 90% in 2003. OD piracy continues at a high level and cassette piracy remains a significant factor in the marketplace. The recording industry is looking to the new enforcement campaign to deal with piracy by factories, both licensed and underground, and piracy at the retail level which remains at massive levels, though the increased raiding in 2004 has had some impact on losses and the piracy rate.

**Internet Piracy:** Internet piracy was a significant concern for the recording industry in 2003, and, as predicted in last year's submission, the situation has worsened in 2004. Websites in China such as [www.9sky.com](http://www.9sky.com) and [www.chinaMP3.com](http://www.chinaMP3.com) are giving away or offering links to thousands of pirated songs. (The new JIs do not criminalize non-profit, free Internet transmission, and it is unclear if the inclusion of advertising as indicative of "for-profit" activity will cover music files on a multi-content Internet site). RIAA estimates there are thousands of active websites hosting infringing MP3 files, and that some of these have thousands of infringing files. The industry is also concerned that international online pirate syndicates are using China-based servers to hide their infringing files. One such example is [www.boxup.com](http://www.boxup.com), which offers songs to paying members (and therefore, if the thresholds are met, should be subject to criminal prosecution under the new JIs). Also overseas pirate sites have been offering their services in China. Taiwan's Kuro is one such example. We understand that Kuro now has a server in China.

The record industry has approached NCAC and the Beijing Copyright Bureau to assist with administrative enforcement. They were told that they must await formal issuance of the new NCAC regulations.<sup>15</sup> While enforcement assistance is welcome, low administrative penalties issued in other piracy cases do not bode well for deterrent enforcement against Internet piracy. It is unclear whether the new regulations will cover P2P services, like Kuro, now under indictment in Taiwan.

**Piracy in the market for entertainment software products:** The market for PC games, console games, and games played on handheld devices is continuing to grow in China. It is the market for online gaming, however, where the growth has been significant in the last few years. Piracy rates are still extremely high for the industry. A number of entertainment software publishers have entered the market and Sony and Nintendo entered the market in 2003 and 2004, respectively. Given these levels of piracy, they do so at considerable risk.

Internet piracy has also become a significant problem, more so than illegal factory OD production. In 2004, there were an estimated 200,000 Internet cafés in China with 100-300 computers at each location with about 60% of the patrons playing games. Typically, these cafés purchase one legitimate copy, or use a pirated copy and load it on each computer. Customers are also generally permitted to download games from *warez* sites and even to burn their own CD-Rs on the premises. The industry is seeking to license these cafes but this process, given the nature of the marketplace, is inevitably slow, absent real enforcement. Although the government has taken actions against several Internet cafes, such actions have been focused on ensuring that the cafés do not allow "unhealthy information to be spread

<sup>15</sup> The latest draft of the NCAC Internet regulations appears to require notices "in writing" and would not permit email notifications. If this pertains in the final regulations, the compliance rate of ISPs is likely to drop markedly. The draft regulations are discussed in detail below.

through the Internet” and requiring that cafés install blocking software for pornographic sites and materials, and other similar sites. There are also other significant restrictions on Internet cafés such as keeping them a specific distance from schools<sup>16</sup> and these regulations are vigorously enforced. However, the government regulations do not address piracy specifically and no enforcement actions have been taken to ensure that the cafes use only legitimate or licensed entertainment software products. China must include copyright provisions in the business licenses it issues to Internet cafes for as Internet and online gaming continues to grow, the cafés are likely to be the primary means for Internet access for much of the Chinese population.

Furthermore, as the market for entertainment software (particularly online gaming) continues to grow, the Chinese government must also ensure that the law and regulations are adequate to take aggressive action against all types of online piracy. The Chinese video game market is likely to be dominated by online gaming; it is essential that the appropriate legal framework be in place to provide copyright owners as well as law enforcement agencies with the necessary tools to protect copyrighted works in the online environment. A particular problem for entertainment software publishers is the existence of offline or pirate servers in China. These unauthorized servers operate sites which emulate a publisher’s online game and thereby divert traffic and potential subscribers from the legitimate site. ESA member companies have attempted to contact Chinese ISPs to request that access to such sites be disabled, but to no avail. Unfortunately, existing Chinese law and regulations has not yet clearly addressed this problem.<sup>17</sup> Neither do there yet seem to be any legal incentives to encourage ISPs to cooperate with right holders in expeditiously disabling these unauthorized or pirate servers.

The manufacturing and assembly of cartridge-based handheld games also continues to be a massive problem in China. Counterfeit Nintendo products continue to be produced in mass quantities in China, and exported throughout Asia, Latin America, the Middle East and Europe. Until the factories engaged in assembling counterfeit cartridge-based products are closed permanently, and significant fines and jail sentences imposed, it will remain difficult to stem the massive production of counterfeit video games in the country. The new JIs now set copy thresholds for initiating criminal actions in the area of trademarks, but they do not appear to address the situation involving a seizure of vast quantities of component parts, which is the prevailing scenario in actions involving cartridge-based games. During a raid, administrative authorities may seize hundreds of the component parts waiting to be assembled into the final counterfeit cartridge game in a factory — that is, the printer circuit boards (PCB) which contain the video game software, the plastic cartridges which will house the PCBs, as well as the labels and instruction manuals to accompany the final pirated product. It seems the case that notwithstanding the seizure of hundreds of these component parts, as they have not yet been assembled into the final product, i.e., what may constitute a “copy,” the JI thresholds may be interpreted as not applying. This would present a serious impediment to pursuing criminal actions against pirates engaged in the manufacture of thousands of counterfeit cartridge games. It is unclear how law enforcement authorities will thus treat instances where they find hundreds of these component parts during a raid, but which have not yet been assembled into the finished counterfeit video game cartridge. Nintendo is concerned that this seeming gap may actually make it easier for pirates to elude seizures and arrest, as fully assembled products

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<sup>16</sup> Some news reports noted that the government would also begin imposing restrictions against the use of entertainment software products in Internet cafés. However, the restrictions do not appear to have been imposed though news accounts have been scarce.

<sup>17</sup> The draft Internet regulations, discussed below, do not address the problem of pirate servers located outside China.

will be immediately removed from the factories and transported (under cover of night) to various locations, thus leaving no finished product on the premises.

**Piracy in the market for business software:** Unauthorized use of software in enterprises in China causes the vast majority of piracy losses faced by the business software industry. Losses also occur in the retail market, including the loading of pirate software on the hard disks of computers as part of the sale of computers. The market is also characterized by huge exports, on a global basis, of high-quality counterfeit software packages. The software industry has struggled for years to persuade NCAC to devote sufficient resources to raiding/auditing enterprises that use unauthorized software. There have been some recently successful administrative actions against end-users (see enforcement discussion) and, as part of the new anti-piracy campaign following the JCCT, the authorities in many of the major cities have announced plans to increase enforcement against software piracy and some have even referenced end-user piracy. However, enforcement remains spotty and resources are still woefully inadequate at the national and local copyright administrations and bureaus. The new JIs did clarify that fake (end-user) licenses fall within the scope of "without permission of the copyright owner." However, the industry's most important priority — to persuade the SPC to amend its JIs to make end-user piracy a criminal offense under TRIPS — was apparently not met.

To significantly reduce the piracy levels for business software, the government, through the existing authorities — the new National IPR Protection Working Group, the State Council, the NCAC and the Ministry of Information Industry — should issue a policy statement or order, accompanied by a national public education campaign, requiring enforcement authorities to enforce the law more vigorously against enterprise end-user piracy. Actual enforcement should be placed under the authority of the new interagency mechanism described above, and enforcement actions should be followed up by the allocation of sufficient resources and their employment in the vastly increased administrative raiding of enterprises using unauthorized software. Without these actions, there is no possibility, in the view of the software industry, of significantly reducing the world's highest piracy rate — 92% of the market!

Unauthorized use of software in government ministries remains a problem, even though in February 1999, the State Council reissued a "Notice" originally released by the National Copyright Administration of China in August 1995 ordering all government ministries at all levels to use only legal software (the so-called "Red Top Decree"). A number of other decrees requiring the legal use of software were issued after this, including a joint decree by four ministries. The most recent was a circular issued by the State Council on the use of legal software by local governments. In the circular, government agencies at the provincial level are requested to legalize their software by the end of 2004, and government at lower levels are to accomplish software legalization by the end of 2005. Some progress has been made but the problem persists, causing large losses for the industry. The value of these decrees is in showing transparent implementation not only to the software industry but also, more important, to the private sector. The government should issue a public report on the status of its internal legalization, including the agencies that have legalized their software use and the amount of public procurements of software resulting from such legalization efforts. Following government legalization, the Chinese government should also issue a decree for the use of legal software in state-owned enterprises since there is no practical way to carry out enforcement and deterrence.

