



## United States Council for International Business

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Ms. Sybia Harrison  
Special Assistant to the Section 301 Committee  
Attn: Special 301 Out-of-Cycle Review Written Comments  
Section 301 Committee  
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### **RE: Special 301 Out-of-Cycle Review**

Dear Ms. Harrison:

This is in response to the United States Trade Representative's Federal Register notice of December 14, soliciting comments in connection with a "Special 301" Out-of-Cycle Review to assess China's actions to implement effectively the commitments it made regarding intellectual property in connection with (1) the Joint Commission on Commerce and Trade, (2) its accession to the World Trade Organization (WTO), and (3) the 1995 bilateral intellectual property agreement with the United States (including additional commitments made in 1996). The United States Council for International Business (USCIB) is pleased to offer its comments on this important subject. USCIB represents over 300 U.S. corporations, professional firms, and business associations, many with substantial trade and investment interests in China.

USCIB believes strongly that improved protection for intellectual property in China will have positive benefits for American companies. It is in this context that USCIB welcomes Administration efforts to help China meet its important obligations in connection with the protection of intellectual property rights. Since acceding to the WTO and taking on obligations in the area of intellectual property rights (IPR) protection, China has made some limited progress in combating copyright piracy and trademark counterfeiting, especially through legislation. However, despite these improvements, piracy and counterfeiting at the wholesale and retail level, and over the Internet, remain rampant due to inadequate penalties, uncoordinated enforcement among local, provincial and national authorities, and the lack of transparency in China's administrative and criminal enforcement system. The patent law has also improved significantly over the past few years, but much work remains concerning implementation.

USCIB notes that Rules on the Determination and Protection of Well-Known Trademarks, Measures on the Implementation of the Madrid Agreement on Trademark International Registration, Measures on the Registration and Administration of Collective Trademarks and Certification Marks, Measures on the Implementation of Administrative Penalties in Copyright cases, and Regulations on the Customs Protection of IPR have been issued recently, which are generally positive developments.

USCIB also notes that at the Joint Commission on Commerce and Trade (JCCT) meetings in the spring of 2004, China made many commitments intended to address U.S. concerns with respect to IPR including: giving new judicial interpretations before the end of the year in an attempt to have strong criminal enforcement of IPR infringements; intensifying a national campaign against IPR infringement; implementing new customs regulations, which came into effect on April 1, 2004, which would increase customs authorities' criminal enforcement actions; accelerating efforts to ratify and join the WIPO Internet treaties; continuing audits to implement the use of legitimate software by government institutions; and conducting public education campaigns on the importance of IPR. We urge USTR and other U.S. government officials to stay closely engaged with the Chinese government to ensure timely action on these important commitments.

We recognize that this discussion is not exhaustive, and that there may be significant issues that our members have not raised with us for various reasons. Similarly, the differences in length and detail provided in the following discussion of specific issues should not suggest that shorter entries are less important than longer entries with more details.

- **Audio Visual Services Concerns**

In the area of audio visual services, China has, per its WTO accession agreement, allowed for minority foreign participation in cinema operations (subsequently revised to allow 75% foreign investment). It has also increased to 20 the number of foreign revenue-sharing films allowed into the market each year. However, the existence of any such quota, along with the lengthy approval process required for each film, only serves to promote the spread of illegal pirated content, as is discussed in greater detail below.

Despite these developments, intellectual property rights violations and the limitations on market access for providing legitimate product into the market constitute the single greatest impediment to the development of a healthy Chinese media and entertainment industry. The situation has hurt not only foreign businesses, but has also left many areas of the domestic industry in a state of general crisis. Without a proper, functioning market where intellectual property rights are respected and laws are enforced, investment will remain depressed, content quality will continue to suffer, and the general population will be left to turn to the black market.

Piracy is worsening in China, whose cities have become open markets for illicit DVDs, VCDs, music CDs, and video games. Although an inefficient enforcement system and low penalties for violators are significant contributing factors, this problem is also partly the result of limits on market access which place legitimate supply far below consumer demand.

Internet piracy has recently emerged as yet another major challenge. Online infringers have used the Internet to distribute a wide range of illegal products that violate copyright protections, particularly those for films. Additionally, the emergence of China as an export country for

pirated DVDS has resulted in thousands of illicit copies of the latest American movies being exported globally, usually via courier companies or express post.

In newspaper and magazine publishing, copyright and trademark protection remains lax, although recently the situation has improved somewhat in the form of successfully prosecuted legal cases. Content is still regularly pilfered from competing sources with impunity, making it both impractical and unprofitable for publications to invest in high-quality editorial content. This, in turn, yields many virtually identical publications, thereby depriving consumers of meaningful choice.

