

***CHINA –MEASURES AFFECTING TRADING RIGHTS AND
DISTRIBUTION SERVICES FOR CERTAIN PUBLICATIONS
AND AUDIOVISUAL ENTERTAINMENT PRODUCTS***

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I. INTRODUCTION

1. China's accession to the World Trade Organization ("WTO") offered real promise for the producers and distributors of books, newspapers, periodicals, DVDs, music and theatrical films. China's commitments to significantly enhance access to the Chinese market for these goods and services opened the prospect of more liberal and efficient markets, greater educational exchange, and stronger commercial opportunities for highly successful global competitors.

2. Unfortunately, China has failed to fulfill its WTO commitments in numerous respects. The Chinese measures at issue in this dispute affect four sets of industries, their services and their products. These products include reading materials (including books, newspapers, periodicals and electronic publications); audiovisual home entertainment products ("AVHE products") (including videocassettes, video compact discs (VCDs) and digital video discs (DVDs)); sound recordings (including songs, "ringtones" and "ringback tones"); and films for theatrical release (collectively, the "Products"). The affected service suppliers include AVHE products and sound recording distributors, as well as reading material wholesalers.

3. China acts inconsistently with its WTO obligations in the following three areas: (1) China prohibits foreign companies and individuals, as well as private enterprises inside China, from importing reading materials, AVHE products, sound recordings and films for theatrical release; (2) China places unfair restrictions on foreign distributors of reading materials and AVHE products and prevents foreign distributors from engaging in the electronic distribution of sound recordings in China; and (3) China uses an array of restrictive measures to discriminate against imported reading materials, sound recordings and films for theatrical release in China.

II. FACTUAL BACKGROUND

A. China's Measures Addressing Trading Rights

4. China limits the right to import reading materials, AVHE products, sound recordings, and films for theatrical release to certain Chinese state-owned enterprises, prohibiting foreign-invested enterprises and privately-owned Chinese enterprises from engaging in these import activities. To import some of these Products, Chinese state-owned importers are required to obtain approval from the relevant regulatory agency. For other Products, the Chinese state-owned importer must be "designated" by the Government of China, a process whereby the relevant regulatory agency appoints one state-owned enterprise or an exclusive set of state-owned enterprises – of that agency's own choosing in the exercise of its discretion – to import a particular type of product or products.

5. China maintains its regime for the importation of reading materials, AVHE products, sound recordings, and films for theatrical release through numerous measures. Some of these measures, apply broadly to all (or almost all) of the Products, and other measures apply more specifically to particular categories of the Products. The broadly applicable measures include: the *Catalogue of Industries for Guiding Foreign Investment* (the "Catalogue"), the *Regulations Guiding the Orientation of Foreign Investment* (the "Foreign Investment Regulation"), the *Several Opinions on the Introduction of Foreign Investment into the Cultural Sector* (the "Several Opinions"), the *Regulations on the Management of Publications* (the "Management Regulation"), and the *Examination and Approval for Establishing a Publication Import Business Unit* (the "Importation Procedure").

6. The general measures establish overarching rules governing, *inter alia*, the right to import the Products into China. They do so in two respects. First, two of these measures – the Catalogue and the Several Opinions – forbid foreign investment in enterprises engaging in the importation of any of the Products. Second, the two other general measures – the Management Regulation and the Importation Procedure – which cover all of the Products except films for theatrical release, further limit the importation of reading materials, AVHE products, and sound recordings to certain Chinese wholly state-owned enterprises. Other film-specific measures impose parallel restrictions on who is entitled to import films for theatrical release.

7. China maintains one additional measure focused on only one subset of reading materials – *i.e.*, the *Regulations on the Management of Electronic Publications* (the “Electronic Publications Regulation”) – which control the right to import certain reading materials known as electronic publications. The United States understands that electronic publications include only books, periodicals, newspapers, and audio books saved as digital codes on the media forms set out above, but do not include AVHE products and sound recordings. The Electronic Publications Regulation implements the restrictive approval and licensing requirements contained in the Management Regulation and the Importation Procedure, and reconfirms the prohibition on any foreign-invested enterprise or foreign individual, or any privately-owned Chinese enterprise, engaging in the importation of electronic publications.

8. Chinese measures also strictly control the importation of AVHE products. Several sector specific measures provide for trading rights restrictions on AVHE products: the *Regulations on the Management of Audiovisual Products* (the “Audiovisual Regulation”), the *Rules for the Management of the Import of Audiovisual Products* (the “Audiovisual Import Rule”), and the *Rules for the Management of Chinese-Foreign Contractual Joint Ventures for the Sub-Distribution of Audiovisual Products* (the “Audiovisual Sub-Distribution Rule”).

9. China regulates imported audiovisual products, including AVHE products, according to whether they are finished or unfinished. Finished AVHE products are legitimately produced and replicated outside of China and require no additional production or replication in China before being made available to consumers. Unfinished AVHE products are master copies to be used to publish and manufacture copies for sale in China. China has designated only one enterprise to import finished audiovisual products: CNPIEC, which is a wholly state-owned enterprise. Likewise, with respect to unfinished audiovisual products, only Chinese wholly state-owned enterprises are permitted to engage in their importation.

