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September 17, 2004

Ms. Gloria Blue
Executive Secretary
Attn: China WTO Written Comments
Trade Policy Staff Committee
Office of the U.S. Trade Representative
1724 F Street, N.W.
Washington, D.C. 20508
FR0437@ustr.eop.gov

RE: China's WTO Obligations

Dear Ms. Blue:

This is in response to the United States Trade Representative's Federal Register notice of July 29, soliciting comments concerning China's compliance with the commitments it made in connection with its accession to the World Trade Organization (WTO). 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.

General

During the long negotiations leading up to China's entry into the WTO in December 2001, USCIB took the position that bringing China in under commercially viable terms represented a giant step forward for the entire global trade system. Broadening the reach of common trade rules is advantageous to all WTO members, but especially to the United States as one of the world's largest exporters. USCIB continues to believe that improved access for U.S. goods and services in China will have positive benefits for American companies, agricultural producers, and workers. It is in this context that USCIB welcomes Administration efforts to help China meet its obligations under the terms of its accession agreement over the past three years, thereby facilitating China's smooth transition into the WTO system.

We appreciate the resolutions that have been achieved over the last year to previous issues that we have raised regarding China's WTO commitments. We welcome the resolution on the discriminatory value added tax on semiconductors that was reached between the U.S. and China in July 2004. We understand that China will not certify any new semiconductor products or manufacturers for eligibility for VAT refunds, and China will no longer offer VAT refunds that

favor semiconductors designed in China. And, by April 1, 2005, China will stop providing VAT refunds on Chinese-produced semiconductors to current beneficiaries.

At the same time, USCIB welcomes China’s decision this spring to open its distribution sector to foreign investment, in accordance with its WTO commitments. Until this year, foreign investment in wholesale operations was generally forbidden in China and the retail sector was subject to carefully controlled experimentation by the central government. Under special approval, foreign-invested retail outlets had to be set up as joint ventures and their number and location were precisely regulated. Effective June 1, 2004, however, new regulations issued on April 16 will permit majority-owned foreign-invested enterprises to distribute imported and locally-manufactured products through integrated wholesale, retail and franchise systems for the first time. Foreign firms will also be able to provide a host of related services, including storage, warehousing and garage services, inventory management, repairs, maintenance, training and delivery. Wholly-owned foreign enterprises, including those already established in China, will be permitted to engage in these activities after December 11, 2004. After this date, all geographical restrictions will finally be lifted, including those confining foreign-invested retail operations to major cities, and limits on the number of retail outlets will be abolished. Effectively implemented, these regulations promise to greatly enhance the ability of our companies to distribute both imported and locally-manufactured goods efficiently within China and to provide a wide range of related logistics services. This, in turn, will allow foreign firms to greatly streamline their China operations and raises the possibility of fully integrating their China business with their global distribution networks. Although we understand that certain sectors, including the automotive and pharmaceutical sectors, will be the subject of separate regulations, we encourage the Chinese government to extend liberalization to these industries in the same manner and ahead of the December 2004 WTO-mandated target date.

Members of USCIB have raised numerous compliance issues with us, and we therefore direct your attention to the specific issues discussed below, which include the following:

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Annex I Transparency in Rulemaking

Annex II Telecommunications (Basic and Value-Added)

We recognize that this discussion is not by any means 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.

Compliance Issues

Anti-Dumping

USCIB urges the Chinese government to incorporate transparency and procedural fairness into the anti-dumping process. USCIB remains concerned that anti-dumping cases at times are being utilized as means of domestic protectionism, without appropriate opportunities for business to comment and input to the government's deliberative process.

Audio Visual Services

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.

The publishing industry has also witnessed important regulatory reform. In March 2003, China issued the *Measures on the Administration of Foreign-Invested Distribution Enterprises of Books, Newspapers and Periodicals*, which became effective on May 1, 2003, and which allow wholly foreign-owned enterprises in publication retailing. The Measures also allow all forms of foreign investment in wholesale distribution from December 1, 2004.

Finally, China has published guidelines permitting the injection of private equity into publishing enterprises, which were previously controlled exclusively by state entities. Although this liberalization is limited, for the present time, to domestic Chinese private investment, it may be indicative of further moves toward the introduction of market forces (including foreign investment) in this sector.

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. The increase in broadband penetration in major Chinese cities has fueled the rise of 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.

