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

(WT/DS363)

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I. INTRODUCTION

1. China made important market opening commitments related to reading materials, AVHE products, sound recordings and films for theatrical release when it acceded to the World Trade Organization. Unfortunately, this much anticipated liberalization still awaits full realization, since China's laws and policies have created major stumbling blocks, and in some cases, have thwarted it entirely.

2. China asks foreign importers to tolerate state-owed importers monopolizing the importation of these products into China. China also asks foreign distributors to accept limited rights to distribute reading materials, AVHE products and sound recordings, and then to satisfy special additional requirements to actually do business – requirements that allow Chinese distributors early and more advantageous access to the Chinese market. Imported films, publications and music likewise face obstacles hampering their success in the Chinese market that their domestic counterparts do not have to endure. Unnecessary delays in achieving important benefits of WTO accession like greater market efficiencies, improved commercial opportunities, and increased educational exchange inevitably result. The United States brought this dispute to gain prompt implementation of China's commitments under its Accession Protocol, the GATS and the GATT 1994 and thus end these delays.

3. In its previous submissions, the United States has demonstrated that China's efforts to implement its trading rights, services and goods obligations fall short in three respects. This submission will show how China's arguments and procedural objections in its First Written Submission, First Oral Statement and Answers to the First Set of Panel Questions fail to rebut the U.S. claims concerning the Accession Protocol, the GATS and the GATT 1994.

4. *First*, China agreed to allow all foreign enterprises, foreign individuals, and enterprises in China to import reading materials, AVHE products, sound recordings and films for theatrical release into China. Despite this commitment, China permits only selected state-owned importers to participate in this business. China's defense to this state of affairs begins with an invitation to the Panel to indulge in alchemy. China asks the Panel to find that China's commitments do not extend to films for theatrical release, unfinished AVHE products or unfinished sound recordings, because the commercial exploitation of these products involves associated services, so, China claims, the goods themselves should be viewed as services. However, the Panel should decline this invitation: when China's trading rights commitments are read in light of GATT 1994, and are considered in light of prior reasoning by the Appellate Body, international classifications, and China's own treatment of these products, it is evident that China's alchemy fails.

5. China also proffers Article XX(a) of the GATT 1994 to try to justify its trading rights prohibitions, but this attempted defense fails as well. The Panel does not need to determine whether the GATT exception in fact applies to China's measures, because China's measures fall far short of satisfying the requirements of sub-paragraph (a), and their application fails to meet the standards in the *chapeau* of Article XX. This leaves the U.S. claim unrebutted; China's measures are inconsistent with its trading rights commitments under the Accession Protocol.

6. *Second*, China has set up troubling obstacles to foreign service suppliers. It prohibits foreign enterprises from supplying certain kinds of distribution services related to reading materials and sound recordings, despite China's broad liberalizing commitments in its Services Schedule. And where China does allow foreign enterprises to distribute reading materials and AVHE products, China imposes discriminatory requirements favoring Chinese competitors and also further hampers foreign AVHE service suppliers by limiting the capital contributions they can make. China has offered no convincing rebuttals to these U.S. claims, making it clear that the measures at issue are inconsistent with China's market access and national treatment commitments under Articles XVI and XVII of the GATS.

7. *Third*, contrary to its national treatment obligations, China maintains two parallel, unequal channels for the commercial exploitation of reading materials, sound recordings and films for theatrical release within China. In one channel, imported reading materials, sound recordings and films for theatrical release travel through a thicket of restrictions that devalue the commercial opportunities available to those products in China. In the other channel, domestic products travel in the fast lane to consumers, unfettered by the limitations imposed on their imported counterparts. China's efforts to justify these measures are unavailing. China's measures accord imported products less favorable treatment than like domestic products in a manner inconsistent with Article III:4 of the GATT 1994 and paragraphs 5.1 and 1.2 of China's Accession Protocol.

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

8. Pursuant to its trading rights commitment, China is obligated to provide all foreign enterprises, all foreign individuals and all enterprises in China 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 reading materials, AVHE products, sound recordings, and films for theatrical release, as none of these products are listed in either Annex.

9. However, China maintains numerous measures that prohibit foreign enterprises or foreign individuals from importing reading materials, AVHE products, sound recordings, and films for theatrical release, and likewise only allows Chinese wholly state-owned enterprises approved or designated by the Chinese Government[1] to import these products. These measures are: the Management Regulation; the Importation Procedure; the Catalogue; the Foreign Investment Regulation; the Several Opinions; the Electronic Publications Regulation; the Audiovisual Regulation; the Audiovisual Import Rule; the Audiovisual Sub-Distribution Rule; the Film Regulation; the Provisional Film Rule; and the Film Distribution and Projection Rule.

[1] *See*, *e.g.*, China's Answers to the First Set of Panel Questions, Question 46(a) (conceding "[o]nly wholly state-owned enterprises are permitted to import reading materials and audiovisual products.").

10. For the reasons explained in our previous submissions, China's trading rights regime for reading materials, AVHE products, sound recordings, and films for theatrical release is 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.[2] While China has advanced several arguments responding to this claim, none of them succeed.

A. Goods vs. Services

11. China makes a number of erroneous arguments that films for theatrical release, unfinished AVHE products, and unfinished sound recordings, are not goods, and therefore, are not subject to the trading rights disciplines. China's arguments have no merit. Indeed, as discussed below, China's line of reasoning would transform all goods commercially exploited through a series of associated services into services themselves. Confronted with the untenable consequence of its argument, China has been unable to articulate a means of distinguishing these products from other goods that are sold through a series of associated services. As the United States has demonstrated, these products are all goods subject to the trading rights disciplines, and the relevant Chinese measures challenged by the United States run afoul of China's trading rights commitments.

1. Films for Theatrical Release

12. In its submissions, China argued that films for theatrical release are not goods based on certain assertions such as: a motion picture is intangible; the commercial exploitation of motion pictures for theatrical release occurs through a series of services and the tangible film is a mere accessory of a service; and international classification instruments confirm the status of motion pictures as a service. However, the text of the GATT, the Appellate Body's guidance on this issue, and China's own treatment of films as goods, all belie China's contentions.

a. China's Description of Films for Theatrical Release and Their Commercial Exploitation Confirms That They are Goods

13. First, the product that is the subject of the U.S. trading rights claim is tangible, hard-copy cinematographic film that can be used to project motion pictures in a theater.[3] Even if, assuming *arguendo*, China were correct that "goods" must be tangible to qualify as goods, the product relevant to the U.S. trading rights claim – *i.e.*, hard-copy cinematographic film – is tangible. China apparently seeks to deny the tangibility of films merely by substituting the term "motion

[2] U.S. First Written Submission, paras. 18-68 and 224-270; U.S. First Oral Statement, paras. 8-39; and U.S. Answers to the First Set of Panel Questions, paras. 1-94.

[3] *See* U.S. First Oral Statement, para. 11; *see also* U.S. Answers to the First Set of Panel Questions, paras. 41-43 (describing the nature of the product that is imported into China).

picture" for "film" and then simply asserting that a "motion picture *per se* is intangible."[4] In making this argument, it appears that China seeks to separate the hard-copy cinematographic film from the content that it carries, focus only on the content, and assert that the content is not a good. However, this effort sheds no light on the actual issue at hand.

14. As the United States set forth in its response to Panel Question 22, none of the U.S. claims depends on the premise that content is a good distinct from a carrier medium. Goods may be of interest to consumers for different reasons; the Products subject to the U.S. trading rights claims, including films for theatrical release, happen to be of interest to consumers because of their content.[5] The fact that the tangible film carries content does not transform the film into something other than a good. Indeed, China's position is not only wrong, but is internally inconsistent. All of the Products subject to the U.S. trading rights claims consist of a hard-copy carrier medium containing content, but China has not argued that reading materials, finished AVHE products or finished sound recordings are not goods.[6]

15. China also unsuccessfully contends that films for theatrical release are not goods because they are exploited through a series of services, and "the commercial value of the motion picture lies in the revenue generated by the services provided for the exploitation of motion picture's rights and not in the fixed revenue generated by the sale of goods."[7] China argues that because the "delivery materials" containing film are mere accessories of such services, films are not goods. If accepted, China's argument would have serious systemic implications.[8] Because the vast majority of goods are commercially exploited through a series of associated services, China's argument would transform virtually all goods into services.

16. In its first oral statement, the United States used the example of a stethoscope, a good that can be imported and commercially exploited through the provision of health care services. The fact that the stethoscope is used to provide health care services does not mean that the stethoscope is no longer a good.[9] Faced with a similar example in one of the Panel's questions, involving a surgical tool, China declined to answer the question posed, a silence that speaks volumes.[10]

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[4] China's First Written Submission, para. 55.

[5] U.S. Answers to the First Set of Panel Questions, para. 63.

[6] U.S. Answers to the First Set of Panel Questions, para. 65.

[7] China's First Written Submission, para. 60.

[8] U.S. First Oral Statement, para. 13.

[9] U.S. First Oral Statement, para. 13.

[10] China's Answers to the First Set of Panel Questions, Question 33. Instead, China went off on a tangent, noting that under the Appellate Body's guidance in *EC – Bananas III*, the appropriate way to determine whether a measure is subject to the GATT or the GATS or both is by reference to whether the *measure* affects trade in goods or trade in services. However, as set forth in more detail in section II.A.1.c below, this discussion provides no support for China's contention that a film is not a good. Indeed, the measures subject to the U.S. trading rights claim for films for theatrical release do relate to trade in goods.

17. China's own customs regime also demonstrates that China itself treats films as goods. First, China concedes that films must go through "customs clearance."[11] Additionally, China's accession schedule of tariff concessions, which only covers goods, includes under heading 3706, "[c]inematographic film, exposed and developed, whether or not incorporating sound track or consisting only of sound track."[12] Finally, Article 2 of the Regulations of the People's Republic of China on Import and Export Duties, provides that "[u]nless otherwise provided for by laws and administrative regulations, the Customs shall, in accordance with these Regulations, collect import or export duties on *all goods* permitted by the People's Republic of China to be imported into or exported out of the Customs territory . . ."[13] As China itself admits, it applies customs duties to films.[14] Thus, China treats films as goods.

b. China's Proposed Criteria for Determining Whether a Good Should be Construed as a Mere Accessory to a Service are Fundamentally Flawed

18. In order to bolster its assertion that the relevant measures should be subject to services disciplines, China goes on to provide certain criteria that it says are not decisive, but claims "may help determine whether a particular good affected by a measure regulating the supply of a service should be treated as an 'accessory to a service'."[15] However, these criteria merely highlight further the flaws in China's argument. Under China's approach, a wide swath of goods would be magically transformed into services.

19. China's criteria are: (1) whether the good is not an object traded in its own right *i.e.*, it will not be used/traded outside the context of the specific service that the measure regulates; (2) the transaction involving the good in the context of the specific service that the measure regulates does not require a transfer of ownership of that good; (3) the supply of the good itself is part of the supply of the service that the measure regulates, and cannot be considered independently from that service; and (4) the good has no own commercial value in the context of the specific service other than the revenue arising from the supply of that service.[16]

20. The United States considers that the vast majority of goods would be transformed into services if these criteria were applied. An instructive example involves a measure regulating the importation of cars for use in a rental car service. If the car is imported for use in a rental car service and is subject to the relevant measure, it will likely not be used or traded in another context. In addition, the supply of the rental service does not involve a transfer of ownership of the car. The supply of the good, *i.e.*, the car, is the quintessential aspect of the supply of a car

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[11] China's First Written Submission, para. 95.
[12] Excerpts from Schedule CLII (in HS96 nomenclature), Exhibit JPN-2.
[13] Exhibit US-73 (emphasis added).
[14] China's Answers to the First Set of Panel Questions, Question 132.
[15] China's Answers to the First Set of Panel Questions, Question 33.
[16] China's Answers to the First Set of Panel Questions, Question 33.

rental service. Finally, in the context of the specific service, car rental, the commercial value of the car arises from the supply of the rental service. Despite the fact that application of these criteria would lead to the conclusion that a car used for rental car services is not a good, China would agree, we hope, that a car is a good.

c. The Relevant Measures Affect Trade in Goods and are Therefore Subject to Goods Disciplines.

21. China also attempts to anchor its argument that films are not goods in the Appellate Body's guidance in *EC – Bananas III* concerning whether the measure at issue affects trade in goods, trade in services, or both.[17] However, an analysis of the relevant measures using the Appellate Body's guidance, which China endorses, reveals that the measures unambiguously affect trade in goods. The Appellate Body's guidance in *EC – Bananas III* is as follows:

> Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and the GATS. These are measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good. In all such cases in this third category, the measure in question could be scrutinized under both the GATT 1994 and the GATS. However, while the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis.[18]

Because the measures relevant to the U.S. trading rights claim relating to films for theatrical release affect trade in goods, they should be scrutinized under the goods disciplines, consistent with the Appellate Body's Guidance.

22. In fact, China's measures themselves refer to the importation of the good separate from and in addition to the provision of services using the good. Article 5 of the Films Regulation is typical. It sets forth the requirements for "film production, import, export, distribution, and

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[17] China's Answers to the First Set of Panel Questions, Question 33.

[18] *EC – Bananas III (AB)*, para. 221.

screening, and the public screening of films."[19] This language refers to both *import* of films *and* the distribution and screening of films. The other measures are structured in a similar fashion.[20] All of these measures refer to the import of films. Since the relevant measures affect both the good and certain associated services involving that good, they are subject to both goods and services disciplines.

23. In fact, China provides no citations to any of its measures – let alone an analysis of the text of these measures – to support its argument that these measures regulate services, and not goods. China does claim, in its first written submission, that the measures at issue here regulate the "licensing service for the exploitation rights of motion pictures for their theatrical distribution" rather than "the importation of goods."[21] Thus, China contends that the "importation" of motion pictures really consists of the distribution, submission for content review, and "customs clearance . . . for the purpose of the distribution of motion pictures to Chinese distributors and theatres."[22]

24. In support of this contention, however, China can only point to a single provision of one of the challenged measures that makes reference to the licensing process, while many other facts contradict China's claim.[23] By China's own admission, films are treated as goods during the importation process since they are subject to customs procedures.[24] They are not exempted from those procedures because the film may subsequently be used in providing a service. Moreover, while the relevant measures may contain provisions affecting services, the United States has

[19] Exhibit US-20. The United States also takes this opportunity to note that China's contention that the relevant measures only regulate films for public showing in theatres, is contradicted by the text of the Films Regulation. *See* China's Answers to the First Set of Panel Questions, Question 28. Article 5 refers to a licensing system for various activities including the "screening and public screening" of films, suggesting that a non-public screening is contemplated by the measure. China's translation of this provision refers to the "distribution and projection of films, and public show of films." (Exhibit CN-11). Furthermore, the public showing of films is just one of the activities that this measure regulates. Article 2 of the Films Regulation states "[t]hese Regulations shall apply to the production, import, export, distribution and screening of films within the People's Republic of China." (Exhibit US-20).

[20] Article X:3 of the Catalogue of Prohibited Foreign Investment Industries includes a prohibition on the "{p}ublication, production, and import operations of audiovisual *products* and electronic publications." Exhibit US-5. As the United States has set forth previously, the term "audiovisual products" includes films for theatrical release. This Chinese measure itself refers to films as "products." *See* U.S. First Written Submission, para. 27. In addition, Article 4 of the Several Opinions provides that "{f}oreign investors are prohibited from setting up and operating . . . motion picture import and distribution companies." Exhibit US-6.

[21] China's First Written Submission, para. 91.

[22] China's First Written Submission, paras. 92-95.

[23] China's First Written Submission, para. 93.

[24] China's First Written Submission, para. 95.

identified other provisions of those measures that regulate trade in goods.[25] Thus, under China's own reasoning, its measures are subject to disciplines governing *both* goods and services.

25. China is asking the Panel to ignore the goods-related aspects of the relevant measures and conclude that the measures are only subject to services rules even where they affect both trade in goods and services. This is in contravention of the Appellate Body's clear guidance, that a measure need not be analyzed under either the goods or services rules, but rather may be subject to both.[26]

d. The Text of the GATT and International Classification Systems Make Clear that Films are Goods

26. China's argument that films for theatrical release are not goods is also belied by the text of the GATT 1994.[27] Article III:10 and Article IV of the GATT 1994, part of the Multilateral Agreements on Trade in *Goods*[28], deal with cinematographic films, and demonstrate a long history of treating films as goods in the multilateral trading system. China tries to dismiss these provisions as historical anachronisms.[29] However, China's argument is misplaced. China concedes that Article III:10 sets forth an exception to the national treatment principle for films, but fails to note that the national treatment principle embodied in Article III of the GATT 1994, as with the rest of the Agreement, only applies to trade in goods. It follows that an exception from that principle for certain products – *i.e.*, films – also relates to trade in goods. If a film were not a good, it would not be covered by Article III in the first place, and no exception would be necessary. As for Article IV, it provides the form that internal quantitative regulations for a particular good – films – may take *i.e.*, screen quotas. In other words, the obligation in Article IV relates to goods, although it makes reference to services.

27. There are also other examples of references to services associated with goods in the GATT 1994. For example, Article III:4 provides that Members must accord no less favorable treatment to imported products than domestic products "in respect of all laws . . . affecting their . . . transportation, distribution . . ." A Member may challenge a measure under this provision for its discriminatory treatment of imported products, even though the measure may also affect

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[25] Catalogue of Prohibited Foreign Investment Industries, Article X:3 (Exhibit US-5); Several Opinions, Article 4 (Exhibit US-6); Management Regulation, Chapter V (Exhibit US-7); Importation Procedure, Article 43 (Exhibit US-8); Films Regulation, Articles 5 and 30 (Exhibit US-20); Film Distribution and Projection Rule, Article II (Exhibit US-21); Provisional Film Rule, Articles 2 and 3 (Exhibit US-22).

[26] *Canada – Periodicals (AB)*, p. 17 (while a periodical may be comprised of elements that have services attributes *i.e.*, editorial content and advertising content, "they combine to form a physical product – the periodical itself."); *EC – Bananas (AB)*, para. 221 (with respect to "measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good, . . . the same measure could be scrutinized under both [the GATT and GATS] agreements. . . .").

[27] *See* U.S. First Oral Statement, para. 11.

[28] Emphasis added.

[29] China's Answers to the First Set of Panel Questions, Question 29.

distribution or transportation services associated with that product. Indeed, in this dispute, the United States challenges, under Article III:4, China's restriction on the entities that may distribute foreign films. Film distribution may be a service, but the measure here is still subject to challenge under Article III:4, since it relates to trade in the product, film. In short, China's attempt to cast Articles III:10 and IV as lone examples of services provisions in the entire Multilateral Agreement on Trade in Goods fails.

28. Finally, contrary to China's contentions, international classifications of films demonstrate that films for theatrical release are goods. As set forth in the U.S. first oral statement, the Harmonized Commodity Description and Coding System (HS), which only covers goods, describes products under heading 3706 as follows: "cinematographic film, exposed and developed, whether or not incorporating sound track or consisting only of sound track."[30] Similarly, although China attempts to gloss over this point, the United Nations' Central Product Classification (CPC) *does* classify cinematographic film as a good in Subclass 3895, in addition to classifying the associated services (in subclass 96113).[31]

29. In short, films for theatrical release are goods subject to China's trading rights commitments. China has failed to articulate a basis on which to conclude that such products are not goods.

2. Unfinished AVHE Products and Unfinished Sound Recordings

30. China merely repeats a few of its unsuccessful arguments related to films in arguing that unfinished AVHE products and unfinished sound recordings are not goods.

31. As with films, China argues that the "master copies" of AVHE products and sound recordings being imported and used for reproduction, are a mere accessory of copyright licensing and therefore are not goods.[32] China's argument is flawed for a number of reasons.

32. First, as noted above in the context of films, the fact that these tangible goods carry content does not take them out of the category of goods. If it did, then reading materials, finished AVHE products, and finished sound recordings, would not be goods, an assertion that China has not advanced in this dispute. In addition, the fact that certain provisions of the relevant measures may regulate copyright licensing does not mean that other provisions of the same measures do not regulate the importation of the goods themselves - *i.e.*, the tangible AVHE products and

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[30] World Customs Organization, Explanatory Notes, VI-3706-1, (4th Ed. 2007) (Exhibit US-53).

[31] Provisional Central Product Classification, Statistical Papers, Series M No. 77, United Nations (1991) (Exhibit US-54).

[32] China's First Written Submission, para. 120. Specifically, China argues that "'the right to import' audiovisual products used for publication consists of the right to enter into a copyright agreement for the publication of copies of an audiovisual content, and not of the right to import goods intended for resale."

sound recordings – and indeed, other provisions do just that.[33] The existence of these other provisions regulating imports demonstrates that China treats these products as goods.

33. Finally, the 2007 Harmonized System (implemented under the Harmonized System Convention, to which China has been a party since 1993) describes products under HS heading 8523, in pertinent part, as follows: "[d]iscs, tapes, solid-state non-volatile storage devices, 'smart cards' and other media for the recording of sound or of other phenomena, whether or not recorded, including matrices and masters for the production of discs."[34] This description makes clear that unfinished AVHE products and unfinished sound recordings are goods.

