## Articles

# PIRATES, DRAGONS AND U.S. INTELLECTUAL PROPERTY RIGHTS IN CHINA: PROBLEMS AND PROSPECTS OF CHINESE ENFORCEMENT

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## INTRODUCTION

I had an unexpected introduction to Chinese intellectual property piracy. In the confines of his Beijing apartment, an American friend furtively showed me a copy of a book published in China. The book bore the imprint "neibu" in Chinese, meaning "internal", which indicated that the book was officially regarded as a state document of the People's Republic of China (PRC) to which no foreigner could legally have access. Possession could be a serious offense. The irony was that the American who showed me the book had actually written it some years earlier and published it not in China but in the United States under an American copyright. The version he showed me—a gift from a Chinese colleague—had been published in China by a state publishing house, with authorization from neither the author nor the American publisher. Under Chinese law, it was illegal for this author to possess a Chinese-produced copy of his own work. Such copies were sold only to Chinese citizens inside special rooms in state-owned bookstores. At the entrance to each room, the threatening prohibition "No foreigners allowed" was prominently displayed; inside, a treasure trove of pirated works from all over the world was for sale.

In the seven years since I examined my friend's book, much has changed and much has remained the same in the world of intellectual property protection in China. Most importantly, piracy is still rampant, and U.S. efforts to control it are ongoing and fairly aggressive. Indeed, as recently as June 1996, Acting United States Trade Representative Charlene Barshefsky (USTR) came to terms with the Chinese following a U.S. threat, formally made in May 1996 but openly discussed for several months before, to impose trade sanctions if the Chinese did not adhere more effectively to the requirements of the latest Sino-American agreement on intellectual property rights,[1] the 1995 Agreement

1. *See* Statement of Ambassador Barshefsky, Office of the U.S. Trade Representative, June 17, 1996 (press release on file with the author); OFFICE OF THE U.S. TRADE REPRESENTATIVE, REPORT ON CHINESE ENFORCEMENT ACTIONS UNDER THE 1995 ENFORCEMENT AGREEMENT (1996); Office of the U.S. Trade Representative, Request for Public Comment and Notice of Public Hearing, Determination Involving Expeditious Action (Proposed Determination Concerning What Further Action to Take Under Section 301(a) in Response to the People's Republic of China's Unsatisfactory Implementation of the 1995 Agreement on Enforcement of Intellectual Property and Market Access), Docket No. 301–92, including Annex I and Annex II, May 15, 1996; David Sanger, *In Trade Rift, U.S. Outlines*

on Chinese Enforcement (1995 Enforcement Agreement or 1995 Agreement).[2] Ambassador Barshefsky's actions will seem familiar to many, but leave some wondering whether Sino-American intellectual property relations are on a treadmill. They are not. To see why, it is important to understand how the present crisis follows in the wake of—and can only be properly understood as a footnote to—a series of Sino-American intellectual property agreements and dozens of negotiating sessions, which themselves have led to substantial changes in intellectual property rights (IPRs) in China, including changes in China's domestic laws, its administrative and judicial institutions, and its status as a participant in international IPR agreements.

Through the 1995 Enforcement Agreement, the 1992 U.S.-P.R.C. Memorandum of Understanding on Intellectual Property (MOU),[3] the 1992 U.S.-P.R.C. Memorandum on Market Access,[4] and other measures, the United States has sought to develop within China, as it has in other lesser developed countries in the pirating business, a Western-style Rule of Law. But agreements negotiated as part of such development projects may be of little value if unaccompanied by effective enforcement mechanisms. Are Western-style enforcement mechanisms, working in concert with Western-style IPR laws, practical in the Chinese context? Some say they are not, that the whole project is doomed because it is based upon a set of assumptions about law and culture that, being Western, cannot be effectively adopted in the Chinese context. The Chinese, it is argued, have neither a Western concept of private property, nor a Rule of Law tradition, and, therefore, cannot be expected to comprehend fully, much less adhere to, Western-style IPR agreements. Such skeptics argue that even if U.S. pressure tactics are effective in the short term, resulting in well-publicized raids and the closing of a handful of pirate factories, they will not have brought about much needed fundamental changes in Chinese attitudes about property rights, the judiciary or the legal profession—changes substantial enough to survive when there are no U.S. threats in the offing. Moreover, they claim, the U.S. has failed to appreciate the degree to which the Chinese have learned to resent the quasi-colonial meddling of foreign powers in China in the nineteenth and early twentieth centuries, and the fact that for this reason some Chinese are exceptionally wary of pressure exerted by foreign countries who want China to build an elaborate legal apparatus to protect what are in significant part foreign IPR interests.[5] Among ordinary Chinese, there is, say

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*Penalties, and So Does China,* N.Y. TIMES, May 16, 1996, at A1; David Sanger, *Apparel Picked as the Target if U.S. Imposes Curbs on China,* N.Y. TIMES, May 14, 1996, at C1. *See also* Ambassador Michael Kantor, U.S. Trade Representative, Address to U.S.-China Business Council (Jan. 31, 1996); James Gerstenzang, *U.S., Citing Lack of Progress, Vows Sanctions Against China,* L.A. TIMES, Jan. 20, 1996, at D1.

2. Letter from Michael Kantor, U.S. Trade Representative, to Wu Yi, Minister of Foreign Trade and Economic Cooperation of the People's Republic of China, and Annex I (Feb. 26, 1995), *reprinted in* 34 I.L.M. 881 (1995) [hereinafter EA Letter and EA Annex]. The nominal deadline for compliance was February 26, 1996—the first anniversary of the signing of the agreement.

3. *See* Memorandum of Understanding Between the Government of the United States of America and the Government of the People's Republic of China on the Protection of Intellectual Property, Jan. 17, 1992, 34 I.L.M. 676 (1995) [hereinafter MOU].

4. *See* Memorandum of Understanding Between the Government of the United States of America and the Government of the People's Republic of China Concerning Market Access, Oct. 10, 1992, 31 I.L.M. 1274 (1992).

5. According to Shen Rongan, Deputy Director of the State Copyright Administration, "[t]he [Chinese Communist Party]-led PRC is not old China under the rule of the Qing dynasty

the skeptics, a deep distrust of law rooted both in Confucian tradition and in the bitter knowledge that the Communist Party has exploited law to serve its own often corrupt ends, as well as those of its more powerful members.

In this essay, I would like to ask whether, in fact, Chinese legal and cultural assumptions are today so profoundly non-Western or anti-Western, and whether, in any case, those assumptions adequately explain non-enforcement in China. Alternatively, I want to ask what other factors, particularly economic factors, might be useful in explaining non-enforcement, and whether those factors might be profitably addressed in designing enforcement schemes and practices for IPRs. On my account, the skeptics undervalue the very real results and prospects that have attended modern Sino-American IPR diplomacy: not only China's large-scale restructuring of domestic IPR law, and its accession to international agreements, but the effects those actions have already had in the courts and the marketplace, and the effects they are likely to have in the context of China's rapidly expanding and increasingly rationalized economy.

Part I presents a pocket brief on the recent history of Sino-American IPR diplomacy. In Part II, the chief actions China has taken to fulfill the commitments made under the 1992 MOU and the 1995 Enforcement Agreement are reviewed, as is the current state of Chinese infringement and enforcement activity in one especially problematic area, that of copyright. Part III looks at culture-based explanations of inadequate Chinese enforcement; it discusses the origins of the claim that Rule of Law assumptions are misplaced in the Chinese context, reviewing the purported "lawlessness" of both Confucianism and the Chinese bureaucracy. Part IV looks at alternative explanations and inquires into the future of intellectual property enforcement in China.

Descriptive and factual matters occupy Parts I, II, and much of III. Normative and theoretical claims are presented in Parts III and IV. Those who are familiar with the historical details of Sino-American IPR diplomacy from 1991 to 1996 may wish to bypass Part I. Those whose interests tend more to the cultural and economic dimensions of piracy and Chinese society may want to concentrate on Parts III and IV. Those who are partial to the nuts and bolts of infringement, enforcement and legal machinery will want to take in Part II as well.

## I. THE RECENT HISTORY OF SINO-AMERICAN IPR DIPLOMACY: A POCKET BRIEF

Sino-American intellectual property relations in the post-Mao Zedong era began with the 1979 U.S.-China Trade Agreement, which called for each nation to offer copyright, patent and trademark protection "equivalent" to the "protection correspondingly accorded by the other".[6] More focused IPR

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or Chiang Kai-Shek. We do not have to act on foreign orders." *China Defends Its Copyright Protection Record*, BBC Summary of World Broadcasts, Jan. 10, 1995, *available in* LEXIS, NEWS Library, NON-US File [hereinafter *China Defends Its Record*]. "The Qing dynasty government drafted regulations in 1898 and 1910 on protecting patents and copyrights. However, these regulations were drafted under pressure from Western powers and were aimed at protecting their economic interests in China. Hence, they were a product of Imperialist aggression against China." *Id.*

6. *See* Agreement on Trade Relations, July 7, 1979, U.S.-China, art. 6, 31 U.S.T.

discussions began a decade ago, in 1986, but negotiations began in earnest only in 1991, when then-USTR Carla Hills identified China as a "Priority Foreign Country" pursuant to the terms of the 1988 Trade Act, and initiated a Special 301 investigation of China's IPR enforcement practices and policies.[7] Ensuing discussions—largely in the form of claims and counterclaims, threats of sanctions and threats of countersanctions—eventually led to the signing of the watershed 1992 MOU.

The January 1992 "southern tour" of Deng Xiaoping, China's paramount leader, was widely seen as a definitive signal that the retrenchment imposed by the Chinese government in the wake of the June 4, 1989, Tiananmen crackdown on pro-democracy demonstrators would come to an end, and that China would aggressively continue the policy of "opening to the outside world" that it had pursued under Deng's leadership since 1979. For China, "opening" to the outside world has meant, *inter alia*, establishing extensive trading ties with the world, but it has been a vexing question when or even whether China would rise to world standards in trade, particularly in the realm of intellectual property. Therefore, Deng made a gesture of considerable moment for the global intellectual property community when the official Xinhua (New China) Overseas News Service reported that Deng had told the chairman of a laser disc company in the Shenzhen Special Economic Zone that it was necessary for China to abide by international regulations on intellectual property rights.[8] On January 17, only two days before Deng's arrival in Shenzhen, the 1992 MOU had been signed, which committed China to joining some of the chief international intellectual property conventions and adopting internal laws, regulations and enforcement mechanisms which would provide it with a Western-style regime of intellectual property rights and remedies. Theoretically, following full implementation of the provisions of the MOU, China would become an upstanding consumer and even a legitimate producer of intellectual property, and cease to be the world's greatest pirating nation, which it had become in the 1980s.

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4651, T.I.A.S. No. 9630. For a valuable historical account of IPR protection in Imperial China, see WILLIAM P. ALFORD, TO STEAL A BOOK IS AN ELEGANT OFFENSE: INTELLECTUAL PROPERTY LAW IN CHINESE CIVILIZATION (1995). For my discussion of Alford's account, see Glenn R. Butterton, *The Empire Strikes Back: Piracy with Chinese Characteristics* 81 CORNELL L. REV. 101 (1996) (reviewing ALFORD, *supra*).

7. The 1988 Omnibus Trade and Competitiveness Act, Pub. L. No. 100–418, 102 Stat. 1107, which amended section 182 of the Trade Act of 1974 (codified as amended at 19 U.S.C. § 2242 (1994)), requires the United States Trade Representative to identify annually countries that deny "adequate and effective" intellectual property protection and "fair and equitable" market access to American companies that depend on intellectual property protection. Three categories of identification were established for this purpose. Those countries whose practices are regarded as unacceptable are to be designated Priority Foreign Countries, and investigated for possible trade sanctions under the so-called Special 301 provisions of the Trade Act, 19 U.S.C. § 2411. Those whose practices were found to warrant careful monitoring, but to be of somewhat lesser concern than the practices of Priority Foreign Countries, were to be designated Priority Watch List countries. Countries whose practices were problematic but of lesser concern than countries in either of the other two categories were to be designated Watch List countries. For a useful discussion of the effectiveness of section 301 actions, see Alan O. Sykes, *Constructive Unilateral Threats in International Commercial Relations: The Limited Case for Section 301*, 23 LAW & POL'Y INT'L BUS. 263 (1992).

8. *Deng Xiaoping's Visit to Shenzhen Reported*, Xinhua Gen'l Overseas News Serv., Mar. 30, 1992, *available in* LEXIS, NEWS Library, WIRES File (No. 0330146). *See also* Lee Sands & Deborah Lehr, *Expanding Trade and Opening Markets in China*, 1993 CHINA BUS. REV. 7–8:11 (1993).

By 1993, however, the MOU in some essential respects was far from fully implemented in China, and piracy was by most accounts more extensive than ever. While the Chinese had engaged in significant law reform at home, and acceded to major international agreements abroad, the situation as regards Chinese domestic enforcement remained abysmal and of considerable concern to U.S. government and industry officials alike. From July 1993 to February 1995, the United States mounted a sustained effort to motivate improvements in Chinese government enforcement programs participating in no less than twenty-one separate negotiating sessions with Chinese officials.[9] On a visit to Beijing in October 1993, then Deputy United States Trade Representative Charlene Barshefsky described enforcement in China as "essentially absent".[10] One month later, on November 30, 1993, United States Trade Representative Michael Kantor placed China on the Priority Watch List.[11] In its National Trade Estimate Report on the People's Republic of China, issued March 31, 1994,[12] the Office of the USTR found piracy to be rampant in China, particularly in the areas of audio-visual materials, publishing and computer software. The International Intellectual Property Alliance (IIPA), a lobbying organization representing the trade groups of a number of important intellectual property-based industries in the U.S.,[13] recommended in its 1994 Special 301 submission to the USTR[14] that the PRC be designated a Priority Foreign Country.[15] The decision whether to include China, along with India and Argentina, on the new list of Priority Foreign Countries was postponed for sixty days on April 30, 1994,[16] but following the postponement, the USTR

9. Press Conference with U.S. Trade Representative Mickey Kantor, Feb. 4, 1995, *available in* LEXIS, LEGIS Library, FEDNEW File.

10. *U.S. Decision to Place China on Priority Watch List Criticized*, Pat. Trademark & Copyright L. Daily (BNA) (Dec. 3, 1993).

