

**Testimony**  
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Mr. Chairman and Members of the Commission, thank you for the opportunity to appear before you today to discuss the long-standing issue of how to assess China's intellectual property regime and, most importantly, its current enforcement policy, and to explore possible strategies for positively impacting both China's WTO compliance and its bilateral obligations with the United States.

If I had to characterize the last decade in terms of these issues, the first point I would make is that while there has been significant progress in dealing with the production for export, that local enforcement issues have remained relatively constant. There has been some progress, most notably improvement in the legal structure itself, but this has done little to expand the commercial opportunities for US record companies in China. Enforcement remains a serious problem and, as a result, China continues to be a marketplace dominated by pirated recordings despite a sporadic increase in the number of raids undertaken and the hundreds of millions of discs seized. Secondly, there continues to be a number of market access barriers that prevent timely entry for many U.S. and other foreign recordings-again, despite an increase in the number of titles that are officially sanctioned for release.

I will return to my conclusions in greater detail but I want to address directly the questions raised by the Commission's letter of invitation.

1. What is the overall assessment of compliance with WTO's IPR rules? What, if any, changes have occurred over the past year and what are the prospects for the future?

There has been some improvement, particularly with long-awaited issuance of the new Judicial Interpretations governing criminal actions, but a definite verdict over whether this will have meaningful results will have to await actual implementation-the real litmus test is effective enforcement and it is one China has historically failed to meet.

As you know, the TRIPS Agreement is basically divided into two parts: the substantive standards (e.g. what rules must be in a copyright law) and effective enforcement. For the most part, China is now in compliance with the standards test. However, it is not in compliance on a number of counts in regard to effective enforcement.

For example, the enforcement section of TRIPS sets out a general set of obligations, beginning with the following from Article 41: “members shall ensure that enforcement procedures...are available under their law so as to permit effective actions against any infringement...covered by this Agreement, including expeditious remedies...which constitute a deterrent to further infringements.” China’s failure, in terms of effective enforcement, centers on its historic and continued reluctance to apply the necessary measures to deter piracy. Simply put, episodic raids and seizures, no matter how successful, will not result in any notable declines in pirate production. Pirates, without facing serious penalties, will simply view raids and seizures as a cost of doing business—and piracy is a very profitable business.

Another and related example, is China’s failure to comply with Article 61, which specifically requires criminal penalties “in cases of willful trademark, counterfeiting or copyright piracy on a commercial scale.” As I noted earlier, China has enacted the necessary laws—the appropriate remedies are on the books. Yet, with very, very rare exceptions, there have been extremely few prosecutions and convictions for copyright piracy. China has persisted in defining “commercial scale” in such a way as to make it highly unlikely any pirate with common sense will be caught in its net as a punishable criminal offense. Even with the recent Judicial Interpretations, the thresholds for a criminal prosecution are likely to continue to prove difficult to meet. Thresholds may be an appropriate test in determining the level of punishment, but they are inappropriate test in determining whether a criminal offense has been committed.

Moreover, China requires that its criminal code remedies are only available in those instances where the pirate is making a profit. Ironic, isn’t it, that the concern is the pirate’s profitability and not the fate of the legitimate business. In addition, the profit test is actually more difficult to meet than the commercial scale requirement. For example, someone intentionally posting online a single copy of a copyrighted recording, without authorization, will cause serious economic harm on a commercial scale if that recording is downloaded over and over again. It would not, however, meet the for profit test.

2. At the April, 2004, meeting of the U.S. –China Joint Commission on Commerce and Trade (JCCT), made several commitments to improve IPR enforcement. What are the concrete results to date?

First and foremost, China committed to significantly reduce the level of piracy. Again, the commitment was to significantly reduce piracy. To date, that has not happened.

While there has been some reduction in the overall level of piracy, it is far from a significant reduction. The legitimate market, while it has improved in the last year, is still under siege. Piracy is down from an astounding 90% to about 85%--progress, yes, but a significant reduction, no.

One important aspect of this is that China committed to revise the judicial interpretation governing application of its criminal code so that criminal prosecutions would occur for copyright piracy. It is true that this promise, at least in theory, has been fulfilled. Whether the thresholds are sufficiently low to prove effective and how they will be implemented in criminal prosecutions is still an open question.

Other JCCT commitments included:

- To increase penalties for IPR violations by taking the following actions by the end of the year:

- increase the scope of IPR violations subject to criminal investigation and criminal penalties;

- apply criminal sanctions to the import, export, storage and distribution of pirate product;

- apply criminal sanctions to online piracy;

Some of these were addressed by the recently published “Judicial Interpretations.” The Interpretations have a number of useful elements and if China has the political will to apply them conscientiously and strictly, then China might be able to meet these commitments. Given China’s history, a healthy dose of skepticism is merited until things actually change. While it is very likely that Vice Premier Wu Yi, who is responsible for IPR and led the Chinese JCCT delegation, is serious about bringing about a reduction in piracy, the police still seem to regard IPR violations as not really a criminal activity that merits their attention in a serious way.