34. China's tariff schedule addresses these items in HS heading 8524[35] described as follows: "[r]ecords, tapes and other recorded media for sound or other similarly recorded phenomena, including matrices and masters for the production of records, but excluding products of Chapter 37.[36] The term "AVHE products" is intended to capture *inter alia* videocassettes, VCDs, and DVDs.[37] As the United States set forth in its response to Panel Question 18, the term "unfinished AVHE products" is intended to capture master copies of such products to be used to publish and manufacture copies for sale in China.[38] Master copies of videocassettes, VCDs, and DVDs to be reproduced and sold in China would be covered by the broad description for HS heading 8524 because these master copies are "records, tapes and other recorded media for sound or other similarly recorded phenomena."

35. Similarly, the term sound recordings as used by the United States covers *inter alia* recorded audio tapes, records, and audio CDs.[39] The United States considers that "unfinished sound recordings" are master copies of sound recordings, such as master recording discs, to be reproduced and sold in China.[40] As with AVHE products, these master recording discs fit within the scope of the description, "records, tapes and other recorded media for sound or other similarly recorded phenomena." Accordingly, these items are treated as goods in China's own customs regime.

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[33] Catalogue of Prohibited Foreign Investment Industries, Article X:3 (Exhibit US-5); Several Opinions, Article 4 (Exhibit US-6); Management Regulation, Chapter V (Exhibit US-7); Importation Procedure, Article 43 (Exhibit US-8); Audiovisual Regulation, Articles 8-10 (Exhibit US-16); Audiovisual Import Rule, Articles 3, 7, 8 (Exhibit US-17).

[34] World Customs Organization, Explanatory Notes, XVI-8523-1 (4th Ed. 2007) (Exhibit US-55).

[35] China's HS Schedule is still in HS nomenclature from 1996. In the most recent revisions to the HS in 2007, HS heading 8524 was deleted and the old description for HS heading 8524 was incorporated into the HS heading 8523.

[36] Extracts from Schedule CLII (in HS96 nomenclature) (Exhibit JPN-2).

[37] U.S. First Written Submission, para. 47.

[38] U.S. Answers to the First Set of Panel Questions, para. 55; U.S. First Written Submission, para. 49.

[39] U.S. Answers to the First Set of Panel Questions, para. 56; U.S. First Written Submission, para. 59.

[40] U.S. First Written Submission, para. 60.

36. Indeed, in response to Question 132, China concedes that it does charge customs duties for "hard-copy audiovisual product (including sound recordings) intended for publication."[41] Moreover, Article 2 of the AV Import Rule defines "audiovisual products" as "audio tapes, video tapes, records, and audio and video CDs which have recorded content."[42] The measure then cross references the HS codes for these "products," which are provided in Annex 1 to the measure.[43] This further reinforces the conclusion not only that these items are goods but that China treats them as goods.

37. The CPC also classifies "recorded media for sound or other similarly recorded phenomena" other than films under goods subclass 47520.

38. In short, China has failed to provide any basis to conclude that unfinished AVHE products or unfinished sound recordings are not goods subject to its trading rights disciplines.

B. China's Measures Are Not Justified Under its Right to Regulate Trade in a Manner Consistent with the WTO Agreement or Article XX(a) of the GATT 1994

39. With respect to the remaining products at issue – *i.e.*, reading materials, finished AVHE products, and finished sound recordings – China concedes that it places limitations on its trading rights commitments, but contends that these limitations are justified.[44] China submits that while it denies all foreign enterprises, all foreign individuals, and all Chinese privately-held enterprises in China the right to import these products into China in contravention of its trading rights commitments, its right to regulate trade in a manner consistent with the WTO Agreement permits restrictions on its trading rights commitments that are consistent with Article XX of the GATT 1994.[45] China argues that the measures at issue are justified under Article XX(a) and that their

[41] China's Answers to the First Set of Panel Questions, Question 132.

[42] Exhibit US-17.

[43] Exhibit CN-15.

[44] China's First Written Submission, para. 128 (stating, "[a]lthough [China's content review mechanism] may result in limitations of the right to trade, it is in full compliance with China's rights and obligations.").

[45] China's First Written Submission, paras. 161-172; and China's Answers to the First Set of Panel Questions, Questions 48, 50 and 52. In paragraph 164 of its First Written Submission, China also contends that the right to regulate is the "expression of the WTO general exception to Members' obligations which leaves room for the implementation of public policies and is crucial for the preservation of China's sovereignty." China, however, does not provide any elaboration of, or support for, this "general exception". There is no textual basis for China's position in the WTO Agreement. Therefore, this argument fails to provide a basis for finding China's measures consistent with China's WTO obligations.

application is consistent with the *chapeau* of Article XX.[46] China, however, has failed to sustain its arguments with respect to the right to regulate and Article XX.[47]

1. China's Right to Regulate Trade in a Manner Consistent with the WTO Agreement Does Not Justify the Measures at Issue

40. Contrary to China's reading of the first clause of paragraph 5.1 of its Accession Protocol, the right to regulate trade in a manner consistent with the WTO Agreement applies to measures regulating goods that are traded, and not to measures regulating whole categories of traders engaged in the importation of goods. Thus, under the first clause of paragraph 5.1, China may require that goods being imported into China satisfy other requirements allowed under the WTO Agreement, such as import licensing, TBT and SPS requirements.[48] In other words, the first clause of paragraph 5.1 does not detract from China's commitments allowing the three enumerated categories of importers – *i.e.*, all foreign enterprises, all foreign individuals and all enterprises in China – to trade in the goods being regulated.

41. During China's accession negotiations, WTO Members agreed to specific limitations on China's trading rights commitments with respect to a set of listed goods. That is, only state trading enterprises are allowed to import the goods enumerated in Annex 2A1 and only designated importers were permitted to import the goods enumerated in Annex 2B until December 2004. China did not list the goods at issue in this dispute in either Annex, and China's trading rights commitments do not authorize China to add to these limitations after accession.

42. Interpreting the first clause of paragraph 5.1 concerning the right to regulate trade, as justifying the measures at issue – and thereby permitting China to prohibit any traders from importing reading materials, AVHE products, sound recordings and films for theatrical release – would render Annexes 2A and 2B redundant. The first clause of paragraph 5.1 does not provide a mechanism through which China can unilaterally reopen the existing exceptions contained in Annexes 2A and 2B that have already been closed. China's reliance on the first clause of paragraph 5.1 of the Accession Protocol therefore fails.

2. China's Measures at Issue Are Not Justified under Article XX(a) and Are Applied in a Manner Inconsistent with the *Chapeau* of Article XX

43. China further contends that the measures at issue are justified by Article XX(a) of the GATT 1994 and that these measures are applied in a manner consistent with the *chapeau* of Article XX.

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[46] China's First Written Submission, paras. 170-234; and China's Answers to the First Set of Panel Questions, Questions 41, 42, and 55.

[47] U.S. First Oral Statement, paras. 23-39; and U.S. Answers to the First Set of Panel Questions, paras. 50-51, 57-62, 68-80, 83-86, 90-94.

[48] Working Party Report, para. 84(b) (Exhibit US-3).

44. As a threshold matter, it is not necessary to determine whether Article XX applies to China's commitments contained in the Accession Protocol and Working Party Report.[49] When faced with a similar situation in *U.S. – Shrimp Bonding*, the Appellate Body examined the measure at issue on an *arguendo* basis, and after finding this measure did not satisfy the requirements of Article XX, concluded that it did not need to express a view on the question of whether Article XX is available as an affirmative defense for a measure found to be inconsistent with the *Anti-Dumping Agreement*.[50] Similarly, China's measures reside well outside of the parameters of Article XX(a), and their application fails to meet the requirements contained in the *chapeau* of Article XX. Thus, it is not necessary here to determine whether Article XX is available as an affirmative defense to China's commitments contained in the Accession Protocol and the Working Party Report.

45. According to China, importers of the goods at issue must be the entities responsible for reviewing the content of these goods.[51] In order to engage in importation accompanied by such responsibilities, China has determined that enterprises must satisfy four "selection criteria": appropriate organizational structure; reliable, competent and capable personnel; appropriate geographical coverage; and limited number.[52] China has also determined that only Chinese wholly state-owned enterprises satisfy all four criteria.[53]

46. Without prejudice to whether Article XX applies to China's commitments contained in the Accession Protocol and Working Party Report, China has not met its burden to establish that the measures at issue satisfy this exception. China has failed to demonstrate that its challenged measures are either "necessary to protect public morals" within the meaning of Article XX(a) or consistent with the *chapeau* of Article XX in their application.

47. The trading rights prohibitions found in China's measures are not "necessary" within the meaning of Article XX(a).[54] As the Appellate Body has explained, "a 'necessary measure is . . . located significantly closer to the pole of 'indispensable' than to the opposite pole of simply 'making a contribution to'."[55] China has focused its argument on showing how content review is necessary to protect public morals, but its focus under Article XX(a) should be on its trading rights prohibitions. China has to establish a nexus between prohibiting all foreign importers and all privately-owned Chinese importers from importing the goods at issue and achieving its content review goals, but it has failed to do so. It has therefore has fallen far short of demonstrating any proximity of this trading rights prohibition to the pole of "indispensable".

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[49] U.S. Answers to the First Set of Panel Questions, paras. 60-61.

[50] *U.S. – Shrimp Bonding (AB)*, paras. 304-319.

[51] China's First Written Submission, para. 197.

[52] China's First Written Submission, para. 153.

[53] China's Answers to the First Set of Panel Questions, Question 46(b).

[54] *See* U.S. First Oral Statement, paras. 32-35; and U.S. Answers to the First Set of Panel Questions, paras. 93-94.

[55] *Korea – Beef (AB)*, para. 161.

48. Indeed, China provides no explanation of why importation and content review should be linked. Content review has no intrinsic connection to importation; it can be performed by individuals and entities unrelated to the importation process. As discussed in the U.S. first oral statement,[56] China itself confirms that content review is unrelated to importation. For example, Article 31 of the Films Regulation provides: "[t]hose intending to import films for public screening shall, before importing, submit the film to the Film Censorship Board for review,"[57] but the Film Censorship Board is not an importer. Similarly, as China explained in its first written submission, the monopoly importer of AVHE products and sound recordings (CNPIEC) performs content review on these goods before it even begins negotiating importation – thus establishing that content review does not need to be connected to importation.[58] These facts establish that restricting trading rights to only a single, or a select few, Chinese state-owned importers is nowhere near "indispensable" to content review, and thus the restrictions on trading rights are not "necessary" within the meaning of Article XX(a).[59]

49. The Appellate Body has also not found a measure to be necessary where there is a "reasonably available WTO-consistent alternative".[60] In this dispute, China has numerous alternatives to achieve its content review objectives that do not restrict the right to import.[61] For example, foreign-invested enterprises could conduct the content review of reading materials, AVHE products, sound recordings and films for theatrical release, after developing the expertise to do so by training existing personnel or hiring experts as employees to conduct such review. Such enterprises could follow the approach currently taken by CNPIEC and conduct the content review prior to engaging in the importation process. Likewise, content review could be conducted during as well as after importation. In all cases, content review would occur before the product enters the stream of commerce in China.

50. Moreover, China fails to show that the application of challenged measures is consistent with the *chapeau* of Article XX, *i.e.*, that this does not constitute a "means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail" and a "disguised restriction on international trade".[62] China contends that "the administrative authorities (GAPP and MOC) need to make certain that the importation entities are able to

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[56] U.S. First Oral Statement, para. 33.

[57] Exhibit US-20.

[58] China's First Written Submission, para. 225.

[59] In terms of the contribution of the measure to protecting public morals, the Appellate Body, in paragraph 145 of its report in *Brazil – Tires*, observed that a contribution exists where there is a "genuine relationship of ends and means between the objective pursued and the measure at issue." Again, China has failed to establish such a contribution of a restriction on trading rights to its content review objectives.

[60] *U.S. – Gambling (AB)*, para. 308. *See also Korea – Beef (AB)*, para. 166.

[61] *See* U.S. Answers to the First Set of Panel Questions, para. 62.

[62] *See* U.S. First Oral Statement, paras. 36-39.

participate effectively and efficiently in the content review process. This can only be achieved through a selection process" that consists of the four previously-mentioned "selection criteria".[63]

51. However, as is evident from China's later answers to the first set of Panel questions, the selection process in fact is far more opaque and extensive than China's initial summary indicates.[64] Indeed, the selection process produces results that are both arbitrarily and unjustifiably discriminatory and a disguised restriction on trade.

52. First, China's selection criteria in fact go well beyond the four factors China cited in its first written submission. China *a priori* requires applicants who want to engage in the importation/content review process for these products to be wholly state-owned enterprises.[65] No other applicants, no matter how well qualified they may be under the four selection criteria China claims are critical, can even apply. This eliminates privately-owned Chinese importers and foreign importers alike, creating arbitrary discrimination against foreigners and demonstrating that China applies those criteria as a disguised restriction on trading rights.

53. Second, China's actual process for selecting import entities for these products involves a number of non-transparent, entirely discretionary Chinese government decisions that also contribute to the discriminatory application of this regime. To be successful, applicants subject to China's approval process must meet the requirements of a "State plan for the total number, structure and distribution of" importers. However, no information is available on these plans. When the Panel asked China what the State plan is, China provided no insights (other than to say that it is not available in written form).[66] This opacity further underscores the arbitrary and disguised nature of the discrimination and the restrictions confronting foreign and privately-owned Chinese importers, and does nothing to explain why such discrimination might be justifiable.

54. Further, China imposes a completely discretionary "designation" process to select importers of most of the products, and in some cases, this process entirely supersedes the "approval" process based on the four selection criteria that China described.[67] Specifically, importers of AVHE products, sound recordings and films for theatrical release are designated by the government without using the approval process, so that no opportunity exists for interested

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[63] China's First Written Submission, para. 153.

[64] China's Answers to the First Set of Panel Questions, Questions 44, 45 and 46(a) and (b).

[65] Management Regulation, Article 42 (providing that in addition to the four "selection criteria", importers of reading materials, AVHE products and sound recordings must be Chinese wholly state-owned enterprises) (Exhibit US-7).

[66] China's Answers to the First Set of Panel Questions, Question 44.

[67] China has confirmed that there are no criteria governing the designation process and that this process is based entirely on the "initiative and discretion" of the relevant agency. *See* China's Answers to the First Set of Panel Questions, Questions 25(a) and (b), 26, and 31(c).

importers to send in applications and demonstrate that they meet any approval criteria;[68] and importers of newspapers and periodicals are designated by GAPP from the pool of enterprises that have been "approved" by that agency.[69] Only importers of books and electronic publications are simply "approved" by GAPP.[70]

55. Overall, China's application of its ban on foreign and private Chinese importers from the business of importing the goods at issue creates significant arbitrary, unjustifiable discrimination and disguised restrictions on trade. At bottom, this ban is "effective[ ] and efficient[ ]" at protecting the business interests of a limited group of Chinese state-owned enterprises, not in implementing China's content review requirements.

56. Finally, China's contention that domestic producers of the goods at issue are subject to content review requirements comparable to those applied to importers is inaccurate for several reasons,[71] and is, moreover, besides the point in a trading rights claim. China states that importers and domestic Chinese producers of reading materials, AVHE products and sound recordings review content via the same process. In fact, while domestic Chinese producers review the content of their goods in-house, pursuant to the system of "editorial responsibility",[72] foreign enterprises and individuals are not permitted to review the products they produce or that they wish to import into China.[73]

57. Moreover, even the officially sanctioned importers are never exclusively responsible, and often are not at all responsible, for content review of these imported products. With respect to importers of reading materials, GAPP is required to review the catalogue of proposed imports submitted by the importer and is authorized to intervene in the day-to-day content review of these imports.[74] For importers of AVHE products and sound recordings, importers must submit these products directly to the MOC for content review.[75] As noted, this contrasts sharply with domestic producers of reading materials, AVHE products and sound recordings, who are responsible for the content review of their products.[76]

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[68] China's Answers to the First Set of Panel Questions, Questions 25(a) and (b) and 40.

[69] China's Answers to the First Set of Panel Questions, Question 25(b).

[70] China's Answers to the First Set of Panel Questions, Question 40.

[71] China's First Written Submission, para. 231; China's Answers to the First Set of Panel Questions, Questions 47 and 134; *See also* U.S. First Oral Statement, paras. 38 and 39.

[72] Management Regulation, Articles 25-28 (Exhibit US-7); and Audiovisual Regulation, Articles 3 and 16 (Exhibit US-16).

[73] Management Regulation, Articles 44-45 (Exhibit US-7); Audiovisual Regulation, Article 28 (Exhibit US-16); and Audiovisual Import Rule, Articles 6 and 11-18 (Exhibit US-17).

[74] Management Regulation, Articles 44-45 (Exhibit US-7).

[75] Audiovisual Regulation, Article 28 (Exhibit US-16); and Audiovisual Import Rule, Articles 6 and 11-18 (Exhibit US-17).

[76] Management Regulation, Articles 25-28 (Exhibit US-7); and Audiovisual Regulation, Articles 3 and 16 (Exhibit US-16).

C. Conclusion

58. As demonstrated by the United States, China's measures do not allow all foreign enterprises, all foreign individuals and all enterprises in China the right to import reading materials, AVHE products, sound recordings, and films for theatrical release into China. The United States has further established that unfinished AVHE products, unfinished sound recordings and films for theatrical release are goods subject to China's trading rights commitments. China's measures are, therefore, inconsistent with Part I, paragraphs 5.1 and 5.2 of the Accession Protocol as well as Part I, paragraph 1.2 of the Accession Protocol to the extent that it incorporates paragraphs 83 and 84 of the Working Party Report. As explained above and in previous U.S. submissions, China's measures are not justified under either the first clause of paragraph 5.1 of the Accession Protocol or under Article XX(a) of the GATT 1994.[77]

59. The United States, therefore, respectfully requests the Panel to find that the Management Regulation, the Importation Procedure, the Catalogue, the Foreign Investment Regulation, the Several Opinions, the Electronic Publications Regulation, the Audiovisual Regulation, the Audiovisual Import Rule, the Audiovisual Sub-Distribution Rule, the Film Regulation, the Provisional Film Rule, and the Film Distribution and Projection Rule are inconsistent with China's trading rights obligations under the Accession Protocol, which is an integral part of the WTO Agreement.

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

60. 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 to foreign service suppliers, including distributors of reading materials, AVHE products and sound recordings. Despite these commitments, China imposes discriminatory prohibitions and requirements on foreign service suppliers seeking to engage in the distribution of reading materials, AVHE products, and sound recordings. These discriminatory prohibitions and discriminatory requirements are contained in the following measures: 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 Internet Culture Rule; the Internet Culture Notice; the Audiovisual Regulation; the Audiovisual Sub-Distribution Rule; the Network Music Opinions; the Catalogue; the Foreign Investment Regulation; and the Several Opinions. These measures are inconsistent with China's obligations contained in Articles XVI and XVII of the GATS. China's arguments to the contrary are unavailing.

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[77] While China also relies on the UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expression and a related UNESCO Declaration to justify the measures at issue, neither the WTO Agreement nor China's Accession Protocol provides for an exception with respect to "cultural goods". *See* China's First Written Submission, paras. 129-135; *see also* U.S. First Oral Statement, paras. 25-26.

A. Reading Materials

61. China made market access and national treatment commitments in Sector 4B of its Services Schedule regarding wholesale trade services under mode 3, and these commitments are no longer subject to any terms, limitations, conditions or qualifications. China, therefore, committed to provide national treatment within the meaning of Article XVII of the GATS to foreign-invested enterprises engaged in the wholesaling of reading materials through commercial presence in China.

62. Despite these commitments, China does not contest the fact that its measures treat foreign-invested service suppliers markedly less favorably than like domestic suppliers, based exclusively on the nationality of their investors. These measures are the Catalogue,[78] the Foreign Investment Regulation,[79] the Several Opinions,[80] the Imported Publications Subscription Rule,[81] the Foreign-Invested Sub-Distribution Rule,[82] the Publication Market Rule,[83] the Electronic Publication Regulation,[84] and the Sub-Distribution Procedure.[85] By imposing discriminatory prohibitions and requirements on foreign-invested reading material wholesalers, the measures at issue modify the conditions of competition in favor of wholly Chinese-owned reading material wholesalers.