11. *See supra* note 7.

12. OFFICE OF THE U.S. TRADE REP., NATIONAL TRADE ESTIMATE, PEOPLE'S REPUBLIC OF CHINA (1994).

13. The IIPA member organizations are The Association of American Publishers, Inc.; The American Film Marketing Association; The Business Software Alliance; The Computer and Business Equipment Manufacturers Association; The Information Technology Association of America; The Motion Picture Association of America; The National Music Publishers Association; and The Recording Industry Association of America, Inc. Through its membership the IIPA claims to represent more than 1350 U.S. intellectual property-oriented businesses.

14. INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE, 1994 SPECIAL 301 SUBMISSION (1994) [hereinafter IIPA, 1994 SPECIAL 301].

15. In its report to the USTR for the previous year, 1993, the IIPA had recommended that the PRC be designated a Priority Watch List country. INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE, 1993 SPECIAL 301 SUBMISSION (1993) [hereinafter IIPA, 1993 SPECIAL 301].

16. 59 Fed. Reg. 96, May 19, 1994, *available in* LEXIS, ITRADE Library, FEDREG File. The reason Ambassador Kantor gave for the postponement was that "intense efforts to resolve [the IPR] problems" were underway and that U.S. interests would be best served by deferring the naming of specific countries while negotiations continued. *U.S. Delays Citing China, India, Argentina Under Special 301 Law*, 11 Int'l Trade Rep. (BNA) No. 18, at 690 (May 4, 1994). The April 30, 1994, announcement postponing the Priority Foreign Country decision followed a series of consultations in which a three-person Chinese delegation met with officials of the Commerce Department on April 13 and 14, 1994, under the auspices of the United States-China Joint Committee on Commerce and Trade, and with officials of the USTR on April 18 and 19, in Washington, D.C. *Chinese Official Outlines Improvements in Intellectual Property Protection*, Pat. Trademark & Copyright L. Daily (BNA) (Apr. 19, 1994). In addition, President Clinton held talks on May 2, 1994, with Chinese Vice-Premier Zou Jiahua on the current state of U.S.-China ties. *Clinton Meets Chinese Officials; Expresses Human Rights Concerns*, 11 Int'l Trade Rep. (BNA) No. 18, at 706 (May 4, 1994) [hereinafter *Clinton Meets*

found that the Chinese remained unwilling to take action against major IPR pirates, and thus on June 30, 1994, designated China a Priority Foreign Country.[17] This action had the effect of subjecting China to a six-month investigation and a possible ninety-day extension, after which time trade

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*Chinese Officials*]. The designation of China as a Priority Foreign Country had been widely expected, and the postponement came as something of a surprise. In fact, because *The New York Times* erroneously reported that China had been so designated, the USTR announced the postponement three days earlier than planned. *See* Douglas Jehl, *Warning to China on Trade*, N.Y. TIMES, Apr. 30, 1994, at 39; *USTR Delays Citing China, Japan for IP Protection, Procurement*, Pat. Trademark & Copyright L. Daily (BNA) (May 3, 1994) [hereinafter *USTR Delays Citing China*]. It is generally believed that the postponement was motivated by a desire not to further complicate negotiations surrounding the upcoming U.S. decision regarding renewal of China's Most-Favored-Nation (MFN) trading status, a decision scheduled to be made June 3, 1994. Jason Berman, president of the Recording Industry Association of America, observed that "[i]t is obvious that it was based on considerations other than those involved in Special 301." *USTR Delays Citing China, supra.* However, U.S. Treasury Secretary Lloyd Bentsen denied that there was any linkage between the postponement and MFN. *Clinton Meets Chinese Officials, supra.* Ultimately, China's MFN status was renewed, and at the same time, President Clinton took the extraordinary step of "de-linking" the annual review of China's MFN status from U.S. concerns about human rights violations which had previously created considerable tension in the U.S.-China trading relationship. For an explanation of the "de-linking" in President Clinton's own words, see Marian Nash (Leich), *U.S. Practice: Contemporary Practice of the United States Relating to International Law*, 88 AM. J. INT'L L. 745 (1994).

17. 59 Fed. Reg. 26,341 (1994); *USTR Publishes China Sanctions List; Tariffs Could Be Imposed Feb. 4*, Int'l Trade Rep. (BNA) (Jan. 4, 1995), *available in* LEXIS, ITRADE Library, INTRAD File. Two weeks in advance of the USTR's June 30 deadline, when the 60-day postponement was to expire, China's State Council issued a White Paper through the Xinhua News Agency stating that "[i]n accordance with its national conditions and current tendencies in international development, China has formulated and fine-tuned various laws and regulations on intellectual property protection, thereby constructing a socialist legal system for intellectual property protection with Chinese characteristics." *White Paper on Intellectual Property: "Intellectual Property Protection in China,"* Xinhua News Agency, *available in* LEXIS, NEWS Library, WIRES File (No. 0616077). Immediately following the announcement of the USTR's decision to designate China a Priority Foreign Country, spokesmen for the Chinese Foreign Ministry and the Chinese Ministry of Foreign Trade and Economic Cooperation described the designation as "irrational and unacceptable", asserting that it would harm bilateral economic and trade relations and that the U.S. government should bear all responsibility for the results of this step. *Decision on China's Intellectual Property Rights Not Acceptable, Says Chinese Government*, Xinhua News Agency, July 1, 1994, *available in* LEXIS, NEWS Library, WIRES File (No. 0701174). Shortly thereafter, in July 1994, the Chinese State Council established the Intellectual Property Rights Working Conference, under the umbrella of the State Science and Technology Commission and chaired by Vice-Premier Li Lanqing, which was designed to study issues and coordinate actions related to the strengthening of copyright protection. Chan Wai-Fong, *Group Set Up on Copyright*, SO. CHINA MORNING POST, July 20, 1994, at 9. Within six months, this new body had issued a set of "four demands" for various localities:

> (1) a plan to inspect law enforcement should be worked out and implemented immediately and law enforcement inspection teams are required to report the results of inspections once a week; (2) local governments should do a good job of investigating and handling piracy activities within their own administrative regions and should cleanse the pirated goods market; (3) all provinces should earnestly inspect and rectify compact disc and laser video disc production lines, including detailed lists of products, production authorization, records of violations of the IPR law and the results of investigations and punishment, in regions within their jurisdiction; and (4) a good job should be done in spreading general knowledge about IPR law and conducting professional training.

*Law and Order; Beijing Boosts Enforcement of Copyright Protection Measures*, BBC Summary of World Broadcasts, Jan. 19, 1995, *available in* LEXIS, NEWS Library, NON-US File [hereinafter *Beijing Boosts Enforcement*].

sanctions could be imposed.[18]

On February 4, 1995, the U.S. did impose US$1.08 billion in sanctions and the Chinese retaliated with sanctions of their own of a like amount,[19] but following the pattern of the 1991–92 IPR negotiations, the parties reached a new agreement at virtually the last minute and averted the imposition of reciprocal sanctions.[20] The new Enforcement Agreement, signed in Beijing on February 26, 1995, called for both enhanced enforcement measures by the Chinese, and greater market access for U.S. intellectual property producers in Chinese markets.[21] Failure of the Chinese to live up to these commitments led to Ambassador Kantor's recent threat to re-impose sanctions in 1996.[22] I would now like to take a closer look at the terms of the 1992 MOU and the 1995

18. During the ensuing six months of the investigation, the two sides engaged in four negotiating sessions, but all talks were broken off on December 14, just short of the expiration of the six-month period on December 31, because, according to negotiator Lee Sands, Director of Chinese and Mongolian Affairs for USTR, China "did not make serious offers." *No U.S.-China Talks Underway So Trade Sanctions Against China Likely*, Int'l Bus. & Fin. Daily (BNA) (Dec. 29, 1994). In September 1994, China had established a national intellectual property rights watchdog in Beijing called the China United Intellectual Property Protection Centre, both to deal with infringements and to provide comprehensive services to domestic and foreign companies. The Centre was designed to monitor the enforcement of IPRs both nationally and regionally—for this purpose it was to have a "watching network" in 26 provinces, municipalities and autonomous regions—and to investigate cases of infringement on behalf of domestic or foreign clients. It was also to secure evidence, file lawsuits and take other legal action, offer advice on IPRs and provide anti-forgery technology and products. *Watchdog on Forgery Launched*, SO. CHINA MORNING POST, Sept. 27, 1994, at TEC1. On the eve of the December 31 deadline, the Chinese produced an "action plan" presumably intended to head off or at least rhetorically answer expected U.S. sanctions. The document spoke to the need to halt piracy, educate Chinese companies and private citizens, and discussed a substantive plan to place unique numerical identifiers on molds used to make compact and laser discs, as is done in Western nations, which would theoretically make pirate products easier to track. *Chinese Intellectual Property Steps Called Insufficient by U.S. Official*, Int'l Bus. & Fin. Daily (BNA) (Jan. 9, 1995) [hereinafter *Chinese Steps Called Insufficient*]; *Copyright Issues; New Coding Measure to Deter Pirate CD Manufacturers*, BBC Summary of World Broadcasts, Jan. 9, 1995, *available in* LEXIS, NEWS Library, NON-US File. But on December 31, Ambassador Kantor announced that he would impose trade sanctions on Chinese imports into the U.S. if China failed to address American IPR concerns by February 4, 1995. 60 Fed. Reg. 3 (1995). On January 17, 1995, the Chinese followed up with an announcement that as of April 1, 1995, all units without registration approval from the Press and Publications Administration would be prohibited from copying and making compact discs and laser video discs without exception. *Beijing Boosts Enforcement*, *supra* note 17.

19. For technical reasons, the reciprocal sanctions would not take effect until February 26, 1995. After the reciprocal sanctions threats had been made, the IIPA urged in its 1995 Special 301 Submission to the USTR that China again be designated a Priority Foreign Country. INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE, 1995 SPECIAL 301 SUBMISSION (1995) [hereinafter IIPA, 1995 SPECIAL 301]. Ironically, due to the renewal of their MFN status in May 1994, the Chinese benefited from the January 1, 1995, termination of all U.S tariffs on toys, which was a byproduct of congressional approval of the new GATT/WTO (General Agreement on Tariffs and Trade/World Trade Organization) agreement in December 1994. The value of the tariff elimination to the Chinese was generally believed to equal or exceed the US$1.08 billion worth of trade sanctions imposed on them by the USTR. David Sanger, *President Imposes Trade Sanctions on Chinese Goods*, N.Y. TIMES, Feb. 5, 1995, at 1:1; David Sanger, *Senate Approves Pact to Ease Trade Curbs*, N.Y. TIMES, Dec. 2, 1994, at A1.

20. Even if the sanctions had been imposed, at US$1.08 billion they would have been minor relative to the US$30 billion worth of Chinese goods that would have been affected if China had lost its MFN status. Amy Chew, *MFN Loss Worse Than Sanctions, Says Chau*, SO. CHINA MORNING POST, Jan. 6, 1995, at Business 3. On the role played by China's MFN status in the decision to place China on the USTR's Priority Foreign Country list, see *supra* note 16.

21. *See supra* note 2; *infra* note 41–72 and accompanying text.

22. *See supra* note 1 and accompanying text.

Agreement, and at the realities of IPR enforcement on the ground in China.

## II. CHINESE COMMITMENTS

### *A. International Agreements and Domestic Law Reform*

#### *1. The 1992 MOU*

As required by the terms of the MOU of January 17, 1992, China acceded to the Berne Convention[23] October 15, 1992, and to the Geneva Phonograms Convention[24] April 30, 1993. (In addition, apart from its MOU obligations, it acceded to the Universal Copyright Convention October 30, 1992.[25]) It issued new regulations September 30, 1992, to implement these conventions and the terms of the MOU and amended its 1990 copyright law with a view toward making it consistent with the Berne and Geneva conventions.[26] The new regulations also confirmed, consistent with Article 3 of the MOU, that "the exclusive right of distribution that applies to all works and sound recordings includes making copies available by rental and that this exclusive right survives the first sale of copies."[27] Furthermore, as of the date of its accession to the Berne Convention, the PRC undertook to recognize and protect computer software programs as literary works under the terms of Berne,[28] and to provide such protection for a term of fifty years; it also undertook to "impose no formalities on such protection,"[29] and to extend protection to "all works originating in a member of the Berne Union", including such works as sound recordings[30] not in the public domain.[31]

Consistent with the requirements of Article 4 of the MOU, China created protections for trade secrets and against unfair competition: the new "Anti-Unfair Competition" law, adopted on September 2, 1993, specifies eleven types

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23. MOU, art. 3, § 1; Berne Convention for the Protection of Literary and Artistic Works (Paris text, 1971). The MOU specified that a bill would be submitted to China's "legislative body" (i.e. the National People's Congress) by April 1, 1992, and that "best efforts" would be used to have the bill enacted by June 30, 1992, at which time the PRC would submit its instrument of accession to Berne to WIPO, the World Intellectual Property Organization, which administers the convention, with accession effective October 15, 1992. As it turned out, China missed the April 1 deadline but met the others. *China's Legislature Approves Membership in Two Copyright Protection Conventions*, Pat. Trademark & Copyright L. Daily (BNA) (July 8, 1992).

24. MOU, art. 3, § 2; Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms (Geneva, 1971).

25. Universal Copyright Convention (as revised, Paris, July 24, 1971).

26. MOU, art. 3, § 4.

27. *Id.*

28. Chinese Software Regulations were promulgated June 4, 1991, and became effective October 1, 1991. The Ministry of Machine Building and the Electronics Industry promulgated Measures for Registration of Copyright in Computer Software on April 6, 1992. 5 WORLD INTELL. PROP. REP. 284 (1992); *Registration Measures Complete Software Registration Scheme*, Pat. Trademark & Copyright L. Daily (BNA) (July 15, 1992) [hereinafter *Measures Complete Scheme*].

29. MOU, art. 3, § 6. Since the Chinese registration requirement is inconsistent with the Berne Convention, which forbids the imposition of any "formalities" as a precondition of protection, it has been assumed that the registration requirement would no longer apply to foreigners of Berne-member nations following China's accession to Berne. *Measures Complete Scheme*, *supra* note 28.