Without a comprehensive approach to this problem, both domestic and foreign producers of media content will continue to perceive China as an unattractive place to make investments. The commitments given by Vice Premier Wu Yi in recent meetings in Washington to take a number of measures to address piracy in China are welcome, but real progress will depend on the successful implementation of these commitments by government agencies and the establishment of an effective interagency coordinating mechanism.

In addition to lax enforcement of intellectual property rights, market access restrictions inhibit the ability of content providers to build a legitimate market and satisfy consumer demand. And although these restrictions affect each sector differently, the situation is most acute in the film and TV markets.

Film import quotas and the tardy distribution of approved film and video products create a vacuum being filled by copyright violators. The failure of China to implement its WTO commitments with respect to customs valuation on entertainment products being shipped to China (basing valuation on subjective criteria of projected revenues or others instead of on the basis of the value of the carrier medium) also increase the costs of getting legitimate product into the country. This negatively impacts the entire value chain of the industry in China, from importation to distribution to exhibition. While total box office receipts in China have declined by 40 percent since the advent of VCD's and DVD's (from 1996 to 2003), the box office in countries with much smaller populations and numbers of screens is far more valuable on a per capita basis than China's, simply because there are few if any restrictions on the number of films that can be imported. The Republic of Korea, with just 40 million people and a third the number of screens in China, has box office revenues more than five times higher than China's in absolute terms and approximately 150 times more valuable per capita. Hong Kong, with a population of just over 7 million, generates almost as much box office revenue as all of mainland China.

A number of actions are needed to build a viable market and to improve market access in the entertainment industry. First, the cap on the number of foreign-revenue-sharing films allowed for exhibition in China each year, which is set at a maximum of 20, should be eliminated, given that an exhibition quota of two Chinese films for each foreign film already exists. China's entertainment market is starved for content and this artificial limit simply drives consumers to the black market to satisfy their desire to see the latest films.

Second, limits on foreign content in television programming in China (25 percent of total dramatic programming, a de facto ban on foreign content during prime time, and restrictions on the availability of foreign channels) should be eased. Chinese broadcasters are working hard to develop a commercially viable industry free of state subsidies, and existing restrictions deprive

broadcasters of access to content with which they could build their business. As China rolls out digital broadcasting and pay-TV channels, there will be a huge increase in the demand for content. Shortsighted policies that limit access to content, handicap the development of the local broadcasting industry.

Third, censorship clearance procedures for optical media should be streamlined. These procedures severely restrict the ability to distribute timely and legitimate CD, VCD and DVD products in China, and provide yet another unfair and unnecessary advantage to pirate producers, who are able to bring their products to market long before legitimate copies are available for sale. This, combined with restrictive licensing policies on retail outlets, which at present require separate licenses in each jurisdiction rather than providing retail chain stores with a national license, severely inhibits the industry's ability to provide consumers with timely access to legitimate products, an important element in the fight against piracy.

With respect to sound recordings, the current investment regime greatly restricts the ability of foreign record companies to enter the Chinese market, and USCIB requests that the Chinese Government reforms its investment and censorship provisions in the music market to facilitate the growth of a healthy record industry in China. While current regulations permit foreign partners 49% ownership in certain joint ventures (JVs), these JVs do not have the right to publish recordings in China, greatly limiting their vitality and resulting in a number of releases that is greatly limited compared to other markets around the world. This seriously inhibits the emergence of a prosperous retail environment and promotes the sale of pirated goods.

In addition, every release in China has to go through a complicated and time-consuming censorship process, which often is an operational nightmare. As with optical media, it effectively limits the number of releases and it gives a further unintentional advantage to the pirates, who are not subject to this process. As a result, the pirates can come to the marketplace before the legitimate industry can, and offer products that were partly or completely banned for distribution by the censorship authorities. If censorship is to be maintained, it must be made more efficient so that it doesn't impair the marketing of legitimate materials and create unintended advantages for the distribution of pirated materials.

- **Copyright Concerns**

Pirated optical media products, CD, VCD and DVD, and counterfeit goods continue to be a major problem, and the piracy rate for optical media products and business software is well in excess of 90 percent. While recent copyright law amendments and regulations made significant progress toward bringing Chinese law into compliance with TRIPS, the law remains deficient in several important respects, including wholly inadequate criminal liability for copyright offenses and overly broad exceptions to protection for computer software.