As part of the government legalization effort as well as to implement the 2002 Government Procurement Law, MOF and MII drafted Implementing Methods for Governmental Procurement of Software. The Methods describe new government procurement practices in

software that are unique to China and that bear little relation to the principles of the WTO Government Procurement Agreement (GPA), whose goal is to ensure non-discriminatory, pro-competitive, merit-based and technology-neutral procurement of goods and services so that governments can acquire the best goods to meet their needs for the best value. The regulation would effectively prevent U.S. software companies from selling software products and services to the Chinese government. When viewed in the context of China's 92% software piracy rate, this discriminatory measure would effectively close China's largest software market to U.S. competition. The U.S. software industry has already lost billions of dollars in export revenue due to rampant piracy and counterfeiting in China; a ban against government procurement of U.S. software would eliminate the industry's best opportunity to expand exports to China and set a dangerous precedent for China's procurement policies in other major economic sectors. Addressing this problem is a very high priority for the U.S. software industry.

While enterprise end-user piracy is the most pressing problem for the business software industry in China, counterfeiting and hard disk loading are also major problems. Indeed, China is the source of some of the most sophisticated counterfeit software anywhere in the world. Industry representatives report that high quality counterfeits are produced in large quantities both for the domestic Chinese market and for worldwide distribution, with software available in multiple languages. However, this problem is unlikely to be brought under any semblance of control without aggressive criminal enforcement.

**Piracy of books and journals:** Previous IIPA Special 301 submissions detailed the successful effort of the Chinese government, in cooperation with the publishing industry, in dealing with the formerly rampant problem of print journals piracy.<sup>18</sup> While these significant improvements are for the most part continuing in 2004, publishers are starting to see increased photocopying of print journals, in part as a result of the lack of sufficient government funding for legitimate journals purchasing by universities. The Chinese government should monitor use of print journals closely to ensure that its successes of prior years are not eroded.

Problems abound for other published materials as well. Illegal commercial photocopying has, for the first time, become the chosen mode of book piracy in China, at least with respect to academic materials. While photocopying had previously taken second place to print piracy in China, decreasing costs of photocopy paper and other necessary materials have resulted in a sharp increase in photocopying in 2004. This photocopying takes place primarily on university campuses, as well as secondary schools and English language teaching programs. Many of these programs draw students by advertising their use of full color, high quality books, and then provide photocopies of books to students upon enrollment.

Despite the rise in photocopying, traditional reprint piracy continues to remain a major problem in China, particularly of higher education textbooks and trade bestsellers. Popular books such as Bill Clinton's *My Life* and J.K. Rowling's latest Harry Potter® book, *Harry Potter and the Order of the Phoenix*, were heavily pirated. The Chinese government needs to take action against hard goods piracy of books with the same vigor with which it tackled journals piracy in 2001.

Counterfeiting problems also abound. IIPA has previously reported the publication of totally bogus books purportedly written by a famous author. This happened most recently with the Harry Potter® series, with Chinese publishers producing at least three additional books about Harry under Rowling's name. One of the publishers was caught and subjected to a \$2,500 fine.<sup>19</sup> Furthermore, well known business and academic trademarks, such as those of

<sup>18</sup> See IIPA's 2003 Special 301 country report on the People's Republic of China, pages 25-26, available at <http://www.iipa.com/rbc/2003/2003SPEC301PRC.pdf>.

<sup>19</sup> Id.

the Harvard Business School, are used illicitly to promote sales of books by implying a nonexistent affiliation or endorsement.

Translation piracy also remains a problem for foreign publishers. Publishers continue to report production of illegal translations, of both textbooks and bestsellers, largely by second-channel distributors. The scope of this problem grows larger in smaller cities and provinces.

**Internet piracy:** Publishers have noticed alarming increases in electronic journals piracy over the past year. University gateways are routinely left open for illegal access by unauthorized users, and file-sharing among users is on the rise. In fact, publishers now report more illegal downloads of online journals as well as digital license violations in China than anywhere else in the world. This problem extends to databases containing other types of published data as well. The Chinese government should take steps to ensure that commercial or institutional users are abiding by their license agreements.

Furthermore, piracy over the Internet is increasingly affecting not only journals, but also academic textbooks and bestsellers, with several websites offering hundreds of scanned published titles for download. Bestsellers are, of course, distributed over peer to peer networks with impunity. This phenomenon is likely to grow during 2005 unless the government is able to take steps to ensure effective measures are available to rights holders to defend their materials.

**Enforcement: Raiding and seizures have increased for most copyright sectors; administrative penalties remain too low to provide a deterrent; criminal enforcement under Articles 217 and 218 has not yet begun; and, consequently, piracy levels have not yet declined.**

Vice-Premier Wu Yi's commitment to "significantly reduce piracy levels" will not be met by the time of this submission. Indeed, overall piracy rates have remained virtually constant from 2003 to 2004.

China does not presently meet its WTO/TRIPS commitments on enforcement and particularly TRIPS Articles 41, 50 and 61 (provide enforcement which "on the ground" deters further infringements, provide effective *ex parte* civil search orders, and provide specific deterrent criminal remedies). To meet this obligation, IIPA recommends that China implement a system in which the Party Central Committee and the State Council ensure that the enforcement authorities (a) cooperate more closely with affected industries (including permitting U.S. associations to undertake investigations in China); (b) significantly increase transparency (c) give Vice Premier Wu Yi even greater and "publicly announced" authority to intervene at all levels, to organize an effective interagency enforcement authority throughout the country, and to coordinate the nationwide enforcement effort; (d) significantly increase administrative penalties and actually impose them at deterrent levels, including closing retail stores that deal in pirated goods; (e) amend the Criminal Law to increase criminal penalties and cover all types of "commercial-scale" infringements; and (f) use the new Judicial Interpretations to their fullest to prosecute — publicly — significantly more infringers under Article 217 and 218, not just for pornography, "illegal business operations" or smuggling. None of these objectives has as yet been met.

In the following sections, we report on what we know about the level of enforcement in the administrative, criminal and civil enforcement system in China in 2004.

## Administrative enforcement

As noted above, NAPPWC appears to have been the most effective administrative enforcement mechanism in China, with a continued large number of raids, seizures and detentions.<sup>20</sup> With the change of the functions of NAPPWC in 2005, it is essential that a similar authority be created to take over the responsibilities of nation-wide coordination of anti-piracy operations and that its jurisdiction be extended to cover enforcement in all copyright sectors, including computer software. It is also critical that this new authority NOT be charged with dealing with pornography, but only piracy, and that it be mandated to have an effective and transparent reporting system. If pornography is included, it will never be known whether the authorities are enforcing for that crime or for IPR violations.

With respect to existing administrative enforcement, NCAC's title verification program continues to work well for only one industry—the motion picture industry—with, in the year 2004, a total of 2,881 title verification requests submitted by MPA, and 146 titles challenged by MPA and I.F.T.A. found to have been unauthorized.

Even with the myriad cases handled by NAPPWC,<sup>21</sup> the lack of transparency in the enforcement system, particularly the lack of industry access to levels of fines and other penalties for infringement, makes it almost impossible to judge whether there have been advances in deterrent enforcement. We do know, however, that the piracy rates remain universally high and thus we have no alternative but to conclude that the administrative enforcement system is not having any serious impact in the marketplace. This is not to say that industry does not welcome or does not fully support these efforts, simply that the Chinese government must focus on vastly increased deterrence as the key to reducing piracy rates. To date it has not done so. The following summarizes the deficiencies in the administrative enforcement system:

- Fines are too low, both as written and as imposed;<sup>22</sup> these need to be increased significantly, imposed in practice and widely publicized throughout China, and the results provided to the U.S.G. as promised in the bilateral IPR agreement.
- The system is almost entirely nontransparent; it is, with some recent exceptions, impossible to ascertain what penalties are imposed in particular cases. This extends to the Chinese public as well as to foreign right holders. Right holders cannot, for example, obtain documents from the government on the activities of CD plants (even though every order the plant accepts must be recorded and reported to the authorities). Foreign right holders are usually told that these are “national confidential documents.” IIPA members have no evidence that these practices will change.
- There is a lack of time limits for investigations, leading to long delays and a resulting failure to deter pirates.
- There is still “local protectionism” by administrative agencies involving politically or financially powerful people engaged in pirate activities.

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<sup>20</sup> It must be noted, however, that the primary mandate of the NAPPWC is to rid the market of pornography or other material deemed by the government to be politically or socially unhealthy.

<sup>21</sup> MPA does confirm, however, that most of these cases involved pornographic material with only a small number limited to purely pirate product. Nevertheless, the interagency body reported the “arrest” of 6,912 offenders and the seizure of 11 illegal production lines (5 DVD lines and six VCD lines). Two OD factories were also penalized. In one of these cases where MPA has information (reported in the text below), the licensed factory was in Hunan and, in July 2004, was fined RMB80,000 (US\$9,660) by GAPP related to copyright infringement. This fine, for an OD factory, is clearly not a deterrent.

<sup>22</sup> Fines can be up to three times the value of the pirated goods measured at pirate prices, but fines as actually imposed are woefully low.

- NCAC continues to fail to use its authority effectively to deal with the all-important problem of corporate end-user software piracy.