30. MOU, art. 3, §§ 7, 8.

31. *Id.* art. 3, § 7.

of unfair competition including infringement upon the trade secrets of another party.[32] Consistent with Articles 1 and 2 of the MOU, China amended its 1984 patent law in 1992, and promulgated new patent regulations effective January 1, 1993.[33] The amendments extended coverage to products and processes for all chemical inventions,[34] and extended the duration of available protection to twenty years, commencing with the date of filing, up from the previous fifteen years.[35] New regulations also provided administrative protection for U.S. pharmaceuticals and agrichemicals which became effective on January 1, 1993. Products that are patented and certified are given market exclusivity for seven years and six months,[36] and protection can be backdated for a period of seven years.[37] The amendments also sharply restricted the availability of compulsory licenses.[38] The PRC presented instruments of accession to the Patent Cooperation Treaty on September 13, 1993, which became effective January 1, 1994.[39] China also updated its trademark law on February 22, 1993, notably adding criminal penalties for violations, which became effective July 1, 1993.[40]

*2. The 1995 Enforcement Agreement*

The 1995 Enforcement Agreement committed China to making significant improvements in enforcement by conducting raids on manufacturing and retail[41] distribution facilities, and eliminating local protectionism; banning the export of pirate products[42] and clarifying and publishing all rules and regulations affecting IPR rights by October 1, 1995.[43] The Chinese also promised to adopt certain technical devices including the use of coded identifier systems ("SID")[44] to permit the unique identification of all CDs, LDs and CD-ROMs; the establishment of a title verification system;[45] and the construction by

32. *Id.* art. 4. The MOU called for the PRC to submit the bill necessary to provide the levels of protection specified in Article 4 to the National People's Congress of the PRC by July 1, 1993, and stated that the PRC would "use its best efforts" to enact and implement the bill before January 1, 1994. The new law was adopted on September 3, 1993, and became effective December 1, 1993. *China: New Unfair Competition/Trade Secret Law Enters into Force*, Pat. Trademark & Copyright L. Daily (BNA) (Apr. 8, 1994).

33. *Patent Law Revisions Include Expansion of Patentable Goods*, Pat. Trademark & Copyright L. Daily (BNA) (Nov. 18, 1992).

34. MOU, art. 1, § 1(a).

35. *Id.* art. 1, § 1(c).

36. *Id.* art. 2.

37. Backdating fees amount to US$10,000 per patent, but evidently can be accomplished with relative ease through either the State Pharmaceutical Administration of China or the Pharmaceutical Intellectual Property Consultative Center. *New Patent Protection*, CHEMICAL WEEK, Aug. 25 & Sept. 1, 1993, at S29, *available in* LEXIS, PAT Library, CHEMWK File.

38. MOU, art. 1, § 1(d). However, regarding patent protection the MOU states 12 conditions for compulsory licensing, compared to only two in the revised Chinese patent law. On this disparity, Gao Lulin, Director General of the Chinese Patent Office, has said, "[t]he Chinese government is very earnest about protecting the patentee. In the past seven years China did not grant any compulsory licenses. This is proof." *Revised Patent Law Will Enter into Force January 1*, Pat. Trademark & Copyright L. Daily (BNA) (Oct. 26, 1992).

39. *China to Become 61st PCT Member*, Pat. Trademark & Copyright L. Daily (BNA) (Oct. 20, 1993).

40. *People's Republic of China: Rules Implementing Revised Trademark Law Enter into Force*, Pat. Trademark & Copyright Law Daily (BNA) (Oct. 13, 1993).

41. EA Letter, *supra* note 2, at 2.

42. *Id.*; EA Annex, *supra* note 2, at 15, § I.G.2.

43. EA Letter, *supra* note 2, at 3; EA Annex, *supra* note 2, at 22, § II.C.

44. EA Letter, *supra* note 2, at 2; EA Annex, *supra* note 2, at 18, § I.H.1.

45. EA Annex, *supra* note 2, at 18, § I.H.2.

December 31, 1995, of a centralized recordation system for cataloguing IP rights.[46] The Agreement included various complementary educational provisions calling for the Chinese to train Chinese lawyers and business personnel in IPR law and enlighten Chinese consumers through anti-piracy publicity campaigns.[47]

In addition, the United States promised to provide, and the Chinese pledged to use, technical assistance provided by the U.S. Customs Service, the U.S. Department of Justice and the U.S. Patent and Trademark Office,[48] and to overhaul the Chinese customs service,[49] effectively remodeling it on the model of the U.S. Customs Service. Chinese Customs would furthermore undertake a special period of intense enforcement lasting from March 1, 1995, to October 1, 1995.[50] The Chinese also promised to facilitate the ability of United States citizens to protect their IPR rights in China by, for example, ensuring the ability of foreign rights holders to "collect information by legal means concerning infringement of their rights," and have that "information be admissible as evidence when administrative agencies initiate investigations;"[51] permitting foreign rights holders to submit petitions for investigations;[52] increasing access to the Chinese market for American IPR producers by eliminating quotas,[53] import license requirements, and other formal and informal barriers; and enhancing joint venture opportunities for American producers in the audio-visual sector, as well as in publishing, and in computer software.[54]

These and other actions were to be taken within the framework of a Chinese-designed Action Plan,[55] which was organized under the auspices of the State Council's Working Conference on IPRs. The State Council's Working Conference was to be comprised of the "State Council's departments in charge of science, technology, foreign trade and economic cooperation, foreign affairs, press and publication, culture, broadcast, film, television, justice, public security, patent, copyright, industrial and commercial administration, and customs, as well as the departments in charge of the relevant industries."[56]

The Action Plan featured a short-term and a long-term component.[57] The short-term component had a "special enforcement period"—which was to begin March 1, a week after the 1995 Agreement was signed, and continue for six months, until August 31, 1995, during which time intensive action was to be taken to investigate and punish infringing activity.[58] It was to focus on "key" geographical regions,[59] and on specific product sectors including audio-visual products, computer software, sound recordings, trademarks, patents and unfair

46. EA Letter, *supra* note 2, at 4; EA Annex, *supra* note 2, at 17, § I.G.2.
47. EA Annex, *supra* note 2, at 14, §§ I.F., II.A.1–3, B.1–2.
48. EA Letter, *supra* note 2, at 4.
49. *Id.*
50. EA Annex at 15, § I.G.
51. *Id.* at 13, § I.E.6.
52. *Id.* at 5, § I.B.6, and at 13, § I.E.5.
53. EA Letter, *supra* note 2, at 3.
54. *Id.*
55. EA Annex, *supra* note 2, at 1.
56. *Id.* at 2, § I.A.2.
57. *Id.* at 1.
58. *Id.* at 6, § I.C.1.
59. *Id.* at 6, § I.C.3.

competition.[60] Factories producing CDs would be given special attention: each would be investigated, and while those found to be legitmate would be re-registered, those involved in pirate activity would be "subject to administrative and/or judicial penalties, commensurate with the level of infringement."[61] All such investigations of CD plants were to be completed by July 1, 1995.[62] Where infringing activity in a given area was not significantly reduced through such investigations by August 31, the term of the special enforcement period would be extended beyond the six-month period.[63]

The long-term component of the Action Plan was to last three to five years, and focus on sustained enforcement activity. Under this scheme the State Council's Working Group on IPRs would work together with task forces, ad hoc groups, and twenty-two other ("sub-central") working conferences associated with provinces, administrative municipalities, autonomous regions and major cities.[64] Provincial, regional, municipal and city working conferences were to establish local offices to carry out day-to-day functions and organize relevant local departments to implement China's intellectual property laws and provide effective enforcement.[65] The State Council's Working Group would coordinate and decide policies, implement regulations, organize and instruct relevant authorities, and provide education and publicity for IPR laws.[66]

Within the scope of this "working group" system, other relevant administrative authorities—including the National Copyright Administration (NCA), the State Administration for Industry and Commerce (SAIC), the Chinese Patent Office, Chinese Customs, and all Chinese police agencies—were to coordinate their activities with those of the working groups and join them in special IPR Enforcement Task Forces.[67] Each task force was to be given legal, investigative and administrative authority to enter the premises of and search suspected pirate operations, review records, seal suspect goods, impose fines and order production to cease.[68] In especially serious situations, an ad hoc enforcement group would be set up to take immediate action.[69]

It is worth noting that the Chinese undertook some of the actions called for by the 1995 Agreement—presumably as part of their bargaining strategy—well in advance of reaching the agreement on February 26, 1995. Such actions included, for example, the creation of the national institution—the State Council's IPR Working Conference—that was to play the chief role in administering the new agreement;[70] the initial formulation of the action plan;[71] and the closing down of seven compact and laser disc pirate factories.[72]

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60. *Id.* at 6, § I.C.4.
61. *Id.*
62. EA Letter, *supra* note 2, at 2; EA Annex, *supra* note 2, at 7, § I.D.1.a.
63. EA Annex, *supra* note 2, at 7, § I.C.6.
64. *Id.* at 2, § I.A.4–5.
65. *Id.* at 3, § I.A.6.
66. *Id.* at 2, § I.A.3.
67. *Id.* at 4, § I.B. and at 11, § I.E.
68. *Id.* at 4, § I.B.1.a–c.
69. *Id.* at 6, § I.B.7.
70. *See supra* note 17.
71. *See supra* note 18.
72. EA Letter, *supra* note 2, at 2.

### *B. Problems of Enforcement*

Under Article 5 of the MOU, the Chinese made a very strong commitment regarding enforcement, pledging to "provide effective procedures and remedies and to prevent or stop, internally or at their borders, infringement of intellectual property rights and to deter further infringement,"[73] and in the 1995 Agreement, the Chinese stated that "[b]oth of our governments are committed to providing adequate and effective protection and enforcement of intellectual property rights and have agreed to provide this to each other's nationals."[74] As for adherence to the terms of the agreements, the official government view, expressed by the Chinese Foreign Ministry in December 1993, nearly two years after the MOU was signed, was that "China has always strictly fulfilled its obligations under the [MOU]."[75] Then in early 1996, nearly a year after the 1995 Agreement, the Foreign Ministry declared that China had achieved "marked results" in protecting IPRs,[76] and the Ministry of Foreign Trade (MOFTEC) asserted that while "[s]ome overseas people have criticized China [for] not living up to its promises on IPR protection, [s]uch attacks are totally groundless."[77]

But while the Chinese have made significant efforts to meet the requirements of the 1992 MOU as regards accession to international agreements and the reform of domestic law, their efforts at policing piracy at home in accord with the terms of those agreements and reforms, and the terms of the 1995 Agreement, have been woefully inadequate. By most accounts, Chinese piracy has grown dramatically since the signing of the MOU, with estimates for piracy of copyrighted materials alone in excess of US$800 million for 1993, roughly double estimates for 1992,[78] and of US$866 million for 1994.[79] Estimates for 1995, have mushroomed to US$1.835 billion, exclusive of losses due to piracy of business software applications.[80] Just how far short of their obligations the Chinese have fallen can be seen by a brief review of post-MOU and post-Enforcement Agreement developments. I now turn to that task, paying special attention to the current state of copyright law and enforcement practices inside China.

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73. MOU, *supra* note 3, art. 5.
74. EA Letter, *supra* note 2, at 1.
75. *U.S. Decision Criticized*, *supra* note 10 (remarks of Foreign Ministry spokesman Wu Jianmin).
76. *Chinese Officials Say U.S. Sanction Would Harm U.S. Businesses in China*, Int'l Trade Daily (BNA) (Feb. 8, 1996).
77. Remarks of MOFTEC official Zhang Yuejiao. *China Denies "Groundless" U.S. Allegations of Copyright Piracy*, Agence France Press, Feb. 13, 1996, *available in* LEXIS, NEWS Library, AFP File. Elsewhere MOFTEC claimed "China was doing everything possible to protect intellectual property rights" even though "IPR protection is a difficult task" and "[i]t is unrealistic to expect violations to vanish in a short period." *China Unable to End Copyright Piracy 'in Near Future'*, Agence France Press, Jan. 22, 1996, *available in* LEXIS, NEWS Library, AFP File.
78. IIPA, 1994 SPECIAL 301, *supra* note 14, at 2; IIPA, 1993 SPECIAL 301, *supra* note 15, at 39. *See also* OFFICE OF THE U.S. TRADE REPRESENTATIVE, NATIONAL TRADE ESTIMATE, PEOPLE'S REPUBLIC OF CHINA 6 (1995).
79. IIPA, 1995 SPECIAL 301, *supra* note 19, at 3.
80. INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE, 1996 SPECIAL 301 SUBMISSION 3 (1996) [hereinafter IIPA, 1996 SPECIAL 301].

*1. Areas of Copyright Infringement*

a. Piracy of Sound Recordings

During 1992 and 1993, the PRC saw a sudden surge in the construction of pirate compact disc plants. While in 1992, about eight plants were believed to be operational, and a further five plants were believed to be either in the planning stages or nearly ready to begin manufacturing,[81] by 1993, no fewer than twenty-six plants were in full production.[82] By February 1996, most estimates put the figure at twenty-nine or more.[83] Much of the output of the plants has consisted of popular recordings whose copyrights are owned by leading multinational recording companies. While the domestic Chinese market for compact discs is estimated to be roughly 5 million a year, China's plants have the capacity to produce 70 or 80 million discs annually and there is ample evidence that surplus production is being systematically exported to Asia, the Middle East, Latin America, Canada and the United States.[84] In Hong Kong alone, the pirate share of the market has been estimated to be as high as twenty percent.[85]

While under the 1995 Agreement, the Chinese were obliged to close seven of the offending plants (and nominally did so even before the Agreement was signed), and to investigate and close all other pirate CD plants within three months, by November 1995, the USTR had found that "[t]o our great dismay, China has instead re-registered—that is, given a clean bill of health to—all but one of the CD factories."[86] Moreover, "[f]actories producing pirated products have shifted their focus from production primarily of music CDs to higher

81. The PRC government was reported to have prohibited plant approvals as of March 1, 1992, but local authorities seem to have forged the dates on approval documents after the deadline, effectively giving retroactive approval to illegal plants. IIPA, 1993 SPECIAL 301, *supra* note 15, at 40.