There is still great need for better coordination between agencies, as well as better coordination between administrative and criminal measures. There have been some successes in bringing civil actions, but deterrent sentencing in criminal courts continues to be ineffective. China's criminal law has rarely been used to prosecute piracy because of the high thresholds for criminal liability established by the People's Supreme Court in its interpretations of the criminal copyright provisions, but USCIB notes that China promulgated a new judicial interpretation on

Dec. 21 that lowered the criminal thresholds for IPR offense punishments. For example, if an individual brings in a minimum of RMB30,000 (USD3,600) in illegal gains [down from RMB50,000] or RMB50,000 (USD6,024) in illegal business volume [down from RMB200,000] from infringing on copyrighted works or reproduces more than 1,000 illegal copies, the individual is eligible for a prison term of no more than three years, while reproduction of more than 5,000 copies calls for a mandatory three-year minimum prison term. However, such thresholds still place a heavy burden on enforcers and, in a seeming oversight, sound recordings are not included in reproduction thresholds. Moreover, illegal business volume is calculated using the price of the infringing work instead of the price of the genuine work. It is unclear how to prosecute repeat offenders and how the thresholds apply to online piracy. Even with the lowering of the criminal thresholds, effective enforcement will not become a reality if there is inadequate attention, investment and training by the Public Security Bureaux (PSB). The PSB needs to treat criminal enforcement of IPR offenses as a top priority. Enforcement remains slow, cumbersome and rarely results in deterrent fines. Although Chinese authorities have undertaken some administrative enforcement actions against pirates, the government's refusal to share information about the activities of CD plants or the ultimate outcomes of these actions makes it very difficult for rightholders to assess the deterrent impact of China's enforcement efforts.

With respect to software, the Copyright Administration (CA) has administrative authority to do surprise audits of companies suspected of using illegal software, but CA offices are reluctant to exercise their authority and are plagued by inadequate manpower, training and resources. Moreover, when they do take action, most of the CA offices have been unwilling to issue a formal punishment with deterrent penalties. In the case of civil enforcement, courts are also reluctant to issue decisions in corporate end user infringement cases, instead urging the parties to settle. Civil enforcement is also far from predictable, due to an uncertain evidentiary standard to support an evidence preservation order. To date, there have been very few instances of an evidence preservation order executed against a corporate end user. Finally, organizational end user piracy should be clarified as a criminal offense to allow for prosecutions against software piracy on a commercial scale and penalties must be high enough to actually deter further infringement.

With respect to online piracy, there need to be express limitations on liability protecting ISPs, including for network conduit functions, caching, hosting, storage and information location tools, as are found in the Digital Millennium Copyright Act of 1998, as rightholders adopt new business models for online distribution of music, movies, software and other copyrighted content. The manufacture and trade in circumvention devices, components, and service should be expressly prohibited and there should be adequate protection against unlawful circumvention of "copy controls" and "access control." China urgently needs to update its Copyright Law by speeding up the drafting process of the Internet regulations by the State Council to bring China in adherence with the WIPO Internet treaties in order to effectively deal with online piracy and create a safe online environment for electronic commerce.

- **Trademark and Counterfeiting Concerns**

For branded products, trademark protection is crucial to maintaining high-quality goods and services in order to build and strengthen customer loyalty. Counterfeiting damages the reputation of companies; compromises the safety and quality of products (which affects Chinese

as well as foreign consumers); results in the loss of tax revenue to the government; and harms China's reputation among foreign companies as a desirable place to do business.

Another challenge faced by major U.S. brand holders is that China only very rarely grants "Well Known" or "Famous Mark" status under Article 6bis of the Paris Convention to non-Chinese trademarks/brands. (This article provides that contracting countries agree to refuse or invalidate a trademark that creates confusion with a mark considered by the competent authority of the country of registration to be well known as a mark of a national of another contracting country.)

In addition to an appropriate legal regime that guarantees trademark integrity, an adequate IPR system must include an effective enforcement mechanism. Transparency is a vital component of this mechanism. Transparency not only increases the confidence that U.S. business has in the viability of the Chinese market, it also decreases the opportunities for corruption.

The following are examples of lack of transparency in the area of trademarks:

- **Bond Requirements:** When Chinese Customs authorities seize counterfeit goods, the U.S. trademark holder is obligated to pay a bond. It is unclear how government officials determine the amount of this bond. In some cases, the amount must be negotiated with government officials. The amounts under consideration can be quite substantial. In fact, they can be large enough to preclude even major U.S. corporations from operating in the Chinese market. Exporters need published guidelines on the basis that Chinese government authorities use to calculate such bond amounts. Clear, published guidelines will provide certainty and will facilitate the financial planning required to undertake commercial operations in the Chinese market.
- **Unexpected Storage Costs:** U.S. corporations are unexpectedly assessed fees for the storage of seized counterfeit goods. As with the bond amounts, there are no clear guidelines on the circumstances under which such fees will be assessed, no prior arrangement for such assessments, and no indication of when payment of such fees will be required. The imposition of uncertain storage fees without prior notice or advance agreement undermines the ability of U.S. business to address the Chinese domestic market effectively. Uniform requirements in a clear, published form, are essential.
- **Patent Concerns**