- Conduct a major crackdown on pirates to demonstrate China’s intentions by mounting a nationwide enforcement campaign to stop the production of pirate Product and punish violators.

It is clear that a one year campaign was launched last September and that this effort has resulted in noticeable increases in the number of raids and product seizures. However, the usual remedies are being applied—product is seized and modest administrative fines are levied. This is not effective enforcement and it will not result in a significant reduction in piracy.

- Improve the protection of electronic data by ratifying the WIPO Internet Treaties as quickly as possible. To date, while there have been some promising public announcements about China’s intention to ratify the Treaties, there has been no demonstrable progress on this, and this legal issue must be viewed against a background that has witnessed a proliferation of sites offering unauthorized recordings.

- Increase customs enforcement actions against imports and exports of pirate products and provide easier remedies for rights holders to secure effective enforcement at the border. Again, there is no indication that is underway.

3. What should the U.S. be doing to ensure compliance? Has technical assistance been provided? Is there a particular problem area that could be the subject of a WTO dispute case?

To ensure compliance the U.S. Government is conducting a Special 301 “out-of-cycle review” at this time. The results of this review are expected in mid March. Options available to the U.S. include initiating a WTO dispute case; placing China on one of the Special 301 lists (priority foreign country, priority watch list, watch list); impose some form of trade sanction that is consistent with our WTO obligations. These options are not mutually exclusive.

The U.S. and its IPR industries have been providing a considerable amount of technical assistance. The international recording industry, for example, has been conducting extensive training of Chinese judges. The U.S. Government has also been training police, prosecutors, and judges and this is likely to increase in 2005. On a related point, our own ability as an industry to assist in the process of fighting piracy is severely restricted in most provinces in China—in contrast to other countries where our investigative resources are welcomed. It is only very recently, for example, that in some jurisdictions the local enforcement authorities have permitted IFPI anti-piracy personnel to accompany them on raids.

In regard to a possible WTO dispute case, I would refer back to the issue of deterrent penalties—a WTO requirement. Currently, China does not provide deterrent penalties, not because it requires legislative changes to its legal system but because it seems to lack the political will to do so.

4. Who should the U.S. be cooperating with in terms of trading partners?

We should be reaching out to the European Commission and to Japan, where there seems to have been has recently a renewed interest in fighting piracy. In truth, the U.S. has attempted to involve both in its efforts to seek improvements in China’s IPR regime—mostly to no avail when it has become clear that some form of pressure is what it takes to prompt China to respond affirmatively. However, I would not abandon the effort, particularly in regard to any potential WTO actions. Both the EU and Japan were invited to and participated in this year’s Roundtable in Beijing. It is interesting to note that the EU representative pointed out that 67% of the counterfeit good stopped at the borders were from China.

In December, at the EU-China Summit, a Customs Cooperation agreement was signed and it also appears as if copyright enforcement was raised by the EU as an

issue to be addressed. In January of this year, the EU and Japan held a joint meeting on The Information Society and, again, IPR and its enforcement was a major issue in regard to China.

### **Market Access Restrictions**

Before I close, there is a very important related topic that I would like to address. This is China's refusal to permit U.S. record companies to participate fully in the Chinese economy. This is what we call denial of "market access."

U.S. record companies' possess great expertise the world over in developing and recording new artists, and distributing, promoting, and advertising their recordings so that the public is aware of them. U.S. record companies must be permitted to undertake the full range of the services they are skilled at providing. Today China severely limits the ability of American record companies to engage in developing, recording and distributing the music of Chinese performers, and in fully participating in developing the Chinese marketplace..

This is done in a number of ways:

#### **Censorship:**

(1) Chinese government censors are required to review the content of foreign-produced sound recordings before their release, but domestically-produced Chinese sound recordings are NOT censored. Of course, pirated product is not censored either. China should terminate this discriminatory process between imported and domestically-produced product.

(2) Censorship offices are understaffed, causing long delays in approving new recordings. In recent months, we have seen some improvement and a new recording takes an average of two weeks to be approved which still gives the pirates a crucial headstart. The best result would be for censorship to be industry-administered, as in other countries. If this is not possible, steps must be taken to expedite the process so that legitimate music can be promptly marketed, preventing pirates from getting there first.

#### **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 record publishing 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 publishing, production and marketing of sound recordings and allow such companies to have foreign investors.

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, publish and market their own recordings in China and to import directly finished products.

Distributing 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 at least MFN status to U.S. record producers per the terms of the CEPA.