82. Dennis Wong, *Cantopop Piracy Poses a Threat to the Music Industry*, THE STRAITS TIMES (Singapore), Dec. 11, 1993, at Money 44. One American official, while speaking on condition of anonymity in Marrakesh, Morocco (in conjunction with the signing of the new GATT/WTO agreement on April 15, 1994), put at 50 the number of companies in southern China producing pirate compact discs. *U.S. Not Ready to Back China's Accession to New World Trade Group, Official Says*, Int'l Trade Daily (BNA) (Apr. 14, 1994). In February 1995, the IIPA estimated that between 29 and 35 such factories were on line, 1995 IIPA SPECIAL 301, *supra* note 19, at 1.

83. *China Launches Publicity Campaign to Promote Protection of IP Rights*, Int'l Trade Daily (BNA) (Jan. 23, 1996) [hereinafter *China Launches Campaign*]; Gerstanzang, *supra* note 1.

84. The Recording Industry Association of America, Inc. believes that of an estimated US$345 million worth of losses due to PRC piracy in 1993, $45 million were lost in the domestic PRC market and US$300 million were lost as a result of PRC pirate exports. IIPA, 1994 SPECIAL 301, *supra* note 14, at 5. 1995 IIPA estimates for recording industry losses in 1994 remained constant at US$345 million. IIPA, 1995 SPECIAL 301, *supra* note 19, at 3. However, estimates for losses in 1995 fell to US$300 million. IIPA, 1996 SPECIAL 301, *supra* note 80, at 3.

85. IIPA, 1994 SPECIAL 301, *supra* note 14, at 3.

86. *Hearings Before the Subcomm. on East Asia and Pacific Affairs of the Senate Comm. on Foreign Relations*, 104th Cong., 1st Sess. (1995) (statement of Ambassador Charlene Barshefsky) [hereinafter Barshefsky]. In a September 1995 action that amounted to little more than wrist-slapping, 12 CD factories were effectively told manufacture of unauthorized CDs was unlawful in China. *China Punishes 12 Factories for Piracy*, UPI, Sept. 26, 1995, *available in* LEXIS, NEWS Library, UPI File. There is also some evidence that pirate production is an "after hours" activity at some plants. *See* Seth Faison, *Copyright Pirates Prosper in China Despite Promises*, N.Y. TIMES, Feb. 20, 1996, at A1.

value-added CD ROMs," and "the seizure of exports of pirated CD ROMs, in particular, have risen by one hundred percent," while "[e]xports of music CDs, video CDs and other high-tech products have not demonstrably declined."[87] In addition, even though on June 28, 1995, the official Xinhua News Agency reported on the authority of the National Copyright Administration (NCA) that CD production lines nationwide had been provided "with a system of source identification marks on every make and model",[88] by December 1995, the Chinese had not, in fact, honored their Enforcement Agreement commitment to require the use of such SID codes. But on January 17, 1996, in a gesture of belated compliance, the State Press and Publication Administration ordered China's 270 CD manufacturers to stamp all products with an SID code.[89]

b. Piracy of Motion Pictures

Piracy of American motion pictures in China has been extensive.[90] As of 1995, estimated annual losses to U.S. filmmakers due to this type of piracy were believed to be about US$50 million,[91] but by 1996, estimates had more than doubled to US$124 million.[92] Films originally produced in the United States have been illegally copied, generally onto videotape, from satellite broadcasts, legitimate videocassettes, or original sixteen or thirty-five millimeter prints. And in the Shenzhen Special Economic Zone in 1993, a compact disc plant called the Shenzhen Shen Fei Laser Optical Systems Company, was found to be producing not only unauthorized compact discs, but also unauthorized laser discs of American motion pictures, with a capacity estimated to be about 1.5 million units annually; its products appear to have been exported to such markets as Hong Kong, the Philippines, Indonesia and Singapore, and to be domestically available in Beijing.[93]

Pirated U.S. films are typically shown in local videocassette "mini-cinemas", or over cable systems; even luxury hotels and official government

87. Barshefsky, *supra* note 86.

88. *China's Anti-Piracy Campaign Pays Off*, Xinhua News Agency, June 28, 1995, *available in* LEXIS, NEWS Library, WIRES File.

89. *China Launches Campaign*, *supra* note 83.

90. Estimates by the Motion Pictures Exhibitors Association of America (MPEAA) suggest that there are in China 226 million televisions, 20 million videocassette recorders, and up to 15 million satellite dishes (though these were recently outlawed by the central government). In addition, there are 30,000 "video cinemas" which show pirated films in a videocassette format to audiences ranging in size from 80 to 150. MOTION PICTURE EXHIBITORS ASS'N, 1993 TRADE BARRIERS REPORT (1993), *reprinted in* IIPA, 1993 SPECIAL 301, *supra* note 15, at 5.

91. IIPA, 1995 SPECIAL 301, *supra* note 19, at 3.

92. IIPA, 1996 SPECIAL 301, *supra* note 80, at 3.

93. The plant's output was found to include many recently released as well as somewhat older films by such motion picture companies as Columbia Pictures, Inc., Paramount Pictures, Inc., Universal Studios, Inc., and The Walt Disney Co., including: *Last Action Hero, Sliver, Beverly Hills Cop III, City Slickers II, Indecent Proposal, Dragon, Die Hard, Terminator, Terminator II, Robocop, Robocop II, Jurassic Park, True Lies,* and *Clear and Present Danger.* IIPA, 1993 SPECIAL 301, *supra* note 15, at 5; IIPA, 1995 SPECIAL 301, *supra* note 19, at 6; Sanger, *supra* note 19. One recent film, *The Lion King*, was available on a pirate laser disc even before it was released as a legitimate videocassette. Jonathan Sprague, *Hong Kong: U.S. Says Gap Narrowed with China on Piracy*, Reuter News Service–Far East, Jan. 16, 1995, *available in* LEXIS, NEWS Library, WIRES File. As recently as February 1995, the Shen Fei plant was known to still be producing illicit CDs and laser discs. IIPA, 1995 SPECIAL 301, *supra* note 19, at 6. But by 1996, it was reputedly "clean" of illicit activity and actively seeking U.S. licenses. IIPA, 1996 SPECIAL 301, *supra* note 80, at 6.

television stations broadcast pirated American films.[94] In seeming response to high-profile U.S. talk of sanctions in 1996, and in anticipation of the one-year anniversary of the signing of the 1995 Agreement, the official Xinhua News Agency reported that the government had imposed a ban January 1, 1996, on public exhibitions of feature films in LD and CD formats "in an effort to bring an end to infringement upon copyrights."[95]

c. Publishing Industry Piracy

Unauthorized book reproduction is a "traditional" form of piracy in China, as in many lesser-developed countries, and the situation is reportedly deteriorating, with estimated annual losses to U.S. publishers in 1993 standing at US$110 million,[96] and increasing to US$125 million for 1995.[97] By mid-1995, the Chinese had closed and fined ten large publishing houses, confiscated all their pirate goods, and taken the most serious offenders to court.[98] The Press and Publications Administration (PPA) also demonstrated a willingness to resolve disputes through non-coercive alternative means, settling a suit brought by the American Association of Publishers on behalf of Prentice–Hall and Harcourt Brace.[99]

d. Computer Software Piracy

According to the Business Software Alliance (BSA), losses by American firms due to software piracy in China stood at US$322 million in 1993, up from US$225 million in 1992,[100] and rose to US$351 million in 1994.[101] But by 1995, BSA Vice-President Valerie Colbourn was willing to claim that software piracy alone was costing the U.S. about US$830 million a year in lost sales,[102] and by 1996, IIPA estimates put losses due solely to illegitimate entertainment software at US$1.286 billion.[103] Use of illegally copied U.S. software has continued unabated in state-owned companies, private companies, government ministries and among private individuals.[104] But, while end-user piracy is widespread, just as it is to varying degrees in the United States, Japan, and Germany, in China one also finds retail establishments selling computers with pirated and installed software included in the purchase price; in addition,

94. In one documented case, Shanghai television broadcast the film *Midnight Run* without any authorization from its American producer and copyright holder, Universal Studios. IIPA, 1994 SPECIAL 301, *supra* note 14, at 5. But, in fact, there are more than 500 state-run television stations in China and outside major cities state broadcasters often show pirated films. IIPA, 1995 SPECIAL 301, *supra* note 19, at 6. In addition, there are over 700 cable systems serving 30 million private residences, factories and government offices, nearly all of which use pirated material. IIPA, 1996 SPECIAL 301, *supra* note 80, at 7.

95. *China Launches Campaign*, *supra* note 83.

96. IIPA, 1993 SPECIAL 301, *supra* note 15, at 6.

97. IIPA, 1996 SPECIAL 301, *supra* note 80, at 3.

98. *China Closes Publishing Houses in Anti-Piracy Crackdown*, Agence France Press, June 29, 1995, *available in* LEXIS, NEWS Library, APF File.

99. Jeffrey Parker, *U.S. Publishers Win China Copyright Settlement*, Reuters Bus. Rep., May 26, 1995, *available in* LEXIS, NEWS Library, REUEUB File.

100. *Enforcing Intellectual Property Law Takes More Than Going by the Book*, SO. CHINA MORNING POST, Apr. 13, 1994, at Business 3.

101. IIPA, 1995 SPECIAL 301, *supra* note 19, at 5.

102. Jeffrey Parker, *As U.S. Looks in, China Software Pirates Flourish*, Reuter Eur. Bus. Rep., Aug. 23, 1995, *available in* LEXIS, NEWS Library, REUEUB File.

103. IIPA, 1996 SPECIAL 301, *supra* note 80, at 3.

104. IIPA, 1995 SPECIAL 301, *supra* note 19, at 5.

these and other establishments also sell pirated software as a separate item.[105]

More ominously, pirates have begun selling computer software in the CD-ROM format. A single CD-ROM pirated in China and containing several prominent commercial programs—including Supersuite by Lotus Corporation, AutoCad by Autodesk, and NewWare by Novell, which together retail in the U.S. for more than US$10,000—can be bought on the streets of Hong Kong for US$6.75.[106] Another pirate CD product available in Hong Kong for US$100 features software for use with the Microsoft Corporation Windows 95 Operating System whose retail cost in the United States is US$30,000.[107]

*2. Inadequacies of Ministerial Oversight*

a. The Post-MOU Environment

Following the signing of the 1992 MOU, the chief agency charged with copyright oversight, the National Copyright Administration of China (NCA), was ill-equipped to perform the task. First, the NCA was seriously understaffed. With only thirty staff members in Beijing and a handful of field officers to cover a country that is basically the size of the United States in area, with four times the U.S. population, it had nowhere near the personnel allotment necessary to carry out an enforcement function effectively under Article 46 of the amended Chinese copyright law.[108] Second, the NCA had what are sometimes called horizontal problems: it often came into conflict with two other agencies at its bureaucratic level regarding administration of the copyright domain. NCA had to contend with both the Press and Publication Administration (PPA) with which it officially shared administration and enforcement responsibilities for the new copyright law, and the Ministry of Film, Radio and Television, which formerly had exclusive responsibility for copyright matters (it even conducted raids on suspected violators).[109] Third, the weakness due to understaffing, combined with interagency jurisdiction battles, created a situation in which enforcement was decentralized; that is, the practical details of enforcement tended to be left to local officials. This was the root of so-called vertical problems: local officials and their constituents often preferred, then as now, to let money-making pirate ventures continue to flourish. Such officials sometimes received financial and other benefits in exchange for cooperating with and effectively protecting the interests of pirates in the local economy. Indeed, such officials or their government work units sometimes owned the pirate operation.[110] Official complicity of this kind, far from being frowned upon, was and is seen by many Chinese as merely practical.[111]

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105. IIPA, 1993 SPECIAL 301, *supra* note 15, at 7.

106. *See* Barshefsky, *supra* note 86, at 3.

107. Larry Campbell & Chris Chapel, *Inaction on Piracy Slammed*, SO. CHINA MORNING POST, Sept. 12, 1995, at Tech. 1.

108. Copyright Law in the P.R.C. (adopted Sept. 7, 1990; effective June 1, 1991), *translated in* ZHENG CHENGSI & MICHAEL PENDLETON, COPYRIGHT LAW IN CHINA 215 (1991).

109. IIPA, 1993 SPECIAL 301, *supra* note 15, at 40.

110. *See infra* note 178.

111. A journalist of *The Sunday Times* of London toured a pirate compact disc factory only to be detained by local Communist Party officials who destroyed his film and made him state in writing that he would not implicate them. Nick Rufford, *Pirate CDs Flooding Markets*,

Fourth, there was rather strong evidence of either higher level complicity, official incompetence, or a disturbing lack of ministerial good faith among NCA officials. Article 3, Section 9, of the MOU recognized the MOU as an agreement under Article 2 of the Chinese Copyright Law, and provided "a basis for protection of works, including computer programs, and sound recordings of U.S. nationals published outside of China until such time as China acced[ed] to the Berne Convention and the Geneva Convention." In addition, it required China to commence protection of U.S. works "no later than 60 days after the signature of this MOU," that is, March 17, 1992.[112] Yet, more than a year later, on April 20, 1993, the National Copyright Administration of China issued a decree which stated that only "[a]s from *October 15, 1993,* the sale of particular reproductions of foreign works" that had been owned and used by Chinese citizens "prior to the date of the coming into force in China of [the MOU]" would be "subject to the authorization of the copyright holder".[113] The decree further reported that the NCA had "learned that the existing quantity of such particular reproductions is small," but that the NCA believed "continued sale thereof would be harmful to the effective implementation of the international copyright treaties [including the MOU] in China." Such a decree not only suggested that Chinese administrators had misconstrued or simply failed to enforce the MOU, but it also tied the hands of those who might have sought to enforce it between April 20 and October 15, 1993, and provided a clear signal to those in the pirating business that they could continue their activities, in the near term at least, without any fear of official impediment, as long as their "reproductions" were characterized as being owned and used by Chinese citizens prior to "the date of the coming into force in China of [the

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SO. CHINA MORNING POST, Feb. 7, 1994, at 7. It is widely believed that insofar as the export of pirate compact discs has become a source of enormous foreign earnings, local officials acquiesce in the construction and operation of pirate plants in exchange for significant "gifts" from the pirate entrepreneurs. According to Nic Garnett, the Chief Executive of the International Federation of the Phonographic Industry, "[w]hat is difficult is getting the central government directives translated to the regional authorities. At the provincial level there's a lot of corruption [and] it's very difficult for the central authorities to break through the provincial protection systems that are set up around the [compact disc] plants." Martin Waller, *Chinese Pirates Prove Imitation Is Not Flattery*, THE TIMES, Apr. 26, 1994.