**The software industry:** As a result of the increased attention to enforcement in the second half of 2004, BSA reports an end-user raid on a design and engineering company which resulted in the detention of four persons and the seizure of 24 computers. This is among the first such actions that has resulted in the detention of an employee from a company engaged in unauthorized use of business software. In October 2004 in Shenzhen in Guangdong Province, six shops engaged in selling pirated software were raided and the software confiscated. In Shangxi Province, two design companies using unauthorized copies of AutoCAD and 3DMAX were raided in October by the Xi'an AIC, the Xi'an Press and Publications Bureau and the Xi'an PSB. Twenty-four copies were seized and the offenders were fined a paltry RMB 2000 (US\$242). BSA also notes that the NCAC took very seriously the administrative enforcement of two major CD-replicators (Beijing, Tianjin), and pro-actively did PR to generate awareness and deterrence. These two cases were included among the top ten 2004 IPR infringement cases published by the State Council Office of Intellectual Property Protection.

**The entertainment software industry:** A number of ESA member companies are active in the Chinese market, with a few engaged in domestic enforcement either through local counsel or its own in-country anti-piracy program. In particular, Nintendo has undertaken a significant number of administrative actions in Guangdong Province, though these actions have been taken largely under the trademark law to protect the globally famous "Game Boy" brand. While trademark actions have generally proven easier to prosecute than copyright cases for Nintendo, available penalties are as low, or lower, than those imposed for copyright infringement. The efforts of the Chinese administrative authorities (specifically in Guangdong Province), in cooperation with Nintendo representatives, have resulted in raids against a number of retail shops and factories. Raids against the factories have also revealed that they are (directly or indirectly) connected with Hong Kong and Taiwanese factories (for instance, funding was often supplied by a Taiwanese national, or a Hong Kong "affiliate" office often served as a conduit for transmitting orders to the factory on the Chinese mainland.

**The motion picture industry:** MPA's separate submission reports in detail on the joint administrative raids in which it was involved in 2004. These joint raids represent only a fraction of the total raids conducted by NAPPWC and by local authorities without notice to the affected association or company. In 2004, 573 joint raids against retail shops were conducted in Shanghai, Beijing, Shenzhen and Guangzhou. MPA is encouraged to report that 145 of these shops, principally in Beijing, were closed after the raids — 510 shops were fined; the average range was from RMB1,000-RMB5000 (US\$121-US\$604). A very few fines exceed this and it is encouraging that one shop named "The 74th Store of Yongshengshiji AV Center," located in Congwen District of Beijing, was fined RMB50,000 (US\$6,041). The average fines remain notoriously low, however, and are hardly a deterrent.

Other information on the level of administrative fines is spotty. The General Administration of Press and Publications (GAPP) ran a raid against a licensed VCD factory on July 27, 2004. The factory had seven lines and reportedly produced very significant quantities of pirate product from 1998 to 2004. The factory was ordered to cease operation from July to September 2004 and was fined only RMB80,000 (US\$9,666). Temporary closures and fines of this level will not deter factory-level piracy. However, MPA was pleased to have at least received notification of the action. We hope this bodes well for greater transparency in the future.

The statistics reported below by MPA for administrative cases come from the Chinese authorities. It cannot be confirmed as covering only U.S. pirate movies but may involve other product. It also cannot be confirmed that the fines levied were just for copyright piracy; they could cover pornography or other legal violations beyond copyright piracy.

**The recording industry:** In its business confidential submission to USTR, RIAA/IFPI noted the lack of transparency that pervades China's administrative enforcement system and reported on isolated actions taken by local and provincial enforcement authorities against factories, distribution centers, retail establishments and street vendors. The recording industry rarely receives information on the level of penalties imposed following those raids, and where information is made available, it is generally distressing. In one raid in Shenyang conducted by the local AIC for example, where over 3000 pirate music CDs were seized, the industry learned that the fine imposed was only RMB30,000 (US\$3,625) or a little over US\$1.00 per pirate CD!

Better information is available from the authorities in Shanghai (the Shanghai Culture Inspection Team), where transparency is somewhat improved. After looking at the data put together from Shanghai, RIAA estimates that the fines ran from about RMB500 to RMB5000 per incident (US\$60-US\$604). However, of the total number of cases, 90% resulted in warnings; only 10% in fines. The authorities also closed approximately 19 warehouses in 2004, but these were only facilities where more than 10,000 copies of pirate product were found. This is a clear example of the non-deterrent nature of the administrative process and Shanghai is far better than other provinces/cities.

**The book publishing industry:** U.S. book publishers have heard of isolated instances of action taken by enforcement authorities against book pirates, but almost entirely on behalf of Chinese companies. Publishers are working with local authorities to increase government administrative activity on behalf of U.S. companies and will be monitoring the degree of cooperation more closely during 2005, though the lack of transparency in the system is a major hurdle.

<b>ADMINISTRATIVE COPYRIGHT ENFORCEMENT STATISTICS FOR 2004</b>			
<b>PEOPLE'S REPUBLIC OF CHINA</b>			
<b>ACTIONS</b>	<b>MOTION PICTURES</b>	<b>BUSINESS SOFTWARE</b>	<b>TOTALS</b>
NUMBER OF RAIDS/SEARCHES CONDUCTED	1,153	12	1,165
NUMBER OF ADMINISTRATIVE CASES BROUGHT BY AGENCY	914	12	926
NUMBER OF DEFENDANTS FOUND LIABLE (INCLUDING ADMISSIONS/PLEAS OF GUILT)	894 (20 cases pending)	9 (2 cases pending)	903
RATIO OF CONVICTIONS TO THE NUMBER OF RAIDS CONDUCTED	77.5% (894/1,153)	75% (9/12)	78% (903/1,165)
RATIO OF CONVICTIONS TO THE NUMBER OF CASES BROUGHT	100%	75%	
NUMBER OF CASES RESULTING IN ADMINISTRATIVE FINES	798	0	798
TOTAL AMOUNT OF FINES LEVIED			
RMB\$0-1,000 (UP TO US\$120)	209	0	209
RMB1,001-5,000 (UP TO US\$604)	264	0	264
RMB5,001-10,000 (UP TO US\$1208)	188	0	188
RMB10,000 AND ABOVE (ABOVE US\$1208)	137	0	137
TOTAL AMOUNT OF FINES ORDERED IN HOW MANY CASES (E.G., \$XXX IN Y CASES)	RMB\$4 million (US\$483,284) in 798 cases	US\$174,735 in 9 cases	

## Criminal enforcement

IIPA and its members (and the USG) have pressed China for years to use its criminal law to prosecute pirates, since it is the only viable means effectively to reduce piracy levels in China. While criminal enforcement does occur periodically under other laws such as those dealing with pornography, smuggling or running an illegal business (Article 225 of the Criminal Code), it will be difficult for China to convince its people that piracy is an economic crime that damages the Chinese economy and Chinese culture until there is a publicly announced commitment from the State Council/Vice-Premier level and an ample record of convictions for “piracy” with deterrent penalties.

IIPA and its members hope that that process begun last April with Vice Premier Wu Yi’s announcements, and, in particular, the recent amendment to the SPC Judicial Interpretations will mark the beginning of an initiative and not its highpoint. Further discussion on the new JIs is set out below.

IIPA members have consistently had difficulty in gathering information on the use of the criminal law against acts of piracy. When we hear of convictions, we discover that they are usually under other laws, like pornography or “illegal business,” not piracy. China publicly announces the seizure and destruction of pirate product on a regular basis, but seems rarely to publicly announce a jail term or deterrent fine for piracy per se. This must change.

**The recording and motion picture industry:** RIAA has reported in their business confidential submission to USTR that it has no knowledge of any criminal “piracy” prosecution involving its product. MPA, on the other hand, last year reported some statistics it was able to unearth. It reported last year that in 2002, 19 criminal cases had been brought and concluded (with reported sentences of six months to 6 years) in Beijing involving that industry’s products—apparently none in any other city. It reported that, in 2003, 30 cases were filed in Beijing and Shanghai, with again, 80% in Beijing. However, it also reported that, to the best of its knowledge, only three of these cases were brought under the criminal “piracy” provisions, Article 218, the high threshold having been met in those 3 out of 49 total cases over 2 years. The rest of the cases were basically censorship/pornography cases brought under Article 225 of the Criminal Law. Jail terms were, however, significant in most of these cases (though the Chinese have traditionally treated pornography very seriously) indicative of the fact that a criminal prosecution, as contrasted with an administrative proceeding, is likely to result in some deterrence—if properly and widely publicized and directly identified with piracy.

In July 2004, the Chinese government announced a major raid conducted by the Economic Crime Investigation Division (criminal copyright enforcement, as noted earlier, is normally undertaken by the less-efficient Social Order Division)<sup>23</sup> of the MPS, assisted by the Shanghai PSB and the U.S. Department of Justice and U.S. Customs. Over 210,000 DVDs were seized in the raid and six people were arrested, including two U.S. citizens. 20,000 of the DVDs were to be sold in the U.S. and the rest were to be transmitted via the Internet to 25 countries. These six defendants were prosecuted under the “operating without a license” provisions in Article 225 of the Criminal Code.

We have also heard from Chinese representatives that there have been other criminal convictions specifically prosecuted under the criminal piracy provisions, though the ones cited have involved Chinese origin works and all have admitted that these cases are very, very few.

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<sup>23</sup> In fact, a senior official in the Social Order Division of the PSB told a visiting US Government delegation during 2004 that copyright piracy was an offense generally committed in the rural regions of China and not warranting criminal prosecutions.