1. Discriminatory Prohibitions

63. China prohibits foreign-invested enterprises from engaging in the following four types of reading materials distribution: (1) distribution of imported newspapers and periodicals, as well as imported books and electronic publications in the limited distribution category;[86] (2) distribution of imported books and electronic publications in the non-limited distribution category;[87] (3) master distribution of books, newspapers, and periodicals;[88] and (4) master wholesale and wholesale of electronic publications.[89] These types of wholesale distribution,

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[78] Exhibit US-5.
[79] Exhibit US-9.
[80] Exhibit US-6.
[81] Exhibit US-30.
[82] Exhibit US-28.
[83] Exhibit US-27.
[84] Exhibit US-15.
[85] Exhibit US-29.
[86] Imported Publication Subscription Rule, Article 4 (Exhibit US-30); Foreign-Investment Sub-Distribution Rule, Article 2 (Exhibit US-28).
[87] Publication Market Regulation, Article 16 (Exhibit US-27); and Foreign-Investment Sub-Distribution Rule, Article 2 (Exhibit US-28).
[88] Catalogue, Article X.2, "Catalogue of Prohibited Foreign Investment Industries" (Exhibit US-5); Foreign Investment Regulation, Articles 3-4 (Exhibit US-9); and Several Opinions, Article 4 (Exhibit US-6).
[89] Electronic Publications Regulation, Article 62 (Exhibit US-15).

which are included within China's services commitments in Sector 4B of its Services Schedule, are reserved entirely to like wholly Chinese-owned service suppliers.

64. China has fundamentally modified the conditions of competition in favor of wholly Chinese-owned reading material wholesalers, resulting in less favorable treatment of foreign-invested wholesale service suppliers, for each type of distribution services enumerated above. Basically, domestic suppliers can provide the enumerated services, while foreign suppliers cannot, rendering the responsible Chinese measures inconsistent with Article XVII of the GATS.

65. In addition, even where foreign-invested reading material wholesalers are permitted to provide certain types of distribution services, they are still disadvantaged vis-a-vis domestic suppliers. With foreign suppliers prohibited from offering a complete range of reading material wholesale distribution services, the services they can provide are inherently less attractive than the broader range of services offered by their wholly Chinese-owned counterparts. On this basis, too, the measures at issue are inconsistent with Article XVII of the GATS.

a. China Prohibits Foreign-Invested Enterprises From Wholesaling Imported Newspapers and Periodicals and Imported Books and Electronic Publications in the "Limited Distribution Category"

66. China prohibits foreign-invested enterprises from wholesaling imported newspapers and periodicals, as well as imported books and electronic publications in the "limited distribution category",[90] pursuant to Article 42 of the Management Regulation[91] and Article 4 of the Imported Publication Subscription Rule.[92] Article 42 of the Management Regulation provides that only Chinese wholly state-owned enterprises are permitted to import reading materials of any kind, and Article 4 of the Imported Publication Subscription Rule then grants an approved sub-set of these wholly state-owned enterprises the exclusive right to distribute these particular reading materials in China.[93]

67. Foreign-invested wholesalers therefore receive less favorable treatment than that accorded to domestic wholesale distributors, since foreign-invested wholesalers do not have the right to wholesale these reading materials. China's measures at issue do not fall within the terms, limitations, conditions or qualifications on market access or national treatment that China has specified in its Services Schedule. Accordingly, the measures at issue are inconsistent with China's obligations under Article XVII of the GATS.

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[90] *See* U.S. First Written Submission, paras. 77-87 and 289-295; U.S. First Oral Statement, para. 40; and U.S. Answers to the First Set of Panel Questions, paras. 100-102.

[91] Exhibit US-7.

[92] Exhibit US-30.

[93] China has defined "distribution" to include wholesale and retail services. *See* Publication Market Rule, Article 2 (Exhibit US-27); and China's First Written Submission, paras. 252-253.

68. As noted above, China does not contest this U.S. claim.

b. China Prohibits Foreign-Invested Enterprises From Wholesaling Imported Books and Electronic Publications in the "Non-Limited Distribution Category"

69. Likewise, given China's market access and national treatment commitments regarding reading material wholesaling, foreign-invested enterprises should be able to engage in the wholesaling of imported books and electronic publications in the "non-limited distribution category". However, China denies this right to foreign-invested suppliers.

70. As the United States has explained,[94] and China has confirmed, the Foreign-Invested Sub-Distribution Rule ". . . makes clear that only books [, newspapers and periodicals] *published in China* are eligible for distribution by FIEs."[95] Foreign-invested enterprises are, therefore, not permitted to engage in the distribution of imported books and electronic publications in the "non-limited distribution category".

71. Since domestic Chinese wholesalers can distribute this category of reading materials,[96] China is again treating foreign-invested wholesalers less favorably than like domestic wholesalers. This prohibition is not justified by any of the terms, limitations, conditions or qualifications on market access or national treatment inscribed by China in its Services Schedule. China's measures that maintain this prohibition are, therefore, inconsistent with China's obligations under Article XVII of the GATS.

72. Again, China does not contest this U.S. claim.

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[94] *See* U.S. First Written Submission, paras. 77-87 and 289-295; U.S. First Oral Statement, para. 40; and U.S. Answers to the First Set of Panel Questions, paras. 102 and 136-137.

[95] China's Answers to the First Set of Panel Questions, Question 78 (emphasis added).

[96] Management Regulation, Articles 36-38 (Exhibit US-7); and Electronic Publications Regulation, Articles 61-71 (Exhibit US-15).

c. China Prohibits Foreign-Invested Enterprises From Engaging in the Master Distribution of All Books, Newspapers and Periodicals

73. China also prohibits foreign-invested enterprises from engaging in the master distribution of all books, newspapers and periodicals,[97] whether imported or domestic.[98] China maintains this prohibition through the Catalogue,[99] the Foreign Investment Regulation[100] and the Several Opinions.[101] As discussed below, master distribution falls within the meaning of distribution services under Annex 2 to China's Services Schedule, and is covered by China's commitments under Sector 4 of its Services Schedule. Accordingly, China's measures are inconsistent with China's market access and national treatment commitments inscribed under mode 3 of Sector 4 of its Services Schedule.

74. China contends that master distribution is a unique type of distribution service that falls outside of China's distribution services commitments. China argues that a master "distributor" is not "necessarily" engaged in distribution activities as defined in Annex 2 of its Services Schedule,[102] explaining that master distributors are engaged in *Fa Xing*, which has "no suitable corresponding English translation".[103] Moreover, China asserts that its distribution services commitments under Sector 4 of its Services Schedule were not intended to cover all distribution activities.[104] China cites its commitments with respect to distribution services of audiovisual products inscribed in Sector 2D of its Services Schedule in support of this argument.[105]

Master Distribution and Distribution Services

75. China's argument that master distribution is not a distribution service fails on numerous grounds. First, China itself concedes that master distribution is a type of distribution service.[106] Indeed, according to Annex 2 of China's Services Schedule, the "principal service" involved in a

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[97] China also prohibits foreign-invested enterprises from engaging in the master distribution of electronic publications. *See* Several Opinions, Article 4 (Exhibit US-6).

[98] China's Answers to the First Set of Panel Questions, Question 101(a) (answering "Yes" in response to the Panel's question "Are foreign-owned companies prevented from applying for a license for each of the products covered by *Zong Fa Xing*?"). *See also* U.S. First Written Submission, paras. 76 and 288; U.S. First Oral Statement, paras. 40-43; and U.S. Answers to the First Set of Panel Questions, paras. 96-97, 140-142, and 220.

[99] Catalogue, "Catalogue of Prohibited Foreign Investment Industries", Article X.2 (Exhibit US-5).

[100] Foreign Investment Regulation, Articles 3-4 (Exhibit US-9).

[101] Several Opinions, Article 4 (Exhibit US-6).

[102] China's Answers to the First Set of Panel Questions, Question 103.

[103] China's Answers to the First Set of Panel Questions, Question 103.

[104] China's Answers to the First Set of Panel Questions, Question 98(b).

[105] China's Answers to the First Set of Panel Questions, Question 98(b).

[106] China's First Written Submission, paras. 252 and 255.

distribution service that falls under Sector 4 is "reselling merchandise".[107] As China has explained, master distributors, when they are separate entities from publishers, themselves sell reading materials, rather than acting as the agents of publishers.[108] This of course means that master distributors are reselling reading materials purchased from publishers through an initial sale. These master distributors are engaging in "distribution services" as defined in Annex 2 that are covered under Sector 4 of China's Services Schedule.

76. Likewise, an examination of how China has defined the elements of this activity reinforce the conclusion that master distribution, far from being unique, is a very ordinary type of distribution service that falls squarely within China's distribution services commitments under Sector 4 of its Services Schedule. As China has explained, master distribution involves reselling,[109] encompasses retailing,[110] and is synonymous with a type of wholesaling (*i.e.*, master wholesaling).[111] Each of these services is enumerated in Annex 2 as falling withing the meaning of distribution services.

77. Further evidence supporting the conclusion that master distribution is not a *sui generis* service comes from an examination of the Chinese term itself. The term *Zong Fa Xing* consists of two elements *Zong* and *Fa Xing*. *Zong* means "master",[112] and *Fa Xing* means "distribution".[113] Despite China's view that *Fa Xing*[114] is not suitable for translation into English, China itself has defined this term as "the generic term covering different features of

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[107] China's Services Schedule, Annex 2: Distribution Services, p. 54 (Exhibit US-2).

[108] China's Answers to the First Set of Panel Questions, Question 93.

[109] China's First Written Submission, paras. 283-284; and China's Answers to the First Set of Panel Questions, Question 93.

[110] China's First Written Submission, paras. 283-284; and China's Answers to the First Set of Panel Questions, Questions 102 and 104.

[111] China's First Written Submission, para. 259.

[112] *See A Modern English-Chinese Dictionary*, p. 417 (defining "master" as the Chinese-character for *Zong*, and used in conjunction with "master plan") (Exhibit US-74). *See also* "Character for *Zong* (Master)" (Exhibit US-75); and *A New Century Chinese-English Language Dictionary*, Foreign Language Teaching and Research Press, p. 2163 (defining *Zong* as "master budget") (Exhibit U-76).

[113] *A New Century Chinese-English Language Dictionary*, Foreign Language Teaching and Research Press, p. 435 (defining *Fa Xing* as "distribute newspapers, distribute lottery tickets . . . release a film/movie (for distribution) . . . cost for distribution.") (Exhibit US-77).

[114] Related to the translation of "distribution" (*Fa Xing*) is the translation of "sub-distribution" (*Fen Xiao*). Despite China's assertions (*see* China's First Written Submission, paras. 252-258), master distribution (which China has stated is synonymous with master wholesale; *see* China's First Written Submission, para. 259.) and sub-distribution are not two distinct distribution channels. Rather, they involve various stages within the same distribution channel. This is confirmed by the definition of "distribution" in the Publication Market Rule cited above, which provides that distribution includes master distribution, wholesale and retail. The United States, therefore, translated *Fen Xiao* as "sub-distribution" because that term addresses a sub-part of the distribution chain. While master distribution involves first-level wholesale, sub-distribution involves wholesale (*i.e.*, second-level wholesale) and retail (*see* Foreign-Invested Sub-Distribution Rule, Article 2 (Exhibit US-28)). In other words, both master distribution and sub-distribution involve wholesale and are thus covered by China's commitments under mode 3 of sector 4B of its Services Schedule.

distribution".[115] In its Publication Market Rule, China enumerates the features comprising *Fa Xing*, which are master distribution, wholesale, retail, rental and trade shows.[116] As explained below, master distribution is also known as "first-level wholesale" and is followed by "wholesale" (*i.e.*, "second-level wholesale").[117]

78. Finally, China's contention that it did not intend to include master distribution within its distribution services commitments is also unpersuasive.[118] If indeed it was China's intention to exclude master distribution from its distribution services commitments in Sector 4 of its Services Schedule, it should have done so with a limitation to the effect. As the panel explained in *US – Gambling*:

> If a Member wishes to restrict market access with respect to certain services falling within the scope of a sector or sub-sector, it should set out the restrictions or limitations on access in the appropriate place in the Member's schedule. Indeed, a specific commitment in a given sector or sub-sector is a guarantee that the *whole* of that sector, i.e. *all* services included in that sector or sub-sector are covered by the commitment.[119]

In Sector 4 of its Service Schedule, China made such a guarantee for all distribution services with respect to the products contained within that sector, including reading materials. The fact that China made distribution commitments and included certain related limitations with respect to audiovisual products under Sector 2D of its Services Schedule, only underscores the fact that, where China intended to place limitations on certain distribution sub-sectors, it explicitly did so. China inscribed no such limitation with respect to master distribution under Sector 4.

Master Distribution and Wholesaling

79. Second, master distribution includes wholesaling. China itself has stated that master distribution is synonymous with "master wholesale".[120] Moreover, China has confirmed that master distribution involves specific services that qualify as "wholesaling" as this concept is defined in Annex 2 of China's Services Schedule. Annex 2 provides: "wholesaling consists of the sale of goods/merchandise to retailers to industrial, commercial, institutional, or other professional business users, or to other wholesalers and related subordinated services."[121]

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[115] China's First Written Submission, para. 252.
[116] Publication Market Rule, Article 2 (Exhibit US-27).
[117] *See* Exhibits US-56, US-57, and US-58.
[118] China's First Written Submission, para. 269.
[119] *US – Gambling(Panel)*, para. 6.290 (emphasis in original).
[120] China's First Written Submission, para. 259.
[121] China's Services Schedule, Annex 2: Distribution Services, p. 54 (Exhibit US-2).

80. In its answers to the first set of Panel questions, China explains that master distributors engage in the sale of reading materials to industrial, commercial, institutional and other professional business users.[122] As explained above, this "sale" is in fact a "resale" of reading materials purchased from the publisher through an initial sale.[123]

81. China seems to imply that the reselling of reading materials to industrial, commercial, institutional and other professional business users, as long as they are "end users", means that master distributors are not engaging in wholesaling.[124] This interpretation finds no support in the definition of "wholesaling" in Annex 2. This Annex explicitly defines "wholesaling" to include sales to industrial, commercial, institutional or other professional business users, without any caveat with respect to whether or not they are "end users". Thus, in accordance with the definition of "wholesaling" in Annex 2, the resale of reading materials to industrial, commercial, institutional and other professional business users constitutes "wholesaling", even if these entities are "end users".

82. In addition to reselling reading materials to industrial, commercial, institutional and other professional business users, China's measures make clear that master distributors can also resell reading materials to "other wholesalers", as provided for in the definition of "wholesaling" in Annex 2. For example, the *Interim Rules on the Management of the Master Distribution of Books*[125] and *Several Opinions on Cultivating and Standardizing Books Market*[126] provide that master distribution, which is also defined in these measures as "first-level wholesale", involves responsibility for the distribution of a particular title or class of books. Furthermore, the *Interim Rules on the Management of Master Distribution of Books* provides that master distributors "shall not wholesale books to a unit whose operation on books and periodicals is not approved," indicating that master distributors can wholesale books to units that are approved.[127]

83. Other sources confirm that master distribution involves the wholesaling of reading materials. For instance, an article on reading material distribution logistics in China, which was written with the "support" of the National Copyright Administration of the People's Republic of China, demonstrates that first-level wholesale is the stage of wholesaling between publication

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[122] China's Answers to the First Set of Panel Questions, Question 101.

[123] Furthermore, China adduces evidence in the form of the *Measures on Tentative Implementation of Tendering and Bidding for Fa Xing of Textbooks of Middle and Primary Schools*, to demonstrate that master distributors sell, *inter alia*, to "institutional" buyers, *i.e.*, schools; *See* China's Answers to the First Set of Panel Questions, Question 99, fn. 35.

[124] China's Answers to the First Set of Panel Questions, Question 101; *see also* China's First Written Submission, para. 277.

[125] Article 2 (Exhibit US-56).

[126] Article II, paragraphs 1-2 (Exhibit US-57).

[127] Article 6(3) (Exhibit US-56).

(*i.e.*, "press") and second-level wholesale.[128] Moreover, Exhibit US-58 further clarifies that master distributors (*i.e.*, first-level wholesalers) can engage in the sale of reading materials to other wholesalers, stating in relevant part, "[w]holesale rights, also known as a 'second-level wholesale right', is one obtained by a distribution unit from first-level wholesale units to distribute books in a certain location."[129] The Electronic Publications Regulation also confirms that master wholesalers engage in wholesaling, stating: "An electronic publication distribution entity must buy from an electronic publication publishing, import, *master wholesale*, or wholesale entity."[130]

84. For all of these reasons, these forms of master distribution fall within the meaning of "wholesaling" as defined in Annex 2 of China's Services Schedule and, therefore, are covered by China's wholesale trade services commitments under mode 3 of Sector 4B of that Schedule. By maintaining measures that prohibit foreign-invested enterprises from engaging in the master distribution of reading materials, China accords these enterprises less favorable treatment than that accorded to like domestic distributors. These measures at issue are therefore inconsistent with China's obligations under Article XVII of the GATS.

Master Distribution and Retailing

85. Finally, to the extent that master distribution also could be considered to involve retailing, master distribution is also covered by China's commitments under mode 3 of Sector 4C of China's Services Schedule. China has stated on numerous occasions that master distribution also involves retailing.[131] Most recently, in its answers to the first set of Panel questions, China indicates that master distributors of primary and middle school textbooks engage in retail sales.[132] China further explains in those answers that all master distributors can engage in retailing through their own stores.[133] Thus, since the Catalogue, Foreign Investment Regulation and the Several Opinions prohibit foreign-invested enterprises from engaging in master distribution, these measures are also inconsistent with China's commitments under mode 3 of Sector 4C within the meaning of Article XVII of the GATS.

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[128] Lin, Zikui; Ru, Yihong; Xu, Jie; and Zheng, Kai, "Countermeasures for the Development of Publications Logistics in China," *China-USA Business Review*, Volume 3, No. 2 (Series 8), February 2004, p. 20, Figure 2 (Exhibit US-78).

[129] Page 2 (Exhibit US-58).

[130] Electronic Publications Regulation, Article 71 (Exhibit US-71).

[131] China's First Written Submission, para. 283-284; and China's Answers to the First Set of Panel Questions, Questions 102 and 104.

[132] China's Answers to the First Set of Panel Questions, Question 102.

[133] China's Answers to the First Set of Panel Questions, Question 104.

d. China Prohibits Foreign-Invested Enterprises from Engaging in Master Wholesale and Wholesale of Electronic Publications

86. Foreign-invested enterprises are also deprived of the right to engage in the master wholesale and wholesale of electronic publications, regardless of whether they are imported or domestically produced. This prohibition is contained in Article 62 of the Electronic Publications Regulation.[134] As such, this measure is inconsistent with China's commitments inscribed under mode 3 of Sector 4B of China's Services Schedule within the meaning of Article XVII of the GATS.[135]

87. China responds that it has removed the prohibition on foreign-invested enterprises from engaging in the wholesale of electronic publications and has rendered the master wholesale of electronic publications obsolete. In its first written submission, China contended that the *Provisions on the Administration of Publishing Electronic Publications* repealed the Electronic Publications Regulation – and the prohibition on master wholesale and wholesale contained therein – on April 15, 2008 (*i.e.*, the date on which the *Provisions on the Administration of Publishing Electronic Publications* entered into force).[136] China added that two GAPP approval decisions "anticipated" this change in 2006.[137] However, China then argues in its answers to the first set of Panel questions, that electronic publications were no longer governed by the Electronic Publications Regulation and instead were governed by the Publication Market Rule and the Foreign-Invested Sub-Distribution Rule as of 2004, which is allegedly confirmed by GAPP response from 2005.[138] Finally, China asserts that the concept of master wholesale was discontinued as early as 1999.[139]

88. China's arguments are problematic for several reasons. While the United States accepts that the *Provisions on the Administration of Publishing Electronic Publications* repealed the Electronic Publication Regulation in 2008, the *Provisions on the Administration of Publishing Electronic Publications* only address the production, publishing and importing of electronic publications and are wholly silent with respect to distribution (including wholesale and master wholesale). According to China, the distribution of electronic publications is governed by the Publication Market Rule and the Foreign-Invested Sub-Distribution Rule.[140] However, these measures maintain the prohibition on foreign-invested enterprises engaging in the master

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[134] Exhibit US-15.

[135] U.S. First Written Submission, paras. 88-89, and 291; U.S. First Oral Statement, paras. 44-37; and U.S. Answers to the First Set of Panel Questions, paras. 96-97.

[136] China's First Written Submission, paras. 259-266.

[137] China's First Written Submission, para. 266 and Exhibits CN-42 and CN-43.

[138] China's Answers to the First Set of Panel Questions, Question 91. *See Response of GAPP to Question on Foreign Investment in Sub-Distribution of Electronic Publications* ("GAPP response"), Document of the General Administration of Press and Publications, Xin Chu Fagui [2005] No. 1048 (Exhibit US-79).

[139] China's Answers to the First Set of Panel Questions, Question 92.

[140] China's Answers to the First Set of Panel Questions, Question 91.

wholesale and wholesale of electronic publications. First, the Foreign-Invested Sub-Distribution Procedure only permits foreign-invested enterprises to engage in the sub-distribution of books, newspapers and periodicals published in China.[141] Second, the Publication Market Regulation only addresses wholly Chinese-owned distributors of electronic publications, among other types of reading materials.[142] As China itself concedes these two measures represent the complete set of rights granted to foreign-invested enterprises with respect to the distribution of electronic publications, those enterprises are only permitted to sub-distribute books, newspapers and periodicals published in China. Therefore, the right of foreign-invested enterprises to master wholesale and wholesale electronic publications is not provided for in either measure.[143]

89. Moreover, China's reliance on the two GAPP approval decisions and the 2005 GAPP response[144] is misplaced. These decisions (dating from 2007, 2006 and 2005) are wholly inconsistent with the prohibitions contained in the Electronic Publication Regulation, which China alleges was repealed – but not until 2008, as well as with the Foreign-Invested Sub-Distribution Rule. Moreover, the approval decisions apply only to the wholesaling of domestic electronic publications, and fail to provide for the wholesaling of imported electronic publications or for the master distribution of any electronic publications. Similarly, the 2005 GAPP response only addresses sub-distribution and not master wholesale of electronic publication, both imported and domestic.