112. In theory, while retroactive Chinese protection for U.S.-registered copyrights was to begin March 17, 1992, such protection for the copyrights of other nations was to have been delayed until China acceded to the Berne Convention, October 15, 1992, which seems to have been a source of some irritation to the nations suffering the delay. *Intellectual Property Experts Discuss Pending Changes in Trademark, Patent Law*, Pat. Trademark & Copyright L. Daily (BNA) (Apr. 16, 1992). It is worth noting, however, that as others see it, the United States has done the "heavy lifting" in attempts to compel China (among other nations), first, to establish a world-class IPR regime and, second, to take enforcement seriously, while many other leading industrialized nations have taken a free ride. That is, other nations have acquiesced in Chinese piracy, content in the knowledge that if the United States effectively suspended participation in Chinese markets, they could rush in to fill the vacuum, and that, alternatively, if U.S. actions improved market access and IPR protection, everyone would benefit, some at little or no cost. Of this predicament, Ambassador Kantor has said, "This is our fate as the world's largest power. We have to blaze the way and others take a free ride." David Sanger, *The World: Martial Arts; This Is a Trade War! Get Your Popgun!* N.Y. TIMES, Feb. 12, 1995, at 4:1. See also David Sanger, *U.S. Blames Allies for Undercutting Its China Policy*, N.Y. TIMES, June 12, 1996, at A1.

113. Document of the National Copyright Administration, Notice Concerning the Use of Particular Reproductions of Foreign Works for Particular Purposes, Guo Quan No. 28, at 1 (Baker & McKenzie trans., 1993) (emphasis added). I am grateful to Maria Strong, Associate General Counsel of the IIPA, for bringing the decree to my attention.

MOU]."[114]

Fifth, there was a disturbing tendency on the part of administrative and judicial bodies to hand out insignificant penalties and damage awards in infringement cases. In the Microsoft trademark case,[115] for example, the Shenzhen Reflective Materials Institute at Shenzhen University was found to have pirated 650,000 holograms specially designed by Microsoft to identify its software products uniquely. The defendant Institute was found to have been filling a fraudulent Microsoft order allegedly placed by a pirate based in Taiwan who then exported thousands of pirated copies of Microsoft software worldwide; the trail of illegal copies has been traced to Canada, Sweden, Italy, Germany, Australia, the United States, the Middle East, the rest of Asia, and even Venezuela.[116] The lost sales for Microsoft have been estimated to be at least US$30 million and possibly as high as US$180 million.[117] Yet a damage award of only US$260 for trademark infringement was rendered against the defendant Institute by the Shenzhen Administration for Industry and Commerce. Clearly, such modest penalties can have little or no deterrent effect on Chinese pirates, be they prime movers or merely co-conspirators in a pirating enterprise, and have raised obvious questions as to China's sincerity in carrying out the terms of the MOU.[118]

b. The Post-Enforcement Agreement Environment

As outlined above, the 1995 Enforcement Agreement contained several provisions intended to reorganize the administrative machinery for dealing with IPR enforcement.[119] But, alas, only part of the machinery has been

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114. The 1979 US-China Trade Agreement required each nation to provide copyright, patent and trademark protection equal to the protection accorded in the other country. Agreement on Trade Relations, July 7, 1979, U.S.-China, 31 U.S.T. 4651, T.I.A.S. No. 9630. Article 3, Section 7, of the 1992 MOU provides that

> (i) With regard to any uses of an original or a copy of a U.S. work on a commercial scale undertaken before establishment of bilateral copyright relations between China and the United States, there will be no liability [and]
> (ii) With regard to such uses undertaken after establishment of bilateral copyright relations, the provisions of the law and regulations will fully apply. With regard to a natural or legal person who owned and used a particular copy of a work for a particular purpose prior to establishment of bilateral copyright relations between China and the United States, that person may continue to make such use of that copy of the work without liability, provided that such copy is neither reproduced nor used in any manner that unreasonably prejudices the legitimate interests of the copyright owner of that work.

MOU, art. 3, § 7(i)–(ii).

115. *See* Harriet King, *Microsoft Nails Some Pirates*, N.Y. TIMES, May 10, 1992, at 3:7.

116. The main pirate production facilities were located in Taiwan where packaging, instruction manuals and diskettes were produced. Only the holograms appeared to have been produced in China, though documents seized in Shenzhen indicated that the Institute had a standing order for 3 million of them. *Observers Expect Taiwan to Be Cited by USTR for Intellectual Property Rights*, Pat. Trademark & Copyright L. Daily (BNA) (Apr. 28, 1992).

117. Mark O'Neill, *China Defends Trademark Protection Record*, Reuter Eur. Bus. Rep., Mar. 26, 1994, *available in* LEXIS, NEWS Library, REUEUB File.

118. A Chinese firm found guilty of infringing the Walt Disney Company's trademark Mickey Mouse character was fined only US$91. Linus Chua, *China Steps Up Enforcement of Piracy Laws*, L.A. TIMES, Apr. 4, 1994, at D3. And a fine for infringement of the rights of the Sino-French joint venture Vie De France (Beijing), Ltd., amounted to only US$1712. Ruth Youngblood, *China Fights Trademark Abuse*, UPI, Apr. 4, 1994, *available in* LEXIS, NEWS Library, UPI File.

119. *See supra* note 64–66 and accompanying text.

reorganized, and even that part is not entirely functional. In the year since the Agreement was signed, China has altogether failed to create a functional title verification system, and also has failed to create and implement in a timely fashion new customs regulations, a centralized recordation system, and an SID regime. On the other hand, it has made many of the structural changes required by the Agreement. Notably, most of China's IPR laws, regulations, and administrative guidance have been published.[120] In addition, thirty inter-ministerial task forces have been established in "virtually all provincial capitals and many major cities" and enforcement task forces have been set up in eighteen provinces and major municipalities.[121] With this degree of reform in place, the Chinese have been able to stage educational programs and publicity campaigns, and make serious inroads into pirate activities at the retail level, even in the economically vibrant southeast; indeed, Chinese trade officials have claimed to have as many as 3,000 inspectors monitoring retail markets nationwide.[122] They report launching 3200 raids, seizing and destroying up to 2 million CDs and LDs, 700,000 pirate videos, and 400,000 pirate books,[123] and claim to have closed down ninety-five percent of illegal video parlours.[124]

But many basic vertical problems, and unknown numbers of horizontal problems, remain such that the essential commitments made in the 1995 Agreement regarding meaningful enforcement—shutting down illegal production lines and destroying inventories—are as yet unfulfilled. The consumer marketplace—in the form of retail merchants and their stocks—has been cleaned up to some degree, but the NCA has been hard-pressed to close down pirate operations at the source. For example, with only one illicit CD plant out of business, most pirate CD producers—along with their means of production and their inventories—are still untouched. CD distributors, too, have largely escaped serious enforcement efforts. The NCA did order a team of 540 inspectors dispatched to all CD and LD factories nationwide to halt pirate production, but it took nearly a year for this January 1, 1996, action to be taken, and then, in a somewhat familiar pattern, this action seemed to come only in response to U.S. criticism and threats to renew sanctions.[125] More importantly, the practical effect of the order, if any, is as yet unknown. The NCA likewise has taken rather mild action on the videotape piracy front, fining just three Chinese factories for copying various American films.[126]

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120. *See* Barshefky, *supra* note 86, at 1.

121. *Id.* at 3.

122. *China Unable to End Copyright Piracy 'in Near Future'*, Agence France Press, Jan. 22, 1996, *available in* LEXIS, NEWS Library, AFP File.

123. *See* Barshefsky, *supra* note 86, at 3.

124. Jeffrey Parker, *China Touts Anti-Piracy Zeal in Face of U.S. Doubt*, Reuter Eur. Bus. Rep., Jan. 31, 1996, *available in* LEXIS, NEWS Library, REUEUB File. *See also Shanghai Reinforces Protection of Trademarks*, Xinhua News Agency, Jan. 29, 1996, *available in* LEXIS, NEWS Library, WIRES File (No. 0129132).

125. *China Launches Campaign*, *supra* note 83.

126. Nanjing Audio and Video Publishing House was found to have illegally copied *The Fugitive*, *In the Line of Fire*, *Hard Target* and *Striking Distance*; Guangdong Audio and Video Publishing House to have illegally copied *The Fugitive*; and Liaoning Radio and Television Publishing House to have illegally copied *Home Alone*. *China to Fine Pirates of the Movie 'The Fugitive'*, Reuter Asia-Pacific Bus. Rep., May 19, 1995, *available in* LEXIS, NEWS Library, REUEUB File; *China-U.S. Copyright Settled*, UPI, May 26, 1995, *available in* LEXIS, NEWS Library, UPI File.

*3. Intellectual Property Courts*

a. IPR Courts and Judges

Some progress has been made in the creation of a judicial mechanism for coping with piracy. Effective August 1993, an intellectual property division was established in Beijing Intermediate People's Court and empowered to hear cases concerning patent, trademark, and copyright (including computer software) infringement, as well as cases concerning licensing agreements and unfair competition law. The Beijing Intellectual Property Trial Division has exclusive jurisdiction for matters arising in the Beijing District, and other analogous trial courts have been established for other geographical areas. By early 1994, courts had been established in Beijing, Shanghai, Fujian, Xiamen, Shenzhen and Haikou,[127] and, as part of a flurry of enforcement activity associated with the April 30, 1994, USTR announcements, the Chinese established additional courts in the cities of Zhuhai, Shantou and Guangzhou, in Guangdong Province.[128] By January 1996, eighteen such courts had been established.[129] In addition, an intellectual property appellate division has been established in the Beijing Municipal Higher People's Court, which has exclusive appellate jurisdiction for the whole of China in much the same fashion as the United States Court of Appeals for the Federal Circuit has jurisdiction for the whole of the United States.

In theory, the Chinese have specially trained the judges of these courts in the various disciplines of intellectual property. In practice—on the Chinese view—the judges have fared extraordinarily well. Two senior Chinese judges, Yang Junqi and Jiang Zhipei, speaking on behalf of the intellectual property rights office of the Supreme's People's Court, have asserted that "in fact, China has set up a complete and effective judicial apparatus to protect intellectual property rights" and the Chinese courts have been "offering fair, effective protection of these rights, both domestic and foreign".[130] The West has been less sanguine. There has, in fact, been considerable skepticism regarding the competence of the judges, however well-intentioned they may be.[131]

Technical competence has become an issue because Chinese judges have sometimes appeared puzzled by the technical nature of the IPR facts before them. For example, in a 1994 case, the Hong Kong-based Broad Mind Computer Company sued the Beijing-based Hai Wei Electronic Engineering Company in Beijing Intellectual Property Court for software copyright infringment in making and selling copies of its CT-110 computer terminal.

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127. Ma Chenguang, *China: More Courts to Protect Trademarks and Patents*, CHINA DAILY, Mar. 29, 1994, *available in* LEXIS, WORLD Library, TXTLNE File.

128. Li Zhurun & Zhou Genliang, *China Steps Up Protection of Intellectual Property*, Xinhua News Agency, Apr. 26, 1994, *available in* LEXIS, NEWS Library, WIRES File (No. 0426164).

129. *IPR Laws Bolstered by Addition of Courts*, Xinhua News Agency, Aug. 23, 1995, *available in* LEXIS, NEWS Library, WIRES File (No. 0823047).

130. *Intellectual Property Rights Protection In China Effective*, Xinhua News Agency, Feb. 1, 1996, *available in* LEXIS, NEWS Library, WIRES File (No. 0201139).

131. "Scepticism over the ability of China's judicial system has been a major reason why many foreign companies have not brought their intellectual property cases to court in China. "'Foreign companies don't bother because they doubt Chinese courts' ability to try such cases in a fair manner,'" Dede Nickerson, *Progress in Moves to End Copyright Row*, SO. CHINA MORNING POST, Jan. 19, 1995, at 1 (citing anonymous source).

Despite an exceptionally clear demonstration in court that Hai Wei had pirated the Broad Mind software, the court lumbered almost aimlessly and appeared incompetent to deal with the case.[132] More generally, administrative and moral competence have been at issue, too. Chinese judges and court officers do not, it seems, always enjoy sufficient independence such that they are free of the meddling of interested parties, including government and Communist Party authorities; nor are they always free of self-interest.[133]

b. IPR Cases

To date, the Chinese court system has generated a notable, if still modest, number of IPR decisions, involving domestic as well as foreign parties. The more prominent domestic cases have involved patent and copyright infringement matters, some of which have even concerned the indigenous Chinese computer software industry. The first all-Chinese case concerning computer software piracy actually antedated the creation of the first intellectual property court by four months. Weihong Computer Software Institute was awarded Y46,000 (US$8,000) after it was found that Yuanwang Technical had secretly copied and sold translating and editing software created by Weihong.[134] In a later case, the Beijing IPR court ruled in favor of a leading Chinese software firm, SunTendy, in its suit against a Chinese pirate. SunTendy makes Chinese Star software which allows Chinese characters to be entered into computers running English language programs.[135] A third case concerned a dispute over the computer input method for Chinese characters known as the five-stroke system. The inventor of the system, Wang Yongmin, won Y500,000 (US$57,500) in compensation when the court supported his claim that Beijing-based China Southeastern Technology and Trading Company had pirated his patented invention.[136]

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132. In 1986, Broad Mind had begun working with a Beijing-based dealer, Talent Electronic Company, on the marketing of its terminals in China; by 1988 Broad Mind had realized substantial and profitable sales in China. But soon counterfeits were discovered on the Chinese market that were traced to Hai Wei, which was then a new company formed by four former Talent employees. According to one account of the trial,

> [t]he judges and court officials of the newly formed Intellectual Property Court have limited knowledge of intellectual property matters and even less knowledge of technical matters addressed in this case. An inordinate amount of time was spent educating the three judges on the technical issues. But they still did not have a clear understanding of how to compare the parties' source codes, and appear[ed] unable to render a decision and close the case.