We have inquired on many occasions about the existence of criminal convictions purely for piracy offenses and we have received no confirmations.<sup>24</sup>

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<sup>24</sup> 2002 may have marked the year of the first pure piracy case ever, involving a factory in Guangdong Province, where two defendants were sentenced in March 2002 to two years' imprisonment for copyright piracy only. This case involved the Foshan Jinzhu Laser Digital Chip Co. Ltd., which had accepted a phony order for 920,000 DVDs from a Taiwan defendant [who was fined RMB 400,000 (\$48,329)]. In addition to the prison terms, three lines were removed, and the GAPP revoked the plant's license. There were other rumors of criminal piracy convictions in Anhui Province but no confirmation was obtained. Another case in Shanghai involved the *Dictionary of Cihai*, but again it appears that this was not a pure copyright case. IIPA has received informal reports of two book-piracy cases which were decided purely under Article 217 and 218, but these may be the Anhui cases for which we have no confirmation.

Bringing criminal cases was not only an obligation in the U.S.-China 1995 Memorandum of Understanding and [Enforcement and Market Access] Action Plan, but is a clear TRIPS requirement. China's JCCT obligations include a commitment that China will "subject a greater range of IPR violations to criminal investigation and criminal penalties," and that criminal sanctions will be applied "to the import, export, storage and distribution of pirated and counterfeit products" and that criminal sanctions will also apply to on-line piracy. China is not now in compliance with either that bilateral agreement, TRIPS or its JCCT commitments. As discussed below, industry is skeptical whether the lowered thresholds and other amendments to the JIs will be implemented in such a way to result in the commencement of many significant criminal prosecutions, though we fervently hope that we are wrong. This is the only way, in industry's view, that "piracy levels can be significantly reduced" in China, as promised by the Vice Premier.

**Other copyright industries:** Except for the statistics cited above, no other industry reports having a criminal case—for piracy—brought or concluded with respect to their products. Indeed, the recording industry, which has brought myriad civil cases against licensed OD factories, continues to voice its frustration that the criminal authorities (the Public Security Bureau) are not taking actions against underground plants where civil actions are not possible.

While the copyright industries welcome actions under Article 225 of the Criminal Law, real deterrence won't be brought to the criminal system until a significant number of widely publicized cases are brought under Articles 217 and 218. For this to happen, there must be political will to bring those cases. Below MPA and BSA report the criminal cases they have been told about, but again, it is likely that, in the case of audiovisual product, few or no such cases were prosecuted for "piracy," but under other provisions, such as operating an unlicensed business under Article 225 or for pornography. Until the authorities commence accurate and granular reporting of these statistics, it will be very difficult to evaluate progress in the enforcement system.

CRIMINAL COPYRIGHT ENFORCEMENT STATISTICS FOR 2004 PEOPLE'S REPUBLIC OF CHINA		
ACTIONS	MOTION PICTURES	BUSINESS SOFTWARE
NUMBER OF RAIDS CONDUCTED	42	2
NUMBER OF VCDs SEIZED	15,172,549	2500
NUMBER OF DVDs SEIZED	22,221,488	
NUMBER OF CD-Rs/DVD-Rs SEIZED	27,157	
NUMBER OF INVESTIGATIONS	50	2
NUMBER OF VCD LAB/FACTORY RAIDS	8	
NUMBER OF CASES COMMENCED	34	1
NUMBER OF INDICTMENTS	30	1
NUMBER OF DEFENDANTS CONVICTED (INCLUDING GUILTY PLEAS)	48	1
ACQUITTALS AND DISMISSALS	2	
NUMBER OF CASES PENDING	13	1
NUMBER OF FACTORY CASES PENDING	0	
TOTAL NUMBER OF CASES RESULTING IN JAIL TIME	21	
SUSPENDED PRISON TERMS		
MAXIMUM 6 MONTHS	5	
OVER 6 MONTHS	1	
OVER 1 YEAR	6	
TOTAL SUSPENDED PRISON TERMS	101 MONTHS	
PRISON TERMS SERVED (NOT SUSPENDED)		
MAXIMUM 6 MONTHS	3	1
OVER 6 MONTHS	14	
OVER 1 YEAR	25	
TOTAL PRISON TERMS SERVED (NOT SUSPENDED)	42	

NUMBER OF CASES RESULTING IN CRIMINAL FINES		
UP TO \$1,000	2	1
\$1,000 TO \$5,000	6	
OVER \$5,000	10	
TOTAL AMOUNT OF FINES LEVIED (IN US\$)	313,020	362

## Civil enforcement

As noted above, one positive development is the increasing sophistication and effectiveness of the IPR courts throughout China. For this reason, Chinese right holders and, increasingly, U.S. right holders have used the civil system as a means to bring some deterrence to the enforcement system in China, given the demonstrated failures of the criminal and administrative enforcement systems.

**The recording industry:** The recording industry has brought over 235 cases against factories since 2002 and many others (through 2004, 202 cases) against retailers and Internet pirates. Ninety-one of the factory cases remain pending. Total damages/settlement amounts in all these civil cases brought by the recording industry amounted to US\$1.9 million. While there may be some limited deterrence associated with these amounts, it is clear that China can not rely upon civil actions to significantly improve the business climate, and that criminal actions are sorely needed. It must also be noted that the industry rarely is made whole for the damages they sustain in these civil cases. In only a few cases do the record companies even recoup their litigation costs (awards average 30% of actual litigation costs). The largest award/settlement in this range of cases was RMB600,000-800,000 (US\$72,493-US\$96,657). These judgments/settlements were against factories suspected of producing millions of units of pirate music CDs at profits which far exceed these meager damages—thus demonstrating that engaging in large scale production of pirate materials, even when you get caught, is presently a rational business decision in China.

As noted above, the recording industry continues to face massive Internet piracy in China but has been required to fight this problem through cease and desist letters to ISPs and, where necessary, civil litigation. More than 2000 cease and desist letters were sent in 2004, with a compliance rate of 75%, a significant improvement over the 30% in 2003. The industry has now completed 17 civil Internet cases. A recent case was won against [www.tyfo.com](http://www.tyfo.com), one of China's most popular pirate websites. Damages awarded were RMB 370,000 (\$45,000) which, while significant, is low given the damage done. In summary, while these cases have been successful, monetary damages have been very low and hardly a deterrent to further infringements. The maximum received in an Internet case was approximately RMB170,000 for 15 songs (US\$1,370 per song) in the case against [www.tj.cn](http://www.tj.cn), awarded by the Tianjin No. 1 Intermediate Court. Compliance has generally been good by the ISPs but litigation and *ex officio* action by Chinese enforcement authorities will be necessary to make a significant difference. Moreover, the industry is very concerned about the new draft Internet regulations, which if adopted, would severely threaten this compliance rate. RIAA/IFPI has brought a number of civil suits against ISPs and websites, which have been reported, in earlier submissions. Some success has been achieved.

**The motion picture industry:** The motion picture industry also embarked on a civil litigation program in 2002, with a total of ten civil cases having been brought under the recent Copyright Act amendments, all of them successful. Four cases against factories were settled. Six cases against three retailers in Shanghai resulted in a damages in favor of the plaintiffs based on statutory damages of up to RMB500,000 (US\$60,410) available under Article 48 of

the 2001 amendments to the Copyright Act. However, evidentiary requirements remain burdensome and unnecessary. Further amendments to the Copyright Act should establish a presumption with respect to subsistence and ownership of copyright and permit, for example, a U.S. copyright certificate to be used.

In 2004, MPA has issued 4,055 cease and desist letters to ISPs in China, primarily for P2P piracy. This was an almost ninefold increase over 2003. However, the compliance rate was, as noted earlier, only 17%. The new “Interpretations” in combination with NCAC’s soon-to-be completed Internet regulations, plus an easing of the burdens to followup with civil cases with significant, and deterrent, damages, must change this result. Any civil enforcement strategy must also be accompanied by aggressive use of China’s administrative enforcement machinery, under the new JIs criminal enforcement.

As discussed in detail in prior submissions, the new copyright law amendments have made certain positive changes that should assist in bringing successful civil cases against infringers.

- Provisional remedies were added in Articles 49 and 50 and, as we understand it, it is intended that these operate on an *ex parte* basis.
- Court-determined “pre-established” damages can now be awarded under Article 48 up to a maximum of RMB500,000 (US\$60,410) where the “actual losses suffered by the holder of the right or the profit earned by the infringing party cannot be determined.”

**The software industry:** These changes are significant improvements, though U.S. right holders have continued to have some problems in successfully bringing civil cases in China, particularly the business software industry. Until this year, very few cases have been brought and concluded. However, the trend has been encouraging with respect to the Chinese civil court system’s willingness to take on and decide end-user cases. There have been, as of this date however, only six such cases. The first two, involving AutoDesk and Adobe, were decided in favor of the copyright owner but evidence of actual damages (which were substantial—in one case over US\$250,000) ended up being rejected and the cases were decided under the new statutory damages provisions of the copyright law amendments. In one case the damages were RMB500,000 (US\$60,410) and in the other RMB115,000 (US\$13,894 including court costs). A third case was settled under pressure from the judge for only RMB50,000 (US\$6,041). In the fourth case, against a large interior design company in Beijing with 15 operations, NCAC finally agreed to raid two locations. After about eight months, NCAC awarded only RMB270,000 (US\$32,621) in fines and the copyright owner then sought to bring civil actions in the courts against four other branches of the enterprise. In October 2003, the Beijing High Court, for the first time ever, awarded damages based upon the number of copies times the retail price—a total in damages of RMB1.49 million (US\$180,023). In the two recent cases, the courts supported almost all the claims made by right holders. In one case the damages were RMB378,200 (US\$45,695) — the decision is on appeal — and in the other RMB290,900 (US\$35,147). While this is a major victory for the software industry, any significant dent in the rate of software piracy in China will need the widespread application of administrative enforcement by NCA and the criminalization of enterprise end-user piracy. BSA also remains concerned that evidence preservation orders are still coming too slowly and are too difficult to obtain, in view of China’s TRIPS obligations in this important area.