90. Finally, the United States continues to seek a finding from the Panel with respect to the Electronic Publications Regulation even though it has been repealed by the *Provisions on the Administration of Publishing Electronic Publications* (2008). Moreover, the United States seeks a finding with respect to the Foreign-Invested Sub-Distribution Rule as it also prevents foreign-invested enterprises from engaging in the master wholesale and wholesale of electronic publications. The Electronic Publications Regulation, as well as the Foreign-Invested Sub-Distribution Rule, are identified in the U.S. panel request and are included in the Panel's terms of reference. Given the absence of disciplines in the *Provisions on the Administration of Publishing Electronic Publications* governing the distribution of electronic publications, and the continued and uncontested operation of the Foreign-Invested Sub-Distribution Rule, such a finding would be particularly important to confirm the WTO-inconsistency of a prohibition on foreign-invested enterprises engaging in the master wholesale[145] and wholesale of electronic publications.

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[141] *See* Section III.A.1.b above; U.S. First Written Submission, paras. 77-87 and 289-295; U.S. First Oral Statement, para. 40; and U.S. Answers to the First Set of Panel Questions, paras. 102 and 136-137.

[142] U.S. First Written Submission, paras. 84-85, and 290; and U.S. Answers to the First Set of Panel Question, paras. 102, and 136-137.

[143] China itself concedes that the Foreign-Invested Sub-Distribution Rule "makes clear that only books, [newspapers and periodicals] published in China are eligible for distribution by FIEs.". *See* China's Answers to the First Set of Panel Questions, Question 78

[144] GAPP response (Exhibit US-79).

[145] China's reliance on the *Interim Provisions on the Administration of the Publications Market* (1999) in support of its argument that master wholesale went out of existence in 1999 is unavailing (*see* China's Answers to

(continued...)

2. Discriminatory Requirements

91. China denies foreign-invested wholesalers the full benefit of China's wholesale trade services commitment by limiting such wholesalers to the sub-distribution of books, newspapers and periodicals published in China,[146] which is only a small part of China's overall commitment under mode 3 of Sector 4B of its Services Schedule. Further, in this limited arena where foreign-invested enterprises may engage in reading material distribution, China imposes numerous discriminatory requirements that deprive foreign-invested wholesalers of national treatment. China discriminates against foreign-invested wholesalers through requirements regarding: (1) operating terms; (2) registered capital; (3) pre-establishment legal compliance; (4) examination and approval; and (5) GAPP decision-making criteria.

92. These five discriminatory requirements modify the conditions of competition in favor of wholly Chinese-owned wholesalers. Foreign-invested wholesalers face a significantly greater risk of being denied entry into the market, as well as more administrative burdens, higher capital requirements, and finite operating terms. These requirements shackle foreign-invested wholesalers that are competing against wholly Chinese-owned wholesalers free from such requirements. China, therefore, accords foreign-invested wholesalers treatment less favorable than that accorded to like wholly Chinese-owned wholesalers in a manner that is inconsistent with Article XVII of the GATS.

a. Operating Term

93. Foreign-invested enterprises are limited to a 30-year operating term, while their wholly Chinese-owned competitors are free of any term limitations.[147] This places foreign-invested wholesalers at a significant competitive disadvantage as their continued operations are subject to the discretion of government authorities. This fact imposes considerable uncertainty on commercial relationships, particularly when operating terms approach their termination. Maintaining current business and generating new business becomes significantly more difficult

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[145](...continued)
the First Set of Panel Questions, Question 92). It is clear that this concept continued to be used following 1999. For example, in 2004 GAPP issued the following two notices regarding professional training programs that explicitly refer to master wholesaling: "Notice on Holding the On-the-Job Training Program for the Managers and Heads of Nationwide Private Bookstore and Newly-Approved Publication Master Wholesale [*Zong Pi Fa*] Companies", General Administration of Press and Publications, Xin Jiao Pei [2004] No. 21, April 28, 2004 (Exhibit US-80); and "Notice on Holding the Second On-the-Job Training Program for the Managers and Heads of Nationwide Private Bookstore and Newly-Approved Publication Master Wholesale [*Zong Pi Fa*] Companies", General Administration of Press and Publications, Xin Jiao Pei [2004] No. 45, August 18, 2004 (Exhibit US-81).

[146] *See* China's Answers to the First Set of Panel Questions, Question 78 (confirming that the Foreign-Invested Sub-Distribution Rule "makes clear that only books [newspapers and periodicals] published in China are eligible for distribution by FIEs.").

[147] Foreign-Invested Sub-Distribution Rule, Article 7.5 (Exhibit US-28); Publication Sub-Distribution Procedure (Exhibit US-29), "Licensing Requirements" para. 5.

when the foreign-invested wholesaler cannot guarantee that it will continue to be in business after the expiry of its operating term.

94. This operating term limitation also modifies conditions of competition to the detriment of the foreign-invested wholesaler, because any extension of the operating term requires the agreement of all investors and all Board Directors, and must comply with the laws, regulations and policies on foreign investment.[148] Under Chinese law, each of these parties holds a veto on extension and can use that leverage to extract concessions from the foreign-invested parties. This artificial and unnecessary commercial situation places undue strain and extra burdens on the foreign-invested enterprise, a predicament not faced by wholly Chinese-owned enterprises.

95. China's contention that the term extension is "non-discretionary, automatic and simplified"[149] is contradicted by Chinese law. In fact, four Chinese measures cited by China state explicitly that extension depends on approval by the examining authority.[150]

> - Article 13 of the *Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures* states, "[a] joint venture that has a contract period should, if the parties to the joint venture agree to extend the contract period, apply to the approval authorities six months ahead of the expiration of the contract period. The latter should make the decision of approval or disapproval within one month as of the date of application."[151]
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> - Article 24 of the *Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures* provides, "[i]f the Chinese and foreign parties agree to extend the period of operation, they shall apply to the examination and approval authority 180 days prior to the expiration of the venture's term. The examination and approval authority shall decide whether or not to grant approval within 30 days of receiving the application."[152]
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> - Article 20 of the *Law of the People's Republic of China on Foreign-Funded Enterprises* explains, "[f]or an extension of the term of operations, an application shall be submitted to the said authorities 180 days before the expiration of the period. The authorities in charge of examination and approval shall, within 30

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[148] *Opinion on the Application by Foreign Investment Enterprises for the Extension of Term of Operation*, Article 3 (Exhibit CN-51); *see also* China's First Written Submission, paras.298 and 322.

[149] China's First Written Submission, para. 321.

[150] China's First Written Submission, para. 300.

[151] Exhibit CN-48 (emphasis added).

[152] Exhibit CN-49 (emphasis added).

> days from the date of such application is received, decide whether or not to grant the extension."[153]
>
> - Article 1 of the *Opinions on Issues Concerning the Application of Extension of Term of Operation of Foreign Invested Enterprises* confirms, "if a FIE wants to extend its operation terms, it shall apply for extension to approving authority prior to the 180th day before the expiry date of the operation terms ("Mandatory Time Period"). The approving authority shall decide whether to approve or not to approve within 30 days after receipt of application."[154]

96. Thus, even after the agreement of the joint venture parties is secured, extension of the operating term is far from automatic, as it depends on another round of examination and approval, procedures under which government authorities have the authority to disapprove requests for extension. Adding further uncertainty, no objective criteria govern such extension decisions. Foreign-invested enterprises are, therefore, subject to the discretion of the decision-making authority.

97. Furthermore, China's argument regarding the requirement that extension is subject to the laws, regulations and policies on foreign investment is circular and does not withstand scrutiny. China contends that this requirement is consistent with Article XVII because all Chinese laws are necessarily consistent with the GATS.[155] While China's laws and regulations on foreign direct investment must comply with China's GATS commitments, that does not mean that they necessarily do comply. China's obligation to comply with its WTO commitments requires China to bring its WTO-inconsistent measures into compliance with its WTO commitments.

b. Registered Capital

98. China's registered capital requirement also modifies the conditions of competition in favor of wholly Chinese-owned sub-distributors of books, newspapers and periodicals. China does not contest that foreign-invested wholesalers of books, newspapers and periodicals published in China must have RMB 30 million in registered capital,[156] while their wholly Chinese-owned competitors need only RMB 2 million.[157] This disparity deprives foreign-invested wholesalers of equal competitive opportunities by exacting a significantly higher price for market entry.

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[153] Exhibit CN-50 (emphasis added).

[154] Exhibit CN-51 (emphasis added).

[155] China's First Written Submission, paras. 299 and 323.

[156] Foreign-Invested Sub-Distribution Rule, Article 7.4 (Exhibit US-28); Publication Sub-Distribution Procedure, "Licensing Requirements", para. 4 (Exhibit US-29).

[157] Publications Market Regulation, Article 8 (Exhibit US-27).

99. China argues, however, that this disparity does not result in less favorable treatment because foreign-invested enterprises can contribute their registered capital in installments, while wholly Chinese-owned enterprises must contribute their registered capital prior to establishment.[158] This argument fails, however, since wholly-Chinese owned enterprises are also permitted to contribute their registered capital in installments.[159] While China cites the Company Law of 1994 as providing that wholly Chinese-owned enterprises must contribute the entirety of their registered capital prior to establishment, China fails to mention that the Company Law was amended in 2005 to provide that wholly-Chinese owned enterprises may also contribute their registered capital in installments over time.[160] Article 26 of the Company Law of 2005 states in relevant part:

> The registered capital of a limited liability company shall be the total amount of the capital contributions subscribed to by all the shareholders that have registered with the company registration authority. The amount of initial capital contributions made by all shareholders of this company shall be not less than 20% of its registered capital, nor less than the legally-defined minimum amount of registered capital, and the outstanding part shall be paid off by the shareholders within 2 years as of the date of the incorporation of this company; in terms of an investment company, that outstanding part may be paid off within 5 years.

100. Subsequent regulations make clear that both foreign-invested and wholly-Chinese owned enterprises may contribute their registered capital in installments over the same period of time, but they do not correct the underlying disparity between the RMB 30 million and RMB 2 million registered capital requirements.[161]

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[158] China's First Written Submission, paras. 295 and 318-319.

[159] Even if only foreign-invested enterprises are permitted to contribute their registered capital over time in installments, this does not offset the radical financial disparity that is imposed on foreign-invested wholesalers. For example, while a wholly Chinese-owned wholesaler contributes the entirety of its RMB 2 million in one year, its foreign-invested counterpart would contribute RMB 2 million each year for 15 years.

[160] *Company Law of the People's Republic of China* ("Company Law"), Adopted at the Fifth Session of the Standing Committee of the Eighth National People's Congress on December 29, 1993. Revised for the first time on December 25, 1999 in accordance with the Decision of the Thirteenth Session of the Standing Committee of the Ninth People's Congress on Amending the Company Law of the People's Republic of China. Revised for the second time on August 28, 2004 in accordance with the Decision of the 11th Session of the Standing Committee of the 10th National People's Congress of the People's Republic of China on Amending the Company Law of the People's Republic of China. Revised for the third time at the 18th Session of the 10th National People's Congress of the People's Republic of China on October 27, 2005 (Exhibit US-82)

[161] *See Implementing Opinions on Several Issues Related to the Application of Law in the Administration of the Examination, Approval and Registration of Foreign-Invested Companies*, issued by the State Administration for Industry and Commerce, the Ministry of Commerce, the General Administration of Customs, and the State Administration of Foreign Exchange on April 24, 2006, para. 9 (providing "The amount of initial capital contribution made by shareholder(s) of a foreign-invested limited liability company (including a one-person limited liability company) shall meet the requirement of relevant laws or administrative regulations; one-off capital

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c. Pre-Establishment Legal Compliance

101. China's discriminatory pre-establishment legal compliance requirement likewise accords further less favorable treatment to foreign-invested wholesalers than to domestic suppliers. Pursuant to this requirement, foreign-invested enterprises are prohibited from engaging in the wholesale distribution of books, newspapers and periodicals published in China if they have any record of legal non-compliance in the three years prior to their application to engage in such services.[162] Wholly Chinese-owned wholesale distributors of reading materials, however, are not subject to this requirement. This requirement modifies the conditions of competition in favor of wholly-Chinese owned wholesalers, as it imposes a market entry barrier exclusively on foreign-invested enterprises, thereby providing more favorable entry opportunities and less market competition for wholly Chinese-owned wholesalers.

102. China argues that Article 65 of the Management Regulation[163] places similar pre-establishment legal compliance requirements on wholly Chinese-owned wholesalers of reading materials.[164] China's reliance on this provision, however, is misplaced. The pre-establishment legal compliance requirement imposes a much more onerous hurdle to entry than Article 65. Article 65 curbs domestic suppliers' freedom of action only for violations of the Management Regulation that result in "the administrative punishment of revocation of [the entity's] license". In contrast, the pre-establishment legal compliance requirement applicable to foreigners totally

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[161](...continued)
contributions shall be made fully within six months from the date of the incorporation of the company; in the event of capital contribution by installments, the amount of initial capital contribution, which shall be not less than 15% of the total amount of the capital contribution to be subscribed to, nor less than the legally-defined minimum amount of registered capital, shall be paid off within three months from the date of the incorporation of the company, and for the outstanding amount of capital contribution, the schedule for its payment shall meet the requirements of the Company Law, relevant laws on foreign investment and the Regulations on the Administration of the Registration of Companies. Where other laws and administrative regulations provide that the shareholders of a company shall make full capital contribution by the time of the incorporation of that company, such provisions shall prevail. Capital contributions made for a foreign-invested joint stock limited company shall meet the requirements of the Company Law.") (Exhibit US-83); *see also Regulations of the People's Republic of China on Administration of Registration of Companies*, Promulgated by Decree No. 156 of the Stale Council of the People's Republic of China on June 24, 1994, and revised in accordance with the Decision of the State Council on Amending the Regulations of the People's Republic of China on Administration of Registration of Companies made on December 18, 2005, Article 20 (stating "For a shareholder of a foreign-invested limited liability company, the amount of his initial capital contribution shall meet the requirements of laws and administrative regulations, and the outstanding part shall be paid off within two years from the date of the incorporation of that company or within five years if that company is an investment company.") (Exhibit US-84).

[162] Foreign-Invested Sub-Distribution Rule, Article 7.1 (Exhibit US-28); Publication Sub-Distribution Procedure, "Licensing Requirements" para. 1 (Exhibit US-29); Several Opinions, Article 6 (Exhibit US-6).

[163] Exhibit US-7.

[164] China's Answers to the First Set of Panel Questions, Question 80.

bars market entry for any "law or regulation violations"[165] or "other bad offenses".[166] Thus, foreign-invested enterprises are prevented from ever engaging in the wholesale of books, newspapers and periodicals if they have any record of non-compliance with any Chinese rules, no matter how minor, or whether it bears any relation to the proper conduct of wholesaling services.

103. Furthermore, Article 65 of the Management Regulation only sanctions the "legal representative or principal responsible person" of the wholly Chinese-owned wholesaler whose license is revoked. According to the terms of Article 65, where the license of a wholly Chinese-owned enterprise is revoked as a result of a violation of the Management Regulation, it is only the "legal representative or principal responsible person" that is prevented from holding that post for a specified duration in the future. The pre-establishment legal compliance requirement, however, provides that no foreign-invested enterprise can engage in the reading material wholesale services, if it fails to meet the standard. This is a far more draconian result than simply precluding particular individuals from holding particular posts within the enterprise.

104. For the reasons explained above and in the U.S. first written submission, this requirement modifies the conditions of competition in favor of wholly Chinese-owned wholesalers so as to accord foreign-invested wholesalers of books, newspapers and periodicals published in China less favorable treatment in a manner that is inconsistent with Article XVII of the GATS.

d. Examination and Approval Process

105. Foreign-invested wholesalers of books, newspapers and periodicals published in China also face a fundamentally discriminatory examination and approval process in order to enter this market. They must go through a six stage process that takes at least 90 days,[167] whereas wholly Chinese-owned wholesalers are treated preferentially to a three stage process, which takes only 40 days.[168] This disparate treatment modifies the conditions of competition to the detriment of foreign-invested enterprises in terms of the time required for, and the administrative burdens

[165] Foreign-Invested Sub-Distribution Rule, Article 7.1 (Exhibit US-28); Publication Sub-Distribution Procedure, "Licensing Requirements" para. 1 (Exhibit US-29); Several Opinions, Article 6 (Exhibit US-6).

[166] Several Opinions, Article 6 (Exhibit US-6).

[167] Foreign-Invested Sub-Distribution Rule, Articles 10-14 (Exhibit US-28). Article 10 provides the GAPP regional office with 15 days, Article 11 provides the GAPP national office with 30 days, Article 12 provides the MOFCOM regional office with 15 days, and Article 13 provides the MOFCOM national office with 30 days, for a total of at least 90 days. Article 14 provides for two additional layers of examination and approval by the GAPP regional office and by the SAIC local office, but does not provide time limits for these two decisions. In its answer to question 106 of the First Set of Panel Questions, China states that the MOFCOM examination and approval takes "less than 45 days". This un-supported assertion conflicts with the explicit text of Articles 12 and 13 of the Foeign-Invested Sub-Distribution Measure.

[168] Publication Market Rule, Article 9 (Exhibit 27).

involved in, examination and approval. Moreover, with three additional approvals required,[169] foreign-invested enterprises are exposed to significantly more risk that they will not be approved. A process that takes more than twice as long and that involves twice as many chances of rejection, creates a considerable obstacle to market entry that wholly Chinese-owned wholesalers do not confront.

106. China broadly asserts with no support that these differences have no "significant impact on the conditions of competition".[170] China contends that the MOFCOM approval process is non-discretionary, but the text of the Foreign-Invested Sub-Distribution Rule belies this claim.[171] While Article 12 of that measure provides that foreign-invested applicants must provide certain enumerated documents as part of this process, no criteria or conditions govern how MOFCOM makes its approval decisions. MOFCOM's approval decision-making is entirely discretionary.

107. China also attempts unsuccessfully to defend the system by claiming that the additional delays imposed on foreign-invested wholesalers of reading materials as a result of the MOFCOM examination and approval process are not as long as the delays imposed by the examination and approval process generally applied to Chinese-foreign joint ventures.[172] This argument falls under its own weight. Even if more discriminatory treatment is being imposed on other foreign-invested enterprises, this does not justify the discriminatory treatment being imposed on foreign-invested wholesalers of books, newspapers and periodicals published in China. It is the more favorable treatment accorded to wholly Chinese-owned wholesalers, and not the even less favorable treatment accorded to Chinese-foreign contractual joint ventures in general that goes to the crux of the U.S. national treatment claim.

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[169] In paragraph 305 of its First Written Submission, China disagrees with the United States that foreign-invested wholesalers face three decision-making sages within GAPP, and contends that only two GAPP approvals are required. Articles 10 and 14 of the Foreign-Invested Sub-Distribution Rule (Exhibit US-28), however, expressly provide for three GAPP approvals: (1) from the regional GAPP office; (2) from the national GAPP office; and (3) again from the regional GAPP office for a Publication Business License.

[170] China's First Written Submission, para. 332.

[171] Exhibit US-28.

[172] China's First Written Submission, para. 333. Moreover, China's assertion that the 45-day examination and approval process applicable to foreign-invested wholesalers is shorter than the 90-day process applicable to "Chinese-foreign joint ventures" is inaccurate. As the United States has explained, the examination and approval process for foreign-invested wholesalers takes 90 days, which includes the 45-day MOFCOM process. Thus, the process is not shorter for foreign-invested wholesalers than it is for Chinese-foreign joint ventures. In addition, China cites three separate laws that are applicable to Chinese-foreign joint ventures – addressing Chinese-foreign equity joint ventures (Exhibit CN-48), Chinese-foreign contractual joint ventures (Exhibit CN-49), and foreign-funded enterprises (*i.e.*, wholly foreign-owned enterprises) (Exhibit CN-50). While the laws on Chinese-foreign equity joint ventures and foreign-funded enterprises provide for a 90-day examination and approval process (*see* Article 3 of Exhibit CN-48 and Article 6 of Exhibit CN-50), the law on Chinese-foreign contractual joint ventures provides that the examination and approval process takes only 45 days (*see* Article 5 of Exhibit CN-49).