10. Rather than providing for a *sui generis* system of trading rights for sound recordings, China includes sound recordings within the legal regime governing the importation of AVHE products, *i.e.*, the Catalogue, the Several Opinions, the Management Regulation, the Importation Procedures, the Audiovisual Regulation, the Audiovisual Import Rule, and the Audiovisual Sub-Distribution Rule. In all of these measures, China defines the term “audiovisual products” to encompass sound recordings – *e.g.*, recorded audio tapes, records, and audio CDs.

11. The Catalogue and the Several Opinions forbid foreign investment in the importation of sound recordings. In addition, the Management Regulation and the Importation Procedure provide that only wholly state-owned enterprises are allowed to import audiovisual products, and

thus, sound recordings into China. For finished sound recordings, CNPIEC (a Chinese wholly state-owned enterprise) is the only entity designated to engage in the importation of finished sound recordings in physical form (e.g., CDs). For unfinished sound recordings (e.g., master recording discs) only wholly state-owned enterprises are permitted to import such sound recordings.

12. In addition to the Catalogue and the Several Opinions, the measures that maintain the trading rights restrictions applicable to films for theatrical release include: the *Regulations on the Management of Films* (the “Films Regulation”), the *Implementing Rules for the Reform of the Film Distribution and Projection Mechanisms (Trial Implementation)* (the “Film Distribution and Projection Rule”), and the *Provisional Rules on Entry Criteria for Operating Film Enterprises* (the “Provisional Film Rule”).

13. Under this Chinese regime, China has designated only a single wholly state-owned entity – the China Film Import and Export Corporation, a subsidiary of China Film Group – to import films for theatrical release. This monopoly applies to all films for theatrical release, regardless of whether a film is imported on a revenue-sharing basis or a flat-fee basis.

B. China’s Measures Addressing Distribution

14. Distribution activities are identified and segmented in numerous ways by the Chinese measures. Key activities that are covered by these measures and that are relevant to this dispute are: *master distribution (Zong Fa Xing)*, the sale of, e.g., a reading material, exclusively by a single distributor; *distribution (Fa Xing)*, which includes master distribution, wholesale, retail, leasing, and exhibition for sale; *sub-distribution (Fen Xiao)*, which includes wholesale and retail; *master wholesale (Zong Pi Fa)*, which is synonymous with master distribution; *wholesale (Pi Fa)*, i.e., the sale of products to businesses that are not ultimate consumers; and *retail (Ling Shou)*, i.e., the sale of products to ultimate consumers.

15. China prohibits foreign-invested enterprises from engaging in, *inter alia*, the master distribution of all reading materials as well as the master wholesale and wholesale of electronic publications. China also prohibits foreign-invested enterprises from engaging in the distribution of any imported reading materials. In addition, where foreign-invested enterprises are permitted to engage in the distribution of reading materials, the measures at issue impose requirements on those foreign-invested enterprises that are more burdensome than those applicable to wholly Chinese-owned distributors of reading materials.

16. China maintains its regime for the distribution of reading materials through measures including: the Management Regulation, the *Administrative Rules for the Publication Market* (the “Publication Market Rule”), the *Rules on the Management of Foreign-Invested Enterprises Sub-Distributing Books, Newspapers and Periodicals* (the “Foreign-Invested Sub-Distribution Rule”), the *Examination and Approval of Established Chinese-Foreign Equity Joint Ventures, Contractual Joint Ventures, and Wholly Foreign-Owned Enterprises for the Sub-Distribution of Publications* (the “Sub-Distribution Procedure”), the *Rules for the Management of Subscribers Placing Subscriptions for Imported Publications* (the “Imported Publications Subscription Rule”), the Electronic Publications Regulation, the Several Opinions, the Foreign Investment Regulation, and the Catalogue.

17. China permits foreign-invested enterprises to engage in only one type of reading materials distribution – *i.e.*, the sub-distribution of books, newspapers and periodicals published in China. To engage in such sub-distribution, foreign-invested enterprises must satisfy requirements different from those applicable to wholly Chinese-owned enterprises also engaged in the same distribution activities. These differential requirements apply with respect to registered capital, operating terms, pre-establishment violations, and approval processes.

18. China’s regulatory regime governing the distribution of AVHE products in China imposes a number of restrictions on distribution by foreign-invested enterprises, including the form of the enterprise (*i.e.*, only be Chinese-foreign contractual joint ventures) and the share of foreign investment (*i.e.*, majority Chinese owned). As a result, Chinese-foreign contractual joint ventures, in which the Chinese party owns the majority of the shares, are the only foreign-invested enterprises permitted to engage in audiovisual distribution services. In addition, China discriminates against even Chinese-foreign contractual joint ventures by imposing on them certain requirements that are different from those that apply to wholly Chinese-owned enterprises engaging in the sub-distribution of AVHE products.

19. With respect to China’s limitations on corporate form and on foreign participation in audiovisual product sub-distribution enterprises, there are four relevant measures: (1) the Audiovisual Regulation; (2) the Audiovisual Sub-Distribution Rule; (3) the Catalogue; and (4) the Several Opinions.