Also of significance is a decision in the summer of 2004 in the Shenyang Intermediate People’s Court which ruled against end users of unauthorized software. The case involved Chinese software (RIP2.1). The court made use of the presumption in the 2001 copyright

amendments to require the defendants to show that their use was legal. The eight defendants were unable to do so and damages of RMB100,000 (\$12,082) were imposed.

**The book and journal publishing industry:** In the area of piracy of literary works—in a major salutary development—a Beijing Intermediate Court rendered a judgment in September 2003 (in a case commenced in 2000) which sought damages against the Beijing New Oriental School. This school had for years administered the TOEFL and GRE tests to Chinese students seeking entrance into U.S. universities. ETS alleged that the school has been stealing ETS’s highly secure test questions and test forms and selling them to its students at a significant profit. The school also distributed these highly secret test questions widely in China. ETS claimed that the security and integrity of the tests have been compromised to the extent that it has led some U.S. universities to doubt the authenticity of all test scores from China, harming the entrance prospects of Chinese students. (Over 10% of the 800,000 students taking the TOEFL test worldwide come from China). New Oriental had been unsuccessfully sued before and the size of the infringement was staggering, with New Oriental adding an average of 10,000 students per month and with a nine-month waiting list. The court finally concluded a case that had been rife with procedural hurdles, and awarded damages of US\$1.2 million to both ETS and GMAT.

U.S. publishers have brought a number of civil cases in the past year, but have been hampered in some important cases by non-transparent and onerous evidentiary burdens. The industry has a number of civil cases pending and will be monitoring the progress of these in the coming months.

CIVIL COPYRIGHT ENFORCEMENT STATISTICS FOR 2004 PEOPLE'S REPUBLIC OF CHINA				
ACTIONS	MOTION PICTURES	BUSINESS SOFTWARE	BOOK PUBLISHING	TOTALS
NUMBER OF CIVIL RAIDS CONDUCTED	0	0	0	0
POST-SEARCH ACTION	0	0	0	0
CASES PENDING	0	0	0	0
CASES DROPPED	0	0	0	0
CASES SETTLED OR ADJUDICATED	2	2	0	4
VALUE OF LOSS AS DETERMINED BY RIGHT HOLDER (\$USD)	0	0	0	0
SETTLEMENT/JUDGMENT AMOUNT (\$USD)	US\$30,000	US\$82,860	0	US\$112,860

# Statutory Law and Regulations: The New Judicial Interpretations, the Criminal Law, the 2001 Copyright Amendments, and the Draft Internet Regulations

## The new Supreme People's Court judicial interpretations

On December 21, the Supreme People's Court issued its long-awaited, and promised, amendment to its Judicial Interpretations of the Chinese Criminal Law. IIPA has reviewed these amendments and comments on them as follow:

- As a fundamental matter, whether the new Judicial Interpretations are positive or not will depend entirely on the **political will** of the Chinese authorities to use them aggressively to bring criminal cases and to impose deterrent penalties on pirates. In IIPA's view, this is a necessary condition for China to redeem its JCCT commitment to "significantly reduce piracy levels."
- Even though some of the thresholds were reduced, and some significantly, it remains to be seen whether, given that the Chinese, for inexplicable and unjustifiable reasons, chose to retain measuring the thresholds at pirate prices, there will be any difference in the number of cases **in practice**.
- If the JIs, as they came out in the end, are any measure of the government's ultimate political will to use the criminal process to reduce piracy, then we cannot be very optimistic since the improvements were so minimal.
- The new "copy" thresholds do hold some promise, particularly if requirements to prove sales are unnecessary. However, 1,000/3,000 copies (individuals/units for the lower penalties where jail time is not mandatory and fines are set by the judge and not in the JIs) and 5,000/15,000 copies (individuals/units for the mandatory three year minimum jail term) still place a heavy burden on enforcement authorities and will only result, it would seem, in the possibility of prosecuting the very biggest pirates — not much different than under the previous JIs. We note that the 1000 copy threshold (for individuals, not units) is double the threshold for prosecuting for illegal business operations under Article 225. We also note that in an apparent inadvertent drafting error, sound recordings are not covered in the copy threshold provisions. Finally, the copy thresholds apparently do not apply to Article 218 offenses involving only "sales." We understand that the SPC has taken the position that "sales" is not the equivalent of "distribution" and that the latter implies some connection with the entire supply chain, beginning with manufacture. This must be clarified since it may result in excluding from possible criminal prosecution owners of warehouses where large seizures have been made, where there is no evidence of the owner being involved in production and where the monetary thresholds have not been met.
- The Chinese government took the exact opposite approach from that suggested by the copyright industries and the U.S. government: they kept "profits" as the main test, with "business volume" as a secondary test at a higher threshold. Only when the pirate price is "unknown" can we apparently measure the threshold by the legitimate price. China is still the only country in the world that uses pirate "profits" as a criterion for what is criminal and what is not. Some benefit may come from the new ability to aggregate income amounts over multiple raids, however.
- They also inexplicably failed to abolish the individual/unit distinction; most sophisticated pirates will now have an even greater incentive to operate only as a "unit" to avoid the lowered "individual" thresholds.

- It is positive that the act of importing and exporting has been added to the JIs, but, again, importers and exporters will not be held liable for direct infringement under Article 217 or 218 but only be held liable as “accomplices” under Article 27 of the Criminal Law. This Article is written in such a manner as seemingly to “encourage” judges to impose the most minimal penalties.
- Specific reference to Internet offenses is also good but it will be even more difficult to provide proof that the thresholds have been met than would be the case with physical piracy. Again, in what is likely an inadvertent drafting error, sound recordings are not covered!
- End-user software piracy “could” be covered as a crime, but BSA reports that all indications are that the intention is NOT to cover it — a huge deficiency. It is also unclear how hard-disk loading piracy of software in the wholesale and retail channels can be adequately covered by the new JIs, given the excessively high copy thresholds.
- It is unclear why the provisions on repeat infringers was removed entirely, rather than strengthened by applying the higher, rather than the lower, tier of statutory penalties.

As noted earlier, it is critical that the PSB be given the resources necessary to implement the new JIs and that the Economic Crimes Division be put fully in charge of criminal copyright enforcement.

### **Section 217 and 218 of the Criminal Code criminalizing copyright piracy must be amended to comply with TRIPS.**

The JIs, as proposed by IIPA, were not amended to rectify the critical TRIPS incompatibilities in Article 217 and 218 of the Criminal Code. IIPA has noted in prior submissions that the criminal piracy articles of Chinese law are deficient on their face, and thus violate TRIPS Article 61, which requires the criminalization of all “copyright piracy on a commercial scale.” These articles must be amended, inter alia, (1) to criminalize end-user piracy; (2) add reference to all the exclusive rights now provided in the law (including the new WIPO treaties rights and unauthorized importation); (3) add criminalization of violations of the anti-circumvention provisions and rights management information; (4) criminalize Internet and other offenses that are without “profit motive” but that have impact on right holders “on a commercial scale”; (5) eliminate distinctions between crimes of entities and individuals; and (6) increase the level of penalties overall.

### **The 2001 Copyright Amendments must be further amended to bring the law into compliance with TRIPS and the WIPO “Internet” treaties.**

The amendments to China’s 1990 copyright law were adopted on October 27, 2001, and IIPA’s 2002 and 2003 submissions provide great detail on both the positive changes, as well as the deficiencies, in these amendments.<sup>25</sup> The amendments sought to bring China into compliance with its WTO obligations and added many provisions that sought to implement the requirements of the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT). The deficiencies detailed in these prior submissions were not fixed by the December 2001 regulations governing computer software or the regulations to the

<sup>25</sup> See IIPA’s 2003 Special 301 country report on the People’s Republic of China, pages 33-36, available at <http://www.iipa.com/rbc/2003/2003SPEC301PRC.pdf>. Copyright Law of the People’s Republic of China, Adopted at the Fifteenth Session of the Standing Committee of the Seventh National People’s Congress on September 7, 1990, Amended in Accordance with “Decision to Amend Copyright Law of the People’s Republic of China,” Adopted at the Twenty-Fourth Session of the Standing Committee of the Ninth National People’s Congress on October 27, 2001 (translation on file at IIPA).