108. Finally, China argues unsuccessfully that its horizontal commitments inscribed under mode 3 of its Services Schedule preserve its right to maintain such discriminatory requirements.[173] That inscription provides in relevant part:

> In China, foreign invested enterprises include foreign capital enterprises (also referred to as wholly foreign-owned enterprises) and joint venture enterprises and there are two types of joint venture enterprises: equity joint ventures and contractual joint ventures.[174]

China further contends that this inscription justifies its discriminatory examination and approval process for foreign-invested wholesalers because China maintained similar discriminatory measures prior to its WTO accession.[175]

109. China's horizontal commitment, however, provides no such safe-harbor for its GATS-inconsistent examination and approval process. China cites to no specific text in its inscription, as there is none, to support its argument that it included a limitation with respect to WTO-inconsistent measures regarding the examination and approval of foreign-invested enterprises. This inscription is a classic GATS Article XVI:2(e) limitation, restricting the types of entities through which a service supplier may supply a service. This explains why it was included within China's horizontal commitments. It provides a list of the three types of enterprises into which foreign-investment is possible, meaning that China undertook no commitments with regard to foreign investment in other forms of enterprises. In fact, China confirms this reading of its horizontal commitment in its answer to the question 113 of the Panel's First Written Questions, stating:

> China confirms that the limitations concerning mode 3 included in its horizontal commitments fall within the scope of Article XVI:2(e) of the GATS. Any type of entity other than sino-foreign equity joint venture, sino-foreign contractual joint venture and wholly foreign-owned enterprises is excluded.

110. Furthermore, the fact that China maintained WTO-inconsistent measures governing the examination and approval of the three types of enterprises contained in its Article XVI:2(e) limitation prior to its WTO accession does not exempt such measures from China's GATS obligations following accession. As the panel reasoned in *EC – Bananas III*:

> any finding of consistency or inconsistency with the requirements of Article[] . . . XVII of GATS would be made with respect to the period of entry into force of the GATS. Moreover, in this connection we note that <u>there is no grandfather clause</u>

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[173] China's First Written Submission, paras. 324-331; and China's Answers to the First Set of Panel Questions, Question 107.

[174] China's Services Schedule, Part I: Horizontal Commitments, p. 2 (Exhibit US-2).

[175] China's First Written Submission, paras. 324-331.

> in the WTO Agreement that would permit Members to maintain indefinitely national legislation that is inconsistent with WTO rules.[176]

111. Indeed, the *raison d'etre* of China's wholesale trade services commitment with respect to reading materials under mode 3 of Sector 4B of its Services Schedule was to provide market access and national treatment for foreign-invested wholesalers of reading materials. By the very nature of its inscriptions, China obligated itself to remove any pre-accession measures, and not issue any new measures following accession, that are inconsistent with China's WTO commitments.

112. In short, as the measure at issue dates from after China's accession, and China's horizontal and Sector 4B commitments contain no limitations that justify its WTO-inconsistent examination and approval process, China's arguments regarding its horizontal commitments are unavailing.

e. Decision-Making Criteria

113. Finally, GAPP's decision-making criteria for approving foreign-invested enterprises – which include friendliness, great capability, standardized management, advanced technologies and reliable foreign investment – modify the conditions of competition by subjecting foreign-invested applicants, but not wholly Chinese-owned applicants, to additional hurdles that must be overcome in order to enter the Chinese market place. These criteria impose discretionary criteria on what is already a more onerous application and approval process for such foreign-invested wholesalers. By limiting market entry of foreign competitors, while failing to impose the same conditions on wholly Chinese-owned wholesalers, China modifies the conditions of competition in favor of its domestic suppliers.

114. China has elected not to advance substantive arguments with respect to these discriminatory requirements. Instead, China contends that the Panel need not rule on the measure containing these discriminatory criteria – *i.e.*, the Several Opinions.[177] For the reasons explained in the U.S. first oral statement[178], this measure is properly before the Panel and is contained within its terms of reference.

115. Through the discriminatory prohibitions and requirements imposed on foreign-invested wholesalers of reading materials, China accords services and service suppliers of other WTO Members treatment that is less favorable than what its own like services and service suppliers receive. Moreover, the measures at issue do not fall within the terms, limitations, conditions, or qualifications on market access or national treatment that China has specified in its Services

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[176] *EC – Bananas (Panel)*, para. 7.308 (emphasis added).

[177] China's Answers to the First Set of Panel Questions, Question 39.

[178] U.S. First Oral Statement, para. 92.

Schedule. China's measures are, therefore, inconsistent with China obligations under Article XVII of the GATS.

B. AVHE Products

116. 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 AVHE products. Specifically, China committed that "[u]pon accession, foreign service suppliers will be permitted to establish contractual joint ventures with Chinese partners to engage in the distribution of audiovisual products . . ." In addition, in the national treatment column, China inscribed no limitations on its obligations. Notwithstanding these commitments, China maintains several measures that are inconsistent with its market access and national treatment obligations for foreign-invested service distributors of AVHE products. These measures are therefore inconsistent with Article XVI:2(f) and Article XVII of the GATS.

1. Article XVI

117. China maintains several measures that limit the participation of foreign capital in Chinese-foreign contractual joint ventures engaged in the distribution of AVHE products.[179] Such limitations are not provided for in China's Services Schedule, and therefore, these measures are inconsistent with Article XVI:2(f) of the GATS.

118. Specifically, as the United States has shown, China's measures are inconsistent with Article XVI of the GATS because: (1) China made a market access commitment in its Services Schedule under mode 3 that Chinese-foreign contractual joint ventures would be permitted to engage in the distribution of AVHE products upon China's accession[180]; (2) China did not inscribe any limitations on the participation of foreign capital with respect to Chinese-foreign

[179] First, Article 8.4 of the Audiovisual Sub-Distribution Rule requires that the Chinese party to a contractual joint venture engaging in audiovisual sub-distribution hold at least 51 percent of the equity. (Exhibit US-18). *See* U.S. Answers to the First Set of Panel Questions, paras. 167-71, explaining the U.S. translation of this provision. The Catalogue states that foreign investment in this activity is restricted in the following way: Sub-distribution of audiovisual products (excluding motion pictures) (limited to contractual joint ventures where the Chinese partner holds majority share). ("Catalogue of Industries with Restricted Foreign Investment", Article VI.3 (Exhibit US-5)); Article 8 of the Foreign Investment Regulation states that the phrase "the Chinese party holds the majority share" as used in the Catalogue means "the total proportion of investment of the Chinese investor in the foreign-invested project is 51% and above." The Several Opinions likewise provide that foreign-invested enterprises can only hold minority shares in contractual joint ventures: Under the condition where the right of our country to examine the content of audiovisual products is not harmed, foreign investors are permitted to set up enterprises for the sub-distribution of audiovisual products, with the exception of motion pictures, in the form of Chinese-foreign contractual joint ventures where the Chinese partner holds a dominant position. Several Opinions, Article 1 (Exhibit US-6)).

[180] U.S. First Written Submission, para. 308, 312.

contractual joint ventures engaged in the distribution of AVHE products[181]; and (3) China's measures limit the participation of foreign capital in Chinese-foreign contractual joint ventures engaged in the distribution of AVHE products.[182]

119. China's contentions to the contrary fail to rebut the U.S. claim. First, China does not even address the language in the Foreign Investment Regulation and the Several Opinions that directly supports the U.S. position. Second, China initially appears to concede the validity of the U.S. interpretation of the Catalogue and the Audiovisual Sub-Distribution Rule, by stating that the relevant measures "provide that the Chinese party to a Sino-Foreign joint venture engaging in the wholesaling of audiovisual products must hold at least 51% of the shares."[183]

120. However, China then contends, contrary to the U.S. description of these measures, that the measures actually regulate the "rate of distribution of profit and allocation of loss,"[184] not the level of participation of foreign equity in contractual joint ventures. Based on this assertion, China then states that Article XVI does not require Members to inscribe limitations with respect to profit and loss allocation in their services schedules. However, China's argument does not withstand scrutiny. China does not provide any textual basis for its conclusion that the explicit limitations on the percentage of shares that the foreign party may hold should be construed instead as a limitation on the allocation of profit and loss between the parties to the joint venture.[185]

121. According to China's translation, Article 8(4) of the Audiovisual Sub-Distribution Rule states that "{t}he rights and interests in the contractual joint venture held by the Chinese cooperator is no less than 51%."[186] This provision in fact makes no reference to profit or loss and therefore does not support China's proffered interpretation. China provides no textual analysis to support the notion that these terms are equivalent or limited to profit and loss. Moreover, as the United States set forth in its response to Question 114, China's translation of this provision is unsupported by the ordinary meaning of the corresponding Chinese terms.[187]

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[181] U.S. First Written Submission, para. 317.

[182] *See* U.S. First Written Submission, paras. 323-25.

[183] China's First Written Submission, para. 337.

[184] China's First Written Submission, para. 337.

[185] China actually seems to contradict its own argument at one point, citing the law on Chinese-Foreign Contractual Joint Ventures for the proposition that parties to contractual joint ventures can freely negotiate the allocation of profit and loss. China's First Written Submission, para. 338. Ironically, China then cites the same law to claim that the percentage of each party's contribution to the registered capital is not limited. However, this law did not prevent China from claiming that the measures at issue effectively restrict the allocation of profit and loss.

[186] Exhibit CN-54.

[187] U.S. Answers to the First Set of Panel Questions, paras. 167-71. The correct translation of this provision, as provided by the United States, is: "A Chinese-foreign contractual joint venture for sub-distribution of audiovisual products shall meet the following conditions: (4) The Chinese cooperator shall hold no less than 51% equity in the contractual joint venture." (Exhibit US-18).

122. In contrast to the U.S. analysis of the text of this provision based on the ordinary meaning of the corresponding Chinese terms, China merely states in response to Question 114 that "the United States mistranslates Article 8(4) of the foregoing measure. 51% of the percentage of rights and interests rather than equity percentage."[188] China provides no analysis supporting this conclusion.

123. With respect to the Catalogue, China merely cites Article VI:3, which China translates as providing that the sub-distribution of audiovisual products is limited to Chinese-foreign contractual joint ventures where the Chinese party has a "controlling interest."[189] This provision also makes no mention of profit or loss.

124. Furthermore, the Foreign Investment Regulation provides guidance on the meaning of the term "majority share" in the Catalogue, which China has translated as "controlling interest." The Foreign Investment Regulation states that this provision means "the total proportion of investment of the Chinese investor of the foreign-invested project is 51% and above."[190]

125. Finally, China's reliance on the Law on Chinese-Foreign Contractual Joint Ventures is unavailing. China cites to Articles 2 and 21 of this provision to support the notion that parties negotiate the profit and loss allocation rates and that such rates may differ from the percentage of contribution to the registered capital, which is not limited.[191] However, this law does not negate the existence of those other measures identified by the United States, which explicitly provide for a limitation on the participation of foreign capital in Chinese-foreign contractual joint ventures engaged in the distribution of AVHE products.

126. In short, China has not rebutted the U.S. claim that the limitations on the participation of foreign capital render the relevant measures inconsistent with Article XVI:2(f) of the GATS.

2. Article XVII

127. China also fails to rebut the U.S. claim that China maintains discriminatory requirements with respect to Chinese-foreign contractual joint ventures engaged in the distribution of AVHE products and that these discriminatory requirements are inconsistent with China's obligations under Article XVII of the GATS.

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[188] China's Answers to the First Set of Panel Questions, Question 114.

[189] Exhibit CN-41.

[190] Exhibit US-9. Even if China's translation of "controlling interest" were viewed in isolation from the Foreign Investment Regulation and construed to mean something other than "majority share", China's GATS commitment contains no limitation allowing China to limit the Chinese-foreign contractual joint ventures engaged in AVHE product distribution services to those where the Chinese party has a controlling interest. And, in fact, China has not pointed to any part of its Services Schedule that would permit such a limitation.

[191] China's First Written Submission, para. 338.

128. In Sector 2D of its Services Schedule, China inscribed no limitations in the national treatment column with respect to the distribution of AVHE products under mode 3. However, China maintains numerous measures that accord less favorable treatment to foreign-invested distributors of AVHE products than wholly Chinese-owned distributors. China discriminates against foreign-invested distributors of AVHE products through requirements regarding: (1) equity participation limits; (2) operating term; (3) pre-establishment legal compliance; (4) examination and approval; and (5) decision-making criteria.

129. These discriminatory requirements modify the conditions of competition in favor of wholly Chinese-owned distributors by imposing greater administrative burdens and inhibiting their competitive freedom. Accordingly, these requirements accord foreign-invested distributors of AVHE products less favorable treatment than like wholly Chinese-owned service suppliers in contravention of Article XVII of the GATS.

a. Equity Participation Limits

130. First, China provides discriminatory treatment to foreign service suppliers by requiring that the foreign party to a Chinese-foreign contractual joint venture hold no more than 49 percent of the shares while the Chinese party can hold up to 100 percent and no less than 51 percent of the shares.[192] In this regard, China repeats its argument that the measures identified by the United States actually regulate the rate of allocation of profit and loss.[193] For the reasons stated above, China's argument is without merit.

131. China also asserts that although its measures provide for different treatment with respect to the allocation of profit and loss among shareholders, "this does not impact the actual conditions of competition to the detriment of such contractual joint ventures."[194] China provides no explanation for this assertion. In fact, the inability to hold a majority position in a joint venture severely disadvantages foreign suppliers by depriving them of important control over the operation of the AVHE product distribution venture, while Chinese suppliers do not face such a disadvantage.

132. As set forth in the U.S. response to Question 65(b), China's restrictions on foreign capital participation in joint ventures engaged in the distribution of AVHE products have the potential to restrict foreign investors' freedom to implement their strategic vision and realize their goals for the enterprise where the vision and goals are inconsistent with those of the Chinese party to the joint venture.[195] This restriction can limit the success of the foreign investor's investment as well as inhibit the future development of the enterprise in China. Chinese like service suppliers do

[192] U.S. First Written Submission, para. 333.
[193] China's First Written Submission, para. 347.
[194] China's First Written Submission, para. 370.
[195] U.S. Answers to the First Set of Panel Questions, paras. 112-15.

not face such a limitation because the Chinese party to a contractual joint venture engaged in the sub-distribution of AVHE products is always ensured the dominant position in the enterprise.

133. In a situation where the partners to a Chinese-foreign joint venture disagree about the goals for the enterprise or the best way for the enterprise to operate, the foreign party is restricted in its ability to set up an enterprise, which reflects its competitive vision and goals. This is a restriction on the ability to compete in the market. In contrast, in the same situation of a disagreement between the joint venture partners, the Chinese party is guaranteed the ability to realize its vision and goals for the enterprise because the Chinese party is guaranteed a dominant position.

134. The limitation on the foreign partner's ability to exercise control over the joint venture may not always serve as an impediment to effective competition by the joint venture. However, the restriction on the foreign investor's freedom to implement its vision and goals for the joint venture, which the Chinese party to a joint venture does not face, provide China's own like service suppliers with greater competitive freedom and therefore a competitive advantage over foreign service suppliers. Accordingly, these measures accord less favorable treatment to foreign service suppliers engaged in the sub-distribution of AVHE products.

b. Operating Term

135. China also requires that foreign-invested entities engaged in the distribution of audiovisual products face a 15-year operating term while wholly Chinese-owned AVHE distributors are not subject to such a limitation.[196] China does not dispute that foreign-invested entities are subject to a limitation on their operating term. However, China contends that (1) these entities "are free to extend that term under normal and transparent conditions" *i.e.*, that all investors and Board Directors agree and that the extension comply with the laws, regulations, and policies on foreign investment;[197] (2) that therefore there is effectively no limitation on operating term for foreign-invested enterprises or wholly Chinese-owned enterprises;[198] and (3) the extension process is non-discretionary, automatic, and simplified.[199] These assertions do not withstand scrutiny.

136. All of these factors, even if true, do not change the fact that foreign-invested entities face greater uncertainty and cost in the continuity of their operations in China than wholly Chinese-owned entities as set forth above. Maintaining current business and generating new business becomes significantly more difficult as the foreign-invested distributor cannot guarantee that it will continue to be in business after the expiry of its operating term. This is a disadvantage and

[196] U.S. First Written Submission, para. 128, 333.
[197] China First Written Submission, para. 350.
[198] U.S. First Written Submission, para. 373.
[199] U.S. First Written Submission, para. 373.

amounts to less favorable treatment for foreign-invested entities contrary to Article XVII of the GATS.

137. This operating term limitation also modifies conditions of competition to the detriment of the foreign-invested distributors because extension requires the agreement of all investors, all Board Directors and the laws, regulations and policies on foreign investment.[200] Under Chinese law, each of these parties holds a veto on extension and can use that leverage to extract concessions from the foreign-invested parties. This commercial situation places undue strain and extra burdens on the foreign-invested enterprise, a predicament not faced by wholly Chinese-owned enterprises.

138. Furthermore, as set forth above, China's contention that extension of the operating term is "non-discretionary, automatic and simplified"[201] is contradicted by the relevant Chinese measures.[202] As these measures set forth, far from being automatic, extension of the operating term depends upon a new round of examination and approval, procedures under which government authorities have the authority to disapprove requests for extension. Adding further uncertainty, no objective criteria govern such extension decisions. Foreign-invested enterprises are, therefore, subject to the discretion of the decision-making authority.

139. Finally, China's argument regarding the requirement that extension is subject to the laws, regulations and policies on foreign investment is circular and does not withstand scrutiny. China contends that this requirement is consistent with Article XVII because all Chinese laws are necessarily consistent with the GATS.[203] While China's laws and regulations on foreign direct investment must comply with China's GATS commitments, that does not mean that they necessarily do comply. Rather, that obligation requires China to bring its WTO-inconsistent measures into compliance with its WTO commitments.

c. Pre-Establishment Legal Compliance

140. China also maintains discriminatory requirements with respect to pre-establishment legal compliance, which accord less favorable treatment to foreign-invested distributors than to like domestic service suppliers. Although China raises certain procedural arguments with respect to these measures,[204] China does not dispute that these measures provide for discriminatory treatment for foreign-invested enterprises in breach of Article XVII. Under the relevant measures, China requires foreign-invested AVHE sub-distributors to have no record of illegal activities in the three years prior to their application for establishment while wholly Chinese-

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[200] *Opinion on the Application by Foreign Investment Enterprises for the Extension of Term of Operation*, Article 3 (Exhibit CN-51); *see also* China's First Written Submission, paras. 298 and 322.

[201] China's First Written Submission, para. 321.

[202] China's First Written Submission, para. 300. *See* supra. III.A.2.a.

[203] China's First Written Submission, paras. 299 and 323.

[204] China's First Written Submission, para. 238.

owned AVHE product sub-distributors face no similar requirement.[205] As set forth in the context of reading materials, this requirement modifies the conditions of competition in favor of wholly-Chinese owned wholesalers as it imposes a market entry barrier exclusively on foreign-invested enterprises, which enhances the competitive opportunities of wholly Chinese-owned wholesalers by reducing the competitive opportunities available to their foreign-invested counterparts.

141. With respect to China's contention that this element of the U.S. claim under Article XVII of the GATS for AVHE products is not within the Panel's terms of reference, the United States has set forth in its first oral statement and in Section VI below, that China's arguments are without merit.[206]

d. Examination and Approval Process

142. China also accords less favorable treatment to foreign-invested entities than wholly Chinese-owned entities engaged in the distribution of audiovisual products by placing more administrative burdens on foreign-invested entities as it relates to the examination and approval process.[207] China's defense to this claim consists of three principal arguments: (1) China asserts its horizontal commitments of its Services Schedules preserves its right to maintain the measures at issue;[208] (2) China disputes some of the U.S. description of the approval process;[209] and (3) China asserts that the measures at issue do not modify the conditions of competition to the detriment of foreign services or service suppliers, as required to establish a claim under Article XVII of the GATS.[210] All of these arguments are without merit.

143. First, China's horizontal commitments merely state in pertinent part that "in China, foreign invested enterprises include foreign capital enterprises . . . and joint venture enterprises and there are two types of joint venture enterprises: equity joint ventures and contractual joint ventures."[211] While China's horizontal commitments in its Services Schedule provide a definition of foreign invested enterprises, those horizontal entries contain no language that qualifies or limits China's national treatment obligations. Nor does China's horizontal commitment provide any such safe-harbor for China's GATS-inconsistent examination and approval process. China cites to no specific text in its inscription, as there is none, to support its argument that it included a limitation with respect to WTO-inconsistent measures regarding the examination and approval of foreign-invested enterprises. Indeed, as China itself recognizes, this type of entry fits within the scope of the market access provision of Article XVI:2(e) of the

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[205] U.S. First Written Submission, para. 335

[206] U.S. First Oral Statement, paras. 95-97. *See also*, Infra. SectionVI.

[207] U.S. First Written Submission, paras. 130-36.

[208] China's First Written Submission, paras. 376-77.

[209] China's First Written Submission, paras. 382-88.

[210] China's First Written Submission, paras. 382-88.

[211] Exhibit US-2.

GATS.[212] It provides a list of the three types of enterprises into which foreign investment is possible, meaning that China reserved the right to deny foreign investment in other forms of enterprises. Accordingly, China's entry regarding types of foreign-invested entities in its horizontal commitments does not insulate China from the national treatment claim advanced by the United States.

