

*Testimony of Jason Berman  
And  
The Recording Industry Association of America  
Before the  
U.S.- China Economic and Security Review Commission  
On  
China's Protection and Enforcement of Intellectual Property Rights*

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America's song writers, performing artists and recording companies have a long history of working with the Congress and the Administration to protect and defend our uniquely successful sector of the U.S. economy. As a participant in this industry, I very much appreciate the efforts of this Commission, the Congress more broadly and the dedicated officials within the various Executive Branch agencies that have worked closely with our industry.

**The importance of the U.S. recording industry and intellectual property protection to the U.S. economy**

A critically important aspect of our nation's competitive strength lies in the creation of knowledge-intensive intellectual property-based goods and services. This is one of those economic activities that Americans do better than others. The "core" U.S. industries that rely on copyright protection account for more than six percent of US GDP.<sup>1</sup> The foreign sales and exports of these industries are nearly \$90 billion, an amount greater than almost any other U.S. industry sector, including automobiles and auto parts, agriculture and aircraft.

International markets are vital to America's creative talent and record companies. Exports and other foreign sales account for over 50 percent of the revenues of the US record industry. This strong export base sustains American jobs.

In this respect, the protection of our intellectual property rights abroad is essential to promoting America's competitive advantages in world commerce. The sale of our recordings abroad makes a major contribution to America's current account balances. Each and every sale of a pirated product abroad that substitutes for the sale of a legitimate American product increases our current account deficit. As our trade deficit has soared, Congress should consider more closely the relationship between our widening trade and current account deficits and copyright piracy.

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<sup>1</sup> These industries include recording, music, motion pictures, book and newspaper publishing, computer software (including business and entertainment software) and radio and television broadcasting.

## **The Effect of Music Piracy**

Music is the world's universal form of communication. It touches every person of every culture on the globe to the tune of \$34 billion annually. America's record companies—small and large—create employment for thousands of people, including composers, singers, musicians, producers, sound engineers, record promoters and retail salespersons, to name only a few.

The piracy of music is almost as old as the music industry itself, but historically it was difficult for the criminal to reproduce copies with the quality of the real thing. Now with the advent of digital recordings, computers and high-speed Internet access, criminals can reproduce perfect copies of any recording. There is widespread manufacture and traffic of illegal CDs, both in the form of molded CDs that are produced in factories, and increasingly pirated CD-R's produced on blank optical discs by computer CD-R burners. And now American recordings are being widely pirated on the Internet.

This illegal music trade is feeding the profits of international organized crime syndicates in addition to their more notorious involvement in drugs, money-laundering and other criminal activities. Music piracy also is costing governments hundreds of millions of dollars in tax revenues.

Therefore the battle against intellectual property theft must be unrelenting. Our country must employ every tool at its disposal, including the critically important leverage provided by international trade agreements.

## **The Problem in China**

Our industry has long been plagued in China by unrelentingly high levels of piracy and suffocating market access barriers.

China is very capable of addressing intellectual property piracy—they have the ability to respond. Allow me to share some history of China's actions in this regard. In 1996, under the pressure of looming U.S. Section 301 trade sanctions amounting to approximately \$1 billion, the U.S. successfully negotiated the closing of nearly half of the 26 known optical disc plants producing pirate product in China. In addition, the Chinese government essentially stopped the massive exportation of pirated CDs, which had been devastating our markets in other countries. Over the next several years as China faced the PNTR vote in the U.S. Congress, China continued to ensure that exports of pirated product remained low. Over the past several years, however, there has been a significant increase in licensed optical disc production facilities in China—the number now approaches 90 such facilities compared to just 26 back in 1996. As a result, pirated optical discs not only flood the Chinese market but are being exported in significant quantities to third markets.

For the past several years roughly 90 percent of all sound recordings sold in China have been pirated, causing our industry to suffer losses in the China in the neighborhood of \$200 million annually. Think about it: an astounding 18 of every 20 sound recordings sold in China are sold by pirates.