Copyright Law, which became effective on September 15, 2002. The following are the key deficiencies in the 2001 amendments that still need to be corrected:

- The most glaring deficiency is that criminal liability is not affected and there are apparently no plans to amend the Criminal Code. As noted, the current Criminal Code articles on copyright violate the TRIPS Agreement.
- While the Law [Article 47(6)] provides anti-circumvention protection, it does not fully implement the WIPO treaties obligation, in that it: (1) does not expressly prohibit the manufacture or trade in circumvention devices, components, services, etc.; (2) does not define “technical protection measures” to clearly cover both “copy-controls” and “access controls”; (3) does not make clear that copyright exceptions are not available as defenses to circumvention violations; (4) does not expressly include component parts of circumvention technologies (assuming devices are covered); (5) imposes an “intent” requirement as to acts (and business/trade if such activities are covered), which might make proving a violation difficult; and (6) does not provide for criminal penalties for circumvention violations (since the copyright law only deals with civil and administrative remedies).
- While the law protects against “intentionally deleting or altering the electronic rights management system of the rights to a work, sound recording or video recording” without consent of the right holder [Article 47(7)], this protection may not fully satisfy WIPO treaties requirements and requires further elaboration. For example, the law does not expressly cover “distribution, importation for distribution, broadcast or communication to the public” of works or other subject matter knowing that RMI has been removed or altered without authority, as required by the WIPO treaties, nor does it define “electronic rights management system” in a broad, technology-neutral manner.
- Temporary copies are not expressly protected as required by Berne, TRIPS and the WIPO treaties. As with the copyright law prior to amendment, protection of temporary copies of works and other subject matter under the 2001 copyright law remains unclear. According to an earlier (February 2001) draft amendment of Article 10, “reproduction” as applied to works was to include copying “by digital or non-digital means.” The phrase “by digital or non-digital means” was removed from the final version of Article 10(5) prior to passage. Article 10(5) also fails (as did the definition of “reproduction” in Article 52 of the old law, which was deleted, and Article 5(1) of the 1991 Implementing Regulations) to specify that reproductions of works “in any manner or form” are protected. Addition of either of these phrases might have indicated China’s intent to broadly cover all reproductions, including temporary reproductions, in line with the Berne Convention, TRIPS and the Agreed Statement of the WIPO Copyright Treaty.<sup>26</sup> As it stands, the current Article 10(5) description of the reproduction right includes “one or more copies of a work by printing, photocopying, copying, lithographing, sound recording, video recording with or without sound, duplicating a photographic work, etc.” Objects of

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<sup>26</sup> The agreed statement to Article 1 of the WIPO Copyright Treaty provides,

[t]he reproduction right, as set out in Article 9 of the Berne Convention, and the exceptions permitted thereunder, fully apply in the digital environment, in particular to the use of works in digital form. It is understood that the storage of a protected work in digital form in an electronic medium constitutes a reproduction within the meaning of Article 9 of the Berne Convention.

Dr. Mihály Ficsor, who was Secretary of the WIPO Diplomatic Conference in December 1996, has stated that the term “storage” naturally encompasses temporary and transient reproductions. Ficsor notes that “the concept of reproduction under Article 9(1) of the Convention, which extends to reproduction ‘in any manner or form,’ must not be restricted just because a reproduction is in digital form, through storage in electronic memory, and just because a reproduction is of a temporary nature.” Mihály Ficsor, Copyright for the Digital Era: The WIPO “Internet” Treaties, Colum.-VLA J.L. & Arts (1998), at 8. See also, Mihály Ficsor, The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation (2002).

neighboring rights (Articles 37, 41 and 44) mention “reproduction” (e.g., Article 41 provides sound recording and video recording producers a “reproduction” right), but the Article 10(5) description is not expressly applied *mutatis mutandis*. It should also be noted that the Article 41 reproduction right for sound recording producers does not expressly extend to indirect reproductions, as required by TRIPS (Article 14.2) and the WPPT (Article 11). China has apparently conceded in the TRM process in Geneva that its law does not encompass temporary copies.

- A new compulsory license (Article 23) permits the compilation of “[p]ortions of a published work, a short work in words or music, or a single piece of artwork or photographic work” into elementary and high school (so-called “el-hi”) textbooks, and “State Plan” textbooks (which we are still trying to determine would not include university textbooks, which would cause even greater concern for U.S. publishers); in addition, sound recordings, video recordings, performances, and broadcasts apparently are subject to this compulsory license. IIPA hopes that the Chinese government will confirm that this compulsory license provision will not be read to apply to foreign works and other subject matter since it would violate the Berne Convention and TRIPS if it did. It would also violate the International Treaty regulations referenced above (which implemented the 1992 U.S.-China Memorandum of Understanding [MOU]), even if it were further confirmed that it only applies to foreign printed materials used in elementary or high school “textbooks” (hard copies). The significant damage to publishers would be further exacerbated if “State Plan” were to encompass university textbooks and/or if “textbook” includes forms other than “printed” forms (e.g., digital forms or multimedia). The regulations must be framed to exclude foreign works or to limit their scope in a manner consistent with the Berne Appendix.
- The provisions on collecting societies leave unclear whether this provision extends to the creation of anti-piracy organizations which can “enforce” the rights of their members in the association’s name. This change is sorely needed in China, particularly for the benefit of foreign right holders, and other laws or regulations which inhibit the formation of such organizations should also be amended or repealed. Regulations did not clarify this point.
- The treatment of works and sound recordings used in broadcasting continues to remain woefully deficient and out of date. While Article 46 spells out that broadcasters must obtain permission to broadcast “unpublished” works (e.g., an exclusive right), Article 47 provides a mere “right of remuneration” for the broadcast of all other works, with the sole exception of cinematographic and “videographic” works. Such a broad compulsory license (not even limited to noncommercial broadcasting) is not found in any other law, to IIPA’s knowledge. Furthermore, the broadcast of sound recordings is not even subject to a right of remuneration by virtue of Article 41 and Article 43. Record producers should not only enjoy full exclusive rights for both performances and broadcasts in line with modern trends, and this treatment appears to conflict with the “Regulations Relating to the Implementation of International Treaties” promulgated in 1992. Article 12 extends these rights to foreign cinematographic works and Article 18 applies that Article 12 applies to sound recordings. The authorities, though asked, did not clarify this contradiction in the Implementing Regulations to the Copyright Law discussed below. Provisions should be added to ensure that certain uses of sound recordings that are the equivalent of interactive transmissions in economic effect should be given an exclusive right. An exclusive importation right should also be added.
- The draft does not take advantage of the opportunity to extend terms of protection to life plus 70 years and 95 years from publication. This is the modern trend.
- A full right of importation applicable to both piratical and parallel imports should have been included.

Deficiencies also occur in the enforcement area:

- Administrative fines need to be substantially increased. The equivalent of injunctive relief must be provided and clarified.
- Again worthy of particular emphasis, however, is the failure of these amendments to address the lack of TRIPS-compatible criminal remedies, probably the single most important change that must be made to open up the Chinese market closed by staggering piracy rates around 90%. Criminal remedies must be extended to include violations of the TPMs and RMI provisions in order to comply with the WIPO treaties obligations.

IIPA also urges China to ratify the WIPO “Internet” treaties by the end of 2005.

### **The Supreme People’s Court’s Internet Interpretations and the NCAC’s Draft Internet Interpretations**

The Supreme People’s Court issued its “Interpretations of Laws on Solving Online Copyright Disputes,” with effect from December 20, 2000.<sup>27</sup> These were amended at the end of 2003.<sup>28</sup> As announced at the JCCT, NCAC and MII were to issue Internet-related regulations by the end of 2004. A draft was released in April 2004 and another in November 2004.<sup>29</sup> These regulations deal entirely with the liability of Internet Service Providers and with the details of “notice and takedown,” and, we understand, are being issued pursuant to Article 58 of the 2001 copyright law amendments pursuant to which the State Council reserves to itself the task of issuing regulations on the “right to transmit via information networks.”

Clarification is necessary on how these draft regulations interrelate with the current 2003 “Interpretations” of the Supreme People’s Court.

With respect to the 2003 amended SPC “Interpretations,” they are deficient or unclear in several respects:

- Article 3 remains problematic. It appears to provide a loophole for the reprinting, extracting or editing of works, once they have appeared on the Internet with permission and remuneration. While the copyright owner can give notice that it does not want its work used further, this “quasi compulsory license” is unworkable in practice. Copyright owners should not have to undertake these notification burdens when they are granted exclusive rights under the Conventions.
- Many of the provisions of the “Interpretations” overlap with the NCAC draft regulations discussed below but it is unclear, for example, whether the notice requirements set forth in the NCAC regulations would also apply in the context of a civil infringement case brought before the courts. There are also inconsistencies. Article 6 seems to imply that the ISP must provide the “author” with information identifying the infringer. This is not part of the NCAC regulations.

<sup>27</sup> “Interpretations of the Supreme People’s Court on Laws for Trying Cases Involving Internet Copyright Disputes” (Adopted at the 1144th session of the Judicial Committee of the Supreme People’s Court on Nov. 22, 2000).

<sup>28</sup> Decision on Revising “Interpretation of the applicable law and some other matters for hearing computer network copyright-related disputes by the Supreme People’s Court” by the Supreme People’s Court (Adopted by the Trial Committee of the Supreme People’s Court at No. 1302 meeting on Dec. 23, 2003).