*A Beijing Court Hears a Software Case, Testing Protection*, Economist Intelligence Unit: Bus. China, July 25, 1994, *available in* LEXIS, WORLD Library, EIUBC File. The judges "had previously worked in the regular Intermediate Court system and were apparently randomly assigned to the Intellectual Property Division. The expertise of the computer software registration officials—despite their presence in the courtroom—was underutilized. There was no formal procedure for calling upon their expert assessment." *Id.*

133. The integrity of Chinese court proceedings has been somewhat tarnished by incidents involving large cash transactions. For example, in one case, American business executives were instructed to pay US$18,000 for a filing fee to have their case heard. The money had to be paid in cash in U.S. currency, and submitted in a suitcase. *Chinese Steps Called Insufficient, supra* note 18.

134. *Copyrights: China Must Stop Growth of Piracy or Risk U.S. Sanctions, Official Says*, Pat. Trademark & Copyright L. Daily (BNA) (Oct. 15, 1993).

135. Jeffrey Parker, *China Software Firm Eyes Precedent in Piracy Case*, Reuter Asia-Pacific Bus. Rep., June 21, 1995, *available in* LEXIS, WORLD Library, REUAPB File.

136. Chenguang, *supra* note 127.

In a high-profile domestic patent case, Beijing Intermediate People's Court ordered Tangshan Fuhao Company to pay US$120,000 to Sun Yingui, to compensate for lost sales caused by its piracy of a popular mineral water dispenser.[137] In another patent infringement case, the Kangbao Electrical Applicances Factory, which invented a device to sterilize food bowls, filed suit against twenty factories, claiming they were illegally using its invention. On December 26, 1994, the Guangzhou Intermediate People's Court found the factories to be infringing Kangbao's patent and ordered them to cease the infringement, whereupon the twenty factories were closed down by provincial authorities.[138]

Decisons involving U.S. parties have been slow in coming, but the limited results to date have been encouraging for plaintiffs. In the early "M & M's" trademark case, Mars, Inc., sought and won an injunction restraining a Chinese firm from making and selling candies in China that infringed on the "M & M's" trademark.[139] More recently, in the California Beef Noodle case, an unfair competition suit was filed in Beijing Intermediate People's Court by U.S. Hongli International against Beijing West City Xingyan. The Court ordered Xingyan to stop using Hongli's registered name and trademarked red, blue and white color scheme, and to pay Hongli US$11,600 in damages and legal expenses, and US$400 in court costs.[140]

But the most visible of all U.S. suits filed in recent years have been those brought by Disney and by BSA. In the Disney copyright case, the Walt Disney Company filed a civil suit in the Beijing Intellectual Property Trial Court, in January 1994, against two Chinese companies for illegally publishing children's books using Disney cartoon characters. Disney claimed that the books were identical to a series produced under a Disney license with a different party that expired in September 1990, and estimated that 300,000 copies of the books were produced between 1991 and 1993. In July 1994 the court found the two companies liable: Beijing Children's Publishing Press for publishing pirated books, and Beijing Publishing Press for distributing copies. Under Chinese law, Disney could only seek actual damages from lost sales, not punitive damages.[141] Finally, in May 1995, three months after the signing of the 1995 Agreement, a Beijing IPR Court awarded Disney US$27,360 in damages and a public apology.[142]

In February 1994, one month after the Disney suit was filed, BSA, on behalf of Lotus Development Corp., Autodesk, Inc., Microsoft Corp. and

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137. Jeffrey Parker, *China Inventor Wins Million-Yuan Patent Judgment*, Reuters Bus. Rep., May 29, 1995, *available in* LEXIS, NEWS Library, REUBUS File.

138. *Guangdong Protects Intellectual Property Rights*, Xinhua News Agency, Jan. 11, 1995, *available in* LEXIS, NEWS Library, WIRES File (No. 0111059).

139. See Xu Lugang, *Trademark "M & M's" (1989)*, 1993 INTELL. PROP. CHINA 1 (1993).

140. *China Court Rules for California Beef Noodle King*, Reuters World Service, June 8, 1995, *available in* LEXIS, ASIAPC Library, REUWLD File.

141. Sally Gelston, *Intellectual Property Protection in China: New Criminal Penalties for Copyright Violators, Disney Wins Copyright Suit*, E. Asian Exec. Rep., July 15, 1994, *available in* LEXIS, ASIAPC Library, EASIAN File.

142. *'Mickey Mouse' Wins Copyright Case*, Xinhua News Agency, May 18, 1995, *available in* LEXIS, NEWS Library, WIRES File (No. 0518171). Only one week later, a court-mediated cash settlement was reached in the suit by U.S. publishers Prentice–Hall and Harcourt Brace. *See supra* text accompanying note 99.

Novell, Inc., filed a suit in the Beijing Intellectual Property Court against five Beijing computer firms (viz., Beijing Gaoli Computer Co., Beijing Sanhua Electronic Control Engineering Corp., Beijing Juren Computer Co., Huili Computer Operations Co., and Huiruan Computer Operator Co.) seeking damages, and claiming illegal copying and selling of software. The suit seemed to show no progress until June 23, 1994, a week before the deadline when China was to be designated a Priority Foreign Country, when the judge suddenly ordered the defendants to produce their financial accounts and other records, and a court-ordered raid was carried out on the defendants' premises to preserve evidence. The police confiscated, *inter alia*, 300 software programs published by BSA members.[143] The BSA cases then continued to languish[144] until October 1995, when suddenly the Court ruled in favor of BSA, and against Beijing Juren Computer Co. and Beijing Gaoli Computer Co., levying fines of up to US$60,000 and awarding damages as well.[145]

*4. Shortcomings of Available Penalties*

While the Chinese have amended their copyright law in keeping with the letter of the MOU, until July 1994, the law made copyright infringement only a civil, not a criminal, offense. This left a copyright owner who suffered infringement with no recourse but to make use of the administrative fine apparatus overseen by the National Copyright Administration. The copyright law called for fines to be imposed in the range of US$150 to US$11,500 or from two to five times the total fixed price of the lost sales of the legitimate product. But such fines did not appear to be applied broadly enough to act as an effective deterrent; nor were they substantial enough in every case to deter repeat offenses by those pirates whose ill-gotten gains may have made them comparatively affluent. Moreover, NCA could not impose fines itself absent the authority of a court order, nor could it make use of local police for enforcement purposes absent the weapon of criminal penalties. Just as the central government declined to provide the NCA with personnel resources adequate to enforcement needs, so, too, it declined to provide the criminal code resources that might have made for a more effective deterrent.[146]

However, only five days after the U.S. announced its decision to designate China a Priority Foreign Country on June 30, 1994, China's legislature, the National People's Congress, approved new criminal penalties for copyright violators. The new law—the Resolution on Punishing the Crime of Copyright Violations—went into effect on July 5, 1994, and added new provisions to China's 1979 Criminal Law providing for fines and jail terms of

143. *Intellectual Property Protection in China: New Criminal Penalties for Copyright Violators, U.S. Software Producers' Lawsuit*, E. Asian Exec. Rep., July 15, 1994, *available in* LEXIS, ASIAPC Library, EASIAN File.

144. IIPA, 1995 SPECIAL 301, *supra* note 19, at 5.

145. *BSA Triumphs in Legal Case Against Distributor in China*, SO. CHINA MORNING POST, Oct. 31, 1995, at Tech. 1; *Software Alliance Wins IPR Victory*, E. Asian Exec. Rep., Oct. 15, 1995, *available in* LEXIS, ASIAPC Library, EASIAN File. *See also* Barshefsky, *supra* note 86, at 4.

146. The February 22, 1993, amendment to the Chinese Trademark Law widened the grounds for imposition of criminal sanctions and substantially increased the criminal penalties for more serious trademark infringements (the maximum term of imprisonment for infringements was raised from three to seven years). *People's Republic of China: Rules Implementing Revised Trademark Law Enter into Force*, Pat. Trademark & Copyright L. Daily (BNA) (Oct. 13, 1993).

up to seven years for violators.[147] The new law is impressive on paper, as are the bulk of domestic IPR reforms initiated by the People's Republic since the 1992 MOU and the 1995 Agreement, and the Chinese have in typical fashion already made dramatic announcements of cases in which criminal penalties have been imposed.[148] However, there is nonetheless abundant skepticism in the international community as to whether the new criminal penalties will be effectively and broadly used to fight piracy.

*5. Inadequacies of Market Access*

If the Chinese more fully relaxed or lifted barriers to market participation by foreign IPR owners, those foreign owners could sell their own goods in China and thereby displace, at least to some extent, pirate products that now have Chinese markets to themselves. Moreover, absent such barriers, some U.S. producers could both sell their "authentic" products in the Chinese market, and also monitor, if not police, infringement themselves on an in-country basis. Such market access adjustments would have application in a number of areas. For example, prior to the 1995 Agreement, there were informal, non-transparent quotas on foreign recordings; and there was also a ban on foreign ownership of, and a ban on foreign minority interests in, joint venture companies established to produce and market recorded music.[149]

According to the Motion Picture Exhibitors Association of America, China has also had an unofficial, unwritten, "shadowy" system of quotas for films, video and television. The system has effectively excluded direct

147. The new law calls for confiscation of violators' illegal profits, as well as copied items and materials and tools involved in the piracy. Punishable crimes include the duplication, distribution and marketing of books, fine art, audio-visual products and computer software. If convicted of making "huge profits" for duplicating or distributing, an offender could be sentenced to up to three years in prison and fined; an offender convicted of making "extremely huge profits" could receive up to seven years in prison and fines, though the law does not assign monetary values to the categories "huge" and "extremely huge". Retail sellers are subject to jail sentences of one year less than those for makers and distributors of pirated material. If a company is the violator, top managers could be held responsible and could be sentenced and fined, and the company itself could also be subjected to fines. *Intellectual Property Protection in China: New Criminal Penalties for Copyright Violators*, E. Asian Exec. Rep., July 15, 1994, available in LEXIS, ASIAPC Library, EASIAN File [hereinafter *New Criminal Penalties*].

148. For example, on January 6, 1995, the Wuxi Intermediate People's Court sentenced Lu Ping, 31, to a life term in prison for pirating 689,000 volumes of 20 different books since July 1990, and for fraud, falsification of public seals and pimping. Jane Macartney, *China Sentences Book Pirate to Life in Jail*, Reuters World Service, Jan. 7, 1995, *available in* LEXIS, ASIAPC Library, REUWLD File. At about the same time, another Chinese pirate, Wu Wangsheng, was sentenced to seven years in prison for illegally publishing and selling 15,000 copies of the third volume of the selected works of Deng Xiaoping. *China Jails Man Who Pirated Deng's Works*, Reuters News Service-Far East, Jan. 20, 1995, *available in* LEXIS, NEWS Library, CURNWS File. In deciding a law suit originally brought by the International Federation of Phonographic Industries, Canton Municipal People's Intermediate Court convicted Su Qiuchun of selling counterfeit CDs. The court ordered him to spend nine months in jail and fined him US$6,024. *China Jails Man For Selling Fake CDs*, UPI, Aug. 5, 1995, *available in* LEXIS, NEWS Library, UPI File.

149. One U.S. company, Warner Music, had its application to form a company that would have recorded and marketed Chinese and international music in China rejected virtually out of hand. IIPA, 1994 SPECIAL 301, *supra* note 14, at 4. More recently, U.S. Senator Dianne Feinstein visited China and suggested that U.S. copyright holders be allowed to form joint ventures with Chinese pirate CD factories in order to help convert them to legitimate operations. Chinese officials bluntly rejected the proposal. *China Faults U.S. Export Curbs for Trade Gap*, Reuters No. Amer. Wire, Jan. 20, 1996, *available in* LEXIS, NEWS Library, WIRES File.

participation by foreign interests and been a fertile ground for pirate practices. Government monopolies have essentially controlled all aspects of the Chinese film industry, from production to distribution and exhibition, by way of the Ministry of Culture and related agencies. The China Film Distribution and Exhibition Bureau and its subsidiaries, in collaboration with the central government, have determined times, places, dates and terms under which films are shown in Chinese cinemas, and censorship has been performed by the Ministries of Culture, Information and Film, Televison and Radio.[150] Contrary to standard industry practice in most of the world, China until very recently refused to permit the licensing of foreign motion pictures in exchange for a percentage of gross receipts; instead, it imposed a flat sales scheme, demanding that it be allowed to pay US$3000 for rights in each film, a figure that is astonishingly modest by world standards. Moreover, all prints of films so licensed have had to be made in Chinese film laboratories according to the regulations of the China Film Bureau. Nor have the Chinese observed the conventional distinction between authorization for home as opposed to commercial use, which has led to the widespread Chinese practice of showing home-licensed videos in public displays.

On the other hand, access to the Chinese film market has improved somewhat; indeed, some improvement occurred even before the 1995 Agreement. For example, the Chinese government decided to officially import ten foreign films on a profit-sharing basis during 1995, despite objections from the domestic Chinese film industry. The first of these was *The Fugitive*, the gross revenues for which were US$2.3 million for the first five months of 1995. This film, too, was pirated and the responsible parties were fined. But despite the fines, the importers of the film, China Film Import and Export Corporation, and the film's American producer, Warner Brothers Pictures, filed suit in Beijing IPR court over the infringement in a case that is still pending.[151]

But the 1995 Agreement mandated changes in China's international trade regime designed to enhance market access for U.S. IPR producers *significantly*, and yet precious little progress has been made on reaching this objective. For example, the Chinese have failed to issue regulations governing joint ventures for motion pictures or recording industry companies, despite a clear requirement to do so stated in the 1995 Agreement.[152] According to the USTR, even though the Chinese have "given every indication that they intend to honor their commitments on market access", they have achieved little to date in this regard, and continue their practices of using "informal quotas", "slow censorship approval rates", "censorship as a market access barrier", and "prohibitively high taxation and tariff rates for video products in particular".[153] Worse still, they have even indulged in retrograde practices: they have invented a "50 percent 'royalty tax'" which is being incorporated into the published tariff rate for sound recordings and video cassettes, and written new investment

150. MPEAA, 1993 TRADE BARRIERS REPORT, at S.12, *supra* note 90.

151. *China to Fine Pirates of U.S. Film 'The Fugitive'*, Reuter Asia-Pacific Bus. Rep., May 19, 1995, *available in* LEXIS, WORLD Library, REUAPB File; *China-U.S. Copyright Settled*, UPI, May 26, 1995, *available in* LEXIS, NEWS Library, UPI File.

152. *U.S. Threat of China Sanctions Could Top $1 Billion, Kantor Says*, Int'l Trade Daily (BNA) (Jan. 24, 1996).

