

**TESTIMONY OF  
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MOTION PICTURE ASSOCIATION OF AMERICA  
BEFORE THE  
US-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION**

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Dear Mr. Chairman and fellow Commissioners,

I am pleased to have the opportunity to appear before you today on behalf of the Motion Picture Association of America (MPAA), and its international sister organization the Motion Picture Association (MPA), to discuss China's progress in implementing effective intellectual property rights protection and enforcement, as well as its progress in opening its market for legitimate product.

The Motion Picture Association of America represents seven major studios that produce and distribute filmed entertainment – theatrical motion pictures, home video entertainment and television programming – all around the world including China. Our members include Buena Vista International, Inc., Metro-Goldwyn-Mayer Studios Inc., Paramount Pictures Corporation, Sony Pictures Releasing International Corporation, Twentieth Century Fox International Corporation, Universal International Films, Inc., and Warner Bros. Pictures International, a division of Warner Bros. Pictures Inc.

The 1995 USTR-negotiated intellectual property rights agreement and the November 1999 USG-China agreement for China's entry into WTO were intended to provide market access opportunities for American entertainment companies, including our members, and to address the unchecked piracy of movies. Since 1995, American entertainment firms have invested heavily in the Chinese market: exporting films to China, co-producing films in China, distributing Chinese films abroad such as the recent U.S. releases of "Crouching Tiger Hidden Dragon", "Hero", "House of Flying Daggers", and "Kung Fu Hustle", investing in the construction of new theaters and the modernization of old ones, hosting Chinese film festivals in the U.S., and sponsoring training sessions.

Despite extensive efforts and steady investments by the MPA and its member companies in the audiovisual market in China, strong support from the U.S. Government and continuous dialogue with Chinese authorities, we have seen only limited progress thus far with respect to both increased market access for American entertainment companies and the fight against the piracy of movies, which still flourishes. Strict market access barriers and rampant piracy continue to thwart efforts to deliver legitimate entertainment products in China, hurting both the Chinese and American film industries. Although box office revenues for

U.S. films in China were up in 2004, this did not begin to make up for the 60% decline in theatrical revenues that our members experienced in China from 1996 to 2003.

As a result of Chinese government imposed trade barriers that limit the importation of legitimate filmed products, thereby giving the pirates free reign to fill the great demand that exists in China for U.S. films, and an insufficient law enforcement response, piracy in China has reached levels not seen since 1995. In 2004, it is estimated that our members lost \$280 million (USD) due to piracy in China, an increase of more than \$100 million (USD) from the already deplorable losses suffered in 2003.

As you, no doubt, are aware, the American motion picture industry is a vital component of our economy. The American broadcast and motion picture industries accounted for \$108.4 billion of the 2001 U.S. GDP. The success of U.S. films abroad is a major facet of the industry's revenue. While most U.S. industries struggle with trade deficits, the American motion picture industry has a trade surplus with every country in which we do business, and directly employs approximately 500,000 U.S. workers.

With respect to China, the reality is that trade in the theatrical market is essentially a one-way street. At the box office potential for U.S. films in China remains anemic because of access restrictions and piracy, U.S. companies are importing PRC films into the U.S. and other markets, which results in considerable revenues for Chinese producers and which help the Chinese economy. Chinese films have done well in the United States, grossing tens of millions of dollars and benefiting enormously from strong marketing and wide distribution arranged by U.S. distributors. For example, in the U.S. alone, "Crouching Tiger Hidden Dragon" grossed over \$125 million (USD); "Hero" opened at #1 in the box office as soon as it was released and grossed over \$50 million (USD); to date, "House of Flying Daggers" has grossed over \$10 million (USD). In sharp contrast, the total box office generated in China for all U.S. films last year was about \$60 million (USD), and, by the way, U.S. companies are only allowed to receive 13% to 14% of that money, the precise amount to be determined by the Chinese government.

From our perspective, this is unacceptable. China must demonstrate its serious commitment to provide adequate market access for our filmed products and effective protection against piracy. Market barriers that invite piracy and prevent the legitimate distribution of U.S. filmed entertainment must be removed.