<sup>29</sup> Administrative Measures on Copyright under the Environment of the Internet (Draft), April 2004. Administrative Protection Measures on the Right of Communication through the Information Network (Draft), National Copyright Administration of China; Ministry of Information Industry, November 2004. English translations on file at IIPA.

- Article 5 makes ISPs fully liable where they are “aware” of the infringement, either before notice from the right holder or after receiving notice and failing to take down the infringing site. Is this a more liberal test than in the NCAC draft regulations? The ISP must also have “adequate evidence” of infringement. What constitutes “adequate evidence” of infringement? Will it be the same as the onerous requirements for an administrative action? All this must be clarified. The “Interpretations” also do not apparently require an “immediate” takedown as provided in the draft NCAC regulations.

The NCAC draft regulations, revised and issued in November 2004, continue to be inadequate in dealing with the realities of infringement on the Internet and must be further redrafted. Below are a few of the deficiencies:

- It is important that ISPs that are in a position to control content not be subject to any limitations on liability. The current language in Article 2 should be clarified to this effect.
- The requirements in draft Article 8 on the content of the notice are unworkable. Articles 5, 7, 8 and 10 imply that only the “copyright owner” can supply the notice, and not an authorized representative of the owner, such as a trade association. This change must be made. Article 8 then continues to list the requirements for a valid notice. The Article requires that the “copyright owner” supply an “ownership certificate of copyright.” This is followed by four other documentary requirements. These are unclear and far too onerous to be practical. All that should be required, as in the DMCA and the U.S. FTAs, is a statement that the copyright owner has a good faith belief that the material is infringing and that the statement in the notice is accurate. There is also no provision which allows the right holder to “substantially” comply with the notice requirement. Indeed, Article 10 permits the ISP to ignore the notice if it is literally “without any of the content prescribed in Article 8.”
- A fundamental flaw in the draft regulations is the requirement in Article 10 that all notices be made “in written form.” Virtually all notices globally are accomplished via *electronic* communications (e.g., email). This provision would seem not to permit this, making the provision wholly impractical and unworkable. It would severely reduce the already low compliance rates for takedowns in China.
- The prior draft was fortunately changed to require the ISP to “immediately” take down the infringing content upon receiving notice, but the complex notice requirements and the “writing” requirement may vitiate this positive feature.
- Article 7 allows the ISP to “put back” the alleged infringing materials upon receiving a counter-notification. However, no notice to the copyright owner of such action is required. Clearly the copyright owner needs to be advised of the putback notice and given time to take further action. This is in the DMCA and FTAs and an essential part of an effective notice and takedown system. Interestingly, Article 7 says “may” which seems to indicate the “put back” is not mandatory. But this is still a poor substitute for notifying the copyright owner.
- The knowledge requirement in Article 11 is too strict. Under the DMCA and the FTAs, an ISP is liable if it “knows” or if it is “aware of facts or circumstances from which infringing activity is apparent” (DMCA, Article 512). That needs to be a feature of these regulations. It is very difficult to prove actual knowledge but easier to show facts

from which the ISP should have known that the material being transmitted was infringing.

- There is no clear right in NCA to order the equivalent of injunctive relief, just the right to fine, and then only three times “income” (which as we know is virtually impossible to prove). Thus, the maximum fine will realistically be only “up to RMB100,000.” This is hardly an effective deterrent to mass infringements. Also, administrative fines can only be imposed if the infringing conduct “impairs the social and public interest” as a condition. NCA has not done well by the software industry using this language. It should be eliminated. Finally, the right to seek injunctions from a civil court must be clarified and preserved. This raises again the critical question of the interrelationship of these regulations with the SPC “Interpretations.”
- There is nothing in the revised draft regulations requiring the ISP to disclose the identity of the infringer, except to NCA directly. In turn, there is no requirement that NCA disclose that identity to the right holder enabling the bringing of a civil or criminal case. An effective and expeditious notification system is a critical element to effective Internet enforcement.
- Finally, Article 4 paragraph 2 defines where an infringement occurs as the place where the server is located. If this is literally the rule, then ISPs have no obligation to take down infringing material emanating from servers in Taiwan or the U.S. or any other country. Moreover, servers can be moved virtually instantaneously. Administrative agency jurisdiction should never depend on the location of the server. Again, such a system is simply unworkable.

## **The Urgent Need for Improved Market Access**

### **China must eliminate its onerous market access restrictions and create a competitive marketplace that can meet domestic demand.**

Most of the copyright industries suffer from non-tariff and tariff trade barriers, which severely limit their ability to enter into business, or operate profitably, in China. These are only selected barriers that affect the named industries:

**Entertainment software:** Hard goods versions of entertainment software titles must go through an approval process at the GAPP. It is believed online versions of games will need to go through an approval process at the Chinese Ministry of Culture before distribution is allowed. The rules and regulations are not transparent at this time.

For hard goods, 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. Protracted content reviews result in considerable delay before a newly released video game title is approved for release in the Chinese market. In the meantime, pirated versions of these games are sold openly well before the legitimate versions have been approved for release to the retail market. Such a delay affords pirates with a virtually exclusive period of distribution for newly released titles. The Chinese government should enforce these regulations and clamp down on pirates who distribute games that are not approved by GAPP for sale in the country.

There is also concern that this review process may now be bifurcated between these two agencies. It would be extremely helpful to the industry for this review function to be lodged with only one agency. Already, there are video games, which though distributed through physical optical disc media, also have an online component. Having to undergo two separate content review processes before two different agencies would be burdensome to entertainment software publishers, adding not only additional costs but also further delay in releasing new product into the market. Further, transparency in the review process would help game companies in preparing games for the market.

In addition, there are other investment and ownership restrictions that must be abolished.

**Book and journal publishing:** In IIPA's 2004 submission, we detailed some of the existing barriers for the U.S. publishing industry. China was required to eliminate some of these barriers by December 11, 2004, in accordance with its WTO commitments. Under the agreement, publishers must be afforded full trading rights (the right to freely import directly into China), and be permitted to engage (with wholly owned companies) in wholesale and retail distribution activities. While it appears that China has fulfilled many of these commitments with its 2004 Foreign Trade Law, which went into effect on July 1, this law has produced as many questions as answers, and the U.S. publishing industry awaits clarification on a number of issues, including how the Foreign Trade Law provisions interact with other laws and regulations pertaining to the publishing industry as well as those restricting foreign investment generally.

In addition to the questions that remain regarding trading rights and distribution, other activities essential to effective publishing in China remain off limits to foreign publishing entities. These include the right to publish (including editorial and manufacturing work) and print books and journals in China without restrictions (except for a transparent, quick and non-discriminatory censorship regime) and the right to invest freely in all manner of publishing related activities without ownership restrictions. Restrictions on these activities result in greater expense to publishers and consumers alike, and discourage development of materials prepared specifically for the Chinese market. These restrictions also create delays in distribution of legitimate product in the Chinese market, opening the door for pirate supply of the market. China's WTO commitments as to these activities must be clarified, and existing regulations prohibiting these activities should be repealed.

Finally, restrictions and high fees related to access to foreign servers result in high costs to publishers of electronic materials (such as academic and professional journals) in making their products available in China, resulting in fewer, lower quality options available to Chinese scholars and students.

### **Motion picture industry**

*Import quotas:* Limits on the number of films imported into China continue. Under the terms of China's WTO commitment, China has agreed to allow 20 revenue-sharing films into the country each year, up from a previous limit of 10. The Chinese are insisting that the 20 are a "maximum," not a "minimum." This interpretation is not in accordance with its WTO obligations and should be corrected. Moreover, the needs of the market far exceed the legal films now available as demonstrated by the huge market in pirated optical discs. The monopoly import structure is the main tool by which these quotas are imposed and enforced. China must begin immediately to dismantle all these archaic, protectionist and discriminatory restrictions. Note that SARFT has previously informally tied any increase in the number of foreign films imported into China to the expansion of the domestic industry.

*Monopoly on film imports and film distribution:* China Film continues to hold a state enforced monopoly on the import of foreign films. China Film also held the monopoly on the distribution of foreign films until Huaxia Distribution was authorized by SARFT to be the second distributor of imported films in August 2002. Huaxia is a stock corporation with investment from over 20 share holders, the largest of which is SARFT, with over 20%, then China Film, Shanghai Film Group and Changchun Film Group, each with about 10%. SARFT requires that the distribution of all foreign films brought into China that are revenue sharing be distributed equally by the Government's mandated foreign film distribution duopoly. Foreign studios or other distributors cannot directly distribute revenue sharing foreign films. This restriction of legal film supply leaves the market to the pirates and they are taking full advantage of this limitation. China should begin now to eliminate all barriers to the import and distribution of films, including all investment and ownership restrictions.

*Cinema ownership and operation:* "The Interim Regulations for Foreign Investment in Theaters" effective on Jan 1, 2004 restricts foreign ownership of cinemas to no more than 49% but provides for 75% in the "pilot cities" of Beijing, Shanghai, Guangzhou, Chengdu, Xi'an, Wuhan and Nanjing. Foreigners are not permitted to operate cinemas. For the growth and health of the industry, foreigners should be allowed to wholly own and independently operate cinemas.