153. *See* Barshefsky, *supra* note 86, at 4.

regulations which "prohibit direct investment in the audiovisual sector" as well as in distribution, and movie theater construction.[154] In addition, the Chinese Ministry of Trade is attempting to interpret the 1995 Agreement in such a way as to require, contrary to the intentions of the U.S. signatories, U.S. software companies to form joint ventures and transfer technology.[155]

## III. CULTURAL EXPLANATIONS OF LAX ENFORCEMENT

Why have the Chinese failed to meet their enforcement obligations under the MOU and the Enforcement Agreement? How have they managed to go so far toward satisfying much of the letter of the MOU while seemingly turning a blind eye to its spirit? Many will find important causal factors in ignorance, poverty, lack of human resources, lack of know-how, official corruption, customary practices, and lack of private property traditions.[156] More generally, these factors will be grouped under the rubrics of "culture" and "cultural differences" and offered as a master explanation of the Chinese tendency to deviate widely from the rule-governed behavior that is the basic assumption of the 1992 MOU and the 1995 Enforcement Agreement in favor of actions that, by Western lights, amount to lawlessness.[157] In its simplest terms, the chief thrust of the explanation from culture is that China has historico-cultural roots that are profoundly different from our own, and that, therefore, we cannot enter into agreements based almost exclusively on our own complex theories of property, with all of the alien economic and cultural baggage they entail, with any reasonable expectation that they will succeed. As Professor William Alford puts it, "laws premised on the values and institutions of an economically advanced capitalist democracy will not generate identical results when transplanted to a different setting. Rules that presume an independent judiciary, a professionalized bar, powerful interest groups and a rights-conscious populace fall chiefly on deaf ears in contemporary China."[158] Put in a somewhat different way, in the words of an official Chinese government spokesman,

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154. *Id.*

155. *Id.*

156. For North-South perspectives on enforcement and IPRs generally, see Frederick M. Abbott, *Protecting First World Assets in the Third World: Intellectual Property Negotiations in the GATT Multilateral Framework*, 22 VAND. J. TRANSNAT'L L. 689 (1989); Carlos Alberto Primo Braga, *The Economics of Intellectual Property Rights and the GATT: A View from the South*, 22 VAND. J. TRANSNAT'L L. 243 (1989); David Hartridge & Arvind Subramanian, *Intellectual Property Rights: The Issues in GATT*, 22 VAND. J. TRANSNAT'L L. 893, 904–05 (1989); Robert E. Hudec, *GATT and the Developing Countries*, 1992 COLUM. BUS. L. REV. 67; *Intellectual Property Issues North and South: Proceedings of the 81st Annual Meeting*, 81 AM. SOC'Y INT'L L. PROC. 1, 9–16 (1987); Robert W. Kastenmeier & David Beier, *International Trade and Intellectual Property: Promise, Risks and Reality*, 22 VAND. J. TRANSNAT'L L. 285 (1989); M.M. Kostecki, *Sharing Intellectual Property Between the Rich and the Poor*, 8 EUR. INTELL. PROP. R. 271 (1991); Hans Peter Kunz-Hallstein, *The United States Proposal for a GATT Agreement on Intellectual Property and the Paris Convention of Industrial Property*, 22 VAND. J. TRANSNAT'L L. 265 (1989); J.H. Reichmann, *Intellectual Property in International Trade: Opportunities and Risks of a GATT Connection*, 22 VAND. J. TRANSNAT'L L. 747 (1989); ROBERT E. HUDEC, DEVELOPING COUNTRIES IN THE GATT LEGAL SYSTEM (1977); *GATT: Indian Proposal Says Developing Countries Should Get Patent, Trademark Concessions*, 6 Int'l Trade Rep. (BNA) No. 29, at 953 (July 19, 1989).

157. For a Chinese perspective that is strikingly Western in its orientation, see Li Maoguan, *Why 'Laws Go Unenforced'*, BEIJING REV., Sept. 11, 1989, at 17.

158. William P. Alford, *Pressuring the Pirate*, L.A. TIMES, Jan. 12, 1992, at M5.

> [t]here are historical reasons for such a state of affairs. As the feudal or semifeudal or semicolonial society lasted for a considerably long period in China, people have been confined by feudal ideas for a long time. Compared with Western countries, democracy and a commodity economy developed relatively slowly in China. As IPR is [sic] an outcome of a market economy, China simply did not have the basic conditions for the "IPR" concept before the end of the 19th century.[159]

To give a somewhat fuller account of the explanation from culture in the Chinese context, I shall briefly sketch some features of Chinese Confucianism that bear upon one or another dimension of MOU enforcement.

### *A. Chinese Culture: Confucianism and Legalism*

In its purest form, the thesis that China is fundamentally at odds with the Western Rule of Law tradition argues that Chinese society is not and essentially never has been devoted to or guided by the concept of law as it is known in the West. In place of Western-style law, the Chinese rely on a notion of personal relationship associated with the concept of *li*. The concept, though it is widely identified with the teachings of Confucius (551–479 B.C.), antedated him and appears to have been established in Chinese bureaucratic thought and the larger culture during the Western Zhou Period (1122–771 B.C.), if not before.[160] What I will call the "Confucian" perspective turns on the concept of *li*, particularly as it stands in opposition to the concept of *fa*. But where the concept of *li* is identified with Confucius' work, the concept of *fa* is associated with the work of the Chinese Legalist philosophers and the harsh rule of the Qin dynasty in the third century B.C. Put in concise, if misleadingly simple, terms, *li* is associated with propriety and moral force, while *fa* is associated with physical force and law, though the concept of law here invoked includes only a limited subset of the meanings of the word "law" in English.[161]

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159. *China Defends Its Record*, *supra* note 5 (remarks of Shen Rengan, Deputy Director of the State Copyright Administration).

160. *See* William P. Alford, *The Inscrutable Occidental? Implications of Roberto Unger's Uses and Abuses of the Chinese Past*, 64 TEX. L. REV. 915, 930 (1986) (citation omitted). On the Western Zhou generally, see CHARLES O. HUCKER, CHINA'S IMPERIAL PAST: AN INTRODUCTION TO CHINESE HISTORY AND CULTURE 30–40 (1975); Frank A. Kierman, *Western Zhou: Founding and Founders*, *in* THE CAMBRIDGE ENCYCLOPEDIA OF CHINA 145–46 (Brian Hook & Denis Twitchett eds., 2d ed. 1991).

161. The name Confucius is a latinization of the Chinese Kungfuzi ("venerable master Kung"), and Confucianism is the name of the philosophy or school of thought which was dominant through most of the history of imperial China (221 B.C.–1912 A.D.). Born near Qufu, in the state of Lu (modern day Shandong province), Confucius was probably a minor court official there for much of his life, though for perhaps 13 years he traveled widely promoting his philosophy. While he enjoyed no significant notoriety in his lifetime, his teachings are generally believed to have been compiled by his students and survive in the Analects ("Lunyu"). *See* THE ANALECTS OF CONFUCIUS (Arthur Waley trans., 1938). When Confucius was born in 551 B.C., the Zhou dynasty, which originated in roughly the twelfth century B.C., was in decline but Confucius set out to restore ancient Zhou values. He did this by venerating the Duke of Zhou—the founder of the dynasty—and by reviving ancient ceremonies and rituals known as *li*. After Confucius died, his philosophy survived but only as one of many that found limited recognition during the Warring States period, when the rulers of various states sought to control the whole of the Chinese world. China was finally integrated in 221 B.C. by the state of Qin, which had adopted the philosophy of Legalism, but Qin control quickly collapsed in 206 B.C., and the Han who succeeded them were partial to Confucius. In a gesture that set the stage for the pervasive influence of Confucianism in Chinese culture for the next 20 centuries, the Han emperor declared in 59 A.D. that sacrifice should be made to Confucius and to the Duke of Zhou. On Confucius, see JOSEPH NEEDHAM & WANG LING, *The*

*1. The Concept of* Li

The concept of *li*, when narrowly construed refers to proper conduct, or politeness or etiquette; more broadly construed, it refers to the whole range of political, social and familial relationships that are the underpinnings of a harmonious Confucian society.[162] Those who are guided by *li* stand ready to adjust their views and demands in order to accommodate the needs and desires of others, and they demonstrate this by yielding to others for the sake of harmony when confrontation and conflict arise. When all parties to a dispute endeavor to make concessions, the necessity for litigation and the promotion of individual rights are both avoided. Individual interests are subordinated to the interests of the group such that one who, to the contrary, insists on individual rights is very much at odds with *li* and with the group as well. "The proper disposition with regard to one's interests," writes Benjamin Schwartz, "is the predisposition to yield rather than the predisposition to insist."[163] *Li* thus tends to lead naturally to compromise and mediation framed not in terms of a legal proposition or requirement but in terms of the circumstances of the participants. As Alice Tay puts it, "Chinese tradition personalizes all claims, seeing them in the context of social human relationships."[164]

*2. Social Roles and the Five Relations*

The "relationships" of Confucian society consist of connections between various types of political, social and familial roles. The roles are also normative, embodying prescriptions that tell those who play the roles how they ought to act when playing them. Thus, the role of father embodies a norm of proper fatherly behavior; the role of friend embodies a norm of friendship; and similarly, other norms are expressed for the other fundamental roles of wife, child, ruler, subject, elder brother and younger brother. Eventually, Confucianism reduced all relationships to a finite set of fundamental relationships that were presumed to be exhaustive, the so-called Five Relations which obtained between father and child, husband and wife, elder and younger brother, ruler and subject, and friend and friend. The *li* expressed the rules of conduct involved in all of these basic relationships, and, at bottom, the *li* were

*Ju Chia (Confucians) and Confucianism, in* 2 SCIENCE AND CIVILISATION IN CHINA 3–32 (1977); FUNG YU-LAN, 1 A HISTORY OF CHINESE PHILOSOPHY: THE PERIOD OF THE PHILOSOPHERS 43–75 (Derk Bodde trans., 1952); HERRLEE CREEL, CHINESE THOUGHT: FROM CONFUCIUS TO MAO TSE-TUNG (1953); JOHN KING FAIRBANK, THE UNITED STATES AND CHINA 53–74 (4th ed. 1983); LUCIAN PYE, CHINA: AN INTRODUCTION 30–56 (1972); Ian McMorran, *Confucianism, in* THE CAMBRIDGE ENCYCLOPEDIA OF CHINA, *supra* note 160, at 301–04.

162. In its narrowest construction, *li* is associated with the proper performance of ancestral sacrifices and other religious rituals. In fact, sinologists believe that *li* developed in conjunction with rituals that accompanied religious observances and sacrifices; the rituals were conducted by an elite class, so *li* regulated the behavior of members of the class, and eventually regulated behavior in the general population. Alford, *supra* note 160. Thus, beyond rituals, *li* embraces every kind of ceremonial and polite behavior, religious and secular, and embodies rules for relationships as diverse as getting married and entering into battle. *See* BENJAMIN SCHWARTZ, THE WORLD OF THOUGHT IN ANCIENT CHINA 67–75, 151–56 (1985). *See also* DERK BODDE & CLARENCE MORRIS, LAW IN IMPERIAL CHINA 19 (1967).

163. Benjamin Schwartz, *On Attitudes Toward Law in China, in* GOVERNMENT UNDER LAW AND THE INDIVIDUAL (Milton Katz ed., 1957), *reprinted in* JEROME A. COHEN, THE CRIMINAL PROCESS IN THE PEOPLE'S REPUBLIC OF CHINA, 1949–1963: AN INTRODUCTION 62, 65 (1968).

164. Alice Tay, *The Struggle for Law in China*, 21 U. BRIT. COL. L.R. 561, 562 (1987).

about the obligations between parties to relationships. Writes William Alford:

> The *li* in their most rigid pre-Confucian form clearly envisioned a hierarchical world, not only along class lines...but also along those of gender and age. They also, however, clearly provided that the person who enjoyed the loyalty or support of others by virtue of holding a superior position—be it socially, politically or in the family—owed a commensurate obligation to those providing that loyalty or support.[165]

*3.* Fa *and the Rule of Law*

It is typically assumed that when government leans heavily on *fa* to reinforce its authority, it does so because it has no effective ability to rule by *li*. *Fa*, in contrast to *li*, is a penal concept; it is associated with punishment,[166] serving to maintain public order through the threat of force and physical violence. The intellectual roots of *fa* are in the Legalist movement—a group of political philosophers primarily active in the China of the fourth and third century B.C., who held that social order could only be maintained by the use of law as a tool for manipulating society.[167] The Qin dynasty adopted the Legalist philosophy and effectively integrated and centralized the whole of the Chinese Empire in the third century B.C. (221–209 B.C.). The Qin ruled with the aid of a harsh penal law and brutal tactics, and developed a vast administrative law bureaucracy to manage the empire they had created. They thus shaped an image of the "rule of law" as brutal and rigid, and that image endured throughout the greatest period of Confucian influence from the first century A.D. to the development of civil-law criminal codes during the late nineteenth-century portion of the Qing dynasty (1644–1912 A.D.) and the beginning of the Republican period following the 1912 revolution, when the last incarnation of those codes was enacted. As for comparing *fa* to *li*, the Confucius of the Analects said "[g]overn the people by regulations, keep order among them by chastisements, and they will flee from you, and lose all self-respect. Govern them by moral force, keep order among them by ritual and they will keep their self-respect and come to you of their own accord."[168]

*4. Magistrates, the Legal Profession and Extra-Legal Procedures*

The penal character of Chinese law led to a general neglect, or at best a limited interest in, such civil law matters as contract, marriage, inheritance and, most importantly for IPR purposes, property rights.[169] By contrast, acts of impropriety or criminal violence tended to upset social harmony which had to be restored through the punishment of the perpetrator. Generally, the law

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165. Alford, *supra* note 160, at 931 (citations omitted).

166. *Fa* has in fact become a synonym for punishment; however, in pre-imperial China the ideogram had many meanings, including not only law, but model, method, technique, rule and regulation. Alford, *supra* note 160, at 939 n.184; SCHWARTZ, *supra* note 162, at 321–22.