20. Even after limiting the sub-distribution of AVHE products only to Chinese-foreign contractual joint ventures, China then imposes numerous other requirements not applicable to wholly Chinese-owned enterprises. These requirements come in the form of operating term limitations, pre-establishment violation conditions, and approval process obligations.

21. China greatly limits the ability of foreign-invested enterprises to engage in the distribution of sound recordings by prohibiting these enterprises from engaging in their electronic distribution – *i.e.*, the distribution of sound recordings using any electromagnetic means, (*i.e.*, not physical copies), including distribution to other distributors or to end users over, *e.g.*, the Internet or mobile telecommunications networks. China maintains these restriction through four measures: (1) the *Interim Rules on the Management of Internet Culture* (the “Internet Culture Rules”); (2) the *Notice of the Ministry of Culture on Some Issues Relating to Implementation of the “Interim Rules on the Management of Internet Culture”* (the “Internet Culture Notice”); (3) and the *Several Opinions on the Development and Management of Network Music* (the “Network Music Opinions”); and the Several Opinions. This prohibition does not extend to wholly Chinese-owned enterprises.

C. China’s Treatment of Imported Products Compared to Domestic Products

22. China maintains requirements for the distribution of imported reading materials, sound recordings, and films for theatrical release that disadvantage these products relative to their domestic counterparts. First, China’s subscription regime operates as the sole distribution channel for a large proportion of reading materials imported into China. Domestic reading materials are free of these restrictions. Second, imported sound recordings intended for electronic distribution must receive prior approval from MOC before distribution. Domestic

sound recordings, in contrast, require no such approval from MOC, they need only be registered with MOC.

23. Third, China requires the distribution of imported films for theatrical release to occur through one of two Chinese state-controlled distributors assigned by the Chinese Government. These two distributors use identical form contracts and allow no negotiation of key terms. By contrast, domestic films for theatrical release can be distributed by the full range of film distributors in China, with that distribution occurring on the basis of commercially negotiated terms covering all relevant aspects of the film's technical preparation, as well as its marketing and distribution. Moreover, domestic films for theatrical release may be distributed by their production studios, as is common throughout the rest of the world.

24. China restricts distribution channels for many kinds of imported reading materials by requiring their distribution to be conducted exclusively through subscription and then imposing requirements on subscribers to these imported publications that do not apply to those that subscribe to equivalent domestic reading materials.

25. The Imported Publication Subscription Rule is a key measure implementing this restricted distribution system. Under this measure, all imported newspapers and periodicals, and imported books and electronic publications in the limited distribution category, can only be distributed through subscription by Chinese wholly state-owned enterprises. While imported books and electronic publications in the non-limited distribution category can be distributed through sales on the market, these reading materials may only be distributed by wholly Chinese-owned enterprises.

26. Domestic books, newspapers and periodicals, on the other hand, can be sub-distributed by foreign-invested enterprises, and distributed by wholly Chinese-owned enterprises (including Chinese privately-owned enterprises), and Chinese state-owned enterprises, through a variety of channels, including but not limited to subscription. The Foreign-Invested Sub-Distribution Rule authorizes foreign-invested enterprises to engage in the sub-distribution of books, newspapers and periodicals published *in China*.

27. China requires all sound recordings, including sound recordings intended for electronic distribution, to undergo content review. The nature of that review, however, varies substantially depending on whether the sound recording is imported or domestic. China's measures require imported sound recordings to undergo content review and approval by the Chinese Government prior to their electronic distribution. In contrast, domestic sound recordings do not have to receive prior approval from the Chinese Government. Instead, they undergo internal company content review, and they simply are registered with the Ministry of Culture. Measures including the Network Music Opinions and the Internet Culture Rule give specific effect to this two-tier regime for sound recordings intended for electronic distribution. In addition, the Audiovisual Regulation and the Audiovisual Import Rule, make clear that imported and domestic sound recordings are subject to different content review regimes.

28. China maintains a dual distribution system for imported and domestically produced films for theatrical release. Imported films can be distributed only by two state-owned enterprises – China Film Distribution Company, a subsidiary of China Film Group, and Huaxia Film

Distribution Company (“Huaxia”). Furthermore, commercial negotiations do not determine the terms for the distribution or which of these two distributors will handle the imported film. Rather, China Film Group determines both the distributor and the basic distribution conditions for all imported films.

29. Domestic films, by contrast, have access to a far more open distribution system. The two state-controlled enterprises authorized to distribute imported films, as well as many other enterprises, including the film’s producer, and many other distributors, both private and state-owned, operating on a local, provincial or national basis, all can compete to distribute a domestic film on commercial terms. Several measures implement this dual distribution regime, including: the Film Regulation, the Provisional Film Rule, and the Film Distribution and Projection Rule.

III. CHINA’S MEASURES REGARDING TRADING RIGHTS ARE INCONSISTENT WITH CHINA’S OBLIGATIONS UNDER THE ACCESSION PROTOCOL AND THE WORKING PARTY REPORT

30. During its accession to the WTO, China committed to provide all enterprises in China and all foreign enterprises and foreign individuals the right to trade in all goods except those listed in Annex 2A or Annex 2B of China’s Accession Protocol. These commitments extend to all of the Products, as none of the Products is listed in either Annex. China’s “trading rights” commitments are expressed in Part I, paragraphs 5.1 and 5.2 of the Accession Protocol, as well as in Part I, paragraph 1.2 of the Accession Protocol, to the extent that it incorporates the commitments referred to in paragraphs 83 and 84 of the Working Party Report.