Computer and Related Services

China's accession protocol to the WTO included commitments to liberalize certain sub-sectors of computer and related services upon accession, namely:

1. Hardware consultancy - full commitments for this subsector;
2. Software implementation - mode 3 requires a joint venture for market access with foreign majority ownership permitted;
3. Data processing - full commitments for this subsector;

USCIB welcomed those commitments. However, there is confusion regarding their implementation. This confusion, which is not unique to China, is due largely to the overlap between the classification of certain sub-sectors of Computer and Related Services and Value-Added Services. In general USCIB believes flexibility on classification is necessary given rapid technological advances. In China, the confusion noted above has resulted in some Internet-delivered Computer and Related Services being defined as Value-added Telecom Services, which are subject to a higher level of control, which could have a negative impact on the growth of the IT industry in China. USCIB members seek full market access and national treatment commitments in both Computer and Related Services and Value-added Services so as to ensure that commitments and classification schemes, such as the GATS, are flexible enough to accommodate technological advances and the evolution in the delivery of services. It is important to note that USCIB does not support revisiting the existing w/120 classifications.

Customs Valuation

China made commitments that Customs valuation would be consistent with GATT AD 4.1 for all products within two years of accession. With respect to digital products, in particular, Customs valuation is to be based on the value of carrier medium, and not on another standard.

Unfortunately, Customs valuation in China continues to vary by Customs office for the same product, with duties for certain products (such as equipment used for CD and DVD production) being assessed based on arbitrary values for the product, or on its potential output, rather than being valued consistent with GATT AD 4.1 on the carrier medium. In fact, any attempt to assess tariffs based on a valuation which includes intangible elements, such as intellectual property recorded on hardware or software, or presumptive values which are inconsistent with transaction value, represent a departure from the undertakings of the WTO Valuation Code.

Several additional concerns about the practices of China Customs on the valuation of digital products include the following:

- China Customs in many localities maintains that the “right to produce” and the “right to use” are synonymous, despite the fact that the WTO Valuation Code states that the “right to use” is a dutiable charge and the “right to produce” is not.
- China Customs is attempting to charge royalties and license fees on imported software even though the WTO Commentaries say that they are not applicable to 4.1.
- China Customs has not adequately defined "condition of sale," leaving the door open to misuse and inconsistent interpretation at the borders.
- China Customs is struggling with inconsistencies between the Decision 4.1 for duty purposes and the requirement to present the customs declaration (with full declared value) in order to remit currency out of the country.
- We have received reports that China Customs is leaning towards excluding pc games from the 4.1 valuation ruling.

Discriminatory Consumption Tax

For certain product categories, the Chinese government engages in a taxation practice that reduces the value of that country's tariff concessions and puts imports from the United States at a marked disadvantage vis-a-vis their Chinese competition. The consumption tax calculation for certain imports and their locally produced competitive counterpart differs materially, resulting in importers paying twice as much as they would if the tax were assessed at the same rate as for China-produced products.

Government Procurement

Since 1996, China has been steadily working to reform its government procurement regime to bring it more strongly in line with global norms in areas such as transparency, fair competition, national treatment, accountability, and Value for Money (VFM). At the same time, when China joined the WTO, it simultaneously became an observer to the WTO's Government Procurement Agreement (GPA) and committed to begin accession negotiations "as soon as possible" thereafter. China also passed a new Government Procurement Law, effective January 1, 2003, which further attempts to establish a predictable and stable market for government procurement that is strictly and efficiently administered by Chinese authorities. USCIB welcomes an open and transparent procurement regime and encourages Chinese officials to see that such rules and practices are put in place at regional and local levels of government as well.

China's 2003 Government Procurement Law, however, also requires that China's government purchase only domestic goods, works and services, with limited exceptions. Although important questions as to the nature and extent of the requirement remain, and basic definitions (for example, "domestically produced") are still unclear, USCIB believes that measures of this kind represent a significant retreat from the progress China has made in the area of government procurement since the mid-1990s, as well as the spirit of openness China embraced when it joined the WTO. China is presently developing sector specific regulations for software procurement, which could roll back market access for an important market that U.S. and other foreign software makers have enjoyed for some time. We are also concerned by reports that Chinese officials do not always recall that China agreed that state-owned enterprises would not be treated as government entities for the purpose of government procurement exceptions to national treatment obligations. We urge USTR and other U.S. government officials to monitor this situation closely and to engage the Chinese on this issue to ensure transparent and non-discriminatory market access to China's government procurement market.