Because China has, thus far, failed to make any of these changes, the MPA joined the rest of the copyright industry members of the International Intellectual Property Alliance (IIPA) in supporting the IIPA's Special 301 recommendation that USTR immediately request consultations with China in the World Trade Organization, and that it place China on the Priority Watch List pending an out-of-

cycle review to be concluded by July 31, 2005, at which time appropriate additional actions can be taken including the possibility of establishing a dispute settlement panel in the WTO.

I would now like to briefly review the current situation and provide some specific recommendations on what needs to be done.

### **MARKET ACCESS RESTRICTIONS SUFFOCATE LEGITIMATE MARKET**

As I stated above, current government imposed restrictions on the importation and exhibition of foreign audiovisual content deprives Chinese consumers of access to legitimate audiovisual content, thereby creating opportunities galore for pirates to fill that existing need by providing stolen media containing uncensored and untaxed content. Legitimate market potential in China continues to be impacted most severely by:

- (i) lack of competition in the distribution of film because the Chinese government permits only one film importer and two film distributors, both of which are components of the same monopoly managed by the State Administration of Radio Film & Television (SARFT);
- (ii) a quota of 20 non-local films per year to be distributed on revenue sharing terms to be determined solely by the Chinese government;
- (iii) limits on the retail sale of legal home entertainment; and
- (iv) government-imposed restrictions on foreign investment, foreign channel carriage, and programming content in the television sector.

These restrictions on foreign audiovisual products tilt the market environment heavily in favor of pirates, who obey none of the government's regulations and restrictions, while capturing at least 95% of the U.S. audiovisual industry market's sales in China. The unchecked piracy of local and foreign films provides clear evidence that the current market access regime does not meet Chinese consumer demands and will cause the Chinese entertainment industry to suffer.

I would now like to offer specific recommendations as to what we believe the Chinese government must do to strengthen the market for legitimate audiovisual products and to combat widespread piracy:

#### **Market Access**

- Set a fixed timetable for the removal of the limits, restrictions, and structural distortions on imported audiovisual products, and allow a free and competitive marketplace to develop in which Chinese consumers, not

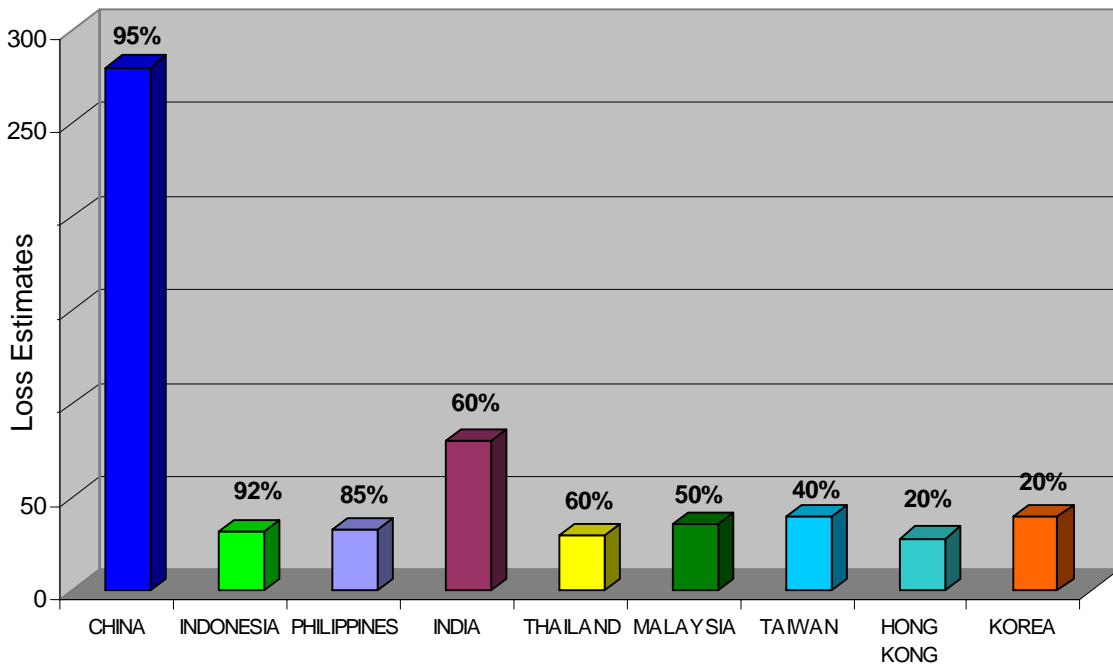
the Chinese government, are able to determine which films and other audiovisual products are most appealing to them.