Although China has put into place a legal and regulatory framework that is substantially in compliance with TRIPS, implementation of those regulations is inadequate. Local public officials evince a stronger interest in protecting their local economy than in policing IPRs and have been known to act uncooperatively in patent infringement suits. Moreover, attempts to enforce patent rights through patent administrative departments are largely ineffective because the administrative agencies only have the power to stop infringements in their local territories and because they act slowly, cannot collect damages and suffer from a lack of transparency. Enforcement actions through the court system are generally more effective, but damages are not calculated in such a way as to compensate all the actual expenses of a rightholder in stopping infringing acts. Procedures for evidence exchange where trade secrets are alleged are not fully defined, and courts have referred matters to appraisal panels without input from parties involved,

despite the clear TRIPS mandate that parties are entitled to see any evidence used to determine their rights. A 2003 Chinese Supreme Court case overturning a high court decision related to an appraisal conclusion based on evidence withheld from the opposing party and holding that parties must have an opportunity to review and challenge relevant underlying evidence, however, may herald improvements in this regard.

Further, while patent infringement is decided through the judicial process, patent validity is decided at the Patent Reexamination Board (PRB) of the State Intellectual Property Office (SIPO). While many countries separate the infringement and validity determinations in a similar way, the PRB has accepted challenges to validity based on arguments already decided during the original patent examination process, and has permitted multiple, simultaneous challenges by the same party, making enforcement and defense of valid patent rights difficult. Moreover, the PRB has improperly generated and applied its own patentability standards that are more restrictive than those in the Chinese Patent Law and Implementing Regulations.

USCIB member Pfizer Inc. has recently had its patent on the use of the active ingredient in Viagra invalidated in China. The decision appears to create and impose standards of patentability that are inconsistent with TRIPS Article 29.1. Moreover, this raises concerns that limiting patentability in such a way subsequent to WTO entry is violative of TRIPS Article 70.2.

The use of the patent system to thwart originator-proprietary companies is also troubling. Some companies, including USCIB member Baxter Healthcare, have faced the situation where a local manufacturer has obtained patents on a foreign company's commercial products in addition to knocking off the product. This has caused the originator-proprietary company to expend time and money to invalidate the pirate's patents. A great deal of effort is required by the administrative agency to prove beyond reasonable scope the invalidity of the patent.

As for design patents, some infringers obtain a design patent registration based on a copied product designed by utilizing the non-substantive examination system in China, and insist the legality of their infringing conduct based on the invalid design patent right, notwithstanding the existing procedures available to invalidate such design patents. In regulated product areas such as pharmaceuticals, there is no linkage between the regulatory agency and the enforcement of patents. Thus, the State Food and Drug Agency approves generic versions of patented medicines without regard to the patent protection that covers the product.

Finally, the judicial enforcement system lacks transparency. All courts should follow the same rules and guidelines, and decisions should be published so that companies can learn how the rules and guidelines are implemented.

In addition to enforcement concerns, foreign companies face impediments to technology licensing. The "Regulations on Technology Import and Export Regulation" of January 1, 2002 define the procedures for technology licensing contracts between a Chinese company and a foreign company. There have been many criticisms, however, that these regulations impose unfair burdens on foreign licensors, requiring them to make excessive warranties.

- **Trade Secrets and Protection of Confidential Test Data**

Enforcement of trade secrets is very difficult because the evidentiary burden is very high, ability for discovery is minimal and local protectionism can be a serious obstacle. Foreign companies are often reluctant to transfer key trade secrets into China because of the serious threat of misappropriation by competitors and employees and the near impossibility of enforcement. The legal infrastructure for the enforcement of trade secrets (including breaches of contracts including confidentiality provisions) needs to be significantly strengthened. In addition, although China's State Drug Administration issued regulations to implement China's commitment to provide six years of data exclusivity pursuant to TRIPS Article 39.3, protection of such data provided to the government from 'unfair commercial use' is inconsistent.

## Conclusion

We appreciate the opportunity to express our concerns about China's intellectual property obligations and trust they will be useful in the Administration's on-going efforts to encourage China's improvement of intellectual property protection. USCIB stands ready to meet with U.S. agencies to discuss our recommendations and concerns at greater length.

Yours truly,



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