Insurance

Industry-Regulatory Dialogue

We applaud industry and regulatory efforts in December of 2002 to establish a regular dialogue on important policy issues affecting the insurance industry in China. Unfortunately, only one such session, focused primarily on capitalization requirements, has occurred. We encourage the China Insurance Regulatory Commission (CIRC) to resume and intensify dialogue between Chinese regulators and industry, on the one hand, and U.S. regulators, government officials and industry on the other. While not limited to the following issues, key topics for such dialogue should include clarification on branching rights for non-life insurance companies, national

treatment for branching and product approval, and greater transparency throughout the rule-making process. The issue of excessively high capitalization requirements should also be revisited in light of recent regulatory changes.

Guaranteed Branching Rights for Non-life Companies

Prior to China's WTO accession, a number of foreign insurance companies were allowed to establish operations in the PRC. All of these companies were requested by the Chinese government to register as operational branches, not as subsidiaries. However, in both the administrative regulations and the rules on foreign-invested insurance companies – the CIRC's only rules covering branching -- no article appears to address the maintenance and development of these branch operations. Instead, the CIRC has encouraged branch operations to convert to subsidiaries. Regulations should be developed to govern those branches already established in China and such future branches that may be established in China. We recommend that these regulations conform to the internationally accepted branch/sub-branch operating structure.

The guaranteed branch/sub-branch structure is a well-established international norm appropriate for application in China. Unlike subsidiaries or investments in a host-country insurance company, branches legally are part of the foreign insurer itself. All policies and liabilities of branches are backed by the full asset base of the parent corporation, not just those of the subsidiary. As such they should not have to provide regulatory capital. In addition, the funding of a branch is facilitated by the fact that it has the same credit rating as its parent, because the parent is fully liable for the branch. Finally, if the host country's insurance supervisor bases prudential ratios on the foreign insurer's total assets, a branch may be less restricted than a subsidiary in supplying scarce and valuable insurance services (e.g., covering large and difficult risks) on a competitive basis in the host country economy.

National Treatment for Branching

Foreign companies should receive the same treatment as their domestic counterparts with regard to branch and product approvals. Relevant provisions in the administrative regulations (Articles 27-33) and the rules on foreign-invested insurance companies (Articles 14-19) are silent on how many branches a company may apply for at one time and whether requested branch approvals will be granted consecutively or concurrently. Domestic companies routinely receive branch approvals on a concurrent basis, even when first establishing their businesses in China. In contrast, no foreign insurance company has received branch approvals on a concurrent basis, including when first establishing their business in China. This is discriminatory and inconsistent with China's national treatment obligations under the WTO, and greatly disadvantages foreign companies' ability to grow their business, establish a nationwide network of branches and sub-branches, and build other distribution networks throughout China.

USCIB acknowledges that new regulations now clearly provide that branches may be established at the provincial-level without the need to secure the CIRC's approval for multiple branches in the same province. Industry would appreciate greater clarity regarding the exact procedures for establishing branches, including subsequent sub-branch approvals and whether sub-branches may be established on a concurrent basis.

Capitalization Requirements

The most notable, positive change in the recently released regulations has been a substantial lowering of capitalization requirements for initial establishment (minimum of RMB200 million

up to RMB500 million; previously RMB200 million up to RMB 1.5 billion) and branching (RMB 20 million; previously RMB 50 million), putting them closer to international norms for some products and business models. Although still considered too high by many, the industry appreciates the CIRC's engagement on this issue as well as consideration of research on international best practices.

Nevertheless, we maintain that an initial requirement of RMB200 million, and RMB20 million for each additional branch up to a cap of RMB500 million (providing all solvency issues have been addressed in any subsequent efforts to expand), are too prescriptive in nature and still much higher than international norms for many lines of business. In fact, according to a study presented to the CIRC in 2003, the capitalization requirements for insurance operations in China – even under the new rules - appear excessive in relation to 11 Asian jurisdictions, the United States, and the European Union. High capital requirements are not an efficient way of ensuring financial solvency and they prevent the efficient use of scarce capital, thus hindering the sound development of China's insurance market. In the end, it is the Chinese individual and commercial consumers who will ultimately be hurt by these constraints.