31. Through a variety of measures, however, China refuses to permit any foreign enterprises or foreign individuals to import the Products, and likewise only allows a subset of enterprises in China – *i.e.*, wholly state-owned Chinese enterprises approved or designated by the Chinese Government – to import the Products. The measures establishing China’s current trading rights regime for the Products are, therefore, inconsistent with China’s obligations contained in Part I, paragraphs 5.1, 5.2 and 1.2 of the Accession Protocol, as well as in paragraphs 83 and 84 of the Working Party Report.

32. Read together, these provisions establish that all enterprises in China, all foreign enterprises and all foreign individuals shall have the right to import the Products into China following a transition period. That transition period ended on December 11, 2004, more than three years ago. Moreover, none of the Products is among those goods listed in Annex 2A of the Accession Protocol that are excluded from China’s trading rights commitments.

33. China first committed to providing all enterprises in China the right to trade in the Products via paragraph 5.1 of the Accession Protocol and paragraphs 83(d) and 84(a) of the Working Party Report.

34. Paragraph 83(d) confirms the obligation contained in paragraph 5.1 of the Accession Protocol – *i.e.*, that China committed to provide trading rights to *all* enterprises in China by December 11, 2004. Paragraph 84(a) likewise confirms China’s obligations with respect to trading rights, as set forth in paragraph 5.1 of the Accession Protocol.

35. As a result of paragraph 5.2 of the Accession Protocol and paragraphs 84(a) and 84(b) of the Working Party Report, China further committed to extend to all foreign enterprises and all

foreign individuals, including sole proprietorships of other WTO Members, the same right to import all goods into China as is accorded to all enterprises in China.

36. Paragraph 84(a) of the Working Party Report confirms and elaborates on paragraph 5.2 of the Accession Protocol. It provides expressly that China shall permit all foreign enterprises and all foreign individuals, including sole proprietorships, to import goods, including the Products, into China. Paragraph 84(b) of the Working Party Report also confirms and elaborates on paragraph 5.2 of the Accession Protocol. Paragraph 84(b) explains that not only are trading rights to be granted to foreign individuals and enterprises, but that these rights shall be granted in a “non-discriminatory and non-discretionary” way.

37. Despite China’s trading rights commitments, China permits only wholly state-owned Chinese enterprises approved or designated by the Chinese Government to import into China reading materials, AVHE products, sound recordings, and films for theatrical release. Underscoring this restriction, China expressly prohibits any foreign-invested enterprises from engaging in the importation of any of the Products. Thus, under Chinese law, any foreign-invested enterprise *in China* – whether the enterprise is wholly-foreign owned or is a Chinese-foreign joint venture – as well as any *foreign enterprise* and any *foreign individual* is denied the right to import the Products.

38. There are four measures broadly applicable to the importation of the Products: (1) the Catalogue; (2) the Several Opinions; (3) the Management Regulation; and (4) the Importation Procedure. Each of these is inconsistent with China’s trading rights commitments. The Catalogue and the Several Opinions prohibit foreign-invested enterprises from importing any of the Products into China. Article X of the Catalogue bans foreign-invested enterprises from engaging in the importation of the Products. Likewise, the Several Opinions definitively forbid foreign-invested enterprises, whether or not they are in China, from engaging in the importation of the Products.

39. These measures are inconsistent with China’s trading rights commitments in two ways. First, by depriving foreign-invested enterprises in China, as well as foreign enterprises and individuals, of the right to import the Products, the Catalogue and the Several Opinions limit the trading rights of these entities, which China’s trading rights commitments do not permit. Second, the Several Opinions and the Catalogue also restrict trading rights in a discriminatory manner, as they insulate certain wholly Chinese-owned enterprises from any competition from foreign sources.

40. The Management Regulation and Importation Procedure are similarly inconsistent with China’s trading rights commitments. First, these measures mandate that only wholly state-owned enterprises satisfying specified criteria, including the State plan for the total number, structure, and distribution/deployment of these enterprises, may import reading materials, AVHE products, and sound recordings into China, giving rise to the same two inconsistencies with China’s trading rights commitments discussed above with regard to the Several Opinions and the Catalogue. Second, the importation of certain reading materials, *i.e.*, newspapers and periodicals, is further restricted to wholly state-owned enterprises specially designated by the Chinese Government, pursuant to Article 41 of the Management Regulation. These measures inject

further qualifying criteria and government discretion into a process that China committed to be “non-discretionary” and are therefore inconsistent with China’s trading rights commitments.