144. China's argument that the laws and regulations governing the approval process were in place at the time of China's accession is also unavailing as the relevant question is whether China currently maintains any measures that are inconsistent with China's GATS obligations. China's Accession Protocol contains no grandfather provision allowing China to keep in place measures that are inconsistent with the commitments that it undertook at the time.[213]

145. China also disputes certain aspects of the approval process as set forth by the United States for Chinese-foreign contractual joint ventures engaged in the distribution of AVHE products. First, China contends that the approval process for foreign-invested distributors of AVHE products involves four rather than six steps, as advanced by the United States.[214] China then states "[i]ndeed, in addition to the MOFCOM approval, the only difference from the approval process applicable to wholly Chinese-owned entities lies in the fact that a second MOC approval is necessary after the MOFCOM approval."[215] However, what China's statement betrays is that the approval process for foreign-invested distributors involves more steps than for wholly Chinese-owned distributors. Whether China now describes these additional steps as insignificant is irrelevant. The foreign-invested distributors face a more burdensome process for becoming an approved entity than wholly Chinese-owned entities. By being subject to additional opportunities for rejection than wholly Chinese-owned distributors, the discriminatory requirements create a competitive disadvantage for the foreign-invested distributors, and therefore accord them less favorable treatment in contravention of Article XVII of the GATS.

146. China also contends that the requirement that the Chinese partner to the joint venture is the party that submits the application is designed to "avoid undue delays and can therefore not be viewed as negatively impacting the conditions of competition."[216] What China's statement ignores, however, is that the Chinese party is appointed as the party that conducts all of the communication with the relevant government authorities during the approval process. This limits the enterprise's opportunity to allocate its resources in a manner that it deems most advantageous.

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[212] *See* China's Answers to the First Set of Panel Questions, Question 113.

[213] *See e.g., EC – Bananas III (Panel)*, para. 7.308 ("any finding of consistency or inconsistency with the requirements of Article[] . . . XVII of GATS would be made with respect to the period of entry into force of the GATS. Moreover, in this connection we note that there is no grandfather clause in the WTO Agreement that would permit Members to maintain indefinitely national legislation that is inconsistent with WTO rules").

[214] China First Written Submission, para. 357.

[215] China's First Written Submission, para. 358.

[216] China's First Written Submission, para. 386.

147. China's third argument regarding the approval process is that the measures do not modify the conditions of competition to the detriment of foreign services or service suppliers. China asserts that while the approval process for foreign-invested entities involves more steps and delay than for wholly Chinese-owned entities, these additional steps or delay are not significant.[217] For example, China states that "the application to the MOFCOM is not burdensome as the required information and documents are not difficult to collect and do not represent a significant workload."[218] In addition, China states that the maximum delay for the process is 30 days, which is "significantly shorter than the 3 months maximum time limit" for the general regime applicable to Chinese-foreign contractual joint ventures.[219] China then contends that the first application to the MOC "only entails a 60-day delay at most. The second application to the MOC normally is expeditious . . ."[220] China's arguments miss the point.

148. Article XVII:3 contains no safe harbor for discriminatory measures that only modify the conditions of competition in favor of domestic entities by a supposedly small amount. Moreover, while China attempts to minimize the significance of the discriminatory treatment, China's measures with respect to the approval process do disadvantage the foreign service suppliers because they face greater uncertainty and cost than wholly Chinese-owned service suppliers. These measures thus treat foreign service suppliers less favorably than Chinese-owned service suppliers, and they are thus inconsistent with China's obligations under Article XVII.

e. Decision-Making Criteria

149. In addition, China also requires that the relevant authorities, in approving applications from foreign-invested joint ventures, give priority to foreign-invested enterprises displaying the friendliness, capital strength, management standardization, and technological advancement of foreign-invested applicants in making their determinations.[221] These additional conditions are only imposed on the approval process for foreign-invested entities and are not applicable to wholly Chinese-owned entities. As set forth in the context of reading materials, these criteria impose discretionary criteria on what is already a more onerous application and approval process for such foreign-invested distributors. By limiting market entry of foreign competitors, while failing to impose the same conditions on wholly Chinese-owned distributors, China modifies the conditions of competition in favor of its domestic suppliers.

150. China has elected not to advance substantive arguments with respect to these discriminatory requirements. Instead, China contends that the Panel need not rule on the measure

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[217] China's First Written Submission, paras. 382-87.
[218] China's First Written Submission, para. 383.
[219] China's First Written Submission, para. 383.
[220] China's First Written Submission, para. 384.
[221] U.S. First Written Submission, paras. 137, 340.

containing these discriminatory criteria – *i.e.*, the Several Opinions.[222] For the reasons explained in the U.S. first oral statement[223], this measure is properly before the Panel and is contained with in its terms of reference.

151. Through the discriminatory prohibitions and discriminatory requirements imposed on foreign-invested distributors of AVHE products, China accords services and service suppliers of other WTO Members treatment that is less favorable than what its own like services and service suppliers receive. Moreover, the measures at issue do not fall within the terms, limitations, conditions, or qualifications on market access or national treatment that China has specified in its Services Schedule. China's measures are, therefore, inconsistent with China's obligations under Article XVII of the GATS.

C. Sound Recordings: Electronic Distribution of Sound Recordings is Within the Scope of China's Services Commitments for Sound Recording Distribution Services

152. As the United States has set forth in its first oral statement, China has failed to establish that the electronic distribution of sound recordings is beyond the scope of its services commitments for sound recording distribution services.[224] As with AVHE distribution services, in Sector 2D of its Services Schedule, China scheduled no market access or national treatment limitations under mode 3 for Chinese-foreign contractual joint ventures engaged in sound recording distribution services.[225] However, China maintains several measures that accord less favorable treatment to foreign-invested entities engaged in the electronic distribution of sound recordings.[226] The relevant measures – the Internet Culture Rule,[227] the Internet Culture Notice,[228] and the Network Music Opinions[229] – effectively prohibit foreign-invested enterprises from engaging in the electronic distribution of sound recordings in mode 3. By doing so, these measures are inconsistent with Article XVII of the GATS.

153. China does not address the U.S. claims that the measures at issue treat foreign-invested enterprises differently from wholly Chinese-owned entities. Instead, China's defense to this claim rests on the argument that China did not undertake commitments in its Services Schedule

[222] China's Answers to the First Set of Panel Questions, Question 39.
[223] U.S. First Oral Statement, para. 92.
[224] U.S. First Oral Statement, paras. 48-76.
[225] U.S. First Written Submission, paras. 342-45; 351-52.
[226] U.S. First Written Submission, paras. 353-57.
[227] Exhibit US-32.
[228] Exhibit US-33.
[229] Exhibit US-34.

with respect to the electronic distribution of sound recordings, but only with respect to distribution of hard-copy sound recordings.[230] China's arguments are without merit.

154. First, an analysis of the term "sound recording distribution services" in China's Services Schedule under Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* confirms that the electronic distribution of sound recordings is within the scope of China's commitments.[231] In particular, with respect to supplementary means of interpretation under Article 32 of the Vienna Convention, China has failed to establish that the electronic distribution of sound recordings was a "new" phenomenon at the time of its accession and thus beyond the scope of its commitments on sound recording distribution services.[232]

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[230] China's First Written Submission, paras. 389-521.

[231] U.S. First Oral Statement, paras. 51-68.

[232] U.S. First Oral Statement, paras. 58-67. In its first oral statement, the United States adduced numerous examples of China's knowledge of the electronic distribution of sound recordings prior to its accession. U.S. First Oral Statement, paras. 61-66. In addition, there are several other examples documenting that China was aware of the electronic distribution of sound recordings as it was negotiating its accession to the WTO. As set forth in the U.S. first oral statement, a Houston-based company and the Government of China formed a joint venture to launch an MP3 website in early 2000. (Exhibit US-61). Attached as Exhibit US-85, is the joint venture agreement between the Government of China and the Houston-based company. *See also*, "China Strengthens Music Copyright Protection, People's Daily (April 18, 2001) (Exhibit US-86) (discusses a Chinese judicial decision regarding Internet service providers and Internet content providers' use of copyrighted music works); Asia Pacific Legal Institute Update, "Beijing Appeal Court Ruled on a Major Case: Copyright Liability for Internet Service Providers Determined" by Andy Y. Sun (January 2000) (Exhibit US-87) (discusses Chinese judicial decision from December 1999 regarding copyright for online content such as music); "The Music Industry and Technological Development" by Jason Berman, presented at the WIPO Worldwide Symposium on the Impact of Digital Technology on Copyright and Neighboring Rights (April 1, 1993) (Exhibit US-88) (discusses the digital transmission of content including music); "WIPO/NCAC Regional Workshop for Asia and the Pacific on Copyright and the WIPO 'Internet Treaties'" paper prepared by Dr. Mihaly Ficsor and presented at WIPO workshop in Shanghai, (May 1999) (Exhibit US-89) (discusses "transmission of works in digital networks" and "The 'Digital Agenda' and the New Treaties"). China has been a member of the WIPO Convention since June 3, 1980. Additional relevant articles also demonstrate that there was discussion globally of the reality of electronic distribution of sound recordings prior to China's WTO accession. *See* Alice Rawsthorn, "Digital music market tunes up," Financial Times (June 23, 1997) (Exhibit US-90) (discussing a Deutsche Telekom business venture to allow consumers to purchase "albums from their homes delivered directly to their computers"); Jon Pareles, "Digital Distribution of Music is Spreading" The New York Times (July 16, 1998) (Exhibit US-91) ("For those who have been sending and receiving music via the Internet, digital distribution is a harbinger of a future when recorded music has been freed entirely from physical form."); Alice Rawsthorn, "Music Industry Tunes Into Digital Distribution" Financial Post (January 20, 1998) (Exhibit US-92) ("Once dismissed as a techie fantasy, digital distribution is now one of the hottest topics in the music industry."); "'Singapore' Buying Music Over the Internet," Internet Asia (January 2, 1998) (Exhibit US-93) ("You could make the trip to the CD shop and get the album or you can now buy and download the song over the Internet and have it saved to your hard disk."); "UMG promises digital distribution of music in US by end of the year" Financial Times (May 5, 1999) (Exhibit US-94) ("The most significant move was the announcement this week by the Universal Music Group (UMG) that in partnership with technology provider InterTrust, it will offer secure digital delivery of music for sale in the US later this year"). Finally, as set forth in the first oral statement, websites such as chinamp3.com were distributing music electronically in China prior to China's accession. An archived version of this website in Chinese with an English translation is provided in Exhibits US-95.

155. Second, even if China were correct that it could not have been aware of electronic distribution of sound recordings as a commercial reality at the time of its WTO accession, China's argument still fails. China has failed to establish that the electronic distribution of sound recordings is more than a new means of supplying an existing service.

156. In an attempt to provide support for its assertion that the electronic distribution of sound recordings is beyond the scope of the relevant services commitment, China argues that the relevant question is not whether a service is "new" but rather whether it is "different" from services for which a Member has made commitments.[233] China goes on to argue that the factors that should be considered in determining whether a service is different are: (1) the essential operational characteristics of the service at issue, (2) the perception by the end-users of the service at issue, (3) the international classification distinguishing between the relevant service and others, and (4) the internationally recognized legal framework applicable to the service at issue.[234] Finally, China states that a new means of delivery of an existing service would not cause changes in these factors.[235]

157. There is no textual basis in the GATS for the application of these factors to an analysis of the meaning of a Member's services commitment. In addition, the United States has set forth examples in previous submissions demonstrating the flaws in China's attempt to characterize the electronic distribution of sound recordings as different from distribution of sound recordings in hard-copy format.[236] The criteria that China has articulated in fact do not afford a principled basis for distinguishing among services. With respect to the first two criteria – the essential operational characteristics of the service at issue and the perception by the end-users of the service at issue – these criteria will often have different implications for different means of supplying a service as well as for different services. For example, the operational characteristics of distributing hard-copy sound recordings through the Internet (*i.e.*, by purchasing the CD online and having it mailed to the purchaser's home) are significantly different from the operational characteristics of distributing the hard-copy sound recordings through retail outlets. In addition, end-users will view online sales very differently from retail outlets. Some of the differences may include: customers can access the list of inventory of online distributors and make purchases at any time day or night as opposed to during the retail outlet's business hours; online distributors will often offer options to customize the service for individual customers such as by offering recommendations for individual customers or maintaining a history of their prior searches; and online distributors will charge delivery costs. Despite these differences, China contends that its services commitments cover distribution of hard-copy sound recordings without distinguishing between sales of hard-copy sound recordings over the Internet and in retail outlets.

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[233] China's Answers to the First Set of Panel Questions, Question 97(a).
[234] China's Answers to the First Set of Panel Questions, Question 97(a).
[235] China's Answers to the First Set of Panel Questions, Question 97(a).
[236] U.S. First Oral Statement, paras. 72-74; U.S. Answers to the First Set of Panel Questions, paras. 145-49.

158. Similarly, in response to Panel Question 110(a), the United States set forth an example of a company that supplies translation and interpretation services through various means, *e.g.*, in hard-copy, with a live interpreter, and over the telephone.[237] All of these means of supply have different operational characteristics and end-users will view these means of supply differently. However, whether provided in person, through a written document, or over the telephone, in all three instances, the service is the same: translation and interpretation services. *It is the means of supply that changes*. Furthermore, as the United States set forth in response to Question 110(b), if the company set up a website in which customers could input words in one language and receive a translation of those words in a downloadable format (*i.e.*, electronically) in exchange for a fee, this would still be the same service although the means of supply has changed. The service would also be the same in spite of the fact that the operational characteristics and end-user perceptions of this means of supply would be different from the other means of supply. Accordingly, the first two criteria provided by China fail to buttress its position that the electronic distribution of sound recordings is a different service from sound recording distribution services.

159. China has also asserted certain other differences associated with the electronic distribution of sound recordings that China claims support the notion that it is a different service altogether from the one scheduled in Sector 2D of its Services Schedule. In fact, China's argument does not withstand scrutiny. China points out that the electronic distribution of sound recordings requires the conversion of content into digital format, the clearing of intellectual property rights, the establishment of an adequate delivery network, and implementation of digital rights management systems and secure billing systems.[238] However, nowhere does China explain how these aspects of the service – which are relevant to many services – establish an altogether new or different service.

160. First, the clearing of intellectual property rights applies to any good with related intellectual property rights, including hard-copy sound recordings. Indeed, Article 41 of China's Copyright Law explicitly contemplates such a right in sound recordings in hard-copy format and those distributed electronically.[239] In addition, the establishment of an adequate delivery network is necessary for any means of supplying a service and any service itself. When China considers the question of an adequate delivery system for supplying sound recordings electronically over the Internet, China again fails to show how this factor differs from the need to set up adequate networks for the sale of hard-copy CDs over the Internet. The infrastructure for the sale of hard-copy CDs over the internet may be very different from the infrastructure needed to sell downloadable sound recordings electronically, but it is also vastly different from the

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[237] U.S. Answers to the First Set of Panel Questions, para. 145.

[238] China's First Written Submission, paras. 404-12.

[239] Copyright Law of the People's Republic of China, Decision of the 24th Standing Committee of the 9th National Congress of 27 October 2001 (Exhibit CN-65) ("The producer of a sound recording or video recording shall enjoy the right to authorize others' reproducing, distributing or renting the sound recording or video recording or making it available to the public through information network . . .").

infrastructure needed to sell sound recordings in a retail outlet. China fails to explain why the difference in the requirements for the electronic distribution of sound recordings is significant enough to transform it into a different service altogether. Finally, the need to convert content into digital format is also not a feature sufficient to take the electronic distribution of sound recordings outside of China's commitments for sound recording distribution services. For example, sound recordings may be converted from a format that is stored on a vinyl record into a format that can be stored on an 8-track tape, or an audiocassette, or a CD. The distributor of the sound recording on an 8-track tape, an audiocassette, or a CD, is still engaging in sound recording distribution services. The conversion of format in each of these instances reflects the impact of new technologies on consumers' preferences and sellers' commercial responses to such preferences. However, the distribution of the sound recording does not constitute an altogether new service in each instance merely because of the conversion of format. Similarly, the conversion of format for the purposes of electronic distribution does not transform the distribution of the sound recording into a new service.

161. With respect to the international classification of such services, China appears to maintain contradictory positions with respect to the relevance of such classification instruments. China claims in response to Question 97(e) that the W/120 and Provisional CPC are not binding on Members and have little utility in determining the meaning and scope of China's commitments. At the same time, in response to Question 96, China argues that the classification of "online audio content" in the CPC Ver. 2, which is under negotiation and has not even been accepted by the relevant parties, demonstrates that the electronic distribution of sound recordings is distinct from other sound recording distribution services.[240] Accordingly, it appears that China seeks to rely on classification instruments that support its argument and dismiss those that run contrary to its argument. In the context of China's Services Schedule, it is noteworthy that while several sectors are framed with reference to CPC codes, sound recording distribution services contains no CPC cross-reference. Given China's dismissal of the provisional CPC as an interpretive tool,

[240] China suggests that because the CPC Ver. 2 provides a special classification for "online audio content," online distribution services is different from other sound recording distribution services. China's Answers to the First Set of Panel Questions, Question 97(e). However, this assertion does not shed light on the meaning of China's services commitment. First, the CPC Ver. 2 has not been accepted by the relevant parties. Second, in contrast to other sections of China's Services Schedule, the commitment on sound recording distribution services is not framed in terms of the CPC. Third, to the extent that certain other Chinese commitments do refer to the CPC, they are framed in terms of the provisional CPC. China attempts to dismiss the fact that the Appellate Body stated that the provisional CPC is "exhaustive" in *US – Gambling* by claiming that it only encompasses products or services existing at a given point in time, and that it is updated to reflect new services. However, while parties drafting a classification instrument may seek to update the classification system to reflect changes in products or services, this does not necessarily imply that the product or service was not classified in previous iterations of the classification system. For example, the HS and individual Member tariff schedules may be updated to reflect changes in trade patterns or in the way that products are perceived. If one tariff category is broken down into additional tariff categories for greater specificity, this does not mean that the new tariff categories fell outside the previous tariff schedule. Rather, they were merely classified differently. Similarly, if the CPC is updated as it relates to a new means of supplying a service, this does not mean that such supply of a service was previously altogether outside of the classification system; it was merely classified differently.

and the fact that the CPC ver. 2 has not yet been agreed upon, there is even less basis for using the CPC ver. 2 as guidance for interpreting China's Services Schedule.

162. Finally, with respect to China's last criterion, it is entirely unclear to the United States to which "internationally recognized legal framework" China is referring or how this criterion would be applied to determine the scope of a Member's commitments in the context of the WTO, which might be considered the relevant internationally recognized legal framework. Accordingly, to the extent the United States understands China's argument, it appears circular.

163. In short, China's proposed (but utterly non-textual) "criteria" fail to effectively distinguish among services, and thus these "criteria" fail to support China's argument. Indeed, many of China's arguments merely corroborate the conclusion that the electronic distribution of sound recordings is a different means of supplying sound recording distribution services, rather than an altogether different service. As the panel in *US – Gambling* stated, "a market access commitment . . . implies the right for other Members' suppliers to supply a service through all means of delivery, whether by mail, telephone, Internet, etc., unless otherwise specified in a Member's schedule . . . If a Member desires to exclude market access with respect to the supply of a service through one, several or all means of delivery . . . it should do so explicitly in its schedule."[241] Since the electronic distribution of sound recordings is within the scope of China's sound recording distribution services commitments, China's measures according discriminatory treatment to foreign service suppliers of such services are inconsistent with Article XVII of the GATS.

D. Conclusion

164. The United States has established that China imposes market access restrictions on AVHE product distribution services – through the Audiovisual Sub-Distribution Rule, the Catalogue, the Foreign Investment Regulation, and the Several Opinions – that deny foreign-invested service suppliers market access within the meaning of Article XVI of the GATS, as provided in China's Services Schedule. The United States has also shown that China imposes discriminatory prohibitions and discriminatory requirements on foreign-invested enterprises engaged in reading material distribution services, AVHE products distribution services and sound recording distribution services that modify the conditions of competition in favor of like wholly Chinese-owned service suppliers.

165. These discriminatory prohibitions and discriminatory requirements – imposed through 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 Internet Culture Rule, the Internet Culture Notice, the Audiovisual Regulation, the Audiovisual Sub-Distribution Rule, the Network Music Opinions, the Catalogue,

[241] *US – Gambling (Panel)*, para. 6.286.

the Foreign Investment Regulation, and the Several Opinions – deny these foreign-invested service suppliers national treatment within the meaning of Article XVII of the GATS, as provided within China's Services Schedule. For the reasons set forth above and in previous U.S. submissions, China has failed to rebut the U.S. claims with respect to Articles XVI and XVII of the GATS.

166. Thus, the United States respectfully requests that the Panel find that the maximum percentage limit on foreign shareholding imposed on AVHE product distribution service suppliers as set forth in the measures at issue is inconsistent with China's obligations under Article XVI of the GATS. The United States further requests the Panel to find that the prohibitions and discriminatory limitations on foreign service suppliers seeking to engage in the distribution of reading materials, and in the distribution of AVHE products and sound recordings, as maintained by the measures at issue, are inconsistent with China's obligations under Article XVII of the GATS.