- **Film:** (1) eliminate the government imposed import monopoly, (2) eliminate the government imposed distribution duopoly, (3) remove film import restrictions and the unreasonably low quota (currently 20 films per year) on the number of revenue-sharing films that are permitted into China, (4) eliminate government determination of box office revenue percentage shares, (5) eliminate government determination of which films will be imported and when they will be released, (6) institute a ratings system with age classifications which will operate quickly, efficiently, and transparently, and (7) eliminate “black-out” periods when new releases of non-local films are denied screen time.
- **Home Video:** (1) streamline and expedite the licensing process for retail outlets by designating one authority with the power to grant retail licenses; (2) ensure import duties are based solely on the value of the imported physical media, not on potential royalties which may never come to fruition; (3) remove restrictions on replication and home video licensing agreements; and (4) streamline and improve the censorship process.
- **Television:** (1) permit foreign satellite channels to be carried on local cable systems; (2) streamline and expedite the censorship process, (3) reduce local content restrictions, (4) continue to reduce investment limitations, and (5) eliminate the local uplink requirement.
- **Internet/E-Commerce:** (1) Designate one governmental body with administrative authority over matters relating to the Internet; (2) establish consistent, centralized, and transparent regulations of the Internet with policies that reflect and reinforce the provisions of copyright laws by protecting content and punishing infringers with stiff administrative criminal penalties, and which include potential liability for Internet service providers (ISPs) for piracy related offenses and satisfactory notice-and-takedown measures for websites offering pirated materials; (3) ensure guaranteed access to a secure environment for legitimate media suppliers to offer the products or services; and (4) implement prohibitions on registering, trafficking in, or using a domain name with bad-faith intent to profit from the goodwill of a trademark belonging to another entity (commonly known as cybersquatting); and (5) clarify existing ambiguities and cure deficiencies in the Copyright Law pertaining to the circumvention, alteration or deletion of electronic rights management systems and to temporary copies so as to comply with the clear letter and spirit of the protections afforded in the World Intellectual Property Organization (WIPO) Copyright Treaty.

## PIRACY FILLS THE VOID

Piracy is ubiquitous in China, filling the void created by strict limitations on foreign access to the legitimate market. China has the highest piracy rate in the Asia Pacific region, estimated at 95% in 2004, and adequate measures are not being taken to address the problem. No legitimate supplier of films, whether local or foreign, can compete with pirates who pay no taxes, endure no censorship obligations, and bear none of the costs of running a studio.

2004 Asia Pacific Region Piracy Rates and Losses



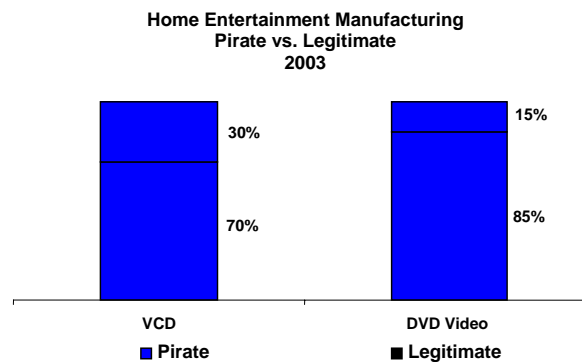
- **Optical Disc Piracy:** Optical disc piracy continues to be exceptionally high, the highest in the region. According to a 2003 article in The Hollywood Reporter, the legitimate home video market in China is only about 5% of the estimated total market of \$1.3 billion (USD). Pirated DVDs of the latest U.S. theatrical titles are readily available within days, if not hours, of their initial release. Despite some efforts by local authorities, underground factories continue to operate around the clock producing thousands upon thousands of pirated discs.