41. The Electronic Publications Regulation is inconsistent with China’s trading rights commitments by imposing limits on which enterprises may import electronic publications into China. Articles 50 and 51 limit which enterprises may engage in the importation of electronic publications according to Chinese Government plans for “total number, structure and deployment” of such enterprises. Articles 52-55 further require approval by multiple layers of Chinese Government decision-makers before an enterprise may import electronic publications. By conditioning trading rights on Chinese Government plans for structuring these activities and on successfully obtaining Chinese Government approvals, the Electronic Publications Regulation is inconsistent with China’s trading rights commitments. It injects qualifying criteria and government discretion into a process that China committed to be “non-discretionary”.

42. China uses a number of measures specific to the audiovisual sector to place restrictions on the right to import AVHE products into China that are inconsistent with China’s trading rights commitments. The Audiovisual Regulation and the Audiovisual Import Rules provide that only enterprises designated by the Chinese Government may import finished audiovisual products, and it provides that importers of unfinished audiovisual products must be approved by the Chinese Government. Under these requirements, only CNPIEC (a Chinese wholly state-owned enterprise) has been designated to import finished audiovisual products, and only Chinese wholly state-owned enterprises may be approved to import unfinished audiovisual products.

43. The Audiovisual Sub-Distribution Rule, which governs the activities of foreign-invested distributors of audiovisual products, specifically provides in Article 21 that Chinese-foreign contractual audiovisual product distribution enterprises are prohibited from engaging in the importation of audiovisual products. Article 21 is therefore inconsistent with China’s trading rights commitments, because it denies these enterprises the right to import AVHE products.

44. China’s trading rights regime with respect to sound recordings is also heavily restricted and is also inconsistent with China’s trading rights commitments. This restrictive sound recordings trading rights regime is incorporated into the general measures governing the importation of the Products as well as the specific measures governing the importation of AVHE products. Accordingly, only Chinese state-owned enterprises are permitted to import sound recordings into China, with foreign-invested enterprises and individuals explicitly banned from these activities.

45. Furthermore, only the state-owned enterprises specifically “designated” by the Chinese Government are allowed to import finished sound recordings. As for unfinished sound recordings, only enterprises that have been approved by the Chinese Government are permitted to import such products. In practice, as is the case with AVHE products, China reserves the exclusive right to import finished sound recordings to CNPIEC, while permitting only Chinese

Government-approved Chinese state-owned enterprises to import unfinished sound recordings into China.

46. China's measures granting China Film Group a monopoly on the right to import films for theatrical release are inconsistent with China's trading rights commitments. The basis for this monopoly is established through such general measures as the Several Opinions and the Catalogue, which forbid foreign-invested enterprises from importing films into China. The restriction is further detailed in the following specific measures: the Films Regulation, the Provisional Film Rule, the Film Distribution and Projection Rule.

47. The Film Distribution and Projection Rule explicitly establishes China's film importation monopoly, designating China Film Import and Export Corporation as the exclusive importer of foreign films into China. Article 30 of the Films Regulation provides the legal basis for this monopoly, providing that only enterprises designated by the Chinese Government are permitted to import films for theatrical release. Article 16 of the Provisional Film Rule confirms this restriction. This monopoly not only deprives enterprises in China (other than China Film Group) as well as foreign enterprises and individuals of the right to import films for theatrical release. It also discriminates against foreign-invested enterprises and foreign individuals, in contravention of China's trading rights commitments.

IV. CHINA'S MEASURES REGARDING DISTRIBUTION SERVICES ARE INCONSISTENT WITH CHINA'S OBLIGATIONS UNDER THE GATS

48. In its Accession Protocol, China made market access and national treatment commitments in the distribution services and audiovisual services sectors of its Services Schedule to open China's market in substantial fashion to foreign service suppliers, including distributors of reading materials, AVHE products and sound recordings. Despite these commitments, China's measures impose discriminatory restrictions and requirements on foreign service suppliers seeking to engage in the distribution of reading materials, AVHE products, and sound recordings. Those restrictions and requirements are inconsistent with China's obligations under the GATS.

49. In Sector 4B, under the Distribution Services heading of its Services Schedule, China undertook market access and national treatment commitments with respect to wholesale trade services ("wholesaling") through commercial presence (mode 3) of, *inter alia*, reading materials (including books, newspapers, periodicals and electronic publications).

50. China committed to permit foreign service suppliers to engage in wholesale trade services via mode 3 with respect to books, newspapers and periodicals within three years after China's accession. After December 11, 2004, therefore, China's Services Schedule provides for no market access limitations under mode 3 for wholesaling services with respect to any reading materials. Having inscribed "None" in mode 3 under the national treatment column in Sector 4B, China provided for no conditions or qualifications on its national treatment commitment with respect to wholesaling services through commercial presence. Moreover, China's inscriptions under mode 3 of its horizontal commitments do not create any limitations on China's commitments in Sector 4B of its specific commitments that would justify the measures at issue.

51. The discriminatory limitations on foreign-invested reading materials wholesalers imposed by China's measures are inconsistent with Article XVII of the GATS. In examining a claim under Article XVII, three distinct elements are relevant to establishing a breach: (1) the Member whose measure(s) is at issue has made a commitment in its services schedule in the relevant sector and mode of supply, and has not inscribed any relevant limitation to that commitment; (2) the Member has adopted or applied a measure affecting the supply of services in that sector and/or mode of supply; and (3) the measure accords to any other Member's service suppliers treatment less favorable than that accorded to its own like service suppliers. China's measures regarding foreign reading material wholesalers are inconsistent with China's GATS Article XVII commitments, since they treat foreign suppliers of these services far less favorably than their domestic counterparts.