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.

- **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 made a commitment at the JCCT meetings this spring to promulgate a judicial interpretation before the end of 2004 that would allow its authorities to effectively use its criminal enforcement regime to address IPR issues. Enforcement is 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, CA offices in Beijing and Shanghai 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.

- **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.

Postal Law

Although the Chinese government has adopted some recommendations from the express industry as witnessed in the most recent draft amendments to China's Postal Law in July 2004, there are still several problems that need to be addressed as the draft has become more restrictive and discourages competition in express delivery services. The draft amendments to China's Postal Law not only add new licensing requirements, but they expand the scope of the postal monopoly in contravention of China's WTO commitments. Parts of the proposed draft amendment include wording that would discriminate against foreign enterprises and would likely be in violation of the WTO's fundamental principle of national treatment, as well as conflict with China's WTO commitment to open the courier business to wholly foreign-owned enterprises in 2005.

USCIB urges USTR and other U.S. government officials to monitor this situation to ensure that any changes in the Postal Law are consistent with China's WTO commitments, including the horizontal commitments under GATS. The creation of a new monopoly, a new tax in the form of the universal service fund, and a new licensing requirement are all potential WTO violations.

Trading and Distribution Rights

China made important commitments to phase in trading and distribution rights for all firms, whether domestically funded or foreign invested, within three years of accession. USCIB views the right to import and export products, as well as to distribute imported products through wholesale and retail systems and to provide related services (after sales service, repairs, maintenance and transport), as central to the meaning of WTO membership. Acquiring the ability to trade, distribute and sell goods themselves will allow U.S. firms to greatly streamline their China operations and eventually, integrate them into their global networks.

As earlier noted, China took important steps this spring in passing regulations that would open up its distribution sector to foreign investment, in accordance with its WTO commitments. Although we understand that certain sectors, including the automotive and pharmaceutical sectors, will be the subject of separate regulations, we encourage the Chinese government to extend liberalization to these industries in the same manner and ahead of the December 2004 WTO-mandated target date.

Transparency

There is still not sufficient transparency with respect to China's implementation of its commitments, despite the fact that enquiry points have been established as required by the Protocol and Working Party Report. For example, MOFCOM continues to wage battles internally with other ministries as to the interpretations of China's commitments and the necessary implementation requirements. China needs, therefore, to ensure that MOFCOM or another State Council unit is given authority to make a final interpretation of WTO commitments and to ensure implementation consistent with this interpretation.

China also agreed to allow for a reasonable period for public comment on most categories of new and revised laws and regulations relating to foreign trade and to regularly publish such measures in one or more of the WTO languages. This commitment strongly reflects the fact that transparency is a crucial element to creating a stable and predictable environment for foreign investment. Yet U.S. firms continue to be blindsided by new measures without notice and prior to any meaningful consultation with those most affected. In certain instances, Chinese agencies and ministries seem to view their obligations to comply in the most nominal of terms, allowing a hasty and poorly publicized comment period to go forward shortly before new rules are announced and go into effect. This situation is exacerbated by deficiencies in Chinese-agency capacity to support robust notice and comment practices. Experience elsewhere has shown that allowing for an adequate public comment period prior to final decisions on regulation tends to lead to better a regulatory framework and enforcement. If the views of business and other interests are solicited and taken into consideration during the drafting process, and if the Chinese government provides its agencies with the staffing and training to support this process, fewer problems will occur during implementation and the overall level of compliance will improve. Common problems encountered in China stemming from the lack of transparency in rulemaking are illustrated by several examples attached as Annex 1 to this document.

Telecommunications (Basic and Value-Added)

USCIB members welcomed China's commitments on basic and value-added telecommunications. Our members have identified several issues regarding China's compliance with its commitments. Please see the attached Annex 2 for more details.

Conclusion

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

Yours truly,



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President
United States Council for International
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ANNEX 1: TRANSPARANCY IN RULEMAKING

Common problems encountered by USCIB members in China stemming from the lack of transparency in rulemaking are illustrated by the following examples from the area of environmental regulation.

1. Rulemaking practices in China still favor the use of government agency-approved academic and technical experts who are often unable to impart into the rulemaking process the full range of industry experience relevant to a particular issue. Thus, many rules present very challenging compliance situations to foreign investors.