IV. CHINA'S MEASURES REGARDING THE INTERNAL SALE, OFFERING FOR SALE, PURCHASE, DISTRIBUTION AND USE OF PRODUCTS ARE INCONSISTENT WITH CHINA'S OBLIGATIONS UNDER ARTICLE III:4 OF THE GATT 1994

167. China's measures governing the internal sale, offering for sale, purchase, distribution and use of imported reading materials, hard copies of imported sound recordings intended for electronic distribution, and imported films for theatrical release are inconsistent with Article III:4 of the GATT 1994. These measures are: the Imported Publication Subscription Rule; 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.

168. These measures accord imported products less favorable treatment than that accorded to like domestic products as follows: China significantly restricts the distributors, the distribution channels, and the consumers that are available to imported reading materials. China also discriminates against imported sound recordings intended for electronic distribution by imposing more burdensome content review requirements than domestic sound recording face. Finally, China's measures confine imported films for theatrical release to two Chinese state-controlled distributors, which do not permit commercial negotiations of key terms. In contrast, domestic films can be distributed by approximately 50 distributors in China, including the two distributors of imported films, and can be distributed on the basis of meaningful commercial negotiations.

A. Reading Materials

169. China treats imported reading materials less favorably than domestic reading materials[242] through the Imported Publication Subscription Rule[243] and the Foreign-Invested Sub-Distribution Rule.[244] These measures: (1) confine most categories of imported reading materials to a single distribution channel; (2) impose onerous conditions on those seeking to obtain imported reading materials; and (3) strictly limit which enterprises are permitted to distribute imported reading materials. Domestic reading materials do not face these restrictions. As the measures imposing these requirements severely disadvantage imported reading materials *vis-à-vis* domestic like products, these measures are inconsistent with Article III:4 of the GATT 1994.

170. First, the Imported Publications Subscription Rule requires all imported newspapers and periodicals, as well as imported books and electronic publications in the "limited distribution category", to be distributed only through a highly restrictive subscription regime.[245] All other distribution channels are denied to these imported products. Domestic reading materials, however, can be distributed through subscription as well as through a wide variety of other distribution channels.

171. Thus, these imported reading materials cannot compete with domestic reading materials on an equal footing. Imported reading materials face significantly reduced opportunities for distribution and for sale in the Chinese market as compared with their domestic counterparts. For example, if a Chinese individual seeks to purchase a domestic newspaper, that individual can either subscribe to that newspaper or purchase individual editions through a variety of other channels. The imported newspaper, however, can only be obtained by that individual via a subscription through that individual's employer.[246]

172. Second, the Imported Publications Subscription Rule also imposes higher burdens on those seeking to obtain imported reading materials and thereby treats imported reading materials less favorably than like domestic reading materials.[247] Thus where imported and domestic reading materials are each obtained through subscription, the requirements imposed on subscribers of imported reading materials are more onerous, requiring examination and approval

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[242] *See* U.S. First Written Submission, paras. 156-180, 368, 378 and 384-388; and U.S. Answers to the First Set of Panel Questions, paras. 100-102, 136-137, 212-226.

[243] Exhibit US-30.

[244] Exhibit US-28.

[245] U.S. First Written Submission, paras. 156-180, 368, 378 and 384-388; and U.S. Answers to the First Set of Panel Questions, paras. 100-102, 136-137, 212-226.

[246] Imported Publications Subscription Rule, Article 5 (Exhibit US-30).

[247] U.S. First Written Submission, paras. 156-180, 368, 378, and 384-388; and U.S. Answers to the First Set of Panel Questions, paras. 221-222.

of the subscriber, which delays and possibly prevents the receipt of the imported reading material by the subscriber.[248] Domestic reading materials do not face this requirement.

173. Third, the Imported Publication Subscription Rule restricts all imported newspapers and periodicals, as well as imported books and electronic publications in the "limited distribution category", to distribution by Chinese wholly state-owned distributors.[249] Similarly, the Foreign-Invested Sub-Distribution Rule restricts all imported books and electronic publications in the "non-limited distribution category" to wholly Chinese-owned distributors.[250] In contrast, domestic reading materials can be distributed by a wide array of distributors that are best suited to the particular needs of the reading material in question.[251] These distributors include foreign-invested enterprises, Chinese-owned private enterprises, Chinese state-owned enterprises and even the reading material's own publisher. As a result of these competitive disadvantages, imported reading materials are afforded less favorable treatment than that accorded to like domestic products.

174. China has not provided any substantive arguments challenging this third aspect of the U.S. claim. We now turn to a rebuttal of the arguments that China has made with respect to the first and START

1. Newspapers, Periodicals, Books and Electronic Publications in the "Limited Distribution Category"

175. China offers two unsuccessful responses to the U.S. arguments. First, China contends that restricting these imported reading materials to distribution through subscription is non-discriminatory, because the "limited distribution category" includes reading materials with prohibited content used by certain government agencies and institutions for research purposes.[252] As domestic products with prohibited content are not permitted to be distributed in China, China alleges that its subscription regime does not accord newspapers, periodicals, books and electronic publications in the limited distribution category treatment that is less favorable than that accorded to like domestic products.

176. However, China provides no support for its assertion that the "limited distribution category" consists of reading materials with prohibited content. In fact, China's proposed

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[248] Imported Publications Subscription Rule, Articles 6 and 9 (Exhibit US-30); and Imported Cultural Products Measure, Article 14 (Exhibit US-10).

[249] U.S. First Written Submission, paras. 156-180, 368, 378, and 384-388; and U.S. Answers to the First Set of Panel Questions, paras. 100-102, 216-217, and 219.

[250] U.S. First Written Submission, para. 180; and U.S. Answers to the First Set of Panel Questions, paras. 102, 136-137, 218-219, and 223-226.

[251] U.S. First Written Submission, paras. 179 and 388; and U.S. Answers to the First Set of Panel Questions, paras. 213-215.

[252] China's First Written Submission, paras. 538-543.

interpretation is inconsistent with Chinese law, which makes distributing prohibited content in China illegal. According to Article 24 of the Publications Market Rule, "[n]o organization or individual may distribute the following publications: . . . (1) prohibited publications . . .; [and] (2) all kinds of illegal publications . . . ."[253] Indeed, the opaqueness of China's "limited distribution category" for imported reading materials is further evidence of the discriminatory treatment imposed on these materials. While China indicates that GAPP has determined that approximately 1,000 titles fall within the "limited distribution category",[254] it is unclear what those titles are, how GAPP arrives at its determination and whether titles can be released from this restrictive category.

177. Regarding its explanation that imported reading materials in the "limited distribution category" are subscribed to by only certain government agencies and institutions for research purposes, China relies on the term "entity" (or "unit" as used in the U.S. translation) found in Article 6 of the Imported Publications Subscription Rule as the basis for its explanation.[255] In other words, China argues that the use of the term "entity" in this measure supports its assertion that only government agencies and institutions are permitted to subscribe to reading materials in the "limited distribution category".

178. The term "entity" (or "unit") appears, however, throughout the Imported Publications Subscription Rule in the context of reading materials in both the "limited distribution category" and the "non-limited distribution category".[256] China's interpretation of "entity" (or "unit") would mean that government agencies and institutions are also the only wholly Chinese-owned entities permitted to obtain imported newspapers and periodicals in the "non-limited distribution category".[257] Privately-held Chinese entities could not obtain subscriptions. Likewise, Chinese individuals could only obtain subscriptions if they work for a government entity. This is contrary to China's argument that there is no "subscriber pre-selection process"[258] and no "rejections of applications"[259] for reading materials in the "non-limited distribution category". In other words, China's newly minted defense would render China's entire subscription regime for imported reading materials more, rather than less, discriminatory.

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[253] Exhibit US-27.

[254] China's First Written Submission, para. 545.

[255] China's Answers to the First Set of Panel Questions, Question 130(a).

[256] Articles 2, 4 and 5 (Exhibit US-30).

[257] Because Article 2 of the Publication Importation Subscription Rule (Exhibit US-30) defines "subscriber" to include "entity" (or "unit") and Article 5 provides that a domestic "entity" (or "unit") may subscribe to imported newspapers and periodicals in the "non-limited distribution category", China's reading would give Chinese government agencies and institutions exclusive subscription rights to *all* imported newspapers and periodicals in China.

[258] China's First Written Submission, para. 544.

[259] China's Answers to the First Set of Panel Questions, Question 131.

2. Newspapers and Periodicals in the "Non-Limited Distribution Category"

179. Second, while China concedes that subscribers of imported newspapers, periodicals, books and electronic publications in the "limited distribution category" are subjected to a "subscriber pre-selection process",[260] it argues that newspapers and periodicals in the "non-limited distribution category" are subject to "quasi-automatic subscription"[261] with "no rejection of applications"[262] and "without the involvement of state agencies".[263] Despite this contention, China's argument conflicts with the express provisions of its own law. As provided in Article 14 of the Imported Cultural Products Measure, "[d]omestic units and individuals inside China who wish to subscribe to outside newspapers and periodicals from newspapers and periodical import units must go through examination and approval procedures."[264] As Article 14 applies to all imported newspapers and periodicals, as opposed to merely those in the "limited distribution category", the Imported Cultural Products Measure confirms that the conditions imposed on subscribers to imported reading materials do not apply to domestic like products.

180. In addition, China fails to address the fact that imported newspapers and periodicals in the "non-limited distribution category" are only available to consumers through subscription, while domestic newspapers and periodicals are available through a myriad of channels. Thus, without a subscription for newspapers and periodicals, consumers in China are not permitted to obtain these imported products. By contrast, subscription is not a prerequisite for obtaining domestic newspapers and periodicals in China.

181. Finally, China's efforts to rebut the U.S. claim based on the number of titles in the "non-limited distribution category" available within China is misplaced. These figures provide no indication of either the burden on subscribers to actually obtain these titles or the treatment afforded to imported reading materials. Moreover, GATT and WTO panels and the Appellate Body have consistently read Article III:4 of the GATT as protecting opportunities, not outcomes, and have not required a showing of trade effects to succeed in a claim under that article.[265]

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[260] China's First Written Submission, paras. 538 and 543. *See* Imported Publications Subscription Rule, Articles 6 and 9 (Exhibit US-30).

[261] China's First Written Submission, paras. 538.

[262] China's Answers to the First Set of Panel Questions, Question 131.

[263] China's Answers to the First Set of Panel Questions, Question 130(e).

[264] Exhibit US-10.

[265] *See e.g., Brazilian Internal Taxes (GATT)*, para. 16; *Italian Agricultural Machinery (GATT)*, para. 12; *EEC Oilseeds (GATT)*, paras. 150-151; *Japan – Alcohol(AB)*, page 16; *EC – Bananas III (Panel)*, para. 7.50; and *Korea – Beef (AB)*, para. 147.

B. Sound Recordings

182. China has failed to rebut the U.S. claim under Article III:4 of GATT 1994 relating to imports of sound recordings intended for electronic distribution. Article III:4 of the GATT 1994 prohibits Members from according less favorable treatment to the products of other Members "in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use." Contrary to this obligation, China's measures impose a more onerous content-review regime on imports of sound recordings intended for electronic distribution than for domestic sound recordings.[266] Moreover, the only criterion for determining whether a sound recording intended for electronic distribution must go through the content review process is the national origin of the product.[267] Accordingly, China accords less favorable treatment to imports of these products than to domestic like products.

183. The relevant measures in this regard are the Audiovisual Regulation,[268] Audiovisual Import Rule,[269] Internet Culture Rule,[270] and Network Music Opinions.[271]

184. The Audiovisual Import Rule, which was issued under the authority of the Audiovisual Regulation, provides more details concerning content review requirements that apply only to imported audiovisual products.

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[266] U.S. First Written Submission, paras. 389-96.

[267] U.S. First Written Submission, paras. 369-73.

[268] Audiovisual Regulation, Article 16 (Exhibit US-16) (provides that for domestic audiovisual products, the publisher itself conducts content review: an enterprise publishing domestic audiovisual products need only exercise an "editorial responsibility system" so that the contents conform with the Audiovisual Regulation) (Audiovisual Regulation, Article 2 (providing that "audiovisual products" including audio tapes, records, and audio CDs) (Exhibit US-16); Audiovisual Regulation, Article 28 (requires imported audiovisual products to be submitted to MOC for formal content review and approval). The United States takes this opportunity to clarify its response to Panel Question 115 regarding the correct translation of paragraph 1 of Article 28 of the Audiovisual Regulation. *See* U.S. Answers to the First Set of Panel Questions, paras. 182-83. As the United States set forth in para. 180 of its answer to Question 115, the United States considers that the U.S. translation of the first paragraph of Article 28 of the Audiovisual Regulation provided in Exhibit US-16 is accurate. Accordingly, the statements in paragraphs 182 and 183 of the U.S. answer to Panel question 115 that changes need to be made to the U.S. translation were in error and the U.S. requests that the Panel accept the original U.S. translation of this provision, which reads as follows: "Audiovisual products imported for publication and finished audiovisual products imported for wholesale, retail or rental shall be submitted to the cultural administration under the State Council for review of their contents."

[269] Audiovisual Import Rule, Article 16 (Exhibit US-17) (makes clear that these content review requirements governing how imported physical audiovisual products are to be distributed apply equally to imported audiovisual products to be distributed over information networks after importation.).

[270] Exhibit US-32.

[271] Exhibit US-34.

185. The Internet Culture Rule[272] and the Network Music Opinions,[273] which post-date the Audiovisual Import Rule, apply their differential content review rules for imported and domestic products specifically to sound recordings intended for electronic distribution.

186. The Internet Culture Rule and the Network Music Opinions establish two separate and distinct content review regimes for sound recordings intended for electronic distribution. On the one hand, imported sound recordings are subject to a more onerous regime, requiring all sound recordings intended for electronic distribution to be submitted to MOC for content review, possible revision, and approval, before they can be digitally distributed.[274] A domestic sound recording, however, is subject to far less burdensome requirements, as it may be reviewed "in-house" by its publisher and only needs to be recorded with MOC prior to its electronic distribution.[275]

187. The more onerous burdens imposed by MOC content review on imported sound recordings have an acute commercial impact. In a hit-driven industry, where speed to the market is vitally important for revenues, delay can be extremely damaging, if not devastating, commercially. In addition, while legitimate imported sound recordings are waiting for MOC approval, pirated sound recordings capture potential customers. Moreover, imported sound recordings become frozen when and if MOC approval is granted; *i.e.*, once approved, the content of an imported sound recording must remain unchanged from the version MOC approved or must undergo MOC content review again. Domestic sound recordings, however, can easily be altered to adjust to demand.

188. China makes several arguments in response to this claim. However, all of these arguments fail to rebut the U.S. claim that China maintains measures that are inconsistent with the national treatment obligation in Article III:4. First, China considers that the electronic distribution of sound recordings is not covered by the GATT 1994 because the GATT 1994 only covers trade in goods.[276] In making this argument, China misunderstands the U.S. claim, which only applies to measures affecting imported hard-copy media containing sound recordings that are *intended for electronic distribution*. The U.S. claim does not include a challenge to any measure's treatment of services or service suppliers involved in the electronic distribution of sound recordings. Accordingly, China's ensuing discussion of the distinction between goods and services is not relevant to this claim.

189. As set forth in the U.S. response to Panel Question 123(a), China's statements regarding the nature of the products are likewise unavailing. Specifically, China states that the hard-copy

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[272] Exhibit US-32.

[273] Exhibit US-34.

[274] U.S. First Written Submission, paras. 185-200.

[275] *See* U.S. First Written Submission, paras. 181-200 (detailing the content review regime for sound recordings intended for electronic distribution).

[276] China's First Written Submission, paras. 578-92.

sound recordings intended for electronic distribution are not for transmission to users but are "'master copies' intended for the reproduction of content to be subsequently offered through network music services . . . They are, in fact mere accessories to what is essentially an intellectual property transaction consisting in the granting of the right to transmit music works to users via the internet."[277]

190. However, the distribution of copyrighted materials – whether incorporated into hard-copy sound recordings sold in hard copy or distributed electronically – always involves one or more intellectual property rights with respect to the copyrighted material. This fact does not demonstrate that the products and measures fall outside the purview of GATT Article III.[278]

191. Finally, while China does not make this clear, China appears to be arguing in paragraph 570, that because these hard-copy sound recordings are "master copies" and mere accessories to services, they are not goods subject to the GATT 1994 disciplines. For the reasons set forth in the U.S. first oral statement China's arguments do not withstand scrutiny.[279]

192. China also asserts that the challenged measures are "border measures" at the importation stage and therefore do not "affect[]" the distribution of products that have already been imported. As set forth in the U.S. first oral statement, this assertion is erroneous.[280] The Ad Note to GATT Article III provides that internal measures applicable to both an imported product and the domestic like product that are enforced for imported products upon importation are internal measures, not border measures.

193. In this case, the relevant measures impose a content review regime on all sound recordings intended for electronic distribution. With respect to imports, the content review procedures are administered upon importation. However, this does not transform the measures into measures to which Article III:4 is inapplicable. Indeed, confronted with a Panel question regarding its border measures argument, China fails to provide any additional support for its argument and merely repeats its prior statements.[281]

194. Furthermore, these measures affect the internal sale, offering for sale, purchase, distribution or use of the sound recordings at issue within the meaning of Article III:4.

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[277] China's First Written Submission, para. 570.

[278] Moreover, China inserts this discussion of "master copies" in a section of its submission addressing the rationale behind its discriminatory content review system, stating that the rationale is to ensure that there is no alteration of content in the conversion into digital format. As the United States set forth in its first oral statement, China's contention in this regard is wholly ineffective in validating China's discriminatory content regime for imports of imported hard-copy sound recordings intended for electronic distribution. U.S. First Oral Statement, paras. 81-82.

[279] U.S. First Oral Statement, para. 78.

[280] U.S. First Oral Statement, paras. 78-79.

[281] China's Answers to the First Set of Panel Questions, Question 132.

Article III:4 states that "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their *internal sale, offering for sale, purchase, transportation, distribution or use*."[282] Accordingly, a measure challenged under III:4 may be "affecting" a variety of elements in the chain from importation to consumption including sale, offering for sale, purchase, distribution or use.[283]

195. In the context of hard-copy sound recordings intended for electronic distribution, the hard-copy sound recording is often provided to an Internet Culture Provider ("ICP") or Mobile Content Provider ("MCP") who makes an additional copy in hard-copy format of the sound recording, transforms the sound recording into a format that can be transmitted electronically, and then transmits the reformatted sound recording electronically. The United States is challenging the discriminatory content review regime that China maintains that requires imports of hard-copy sound recordings intended for electronic distribution to undergo a more onerous content review than like domestic products.[284] Thus, before distributing a sound recording electronically, the ICP or MCP must go through the delay and administrative burden of a content review process that the ICP or MCP need not go through for domestic like products. These measures, therefore, affect the movement of these imports through the process from importation to consumption. Accordingly, the relevant Chinese measures affect the "sale, offering for sale, purchase, distribution or use" of such products within the meaning of Article III:4.

C. Films for Theatrical Release

196. China's regime for the sale, offering for sale, purchase, distribution or use of films for theatrical release likewise accords less favorable treatment to imported products within the meaning of Article III:4 of the GATT 1994.[285] China's unfavorable regulatory structure for imported films is established through the Film Regulation,[286] the Provisional Film Rule[287] and the Film Distribution and Projection Rule.[288] These measures provide that imported films can only be distributed by one of two state-controlled enterprises – China Film Group and Huaxia. Furthermore, commercial negotiations do not determine the terms of distribution or which of these two distributors will handle the imported film. China Film Group and Huaxia dictate essential aspects of the distribution arrangement including with respect to financial remuneration,

[282] Emphasis added.

[283] U.S. Answers to the First Set of Panel Questions, paras. 254-57.

[284] U.S. First Written Submission, paras. 369-73, 379-81.

[285] *See* U.S. First Written Submission, paras. 201-222, 374-376, 382, and 397-409; and U.S. Answers to the First Set of Panel Questions, paras. 243-253.

[286] Exhibit US-20.

[287] Exhibit US-22.

[288] Exhibit US-21.

marketing and promotion, dubbing and subtitling, release dates and screening times, making any agreement between the parties a contract of adhesion.

197. In contrast, domestic films may be distributed by these two enterprises as well as by any of the approximately 50 other film distributors established in China, as well as by the film's own producer. Commercial terms regarding remuneration, marketing, and other essential components of a successful film run are the subject of meaningful negotiations. As a result, domestic films face competitive opportunities that are unfettered by the restrictions imposed on imported films in China.

1. Goods vs. Services

198. China's principal argument with respect to the U.S. claim under Article III:4 of the GATT 1994 for films for theatrical release is that such items are not goods subject to the GATT 1994 disciplines. As set forth in the U.S. first oral statement and in Section II.A.1 above, China's contention that films are not goods is untenable.[289]

199. China also argues that films cannot be "distributed" within the meaning of Article III:4 because "distribution" is limited to the supply of goods to on-sellers or consumers.[290] As the United States set forth in response to Panel Question 138, China's interpretation of the term "distribution" in Article III:4 is flawed. The ordinary meaning of the term distribution and the panel's reasoning in *Canada – Wheat* support the conclusion that "distribution" in Article III:4 encompasses a broader concept than the supply of goods to on-sellers or consumers.[291] The next step in China's reasoning – that because movie-goers purchase the right to attend a screening, rather than purchasing the film itself, there is no distribution under Article III:4[292] – is also flawed.[293] Accordingly, China has failed to establish that there is no distribution under the meaning of Article III:4.