52. China maintains numerous measures affecting the supply of reading material wholesaling services under mode 3. These measures include the Management Regulation, the Publication Market Rule, the Foreign-Invested Sub-Distribution Rule, the Sub-Distribution Procedure, the Imported Publication Subscription Rule, the Electronic Publications Regulation, the Catalogue, the Foreign Investment Regulation and the Several Opinions. These measures affect the supply of reading material wholesaling services in mode 3 within the meaning of Article XVII, because they directly regulate the wholesale distribution of reading materials in China.

53. On their face, these measures treat foreign-invested wholesalers of reading materials operating under mode 3 less favorably than wholly Chinese-owned wholesalers. First, China prohibits foreign-invested enterprises from engaging in several forms of reading material wholesaling. Further, where China has made a limited exception to this general ban, as it did for foreign-invested enterprises engaging in the sub-distribution of books, newspapers and periodicals published in China, foreign service suppliers are subjected to requirements – governing registered capital, operating terms, pre-establishment violations, and examination and approval procedures – that are more onerous than those applicable to their wholly Chinese-owned competitors. This treatment is less favorable because it modifies the conditions of competition in favor of wholly Chinese-owned reading material wholesalers compared to like foreign-invested reading material wholesalers.

54. In Sector 2D of its Services Schedule, entitled "Audiovisual Services", China undertook market access and national treatment commitments under mode 3 for the distribution of a range of products, including AVHE products such as videocassettes, VCDs, and DVDs.

55. In the first column of Sector 2D, China inscribed "Videos, including entertainment software and (CPC 83202), distribution services" under "audiovisual services", which covers the distribution of, *inter alia*, videocassettes, VCDs, DVDs, video games, computer games as well as the leasing or renting services concerning videocassettes.

56. Under the market access column for Sector 2D, China inscribed the following: "Upon accession, foreign services suppliers will be permitted to establish contractual joint ventures with Chinese partners to engage in the distribution of audiovisual products, excluding motion pictures, without prejudice to China's right to examine the content of audio and video products (see footnote 1)." China's horizontal market access commitment under mode 3 describes three forms

of foreign-invested enterprises – *i.e.*, foreign capital enterprises (also referred to as wholly foreign-owned enterprises), equity joint ventures and contractual joint ventures. Foreign investment in equity joint ventures must account for a minimum of 25 percent of total registered capital; no maximums for foreign investment participation in equity joint ventures are established.

57. For contractual joint ventures, China inscribed no limitations – whether minimums or maximums – on foreign equity participation, either in its horizontal commitments or in Sector 2D. China’s horizontal market access commitment under mode 3 provides that the level of equity participation in contractual joint ventures is to be determined by the parties as memorialized in the terms of the contract.

58. Returning to the second column of Sector 2D, China excluded the distribution of “motion pictures” from its market access inscription under mode 3. “Motion picture” is defined as a “cinema film” and means in this context a film for theatrical release as opposed to an AVHE product, such as a videocassette, VCD or DVD.

59. Reading China’s market access commitment under mode 3 in Sector 2D together with its horizontal commitments, China scheduled no market access limitations on the contractual joint ventures that foreign invested enterprises may establish with Chinese partners to engage in the distribution of audiovisual products, excluding films for theatrical release, without prejudice to China’s right to examine the content of audio and video products. In particular, China did not schedule any limits on the level of foreign equity participation in such contractual joint ventures; rather, it expressly acknowledged that this level is to be negotiated and agreed by the parties to the contractual joint venture. Turning to national treatment, China inscribed “None” – *i.e.*, no limitations – in the national treatment column of Sector 2D.

60. The foreign equity participation restrictions imposed by China on foreign-invested AVHE product distributors are inconsistent with Article XVI of the GATS. Article XVI:2, subparagraph (f) provides that where a Member has made a market access commitment in its Services Schedule, that Member is prohibited from imposing limitations on the participation of foreign capital, whether in terms of maximum shareholder percentage limits or in terms of the total value of foreign investment (on either an individual or aggregate basis), unless the Member included that limitation in its Service Schedule.

61. Thus, in order to show that a Member’s measure is inconsistent with Article XVI:2(f), it is necessary to demonstrate: (1) that the Member made a market access commitment in the relevant sector or sub-sector and mode of supply in its Services Schedule; (2) that the Member did not include a limitation on the participation of foreign capital in that sector or sub-sector and that mode of supply in its Services Schedule; and (3) that the measure at issue imposes such a limitation.

62. As discussed above, China committed to permit foreign service suppliers to establish contractual joint ventures with Chinese partners to engage in the distribution of AVHE products. China, however, maintains numerous measures limiting the percentage of shares foreigners may own in contractual joint ventures engaged in the distribution of AVHE products. These measures

include the Audiovisual Sub-Distribution Rule, the Catalogue, the Foreign Investment Regulation and the Several Opinions.