The Chinese government in recent months has been conducting a public relations offensive asserting that it is engaged in a stepped up nation-wide campaign against pirated and counterfeit products. Press accounts coming out of China quote official statistics about millions of pirated discs being seized by the Chinese authorities as a result of thousands of raids against retail and wholesale establishments. There is no reason to doubt that such raids and seizures are in fact occurring as they often do during the periodic charm offensives China has repeatedly undertaken when faced with mounting U.S. trade pressure. But, Mr. Chairman and members of this Commission, if you were to take field trip to China today, you would find that pirated optical discs are as prevalent on the streets of China's cities as they were last year, or the year before that.

Demand for American musical recordings in China is enormous, as evidenced by the massive piracy of our products there. The result has been a colossal lost opportunity for American writers, performers and record producers to benefit from the fast-growing Chinese society and economy. Here's why:

- 1. The Chinese do seize massive amounts of pirated product, but the penalties imposed, if any, are grossly ineffective. This is why China's enforcement system is ineffective and it is why China's "efforts" to combat copyright piracy fail in comparison to nearly every other country. Chinese authorities might raid a manufacturing facility, a warehouse or a retail outlet, and seize the pirate products found there—and they seize millions—but the resulting penalty, if any, is almost always just a small fine and/or a suspended sentence. Pirates are entrepreneurs who see such raids and seizures as a cost of doing business—a "slap on the wrist"—and the occasional interruptions are built into their business model. The penalties do not deter, punish or in any way incapacitate the thieves.*

We believe there are around 90 optical disc plants in China, operating nearly 1,400 optical disc-making lines, with a total disc capacity of a staggering 4.8 billion discs per year. Most production lines are interchangeable, switching easily between audio CD, VCD, DVD, and even CD-R or DVD-R production.

Unfortunately, a considerable amount of China's production is destined for export. In 2005, infringing product from China was found in nearly every major market in the world, including Germany, Italy, Australia, Norway, Belgium, Canada, Mexico,<sup>2</sup> the United States, Russia, the United Kingdom, the Netherlands, Israel, Paraguay, Lithuania, Singapore, Taiwan, the Philippines, Indonesia, Vietnam, Hong Kong, Malaysia, Thailand, Chile, and South Africa. Known shipments and seizures around the world are

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<sup>2</sup> The Mexican Association of Gift Producers (AMFAR) reported that during 2005 holidays, nearly 80% of traded merchandise was imported from China through illegal means. *AMFAR: 80% of Chinese merchandise, illegal*, Corporate Mexico, January 18, 2006.

only the tip of the iceberg of the total exports of pirate optical discs from China. That China's factories have once again returned to large-scale exporting. This stands in stark and disappointing contrast to the near eradication of pirated Chinese exports in the mid-to-late 1990s—the result of strong U.S. political and economic pressure that forced the Chinese to take effective enforcement actions. It should also be noted that the European Commission has identified China as the leading source of counterfeit goods seized at the Community's borders.

2. *Internet piracy is growing rapidly in China. China has over 100 million Internet users and 600,000 websites, only 8,000 of which were legally registered. Many websites offer the unauthorized downloading of music files, some for a financial charge, others for free. Certain China-based ISPs have become online "warehouses" for international pirate syndicates. Many of the legal deficiencies that enable physical piracy to flourish in China plague the on-line environment as well.*

The Internet penetration rate per capita and per household in China is still relatively small. However, the sheer numbers of broadband lines (reported to be 35 million as of September 2005), and the rapid rise of mobile applications, make China one of the world's largest potential markets in terms of digital delivery of copyright content, and unfortunately, one of the world's largest emerging digital piracy problems. The Chinese publication "Economic Daily" reported that as of the end of 2005, 64 million Chinese accessed the Internet via broadband connections.

Hundreds of websites emanating from China now offer streams, downloads or links to unauthorized files of copyright materials (music, films, software, and books). Disturbingly, there are many Bit Torrent (BT) sites based in China now (BT is a recent P2P architecture which allows for faster file-sharing due to the way users cooperate in uploading and downloading pirate content simultaneously). There are at least four "eMule/eDonkey" servers; at least seven specialized "MP3 search engines," which offer deep links to thousands of infringing song files for instant downloads or streaming; and at least eight China-based peer-to-peer (P2P) services (including Kuro China, whose Taiwanese affiliate has been found guilty in a criminal court in Taiwan).