- Example: China Compulsory Certification (CCC) product quality marking regime. Exemptions from the marking requirements are available for certain products. However, in many cases, companies must apply for these exemptions and the exemptions must be renewed *each* month.

2. Insufficient industry input into the rulemaking process also facilitates the creation of product standards that are based on Chinese or other national models. In so doing, the resulting standard may prohibit from import products that do not conform to these models.

- Example: The use of Chinese food products as the models for chemical content in certain standards included in the “Circular on Seeking Comments on the ‘Hygiene Standard for Raw Milk,’ [and other standards in a total of] 90 National Standards” (MOH) (pending).

3) Lacking insight into the realities of business, Chinese rulemakers often develop regulatory requirements that are aspirational in nature. This approach can serve as a barrier to compliance, especially for companies with U.S.-type compliance cultures.

- Example: The Regulation on Mercury Content Limitation for Batteries (promulgated Dec. 31, 1997) sets 1 ppm mercury content restriction for certain battery chemistries. Chinese law drafters involved in the development of this Regulation indicated that one of their key goals in setting the very low mercury-content restriction was to spur local industry to reduce battery mercury content. However, the 1 ppm limit actually requires manufacturers to reduce the limit of mercury in batteries subject to the rule *below natural background levels*, a very aspirational limitation indeed.

4) Often, a significant period of time passes before key implementing measures and documents are issued that enable compliance with a particular Chinese law.

- Example: October 18, 2002, the State Economic and Trade Commission (SETC) (now disbanded) issued Regulations on the Registration of Dangerous Chemicals, Regulations on Licensing for Business and Sale of Dangerous Chemicals, and Regulations on the Manufacturing of Packaging and Containers for Dangerous Chemicals. These regulations entered into effect November 15, 2002. However, the implementing rules for these laws

were not released until November 21, 2002, and the associated registration/license application forms were not published until January 2003.

ANNEX 2: TELECOMMUNICATIONS

China has made no meaningful progress towards complying with its WTO telecommunications commitments in the past year, so many of our comments will of necessity be repetitive. There are reports that a long-awaited Telecom Law is making its way through the Chinese bureaucracy, and that provides a modicum of hope that China may take such steps as overhauling its licensing regime and establishing an independent telecom regulator. Offsetting this apparent development, there has been regression in other areas such as the regulation of value-added services. In most other liberalizing countries, the concept of value added services was introduced as a way to open up the telecom market to competition. By contrast, China has become more conservative with the concept of basic versus value added services since WTO accession, shuffling some very important value-added services into the highly protected basic category. It would be an improvement if the pending law were to replace these conservatively applied vertical service classifications with more objective and transparent guidelines for Type I (facility-based) and Type II (non-facility based) services. China has the opportunity to demonstrate its commitment to both liberalization and to transparency by making the draft law available for public comment well in advance of adoption. Further, China should seize this opportunity to grant equivalent national treatment to both domestic and foreign investors, boldly taking advantage of the gains that an open telecom market can bring to the economy as a whole.

China's WTO commitments to liberalize telecommunications services became effective upon its accession to the WTO on December 11, 2001. These commitments include a six-year schedule for phasing in direct foreign participation in value-added network services and basic telecommunications. China also agreed to be bound by the obligations in the Reference Paper to establish an independent, impartial regulatory authority and a pro-competitive regulatory regime. USCIB recognizes and appreciates the positive steps China has taken to implement its WTO commitments. However, China's overly narrow interpretation of market access opportunities for foreign participants and a lack of an independent regulator have negatively impacted market opportunities for U.S. telecommunications companies, contrary to China's WTO commitments. We are especially concerned by China's unreasonably high capitalization requirements for basic services, which will greatly limit market access.

High Capitalization Requirements: In 2003, China's regulator, the Ministry of Information Industries (MII), reclassified several international value-added services as basic services. This action had the undesirable effect of delaying until December of 2004 the ability of foreign entrants to offer these services, thus subjecting any would-be entrant to the excessively high capitalization requirements placed on new basic services providers. This reclassification has had an unwelcome market constraining effect. A basic services license, when available for application by foreign invested joint ventures in late 2004, will be subject to a 2 billion RMB (US\$250 million) capitalization requirement, or 100 times the capital requirement for value added service licensees. USCIB considers the existing capitalization requirement in basic services an excessively burdensome and unjustified restriction that violates Article VI of the GATS. The requirement was effected by State Council Order No. 333 of December 11, 2001, the day of China's accession to the WTO, and "could not reasonably have been expected" when

China made its commitments, as stipulated by Article VI 5 (a)(ii). A narrowly tailored performance bond would be sufficient to address any existing concerns. In addition, the approval process for equity joint ventures is cumbersome and lengthy: four separate government authorities are required to approve such ventures pursuant to a long and complicated process.