63. China's measures at issue are also inconsistent with Article XVII of the GATS. In the market access column under mode 3 of Sector 2D of its Services Schedule, China committed to permit foreign service suppliers to establish contractual joint ventures with Chinese partners to engage in the distribution of AVHE products through commercial presence. In addition, China scheduled no limitations on its national treatment commitment under mode 3.

64. The measures at issue affect the supply of video distribution services under mode 3 of Sector 2D of China's Services Schedule by directly regulating audiovisual distribution services, including distribution services regarding AVHE products in China.

65. China's measures fail to meet the obligations of Article XVII: they treat AVHE product distribution services and service suppliers of other Members less favorably than China's own like services and service suppliers. The measures at issue limit the operations of foreign-invested enterprises wishing to engage in AVHE product distribution services by imposing more stringent requirements – governing equity participation, operating terms, the existence of pre-establishment legal violations, examination and approval processes, and decision-making criteria – on foreign-invested enterprises engaged in these services compared to their wholly Chinese-owned competitors.

66. In Sector 2D of its Services Schedule, China undertook market access and national treatment commitments under mode 3 with respect to sound recordings distribution. China has also inscribed "sound recording distribution services" under the audiovisual services sector of its Services Schedule. Thus, the market access and national treatment commitments that China has included in the second and third columns under mode 3 of Sector 2D also apply to sound recordings distribution in China.

67. In addition, China inscribed no limitations on its market access commitment under mode 3 regarding the means of delivery used for sound recordings distribution. That is, China did not identify any means of delivery – whether by mail, Internet, mobile telecommunications networks, or any other means – that Chinese-foreign contractual joint ventures were precluded from using to distribute sound recordings.

68. As the panel noted in *US – Gambling*, "the GATS does not limit the various technologically possible means of delivery under mode 1", which is reflected in the principle of "technological neutrality" espoused in the Work Programme on Electronic Commerce – Progress Report to the General Council and relied on by the panel in *US – Gambling*.

69. China's measures do not provide national treatment to foreign-invested enterprises engaged in sound recording distribution under mode 3 and thus are inconsistent with Article XVII of the GATS.

70. China's measures affect the supply of sound recording distribution services via mode 3. The Internet Culture Rule, the Internet Culture Notice, the Network Music Opinions and the Several Opinions dictate how certain types of electronic distribution are to be conducted through commercial presence within China, and they likewise dictate who may engage in these activities.

These measures likewise accord less favorable treatment to foreign-invested enterprises by prohibiting them from engaging in any electronic distribution of sound recordings through commercial presence.

V. CHINA’S MEASURES REGARDING PRODUCT DISTRIBUTION ARE INCONSISTENT WITH CHINA’S OBLIGATIONS UNDER ARTICLE III:4 OF THE GATT 1994

71. Imported copyright-intensive products face numerous disadvantages in the Chinese marketplace and are deprived of national treatment *vis-à-vis* their domestic counterparts. China significantly limits the distributors and distribution channels that are available to imported reading materials; they impose a restrictive subscription regime on a large portion of these imported products. China also discriminates against imported sound recordings intended for electronic distribution by imposing more burdensome content review requirements prior to distribution. Finally, China confines imported films for theatrical release to two Chinese state-controlled distributors. In each instance, China accords treatment to imported reading materials, sound recordings intended for electronic distribution, and films for theatrical release that is less favorable than that accorded to like domestic products.

72. China’s measures governing the distribution of imported reading materials (Imported Publication Subscription Rule and the Foreign-Invested Sub-Distribution Rule), hard copies of imported sound recordings intended for electronic distribution (the Audiovisual Regulation, the Audiovisual Import Rules, the Internet Culture Rule, the Network Music Opinions), and imported films for theatrical release (the Film Regulation, the Provisional Film Rule, and the Film Distribution and Projection Rule) are inconsistent with Article III:4 of the GATT 1994.

73. The Appellate Body has identified three distinct elements that are required to establish a breach of Article III:4: (1) the imported and domestic products are “like products”; (2) the measure is a law, regulation, or requirement affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of the imported and domestic like products; and (3) the imported product is accorded less favorable treatment than the domestic like product.

74. For each product, imports are “like” those made in China within the meaning of Article III:4. The question of whether imported and domestic products are “like products” for the purposes of Article III:4 is readily answered where the measures at issue make distinctions between products based solely on origin. As the panel found in *India – Autos*, where “origin [is] the sole criteria distinguishing the products, it is correct to treat such products as like products within the meaning of Article III:4.”

75. Whether they are reading materials, sound recordings intended for electronic distribution, or films for theatrical release, the imported and domestic products shares the same physical characteristics and commercial uses. However, Chinese measures discriminate against imported reading materials, imported sound recordings intended for electronic distribution, and imported films for theatrical release on the basis of national origin through measures that favor the purchase and use of their domestic counterparts.

76. The second prerequisite to a finding of an Article III:4 inconsistency requires a showing that the measures at issue “affect[] [the] internal sale, offering for sale, purchase, transportation,

distribution, or use” of like products. The term “affecting” in Article III:4 has been understood to have a “broad scope of application”, and to cover measures even beyond those which directly regulate or govern the sale of imported and domestic like products. The measures at issue here all regulate at least the internal sale, offering for sale, purchase, distribution or use of imported and domestic like products, and thus readily qualify as “affecting” these activities within the meaning of this term in Article III:4.