The largest MP3 search engine is Baidu, the subject of two civil lawsuits in 2005; it lost one in September 2005 but has appealed.<sup>3</sup> Baidu, as well as Yahoo!CN provide independent MP3 search functionality that produces indexes, and even deep links to, infringing files, thereby directly inducing and facilitating the misappropriation of American intellectual property.

Most of the pirate websites in China generate income through advertising, so they are profit-making ventures even though copyrighted materials are provided for free. At least three of the P2P services charge subscription fees. Unfortunately, the availability and use

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<sup>3</sup> On September 16, 2005, the People's Court of Haidian District in Beijing reportedly ordered Baidu to pay RMB68,000 (US\$8,400) to mainland music company Shanghai Busheng Music Culture Media for unauthorized downloads of 46 songs. Baidu has reportedly appealed the ruling.

of these services, spurred by the rapid growth of broadband technologies in China, indicate that Internet piracy will be one of the greatest challenges that industry and the Chinese Government must face.

Most unfortunately, enforcement against Internet piracy in China has been made more difficult by recent Chinese government decisions. In 2003 and 2004, thousands of “takedown” notices were sent by the recording industry to Chinese ISPs and content providers, and the takedown rate of these ISPs was relatively high.<sup>4</sup> However, the April 2005 “Administrative Measures on Protecting Copyright on the Internet” made such takedowns more difficult and compliance by ISPs fell precipitously in 2005.<sup>5</sup> The Administrative Measures do not allow e-mail notices and required that notices include, for each infringing site, evidence of all infringements and proof of copyright ownership for each book, song or film infringed, among other things. The ISPs thus ignored notices that do not meet this unrealistically burdensome standard.<sup>6</sup>

The State Council is expected soon to issue new Internet regulations that will replace these Administrative Measures. The most recent draft would lessen the notice requirements. However, there are other concerns with the draft regulations that need to be addressed prior to its issuance (including provisions on protection of technical protection measures, the scope of limitations on liability of ISPs, and the form of the notices to be sent to ISPs).

3. *On top of the blatant piracy of our products, the record industry faces severe restrictions on its ability to do business in China. Frankly speaking, it will be very difficult to ever significantly reduce piracy in China if the Chinese will not let our companies expand their ability to sell legitimate products to Chinese consumers. China must abolish these restrictions.*

The Chinese Government does not allow foreign sound recording producers, motion picture companies (for theatrical and home video, DVD, etc. distribution), or entertainment software publishers to enter the Chinese market except as a partner in a minority-share (up to 49%) joint venture with a Chinese company.

Record companies are prevented from developing talent in China and from getting legitimate product quickly to market. The fact that U.S. record companies cannot “publish” or release a recording without permission of a state-owned company and cannot manufacture, distribute or engage in retailing of their products makes it extraordinarily difficult for legitimate companies to participate effectively. U.S. record companies are skilled at and desirous of developing, creating, producing, distributing and

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<sup>4</sup> The recording industry achieved takedowns of three China-based servers, of at least seven international sites (Supermusic, Crazymp3, 21century-mp3, Mp3explosion, Easyp3s, Realalbums, and Finestmp3s), infringing music files hosted on large Chinese portals like Wanwa, Hitmusic, Sohu, and 9sky (9sky has since become a licensed music site, as have four other sites), and 17 “eDonkey” servers based in China.

<sup>5</sup> From September to November 2005, the takedown rate by ISPs was as low as 25%.