### China: Piracy/Manufacturing Capacity

	Licensed plants	DVD plants	Production lines	DVD lines
2003	71	32	569	65
2004	83	71	765	152

There is an immense illegal optical disc manufacturing capacity in China, far in excess of domestic demand. China's total optical disc manufacturing capacity from recognized and licensed replication facilities (not including blank CD-Rs) is 2.67 billion discs annually, which does not include the millions of discs that are produced in underground, unlicensed facilities. In addition to fulfilling the unmet demand for domestic consumption, huge numbers of these discs are illegally exported to other countries, thereby infecting those markets too.

*Understanding and Solutions* estimated that in 2003, 69% of the VCD and 85% of the DVD discs manufactured in China were pirate product.



Source: *Understanding & Solutions*

The abundance of pirate optical discs in China is evidenced by the low prices for those discs, lower than anywhere else in the region.

### Asia Pacific Region: Prices for Pirate DVDs

Country	Pirate DVD (USD)	Country	Pirate DVD (USD)
Australia	7.30	South Korea	4.35
<b>China</b>	<b>0.60</b>	<b>Malaysia</b>	<b>3.42</b>
Hong Kong	2.56-3.85	New Zealand	7.50
India	2.67	Philippines	1.42
Indonesia	1.22	Singapore	7.00
Japan	8.93-13.40	Taiwan	4.42
		Thailand	3.75

- Pirate Exports:** The export and transshipment of pirate optical discs from and through China continues to grow at alarming rates. Exports of pirated DVDs from China to the U.S., the UK, and other countries have increased steadily over the last three years and show no signs of abating. Although MPA appreciates the assistance of Customs, the fines and penalties that

are generally levied against pirates who are apprehended are considered low and not deterrent.

- **Television Piracy:** There has also been a significant increase in cable and VOD piracy in China. Provincial television stations routinely make unauthorized broadcasts of MPA member company titles, often relying upon counterfeit "letters of authorization" or "licenses" from companies in Thailand, Hong Kong, and Taiwan, which purport to convey broadcast rights. There are approximately 1,500 registered cable TV operators in China and 45 digital TV operators, serving more than 100 million households, all of which routinely include pirate product in their programming. Very few enforcement actions have been taken to date.
- **Internet piracy:** Internet piracy involving illegal hard good sales and unauthorized downloading and streaming of MPA member company films is also on the rise. A large number of Chinese ISPs host these infringing websites. In 2004, MPA sent out 3,905 cease-and-desist letters to ISPs in China, requesting the ISPs to "take down" infringing websites, compared with 444 such letters in 2003. While overall compliance rates are difficult to discern, we do know that when such notices were sent to non-P2P targets (mostly streaming sites), the compliance rate was a very disappointing 17%.
- **Losses Due to Piracy:** Theatrical feature films are released in a sequential pattern – first in cinemas, then in home video, and later in television. It is the hope of every film producer that the release pattern can generate revenues sufficient to recoup the investment in the film and, hopefully, return some profit for investors and for reinvestment into new projects. Piracy adversely affects every phase of the recoupment process. From 1998 to 2003, piracy-related losses to U.S. film companies topped \$740 million (USD) in China. In 2004, piracy-related losses in China are estimated to reach \$280 million (USD). Piracy is not only stifling foreign importers, it is crippling the entire Chinese film industry – studios and the cinemas.
- **Government Will:** Government recognition of the piracy problem, although improving, still has a long way to go. The bottom line is that China's actions have not produced substantial progress toward a significant reduction in copyright infringement levels, as had been promised by Vice Premier Wu Yi at the US-China Joint Commission on Commerce and Trade (JCCT). Moreover, China has not met its WTO TRIPS commitment to provide effective enforcement, particularly criminal enforcement, against piracy "on a commercial scale," nor has it honored its continuing bilateral obligations as reflected in the 1995-1996 bilateral agreements and action plans. Although the MPA welcomed the 2004

announcement by Vice Premier Wu Yi of an IP protection campaign across China, and the establishment of a National IPR Protection Office (NIPO), and takes note of the fact that there has been a recent increase in raiding activity and better coordination of administrative enforcement efforts in various regions, those efforts, while welcome developments, have had little to no effect on the piracy situation. Criminal copyright cases against pirates are extremely rare in China, and there has been insufficient government messaging to Chinese consumers regarding piracy.