77. The last element in an Article III:4 analysis is whether the measures at issue accord less favorable treatment to imported products than to domestic products. The Appellate Body has found this to be the case when, for example, the measure at issue modifies the conditions of competition in the relevant market to the detriment of imported products. The panel in *Canada – Wheat* found that “the imposition of additional, or extra, requirements on imported products as compared to like domestic products constitutes less favorable treatment”. The measures at issue systemically distort competition between imported and like domestic products. These regulatory constraints, from which competing Chinese products are exempt, create major disadvantages for imported products in the Chinese market place.

78. China’s Imported Publication Subscription Rule accords less favorable treatment to imported publications than that accorded to domestic publications by modifying the conditions of competition in the Chinese marketplace to the detriment of imported publications. This measure only permits distribution of imported newspapers and periodicals, and imported books and electronic publications in the limited distribution category via a highly restrictive subscription regime that does not apply to domestic reading materials.

79. Imported reading materials suffer further competitive disadvantage from the fact that they may only be distributed by a limited set of distributors in China, *i.e.*, wholly Chinese-owned distributors. Domestic publications are subject to neither the subscription requirement nor the limitation on who can distribute them, as clarified by the Foreign-Invested Sub-Distribution Rule. As a result, China accords less favorable treatment to imported publications than it accords to domestic publications in contravention of Article III:4.

80. China’s measures modify the conditions of competition in its sound recordings market to the detriment of imported sound recordings. Specifically, Article 9 and Appendix 2 of the Network Music Opinions provide that imported sound recordings intended for electronic distribution must be subjected to a formal content review and approval process run by the Ministry of Culture (MOC) that must be successfully completed before the imported products can be distributed. The like products at issue – domestic sound recordings intended for electronic distribution that have Chinese copyright owners – are not covered by this mandatory regulatory process as a precondition to their distribution. The measure provides that employees of the domestic sound recording’s publisher can review the content in-house, and then simply register the recording with MOC at the time the recording is ready for distribution.

81. The Internet Culture Rule further perpetuates this disparate treatment by providing for asymmetrical content review requirements that decidedly favor domestic over imported sound recordings intended for electronic distribution. In contrast, Article 19 of the Internet Culture Rule states that domestic Internet cultural products are to be reviewed by their domestic

distributor's internal content examination system. Article 16 further provides that such domestic products only need to be registered with MOC within 60 days *after* being distributed.

82. The Audiovisual Regulation and the Audiovisual Import Rules echo this discriminatory content review requirement. These two measures impose additional content review requirements on imported products as compared to like domestic products resulting in distorted competitive conditions that disadvantage imported sound recordings *vis-à-vis* domestic like products.

83. China's regime for the distribution of films for theatrical release also creates discriminatory competitive conditions that harm imported products. First, the Provisional Film Rule and the Film Distribution and Projection Rule only permit imported films for theatrical release to be distributed by two state-controlled enterprises, China Film Group and Huaxia. In contrast, domestic films can be distributed by these two enterprises as well as by any of the other film distributors established in China.

84. Second, the two state controlled distributors that are the only option for distributing imported films are explicitly required by law to support the distribution and exhibition of *domestic* films. These requirements treat imported films less favorably than domestic films. The distribution opportunities afforded to domestic films are radically different, involving access to the complete range of distribution channels.

VI. CHINA'S MEASURES REGARDING PRODUCT DISTRIBUTION ARE INCONSISTENT WITH CHINA'S OBLIGATIONS UNDER THE ACCESSION PROTOCOL

85. The Imported Publication Subscription Rule, the Foreign-Invested Sub-Distribution Rule, the Network Music Opinions, the Internet Culture Rule, the Audiovisual Regulation, the Audiovisual Import Rules, the Film Regulation, the Provisional Film Rule and the Film Distribution and Projection Rule are also inconsistent with paragraph 5.1 of Part I of the Accession Protocol with respect to imported publications, imported hard copies of sound recordings intended for electronic distribution, and imported films for theatrical release. As these measures are all inconsistent with Article III:4 of the GATT 1994, they are likewise in breach of Section 5.1 of Part I of the Accession Protocol.

86. These measures are also inconsistent with China's obligations under paragraph 1.2 of Part I of the Accession Protocol, to the extent that it incorporates commitments in paragraph 22 of the Working Party Report. As these measures are inconsistent with China's obligations under Article III:4 of the GATT 1994 regarding national treatment with respect to imported and domestic products, they are consequently inconsistent with Section 1.2 of Part I of the Accession Protocol and paragraph 22 of the Working Party Report.

VII. CONCLUSION

87. For the foregoing reasons, the United States respectfully requests that the Panel find that China's measures, as set out in the U.S. panel request are inconsistent with China's obligations under the Accession Protocol, the GATS, and the GATT 1994. The United States further requests, pursuant to Article 19.1 of the DSU, that the Panel recommend that China bring its measures into conformity with its obligations under the Accession Protocol, the GATS, and the GATT 1994.