<sup>6</sup> Administrative Measures on Protecting Copyright on the Internet, issued by the National Copyright Administration of China (NCAC) and the Ministry of Information Industry (MII), effective April 30, 2005.

promoting sound recordings worldwide.<sup>7</sup> The universal experience of nations in which the international record companies do business is that local artists have expanded opportunities to have their music recorded and distributed widely. The in-country presence of U.S. companies also has brought jobs and expertise in a wide variety of areas. China should permit U.S. (and other foreign) sound recording producers to engage in:

- the integrated production, publishing and marketing of sound recordings.
- replicating, distributing, and retailing sound recordings (at present, these activities must be performed by other companies, which segments industry activity and drives up costs; even Chinese sound recording producers may not engage in these activities, meaning all musicians, including Chinese, who record in China operate at a competitive disadvantage with those recording music outside China).
- production, publication and marketing their own recordings in China and direct importation of finished products (at present, a U.S. company must (1) license a Chinese company to produce the recordings in China or (2) import finished sound recording carriers (CDs) through the China National Publications Import and Export Control (CNPIEC)).

China should also permit foreign-owned record companies to release sound recordings in China.

### **The Criminal Enforcement System Remains Non-Deterrent**

Despite China's promise in the JCCT to increase the number of criminal prosecutions for copyright piracy, little has yet been done. The current criminal system in China continues to operate ineffectively, non-transparently and without deterrence.<sup>8</sup> Moreover, there are legal problems with respect to which acts constitute crimes and what proof meets the criminal thresholds (including, *inter alia*, how to measure harm to meet the thresholds) that make it essentially impossible for copyright owners to obtain deterrent enforcement.

Further, there is not one Ministry that takes responsibility for copyright enforcement, including the raid, arrest, seizure, and transfer of a case file for prosecution. Retailers,

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<sup>7</sup> The work of these companies encompasses a wide range of activities, including developing and investing in state of the art recording, mastering and engineering facilities; identifying and training talented singers, songwriters, composers, and musicians; promoting and advertising acts and recordings; establishing efficient and competitive distribution systems to take products from recording studio to replicator to wholesalers to retailer; and using global arrangements and distribution services to release products in markets outside the local market. U.S. record companies have long sought to bring these skills to China to develop and record Chinese artists for the Chinese market and for export.

<sup>8</sup> A fundamental issue remains that copyright piracy is still viewed by many in China as a problem to be dealt with administratively rather than in the criminal courts. Administrative enforcement of copyright has been under the auspices of the National Copyright Administration of China (NCA), which is neither properly equipped nor staffed with the resources or personnel to address the large-scale piracy problem in China. The failure to have any one agency in charge, which has the wherewithal to do the job of achieving deterrent enforcement, has led to *ad hoc* approaches to enforcement.

distributors, warehouse owners, and even pirate producers know that administrative raids will rarely be transferred by China's many administrative enforcers to China's criminal enforcement authorities. Thus pirates in China operate for the most part in the open without fear of effective enforcement action. Repeat offenders often pay insignificant administrative fines and disregard administrative orders to cease their infringing activities. And, importantly, when cases are transferred for criminal prosecution, rightsholders have difficulty learning the disposition of these cases. Unless China criminally prosecutes pirates in a transparent manner piracy will remain pervasive in China. In fact, there has been very little transparency in any of these government processes.

The U.S. copyright industry has repeatedly emphasized the importance of addressing the current absence of criminal prosecutions. While the Chinese government claims that such prosecutions have occurred, the U.S. copyright industry is aware of only a very few that have involved U.S. or other non-Chinese works. One of these cases was the infamous *Guthrie* case (involving a large DVD wholesale piracy ring run by a citizen of the United States). While this case did involve piracy of U.S. product, it is dwarfed by comparison with the organized criminal activities conducted by Chinese citizens, who are rarely prosecuted for their crimes.<sup>9</sup>

### **China's Commitments in the US-China Joint Commission on Commerce and Trade—the "JCCT"**

In meetings of the US-China Joint Commission on Commerce and Trade – the JCCT – in April 2004, July 2005, and April 2006 China made a number of potentially important commitments to improve intellectual property enforcement for our industry, but so far China's implementation of these commitments has been lacking.