- **Lack of Deterrence:** Current law in China does not contain deterrent penalties and contains inordinately high criminal thresholds, which preclude effective prosecution and sentencing (more than 99% of raids currently result in administrative fines, most of which are quite low and do not act as a serious deterrent). The recently-amended Supreme People's Court's "Judicial Interpretations" do little to help the situation, lowering only slightly the monetary thresholds (which continue to be calculated at pirate prices, rather than legitimate retail prices) that must be achieved before a prosecution can be undertaken. There are additional problems regarding the definition of distribution, penalties/criminality of importing and exporting of pirate products, the rules with respect to repeat offenders, and other areas of the Interpretations. Unfortunately, we believe that these minor changes to existing law are highly unlikely to result in a sufficient number of criminal cases being brought or high enough penalties being imposed which might otherwise sent a real message of deterrence. Finally, criminal enforcement of copyright piracy continues to be burdened by the fact that Articles 217 and 218 of China's criminal code require a demonstration that piracy is occurring for the purpose of making a profit, something very difficult to demonstrate in the online environment. TRIPS requires criminalization of "copyright piracy on a commercial scale" – not just piracy for the purpose of making a profit.

In our opinion, the Chinese government should take the following steps to help curb the rampant piracy situation that currently exists:

- **Fixed Timetable:** Establish a fixed timetable to reduce piracy from its current level of over 95%, setting as an immediate goal reducing piracy levels to less than 50% by the end of 2005.
- **Criminal Threshold:** Immediately reduce or eliminate the high criminal thresholds (and accompanying procedural hurdles) that prevent the effective application of the criminal law to audiovisual piracy — the only way to significantly reduce piracy in China. Sending major criminals to jail is key to bringing this form of large scale, criminal activity under control.



- **National Task Force:** Under Vice-Premier Wu Yi's leadership, establish a national Anti-piracy Criminal Task Force to deter all forms of optical disc factory piracy, wholesale and retail piracy, and online piracy of software, books, music, games, filmed entertainment, and the like. This Anti-Piracy Task Force should engage in a transparent, well-publicized, and sustained national campaign to prevent and punish criminal acts of piracy occurring within the country and at its borders.
- **Criminal Code Amendment:** Amend the Criminal Code to clarify its full and effective application to all piracy crimes (including enterprise end-user piracy of software), thus bringing it into compliance with TRIPS.
- **Administrative Fines:** Significantly increase administrative fines for piracy and better utilize that process against all forms of piracy, including enterprise end-user piracy of software.
- **Copyright Law:** Through amending its copyright laws or implementing regulations, China should correct the deficiencies in its implementation of the WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty, and should ratify those two treaties. As stated above, although China revised its copyright law in October 2001, deficiencies remain, including the unreasonably high threshold of commercial piracy necessary to trigger a criminal prosecution, and penalties that are not deterrent. China's failure to apply the criminal law to piracy is "in practice" a violation of TRIPS Articles 41 and 61 (requiring enforcement which "on the ground" deters further infringements, effective ex parte civil search orders, and specific deterrent "criminal" remedies). Further, China's copyright laws should (1) criminalize end-user piracy; (2) add reference to all the exclusive rights now provided in the law, particularly the new WIPO treaties rights and unauthorized importation; (3) add criminalization of violations of the anti-circumvention provisions and rights management information; (4) criminalize Internet offenses that are without "profit motive" but which have an adverse impact on rightholders "on a commercial scale"; (5) eliminate distinctions between crimes of entities and individuals; and (6) increase the level of penalties overall.
- **Public Awareness:** The government must make a much stronger effort to build consumer awareness of the dangers and penalties of engaging in piracy. Not only does piracy drain the national economy, it invariably fosters an expansion of other forms of criminal activity, including tax evasion and avoidance of censorship laws. All enforcement actions and prosecutions should be accompanied by heavy media coverage, spreading the message that the government considers piracy to be a serious offence. The Chinese government has demonstrated on innumerable occasions that, when it wants to do so, it can shape powerful

forces in its society through enforcement efforts and extensive media coverage. It can do the same with piracy.

## **CONCLUSION**

Mr. Chairman, on behalf of the Motion Picture Association of America, as well as the thousands of law-abiding people who work in the movie industry and whose livelihoods are threatened by piracy, I want to thank you again for inviting me to testify today. I would be happy to answer any questions you may have at this time.