2. China Accords Less Favorable Treatment to Imported Films for Theatrical Release than that Accorded to Domestic Films for Theatrical Release

200. China's regime governing the distribution of films for theatrical release entails a number of significant disadvantages for imported films, including the denial of access to the full range of distributors available to domestic films as well as the inability to make commercial decisions

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[289] U.S. First Oral Statement, paras. 9-18.

[290] China's First Oral Statement, para. 29; China's Answers to the First Set of Panel Questions, Question 138.

[291] *See* U.S. Answers to the First Set of Panel Questions, paras. 271-275; *Canada – Wheat (Panel)*, para. 6.171.

[292] China's First Oral Statement, para. 30.

[293] U.S. Answers to the First Set of Panel Questions, paras. 273-75.

regarding which distributor is best suited for a particular film given the terms and expertise being offered. In addition, China's distribution restrictions curtail opportunities available to imported films relative to domestic films by controlling several key elements of the distribution process. China therefore accords to imported films less favorable treatment than that accorded to domestic films.

a. China Restricts Imported Films for Theatrical Release to Two State-Controlled Distributors

201. While China contends that there is no mandatory duopoly for the distribution of imported films in China,[294] it admits that only two entities are currently designated to distribute such films.[295] Indeed, the question arises as to why China has not designated every one of the distributors that is available for domestic films?[296] Or, for that matter, why does permission to distribute domestic films not automatically entail permission to distribute imported ones? China has no good answers to these questions. Regardless of whether this duopoly is mandatory, it is discriminatory nonetheless.

202. Further, China's contention that there is no mandatory duopoly does not withstand scrutiny. The Distribution and Projection Rule expressly provides for such a duopoly. Article III of that measure states, "[o]pen up major channels owned by the State and establish two imported film distribution companies. Maintain the original China Film Group Imported Film Distribution Company while establishing another imported film distribution company based on the shareholding system."[297] In addition, the Distribution and Exhibition of Domestic Films Measure, which post-dates both the Film Regulation and the Provisional Film Rule, confirms that China Film Group and Huaxia are the only two distributors of imported films in China.[298]

203. China further submits that the number of approved distributors of imported films is limited by SARFT because the number of films imported into China is limited.[299] It maintains that the limited quantity of distributors available to imported films is made up for by the quality of the distribution provided for by China Film Group and Huaxia. It adds that restricting imported films to only two of the largest and most efficient distributors ensures the "smooth distribution" of such films.[300]

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[294] China's First Written Submission, paras.618-622.

[295] China's Answers to the First Set of Panel Question, Question 136.

[296] If domestic distributors have not applied to distribute the lucrative imported films, as China suggests, (*see* China's Answers to the First Set of Panel Questions, Question 136), this merely leads to the conclusion that they all recognize China Film Group and Huaxia are the exclusive distributors of imported films.

[297] Exhibit US-21.

[298] *See e.g.*, Articles III.1, IV.II.1 (Exhibit US-40).

[299] China's First Written Submission, para. 623.

[300] China's First Written Submission, paras. 626-627.

204. China's attempt to justify its actions by suggesting there is a reasonable correlation between the quantity of films imported into China and the quantity of available distributors, however, only confirms that imported films receive less favorable treatment than that accorded to domestic films. China states that in 2007, 50 imported films were distributed in China in the "mainstream", and that of the 402 domestic films produced, 150 domestic films were distributed in the "mainstream".[301] Thus, as demonstrated in the chart below, there is one distributor for every 25 imported films – as there are two distributors and 50 imported films. In contrast, there is one distributor for every 3 "mainstream" domestic films – as there are 50 distributors and 150 "mainstream" films – and one distributor for every eight domestic films that are produced – as there are 50 distributors and 404 domestic films produced. These ratios further demonstrate the disadvantageous treatment received by imported films.

In 2007, the Ratio of Distributors to Films was Significantly more Favorable for Domestic Films than for Imported Films

Origin of Films	Number of Distributors	Number of Films	Ratio of Distributors to Films
Imported Films	2	50	1:25
Domestic Mainstream Films	50	150	1:3
Domestic Films Produced	50	402	1:8

205. Even leaving aside the discriminatory nature of the actual distribution ratios, China cannot justify its limits on the number of distributors for imported films based on the limits China has imposed on the number of films imported into China. Despite China's contentions, WTO Members are not permitted to provide less national treatment in the case of limited imports and more national treatment in the case of many imports. Article III:4 of the GATT 1994 provides that each imported product must be accorded treatment no less favorable than that accorded to each domestic product.

206. China's supposition that China Film Group and Huaxia are the strongest distributors and the only two distributors capable of carrying out the "smooth distribution" of films on a nation-wide basis is also unsupported. Several other domestic distributors in China are capable of nation-wide distribution and have been responsible for distributing some of China's largest grossing domestic films.[302] Moreover, the domestic distributors available to domestic films have also demonstrated the ability to specialize in certain aspects of film distribution that make them

[301] China's First Written Submission, para. 629-630.

[302] *See* China eCapital Corporation, "Chinese Media & Entertainment Research: The Chinese Film Market", March 18, 2005, pages 76-81 (Exhibit US-26).

particularly attractive as distributors for particular films.[303] Finally, unlike the case for imported films, domestic studios are permitted to distribute their own films,[304] allowing those films to benefit from the efficiencies and marketing and promotion strategies that can result from streamlining and greater control of the distribution process.

b. China Denies Imported Films for Theatrical Release Opportunities Equal to Those Available To Domestic Films for Theatrical Release

207. China goes on to argue that the trade impact of its discriminatory distribution regime does not rise to the level of less favorable treatment under Article III:4. In this regard, China contends that imported films have on average longer screening durations, a larger percentage of box-office revenues and greater market share than domestic films.[305] China contends that, where imported films are successful in the market, imported films are not accorded less favorable treatment than that accorded to like domestic products.

208. However, consistency with Article III:4 is not determined on the basis of outcomes or trade effects. Article III:4 protects opportunities, not outcomes.[306] As the GATT panel noted in *EEC – Oilseed*, determining consistency with Article III:4 on the basis of trade impact rather than trade opportunities would expose WTO Members to findings of inconsistency with the GATT based on factors they do not control.[307]

209. Limiting imported films to two distributors, which do not permit negotiation on key commercial terms, while domestic films have access to all available distributors on commercial terms, is a fundamental denial of equal opportunity.[308] Imported films are thereby excluded from the full range of more than 50 distributors operating commercially in China, and are thus denied the opportunity to select which distributor is best suited to market that film. Moreover, China Film Distribution Company and Huaxia set the revenue-sharing arrangements for the few qualifying imported films through a non-negotiable Master Contract containing set terms. The Master Contract, *inter alia*, limits a film's producer to only 13-15 percent of the film's total box

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[303] *See* Screen Digest and Nielsen NRG, "Cinema and Home Entertainment in China", January 2007, page 44 (Exhibit US-24) (highlighting the "heavier marketing and promotion" of one distributor of Chinese films); and China eCapital Corporation, "Chinese Media & Entertainment Research: The Chinese Film Market", March 18, 2005, pages 62 and 77 (Exhibit US-26) (referring to the "mind-blowing marketing campaign" of another distributor of Chinese films).

[304] Film Regulation, Article 13(3) (Exhibit US-20).

[305] China's First Written Submission, paras. 631-638.

[306] *See e.g.*, *Brazilian Internal Taxes (GATT)*, para. 16; *Italian Agricultural Machinery (GATT)*, para. 12; *EEC Oilseeds (GATT)*, paras. 150-151; *Japan – Alcohol(AB)*, page 16; *EC – Bananas III (Panel)*, para. 7.50; and *Korea – Beef (AB)*, para. 147.

[307] *EEC – Oilseeds (GATT)*, para. 151.

[308] U.S. First Written Submission, paras. 201-222, 374-376, 382, and 397-409; and U.S. Answers to the First Set of Panel Questions, paras. 243-253 and 258-270.

office receipts. China's assertion that this figure is closer to 40 percent is speculative and unverified.[309] Domestic films, by contrast, are distributed predominantly on a revenue-sharing basis that is freely negotiated between the producer and the distributor, with domestic producers typically receiving two times the percentage of receipts that foreign producers can receive.

210. In addition, Article III:4 does not allow Members to balance off less favorable treatment in one area with more favorable treatment in another area in order to achieve some kind of "net" national treatment.[310] Thus, the fact that China asserts (again without any supporting evidence) that the payment of taxes and other costs by China Film Group or Huaxia may result in imported films receiving a higher percentage of total box office receipts,[311] does not justify the discriminatory non-negotiable terms imposed on imported films by one of two distributors, while domestic films are free to choose among all distributors and negotiate their contracts as they wish.

211. Moreover, where imported films have been successful at the box office and may have had longer screening runs, China has advanced no argument linking such successes with the quality (and equality) of the distribution opportunities provided. Indeed, the strong demand for those imported films despite less favorable distribution opportunities, provides a more convincing explanation of their success. And as a factual matter, it is unclear that imported films account for the majority of box office, as China asserts.[312]

212. Finally, China submits that China Film Group and Huaxia are only obligated to comply with China's screen quota and that these two distributors are not required to support domestic films in any other way.[313] China proffers no evidence to substantiate this contention, and China's position does not withstand scrutiny. As explained in the U.S. first written submission and the U.S. answers to the first set of Panel questions,[314] China's requirement that China Film Group and Huaxia actively support domestic films is not limited to complying with the screening quota.[315]

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[309] China's First Written Submission, para. 635.

[310] *US – Gasoline (Panel)*, para. 6.14.

[311] China's First Written Submission, para. 634-635.

[312] The following sources suggest the opposite trend – *i.e.*, that domestic films accounted for between 53.4 and 54.5 percent of box office in 2007 and have surpassed imported films for the past five years. "Year in Review: Chinese Film Industry", Special Issue on the Chinese Film Industry: Custom Publication, *The Hollywood Reporter*, 2008, page 2 (Exhibit US-96); "Local Markets for Indigenous Films", *Screen Digest*, May 2008, page 134 (Exhibit US-97).

[313] China's First Written Submission, para. 639; and China's Answers to the First Set of Panel Questions, Question 137(a).

[314] U.S. First Written Submission, paras. 218-221 and 407; and U.S. Answers to the First Set of Panel Questions, paras. 247-251.

[315] Note that the United States is not challenging China's screening quota requirement.

213. The Film Distribution and Projection Rule as well as the Distribution and Exhibition of Domestic Films Measure set metrics for supporting domestic films that have no direct relationship with the screening quota.[316] Thus, while the screening quota requires that domestic films receive no less than two thirds of the total amount of screening time each year,[317] China Film Group and Huaxia are also required to distribute at least 30 new domestic films each year, including 10 government-recommended films, and to achieve a total annual box office for domestic films of RMB 100 million.[318] Where China Film Group and Huaxia fail to satisfy these metrics, they are penalized by losing the right to distribute individual imported films. Imported films are therefore treated as benefits to be withheld from China Film Group and Huaxia when these two state-controlled distributors fail to sufficiently support domestic films. As a result, imported films are accorded less favorable treatment as their distribution by two distributors is entirely contingent on the successful distribution of domestic films by the same two distributors.

D. Conclusion

214. The United States has demonstrated that China accords imported reading materials, imported sound recordings intended for electronic distribution, and imported films for theatrical release less favorable treatment than that accorded to domestic reading materials, domestic sound recordings, and domestic films for theatrical release. China's measures impose an onerous subscription regime on the distribution of many imported reading materials, and restricted distribution channels for all imported reading materials; a burdensome content review requirement on imported sound recordings intended for electronic distribution; and a highly restrictive two-distributor system for distributing imported films for theatrical release. As explained above and in previous U.S. submissions, China has failed to rebut the U.S. claims under Article III:4 of the GATT 1994.

215. Therefore, the United States respectfully requests that the Panel find that the Imported Publication Subscription Rule, the Foreign-Invested Sub-Distribution Rule, the Audiovisual Regulation, the Audiovisual Import Rules, the Internet Culture Rule, the Network Music

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[316] Indeed, both measures require China Film Group and Huaxia to support domestic films in numerous ways other than via the screening quota. For instance, Article III of the Film Distribution and Projection Rule provides, "[t]he regulations on distribution ratios between imported films and domestically produced films shall be conscientiously followed, and the production, distribution, and projection of domestically produced films shall be actively supported" (*see* Exhibit US-21 (emphasis added)). Likewise, the Distribution and Exhibition of Domestic Films Measure identifies multiple objectives underlying the requirement to support domestic films – to strengthen the socialist cultural construction, to promote the healthy development of the movie industry, to implement the screening quota, to promote the distribution and exhibition of excellent domestic movies, and to satisfy multi-level and various spiritual culture demands of the masses (*see* Article I, Exhibit US-40).

[317] Film Regulation, Article 44 (Exhibit US-20).

[318] Distribution and Exhibition of Domestic Films Measure, Article III.1 (Exhibit US-40); *See also* Film Distribution and Projection Rule, Article III and IX (referring to "achievements in distribution and projection of domestically produced films, especially that of domestically produced films recommended by the State.") (Exhibit US-21).

Opinions, the Film Regulation, the Provisional Film Rule, and the Film Distribution and Projection Rule are inconsistent with China's obligations under Article III:4 of the GATT 1994.

V. CHINA'S MEASURES REGARDING THE INTERNAL SALE, OFFERING FOR SALE, PURCHASE, DISTRIBUTION AND USE OF PRODUCTS ARE INCONSISTENT WITH CHINA'S OBLIGATIONS UNDER THE ACCESSION PROTOCOL

216. For the reasons explained above and in previous U.S. submissions, the following measures are inconsistent with Article III:4 of the GATT 1994 – 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. As a consequence, these measures are also inconsistent with paragraphs 5.1 and 1.2 of Part I the Accession Protocol with respect to imported reading materials, imported hard copies of sound recordings intended for electronic distribution, and imported films for theatrical release.[319]

VI. THE PANEL'S TERMS OF REFERENCE

217. China also objects to the inclusion of several of its measures, as well as one of the U.S. claims, in the Panel's terms of reference.[320] As explained in the U.S. first oral statement and the U.S. answers to the first set of Panel questions, China's objections are unavailing.[321] China's answers to the first set of Panel questions, however, do raise three issues meriting further discussion.

218. First, China erroneously contends that the Sub-Distribution Procedure is a non-binding web-page on which the Panel need not rule.[322] China contradicts this contention, however, in its answer to the first set of Panel questions regarding the Network Music Opinions. As China explains, the Network Music Opinions were are enacted pursuant to "decisions of the State Council", and are legal instruments applicable in the context of administrative acts.[323] China neglects to indicate that the State Council decision pursuant to which the Network Music Opinions were enacted – the *Decision on Setting Up Administrative Licenses for Administratively Examined and Approved Projects that Truly Need to be Kept*[324] – is the very same State Council decision that serves as the basis for, and that is implemented by, the Sub-

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[319] *See* U.S. First Written Submission, paras. 412-416.

[320] China's First Written Submission, paras. 24-28, 237-250, 523-536, and 555-557, and fns. 49, 125, and 147.

[321] U.S. First Oral Statement, paras. 84-108; and U.S. Answers to the First Set of Panel Questions, paras. 4-17, 197-206, and 235-242.

[322] China's First Written Submission, fn. 125; and China's Answers to the First Set of Panel Questions, Questions 38 and 39.

[323] China's Answers to the First Set of Panel Questions, Question 37(c).

[324] State Council Order No. 412.

Distribution Procedure.[325] China's assertion that only one of two measures implementing the identical State Council decision is a legal instrument, further undermines China's supposition that the Sub-Distribution Procedure is merely internal guidance.

219. Second, China asserts, without citation, that the Several Opinions and the Importation Procedure are merely internal guidance among various government agencies and not "applicable in the context of administrative acts".[326] The United States, however, has submitted an exhibit from China's Supreme People's Congress demonstrating that legal instruments such as the Several Opinions and the Importation Procedure are legally binding on their issuing agencies, guide the enforcement of law and implementation of administrative measures and serve as a basis for particular administrative acts.[327]

220. Finally, China concedes that the Several Opinions, the Importation Procedure and the Sub-Distribution Procedure are measures, and it does not contest that they are identified in the U.S. panel request and included in the Panel's terms of reference.[328] China, however, "believes that it would not be necessary to rule on them because China does not consider those measures can serve as the legal basis for any administrative acts."[329] As previously discussed,[330] the United States disagrees and continues to seek a finding on these measures, particularly given the absence of any grounds for China's objection.

221. For the reasons cited above and in previous U.S. submissions, the United States, respectfully requests that the Panel dismiss China's procedural objections and rule on these measures and this claim, which are all properly before the Panel and within its terms of reference.

VII. CONCLUSION

222. The United States respectfully requests the Panel to find that China's measures at issue 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.

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[325] "Stated Basis", Exhibit US-29.

[326] China's Answers to the First Set of Panel Questions, Questions 37(c), 38, and 39.

[327] *Minute of the Meeting on Issues Related to the Application of Legal Norms in the Hearings of Administrative Cases* (Exhibit US-62); *See* U.S. Answers to the First Set of Panel Questions, paras. 12-14.

[328] China's Answers to the First Set of Panel Questions, Question 39.

[329] China's Answers to the First Set of Panel Questions, Question 39.

[330] U.S. First Oral Statement, paras. 91-94; and U.S. Answers to the First Set of Panel Questions, paras. 12-17.

TABLE OF EXHIBITS

U.S. Exhibit No.	Description
US-73	Regulations of the People's Republic of China on Import and Export Duties (November 23, 2003)
US-74	*A Modern English-Chinese Dictionary* (1995), p. 417
US-75	"Character for *Zong* (Master)"
US-76	*A New Century Chinese-English Language Dictionary* (2003), p. 2163
US-77	*A New Century Chinese-English Language Dictionary* (2003), p. 435
US-78	Lin, Zikui; Ru, Yihong; Xu, Jie; and Zheng, Kai, "Countermeasures for the Development of Publications Logistics in China," *China-USA Business Review*, Volume 3, No. 2 (Series 8) (February 2004)
US-79	Response of GAPP to Question on Foreign Investment in Sub-Distribution of Electronic Publications (2005)
US-80	"Notice on Holding the On-the-Job Training Program for the Managers and Heads of Nationwide Private Bookstore and Newly-Approved Publication Master Wholesale [*Zong Pi Fa*] Companies," GAPP (Excerpt) (April 28, 2004)
US-81	"Notice on Holding the Second On-the-Job Training Program for the Managers and Heads of Nationwide Private Bookstore and Newly-Approved Publication Master Wholesale [*Zong Pi Fa*] Companies," GAPP (Excerpt) (August 18, 2004)
US-82	Company Law of the People's Republic of China (2005)
US-83	Implementing Opinions on Several Issues Related to the Application of Law in the Administration of the Examination, Approval and Registration of Foreign-Invested Companies (Excerpt) (2006)
US-84	Regulations of the People's Republic of China on Administration of Registration of Companies (2005)
US-85	Cooperation Agreement of Beijing Artists Online Co. Ltd. (February 21, 2000)
US-86	"China Strengthens Music Copyright Protection," *People's Daily* (April 18, 2001)
US-87	Asia Pacific Legal Institute Update, "Beijing Appeal Court Ruled on a Major Case: Copyright Liability for Internet Service Providers Determined," by Andy Y. Sun (January 2000)

US-88	"The Music Industry and Technological Development," by Jason Berman, presented at the WIPO Worldwide Symposium on the Impact of Digital Technology on Copyright and Neighboring Rights (April 1, 1993)
US-89	"WIPO/NCAC Regional Workshop for Asia and the Pacific on Copyright and the WIPO 'Internet Treaties'," paper prepared by Dr. Mihaly Ficsor and presented at WIPO workshop in Shanghai (May 1999)
US-90	Alice Rawsthorn, "Digital music market tunes up," *Financial Times* (June 23, 1997)
US-91	Jon Pareles, "Digital Distribution of Music is Spreading," *The New York Times* (July 16, 1998)
US-92	Alice Rawsthorn, "Music Industry Tunes Into Digital Distribution," *Financial Post* (January 20, 1998)
US-93	"Singapore Buying Music Over the Internet," *Internet Asia* (January 2, 1998)
US-94	"UMG promises digital distribution of music in US by end of the year," *Financial Times* (May 5, 1999)
US-95	Archived Website, www.chinamp3.com (May 4, 1999)
US-96	"Year in Review: Chinese Film Industry," Special Issue on the Chinese Film Industry: Custom Publication, *The Hollywood Reporter* (2008)
US-97	"Local Markets for Indigenous Films," *Screen Digest* (May 2008)