Perhaps most importantly, China committed in April 2004 to "significantly reduce IPR infringement levels". Under any measure, this clearly has not happened. The legitimate market, while it has improved somewhat, remains under siege. Piracy of sound recordings remains at an astounding 90 percent .

In addition, China has agreed in the JCCT to:

- Increase penalties for IPR violations by taking the following actions by the end of 2004:

- Subject a greater range of IPR violations to criminal investigation and criminal penalties.

- Apply criminal sanctions to the import, export, storage and distribution of pirated and counterfeited products.

- Apply criminal sanctions to on-line piracy.

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<sup>9</sup> *In re Randolph Hobson GUTHRIE III, Abram Cody THRUSH, WU Dong and WU Shibiao* (Shanghai No. 2 Intermediate Court, April 19, 2005).

- Crack down on violators by:

- Conducting nation-wide enforcement actions against piracy and counterfeiting, stopping the production, sale and trade of infringing products, and punishing violators.

- Increasing customs enforcement action against the import and export of infringing products and making it easier for rights-holders to secure effective enforcement at the border.

- Improve protection of electronic data by complying with, ratifying and implementing the World Intellectual Property Organization (WIPO) Internet Treaties as soon as possible.

The bottom line is that the value of these Chinese undertakings in the JCCT is in their implementation. China has taken some positive steps, particularly with respect to modifying laws and regulations that appeared to be preventing effective enforcement. But despite these changes, enforcement remains far from being effective. The missing ingredient, as has been so often the case in China, is that China's law enforcement authorities, especially their police and prosecutors, remain unwilling to aggressively enforce their laws against commercial copyright pirates, despite the fact that these pirates are acting in contravention of China's law.

### **Our Recommendation**

China's current reliance on administrative inspections, seizures and modest fines does not work. China's criminal enforcement authorities must become actively and transparently involved in the fight against piracy in China. Unless this occurs, we foresee matters either staying the same or becoming even worse.

The US Government—our Executive Branch and the Congress—has been increasing pressure on China toward this end. We are extremely grateful for the help that the U.S. Government is providing us. This hearing helps in this regard. The U.S. Government and U.S. industry must continue to insist that China fully implement the commitments it made in the WTO—and in the JCCT over the past three two years—especially to significantly reduce piracy. The U.S. recording industry is working intensively with the Office of the U.S. Trade Representative to prepare the necessary elements of a possible WTO legal complaint against China, but of course we hope that the Chinese Government will quickly take steps to address the inadequacies of the current flawed system such that litigation will not be necessary.

### **Russia: the Next China?**

As serious as problems are in China, and they are serious indeed, the challenges we face in protecting our intellectual property in Russia are even more daunting. Lawlessness, physical danger, and corruption are part of the daily challenges we face in trying to



protect our rights in Russia. These types of problems are even more prevalent in Russia than in China.

**We must learn from the China experience. Congress should insist upon demonstrated and sustainable reform before supporting Russia's accession to the WTO.** Otherwise, in the future, Congress will be creating a Russia Economic Commission. By every measure, the steps taken before China was admitted to the WTO have failed America's inventors and creators. The U.S. should ensure that relevant legal and enforcement measures are in place and implemented before we accept Russia into the WTO. WTO accession is not a political prize -- it represents a commitment to abide by international rules. The WTO institution and global confidence in world trade rules is quickly undermined when WTO parties openly mock trade discipline.

Let's face it – today Congress has some bilateral leverage because Russia wants to enter WTO. Once they are in, the leverage diminishes significantly, as we have seen with China. One aspect of Russia's accession to the WTO, known as granting them "Permanent Normal Trade Relations" or "PNTR" must be approved by Congress. We urge Congress to inform our Executive Branch that it will not approve PNTR unless and until Russia acts to significantly clean up its copyright piracy mess.

### **Conclusion**

Copyright piracy in China—and in Russia—remains rampant. Much more needs to be done by each of these countries. Our industry urges the United States—and the rest of the international trading community—to bring greater pressure on China and Russia to combat much more effectively the rampant piracy in their countries. This must not be allowed to continue. It has already gone on for far too long.