*Broadcast quota:* Under SARFT's "Regulations on the Import and Broadcasting of Foreign TV Programming" effective on 23 October 2004, the broadcast of foreign film and television drama is restricted to no more than 25% of total air time each day and is not permitted to be broadcast during prime time between 7:00 PM and 10:00 PM on any forms of television broadcast other than pay television without SARFT approval. A channel's other foreign television programming (news, documentary, talk shows, travel etc.) is restricted to no more than 15% of total air time each day. Foreign animation programming must follow the same censorship procedure as general programming and cannot exceed 40% of total animation programming delivered by each station on a quarterly basis. Since new regulations on the animation industry became effective in April 2004, only producers of domestic animation programming can import foreign animation programming and can only import the same proportion of foreign animation programming as they produce domestically. The quota on air time should be raised to at least 50%, and the prime-time quotas should be eliminated altogether. China should begin now to eliminate all these discriminatory restrictions.

*Retransmission of foreign satellite signals:* Foreign satellite channels may only be shown in three-star hotels and above and in foreign institutions. Moreover, foreign satellite channels beaming into China are required to uplink from a government owned satellite for a fee of \$100,000, placing a significant and unnecessary financial burden on satellite channel providers. The up-linking fee should be eliminated because it inhibits the development of the television market. Indeed, all these restrictions and barriers should be eliminated.

*Television regulations:* Under the 1997 Foreign Investment Guidelines, companies that are wholly or jointly owned by foreign entities are strictly prohibited from investing in the broadcast industry. MPA member companies are not allowed to invest in broadcast stations or pay television systems. China TV Program Agency under CCTV, the government acquisition arm, must approve all importation of foreign programming under the guidance of SARFT. The "Interim Management Regulations on Sino-Foreign Joint Ventures and Sino-Foreign Cooperative Television Program Production Enterprises" effective on 28 November 2004 sets out that:

- Foreign companies can hold up to 49% stakes in production ventures, which must have

initial capital of at least US\$2 million (or US\$1 million in the case of animation companies). Local partners can be private, but must be existing holders of a production license.

- Foreign partners must be “specialized radio or TV ventures”, a requirement aimed at ensuring the liberalization brings in expertise that will help the industry — although an indirect role for non-media investors may be possible.
- The joint ventures must also have a unique logo — a provision intended to ensure they are not used to promote the brand of foreign parents.
- Ventures must use “Chinese themes” in two-thirds of programs — the government will ensure that foreign-invested TV ventures produce original content rather than adapt their overseas programs for mainland audiences.

All such restrictions should be abolished along with other foreign investment restrictions embodied in the June 1995 foreign investment guidelines, which restrict investment, on a wholly owned basis, in other important segments of the film, video and television industries.

*Taxation:* The theatrical and home video industries have been subject to excessively high duties and taxes in China. These levels have a significant impact on revenues and continue to hinder market access. With its accession to the WTO, however, China committed to reducing import duties by approximately one third; duties on theatrical films were reduced (from 9% to 5%) and home video imports (reduced from 15% to 10%). These should be fully and fairly implemented.

*Internet regulation:* To monitor the Internet, economic and telecommunication-related ministries have staked out their turf on the web and have drafted competing regulations that are often vague and inconsistent. The State Council has been charged with creating a clear, effective and consistent Internet policy. Until the State Council completes its work, however, the landscape of existing regulations will remain confusing, with the Internet governed by regulations promulgated by a dizzying array of ministries and agencies. A stable, transparent and comprehensive set of regulations is necessary to guide the development of the Internet and e-commerce in China. China has also attempted to regulate and censor content on the Internet through regulation and technological controls. For example, the State Secrecy Bureau announced in January 2000 that all websites in China are to be strictly controlled and censored. In addition, the State Council set up the Internet Propaganda Administration Bureau to “guide and coordinate” website news content in April 2000. Jointly issued by the State Press Publication Administration and the Ministry of Information and Industry, the Provisional Regulation on Management and Control of Internet Publications became effective August 1, 2002, providing an additional mechanism for the government to intensify supervision of newspapers, periodicals, books and audio-visual content available online. The Ministry of Culture published “Interim Regulations on the Administration of Internet Culture,” effective July 1, 2003. These regulations require that providers of Internet-based content (with any broadly defined “cultural” attributes) receive MOC approval prior to distribution in China. The National Copyright Administration of China will publish regulations on the use of copyright material on the net in early 2005. SARFT also claim governance of certain censorship rights on the Internet.

From a technological standpoint, China maintains firewalls between China and foreign Internet sites to keep out foreign media sites, and regularly filters and closes down Chinese sites that are seen as potentially subversive. In September 2002, for example, both the Google and Alta Vista search engines were blocked without explanation or acknowledgement by the government. While the industry respects the rights of China to ensure that its population is not subject to content that may be questionable under Chinese values, the breadth of China's restrictions on the Internet are unprecedented. Such restrictions will likely limit the growth in the sector and severely restrict the ability of MPA member companies to distribute product via this nascent distribution medium.

**Recording industry:** The recording industry is also severely hampered both in the fight against piracy and in helping to develop a thriving music culture in China by the many and varied market access and investment restrictions that affect the entire entertainment industry, specifically:

*Censorship:* Only legitimate foreign-produced music must be approved by Chinese government censors. Domestically produced Chinese sound recordings are NOT censored. China should terminate this discriminatory process. Censorship offices are also woefully understaffed, causing long delays in approving new recordings. Censorship should be industry-administered, as in other countries. If not possible, steps must be taken to expedite the process so that legitimate music can be promptly marketed, preventing pirates from getting there first. For example, staff shortages must be filled. In the near-term, China should be pressed for a commitment to (1) end discrimination in censorship; and (2) complete the approval process within a reasonable period (e.g., a few days). In the long term, censorship should be abolished.

*Producing and publishing sound recordings in China:* U.S. record companies are skilled at and desirous of developing, creating, producing, distributing and promoting sound recordings by Chinese artists, for the Chinese market and for export from China. However, onerous Chinese restrictions prevent this from occurring. For example, for a sound recording to be brought to market, it must be released through an approved "publishing" company. Currently only state-owned firms are approved to publish sound recordings. China should end this discrimination and approve foreign-owned production companies.

Further, production companies (even wholly owned Chinese ones) may not engage in replicating, distributing or retailing sound recordings. This needlessly cripples the process of producing and marketing legitimate product in an integrated manner. China should permit the integrated production and marketing of sound recordings.

U.S. record companies may market non-Chinese sound recordings only by (1) licensing a Chinese company to produce the recordings in China or (2) importing finished sound recording carriers (CDs) through the China National Publications Import and Export Control (CNPIEC). China should permit U.S. companies to produce their own recordings in China and to import directly finished products.

*Distribution of sound recordings:* Foreign sound recording companies may own no more than 49% of a joint venture with a Chinese company. However, the recently concluded "Closer Economic Partnership Agreement" (CEPA) between China and Hong Kong permits Hong Kong companies to own up to 70% of joint ventures with Chinese companies engaged in distributing audiovisual products. China should grant MFN status to U.S. record producers per the terms of the CEPA.

**Business software industry:** The software industry's ability to increase exports to China — and recoup billions of dollars in piracy-related losses — is severely limited by China's failure to take the steps necessary to create a fair and level playing field for U.S. software developers and other IT companies. As noted in USTR's 2004 Report to Congress on China's WTO Compliance, "China's implementation of its WTO commitments has lagged in many areas of U.S. competitive advantage, particularly where innovation or technology play a key role." Of particular concern to BSA is China's pending software procurement regulation (described above), which would effectively prevent U.S. software companies from selling software products and services to the Chinese government.

The Chinese government procurement market represents one of the most significant growth opportunities for the U.S. software industry, which derives more than half of its revenues from exports. The Chinese government sector is the primary purchaser of software in the world's largest emerging market for IT products. According to a recent study conducted by IDC, the Chinese market will continue to grow at a compound annual rate of 25.8 percent, making it a \$5.1 billion market by 2007. This explosive demand for software and other IT products will be fueled in significant part by government IT procurements.

IIPA is thus deeply concerned about China's plan to close its government procurement market to U.S. software products and services. The U.S. software industry has already lost billions of dollars in export revenue due to China's ongoing failure to address rampant domestic piracy and massive counterfeiting; a ban against government procurement of U.S. software would eliminate the U.S. software industry's most meaningful opportunity to expand exports to China, and would set a dangerous precedent for China's procurement policies in other major economic sectors.

These are not theoretical concerns; U.S. software companies are already experiencing the harmful effects of China's restrictive procurement policy in the marketplace. According to media reports, U.S. companies are being excluded from government procurement deals in several provinces as a direct result of the government procurement law. Thus, China's decision to close or greatly restrict its government procurement market to much of the world's best software products is already translating into losses in export revenues.

China's proposed domestic software preference reflects a troubling trend toward protectionism in the technology sector, which has resulted in a number of industrial policies designed to promote the use of domestic content and/or extract technology and intellectual property from foreign rightholders. If left unchecked, these discriminatory industrial policies would significantly limit imports of U.S. software products into the Chinese market. China's JCCT commitments to legalize government software use and combat software piracy would



therefore be of very limited value.