Market Access: Presently, market entry is being delayed by the MII's extremely narrow views of what constitutes a value-added service for purposes of international value added network service licensing. The regulator has construed the meaning of value-added services in its WTO commitment schedule so narrowly that any meaningful offerings, such as IP-VPN services demanded by global enterprises, are excluded. The Catalogue of Telecommunication Services defines basic and value-added services in a manner that discourages and severely limits new providers from entering China's telecommunications market. The narrowing of the scope for value added services represents a counter-liberalization trend inconsistent with China's WTO commitments. For example, it limits virtual private networks to "domestic" services, and deletes "resale" services.

The June 2001 edition of the Catalogue had listed VPNs under Internet and data transmission value added services, but the latest revision allows value added service providers to offer only "domestic" VPN services. By contrast, China's WTO commitment makes no distinction in treatment between domestic and international services with value added service characteristics, such as VPN applications. Foreign investors are not only precluded from offering basic telecom services until December 2004, at unreasonably high pre-qualification market entry costs, but they are also allowed to do so only in partnership with a licensed basic services carrier. China is nearing the end of its third year of WTO membership, yet unfavorable market conditions continue to make foreign companies wary to apply for licenses. To our knowledge, no foreign companies have been licensed to provide value added services in the areas identified in the schedule of commitments. Due to a lack of transparency in the application process, USCIB is unaware if this is due to a lack of applications from foreign providers or to rejected applications. According to the schedule, by 2004 China is obliged to permit value added service joint ventures with no geographic limitations, but has failed to license any foreign carriers to do so. It is imperative that China phase out its geographical and ownership restrictions strictly according to its schedule of commitments.

Independent and Impartial Regulator: China is far from achieving its Reference Paper Section 5 commitment to establish an independent regulator. The Chinese Government owns and controls all of the major operators in the telecommunications industry, and the MII still occupies dual roles as protector of state enterprise operators and as industry regulator. The pending Telecom Law could improve this situation by mandating a regulatory body that is organizationally separate from government agencies that are focused on developing the state-owned telecommunications industry. Because this new law has been pending for a long time, finalizing and adopting it should be a top priority for the government. Interested parties must also be provided a reasonable period for review and comment on the Ministry's regulations and decisions as required by China's accession documents. Virtually no notice was given, and no comments invited, before the revised Telecom Catalog went into effect last year.

USCIB encourages USTR and others in the U.S. Government to place a high priority on working with China to establish a regulatory body that is separate from, and not accountable to, any basic telecoms supplier, and that is capable of issuing impartial decisions and regulations affecting the telecoms sector. In this context, it is important that the regulatory body adopts the following:

- transparent processes for drafting, finalizing, implementing and applying telecom regulations and decisions;
- appropriate measures, consistent with the Reference Paper, for the purpose of preventing major suppliers from engaging in or continuing anti-competitive practices;
- a defined procedure – as it has done for interconnection -- to resolve commercial disputes in an efficient and fair manner between public telecom suppliers that are not able to reach mutually acceptable agreements;
- an independent and objective process for administrative reconsideration of its decisions; and
- appropriate procedures and authority to enforce China's WTO telecom commitments, such as the ability to impose fines, order injunctive relief, and modify, suspend, or revoke a license.

At present the regulatory environment in China is discouraging new entrants from participating. This will continue until foreign investors have confidence that China has a clear intention and a demonstrated plan to implement its WTO commitments.

Geographic Restrictions: Notwithstanding the business model of the Internet, MII has at times suggested that a commercial presence must be established in each city where customers will be located, and that an inter-regional service, based in one city but serving customers in another, is not permitted. Such an interpretation is inconsistent with the global model of how value-added, non-facilities based Internet service providers are structured, and imposes geographical restrictions that make an inter-regional, or national scaled business model non-viable. The impact of this interpretation is to negate the benefits accorded to foreign value-added telecommunications providers under the WTO agreement.