167. The expression *fa chia* (school of *fa*) refers to various Chinese thinkers loosely grouped under the Legalist rubric, such as Guang Zhong (d. 645 B.C.), Shang Yang (d. 338 B.C.), Han Fei (d. 233 B.C.) and Shen Buhai (d. 337 B.C.). On the Legalists, see Angus Graham, *Legalism, in* THE CAMBRIDGE ENCYCLOPEDIA OF CHINA, *supra* note 160, at 312–13; Joseph Needham & Wang Ling, *Legalists, in* 2 SCIENCE AND CIVILIZATION IN CHINA 204–15 (1977); SCHWARTZ, *supra* note 162, at 34–36; Alford, *supra* note 160, at 939 n.184. Professor Herrlee Creel argues that Shen was not a Legalist. *See* HERRLEE CREEL, SHEN PU-HAI: A CHINESE POLITICAL PHILOSOPHER OF THE FOURTH CENTURY B.C. 135–62 (1974).

168. 2:3 THE ANALECTS OF CONFUCIUS, *supra* note 161, at 88.

169. *See* BODDE & MORRIS, *supra* note 162, at 3–4.

operated not between two individuals with the state acting as an intermediary, but rather between an individual and the state. Persons who had suffered injury brought complaints to the state which would then determine whether to act against the offending party; injured individuals never brought claims directly against offending parties nor could they secure legal assistance or expertise from lawyers since there was no formal legal profession that could aid individuals. Typically, an injured party brought a complaint to a magistrate at the district or county level who had wide ranging administrative responsibilities, including "the collection of taxes, the maintenance of public order, and the investigation, prosecution and adjudication of criminal matters".[170] The magistrate, acting as judge and prosecutor, typically had no legal training, but was assisted by an unofficial secretary who was often familiar with the relevant laws and rules and was able to organize trials, propose sentences and write case reports.[171]

The magistrate structure was the device through which the formal system of law figured into the life of the average Chinese, but it was quite distinct from the web of social relationships that gave expression to *li* and effectively shaped behavior in Confucian China. Those relationships included one's extended family and lineage; one's non-blood relatives or extended "family" acquired through friendship; the trade association, guild or crafts group to which one might belong; and the collection of sages in one's community or within one's social circles. The advice, opinions, criticism, mediation efforts and general normative influence of persons in those relationships tended to be the anchor of local society. If conflicts or controversies arose, they were resolved not by the meager formal legal apparatus provided by the Emperor, but by elements of the social court of Confucian society, through the functioning of what are sometimes called "extra-legal procedures".[172] This orientation toward community norms rather than formal law also betrays a deep skepticism toward formal law, its methods of dispute settlement, and especially its outcomes.[173] The extra-legal system, by contrast, had the pragmatic virtue of promising and delivering results since it had the respect of the participants and was built on a deep, local knowledge of the issues and disputants, as well as a powerful drive to restore and maintain community harmony.

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170. William P. Alford, *Of Arsenic and Old Laws: Looking Anew at Criminal Justice in Late Imperial China*, 72 CAL. L. REV. 1180, 1192 (1984).

171. *See* BODDE & MORRIS, *supra* note 162, at 5. The relevant laws and rules "prescribed an inquisitorial mode of adjudication that encompassed little of what we see today as fundamental procedural 'due process'. Persons accused of crimes were not presumed to be innocent; nor were they entitled to notice, either of the law or of their alleged crimes." Alford, *supra* note 170, at 1194 (citations omitted). They were not permitted to consult during trial with unofficial legal counselors known as "litigation tricksters"—persons informally educated in legal matters who prospered by, for example, preparing petitions for litigants—nor were they permitted to refuse to answer the magistrate's inquiries. "Indeed, magistrates were permitted to apply torture in order to secure confessions. And neither the evidence gathered nor the reports prepared by the magistrate at trial's end were necessarily made available to the accused." *Id.*

172. *See* BODDE & MORRIS, *supra* note 162, at 5–6.

173. As Chinese proverbs indicate, in the formal system one would likely lose one's case even if nominally winning ("Win your lawsuit and lose your money") and the legal reasoning would likely be obscure ("Of ten reasons why a magistrate may decide a case, nine are unknown to the public"). *Id.* at 6.

### *B. Chinese Decision Making*

One cannot, of course, take exception to the self-evident proposition that the roots of culture in China and the West have been growing separately for centuries and only very recently, only in the last two centuries, have begun to have significant contact and grow together in some limited sense. But one must object to the central assumption of the explanation from culture that the difference in cultures, profound though it may be, necessarily precludes the production of MOU results of the sort that the governments of the U.S. and, presumably, China wish to see. Enforcement does not require the two cultures to become one; it is of no consequence whether the Chinese conceptually resist or ultimately adopt wholesale the Western values and institutions on which the MOU is based as long as the agreed-upon MOU objective—appropriate enforcement—is realized.

In this regard, I take one basic, and by now familiar, U.S. task to be that of investigating Chinese decision making processes on the assumption that if those processes are well enough understood, it may be possible to find effective ways to influence them, thereby enhancing enforcement. If the explanation from Chinese culture is relevant to this project, it will continue to figure prominently in, and indeed may well remain an important element of, accounts of Chinese decision making in the IPR area; if other considerations, such as economic ones, provide more powerful means of explaining and predicting Chinese behavior, they may displace, or at least complement, culture in such decision making accounts and lead perhaps to net gains in IPR enforcement levels.[174]

In this discussion, I shall use the expression "decision making consciousness" to refer to processes of thought and rational calculation about future behavior on the part of Chinese intellectual property actors. The point of studying decision making consciousness in this context is to establish a framework for determining the extent to which certain kinds of normative considerations—cultural, economic or legal—play a causal role in decision making and thereby actually help shape the behavior of actors. Thus, in some cases, for a given norm *N*, a Chinese intellectual property actor *C*, and a

174. For some economic accounts of Japanese actions that are typically characterized in cultural terms, see J. Mark Ramseyer, *Legal Rules in Repeated Deals: Banking in the Shadow of Defection in Japan*, 20 J. LEGAL STUD. 91 (1991), and Mark West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 NW. U. L. REV. 1436 (1994). William Alford sounds a wise cautionary note to those engaged in the theoretical analysis of Chinese and other foreign cultures: "[I]t is incumbent upon all of us in the field of comparative law—and particularly those of us who focus upon non-Western legal systems—to resist the pressure, often emanating from well-meaning colleagues, to approach distant cultures armed with or in search of 'grand theory'." *See* William P. Alford, *On the Limits of "Grand Theory" in Comparative Law*, 61 WASH. L. REV. 945, 946 (1986). Alford does not suggest that "we should avoid bringing our own values to bear in evaluating foreign legal systems, even if we could do so," but rather is concerned that

> our efforts at engaging in broad theoretical work may unwittingly lead us to believe that we are considering foreign legal cultures in universal or value-free terms when, in fact, we are examining them through conceptual frameworks that are products of our own values and traditions, and that are often applied merely to see what foreign societies have to tell us about ourselves.

*Id.* In this regard, I should make clear that my focus in the present work is strictly on explanation and prediction. I make no claim that this discussion considers China in universal or value-free terms, only that it may enhance our ability to explain Chinese decision making, and thereby predict Chinese behavior in hopes of improving IPR enforcement in the PRC.

piracy-related action *A*, we will be able to say that *C* performed *A* in part because of *N*. In such cases, *C* has a belief about *N* and acts on the basis of that belief. Where *N* is a legal norm, *C* believes that the law works in a certain way—that it requires certain conduct of him—and that fact is important in *C*'s decision to perform (or refrain from performing) *A*. Similarly, where *N* is a cultural norm, *C* will have beliefs about customary practices in the community and those beliefs will play a causal role in *C*'s decision to perform or refrain from performing *A*. And where *N* is an economic norm, *C* will have beliefs about the economic desirability of a given action *A*, and will perform or refrain from performing *A* partly on the basis of those beliefs. The intellectual property actors here may be bureaucrats or pirates or consumers or others whose behavior bears in some fashion on the enforcement concerns at issue in the MOU. For any given piracy-related event in which *C* participates, *C*'s behavior will be consistent or inconsistent with *N*. Consistent or not, we can ask whether *C* was aware or not aware of *N*. If *C* was aware, we can ask whether *C* acted because of *N*, or despite *N* or with indifference to *N*.

### *C. Lingering Confucian Influences*

Since Confucius has been alternately reviled and embraced in China under the Communists, it is perhaps not surprising that many Confucian habits have not only survived but prospered in the post-1979 China of Deng's reforms.[175] The personal relationship or connection, what the Chinese call *guanxi*, remains central in interpersonal, bureaucratic and commercial dealings in China today. The Chinese do not necessarily care to be bound by the fetters of law as they appear, for example, in the written language of contract, or in precise codifications of terms or individual rights and responsibilities. They prefer instead to remain flexible, free to adjust their views from time to time as befits unfolding circumstances in light of the needs of their ongoing personal relationships.[176] To many, the shifting sands of "flexibility" and ad hoc adjustments are synonomous with a host of corrupt business practices, and the opportunism, rent-seeking and shirking that are endemic in the state industries and administrative bureaucracies of Communist China.[177] To the extent that the rule of law is antithetical to such practices, *fa* remains in low esteem, and the concept of *li*, as regards the centrality of personal relationships, endures as a

175. On attitudes of the Chinese Communists toward Confucius, see, for example, FOX BUTTERFIELD, ALIVE IN THE BITTER SEA 69, 330 (1982); NIEN CHENG, LIFE AND DEATH IN SHANGHAI 437–38, 458 (1986); CREEL, *supra* note 161, at 235–57; NICHOLAS KRISTOFF & SHERYL WUDUNN, CHINA WAKES: THE STRUGGLE FOR THE SOUL OF A RISING PEOPLE 318–22 (1994); PERRY LINK, EVENING CHATS IN BEIJING: PROBING CHINA'S PREDICAMENT 160, 192–93 (1992); PYE, *supra* note 161, at 342–58; Franz Schurmann, *Party and Government, in* COMMUNIST CHINA 116–17 (Franz Schurmann & Orville Schell eds., 1967); JONATHAN SPENCE, THE SEARCH FOR MODERN CHINA 635–37 (1990); ANNE THURSTON, ENEMIES OF THE PEOPLE 277–78 (1987); Christopher Wren, *A Return to the Thoughts of Confucius*, N.Y. TIMES, Oct. 14, 1984, at 4:7.

176. It has been precisely such notions of flexibility that have so rankled foreign investors in China since 1979 and led to demands for transparency in trade regulations, and, in the case of the U.S., to the market access provisions of the 1995 Agreement, and the signing of a separate MOU with China on market access. *See supra* note 4 and accompanying text.

177. On the structure of the Chinese bureaucracy under Deng's reforms, see BUREAUCRACY, POLITICS AND DECISION MAKING IN POST-MAO CHINA (Kenneth Lieberthal & David Lampton eds., 1992). On corruption in contemporary China, see Helen Kolenda, *One Party, Two Systems: Corruption in the People's Republic of China and Attempts to Control It*, 4 J. CHINESE L. 187 (1990).

guiding principle of Chinese social and economic life.

Thus, as regards lax IPR enforcement, the explanation from culture teaches us that the MOU and its attendant domestic law reforms are undermined by a basic Chinese distrust of the formal law upon which enforcement might be predicated, a contempt for the promotion of individual rights of copyright owners at the expense of ongoing personal relationships and "harmony" in the community, and a continuing desire to be able to adjust one's enforcement behavior as regards the rule of law on an ad hoc basis. To the NCA field officer or local proxy, for example, it may be far more worthwhile, and sometimes literally more lucrative, to build a good ongoing relationship with the owner of the local pirate compact disc plant, than to enforce a law whose ultimate effects on the local community may be devastating in terms of loss of jobs and prosperity. This will be all the more true when, as is frequently the case in China, the owner or part-owner of the plant is a government or party official, or the relative of such a person; or a government unit; or a military unit; or even a police unit in charge of raiding pirate factories.[178]

*N* is here a cultural norm (personal relationships and community harmony should be of central significance). *C* (the NCA enforcer) has beliefs about customary practices in the community (personal relationships override rules of law) and those beliefs play a causal role in *C*'s decision to perform or refrain from performing *A* (*C* refrains from enforcing applicable copyright laws while servicing the needs of personal relationships and maintaining community harmony). In such a case, the violating pirate effectively circumvents the rule of law by building a personal friend-to-friend relationship with its official representative. The NCA enforcer or the local proxy sees his role as designed not to do his local part to enhance the application of a system of law on a national scale, but to "adjust" the enforcement of a particular rule even to the point of ignoring it in favor of superior needs that may emerge out of local circumstances.

## IV. ALTERNATIVE EXPLANATIONS

### *A. An Explanation from Economics*

I want now to turn to an alternative view, one that is not wholly

178. The Shen Fei Laser Optical Systems plant in the Shenzhen Special Economic Zone is believed to be owned by a man whose niece is married to the son of Chinese Premier Li Peng. IIPA, 1993 SPECIAL 301, *supra* note 15, at 5. More generally, the links are believed to be extensive between many of the pirate operations and local governments, Communist Party officials or their relatives, and, in some cases, businessmen and organized crime figures in Taiwan and Hong Kong. *See* Philip Shenon, *Chinese Accused of Pirating Disks*, N.Y. TIMES, Aug. 18, 1994, at D1; Geoffrey Crothall, *Close All Pirate CD Factories, US Insists*, SO. CHINA MORNING POST, July 22, 1994, at Business 1, *available in* LEXIS, NEWS Library, SCHINA File; Waller, *supra* note 111; Chan Wai-Fong, *Resistance to Moves Against CD Piracy*, SO. CHINA MORNING POST, July 25, 1994, at Cables 9, *available in* LEXIS, NEWS Library, SCHINA File; Nick Rufford, *Pirate CDs Flooding Markets*, SO. CHINA MORNING POST, Feb. 7, 1994, *available in* LEXIS, NEWS Library, SCHINA File; Jane Macartney, *Sino-U.S. Talks Begin On Averting Trade War*, Reuter News Serv.-Far East, Jan. 18, 1995, *available in* LEXIS, NEWS Library, TXTNWS File; Ruth Youngblood, *China Fights Trademark Abuse*, UPI, Apr. 12, 1994, *available in* LEXIS, NEWS Library, UPI File; *No U.S.-China Talks Underway So Trade Sanctions Against China Likely*, Int'l Bus. & Fin. Daily (BNA) (Dec. 29, 1994), *available in* LEXIS, NEWS Library, BNAIBF File; Sanger, *supra* note 19; Seth Faison, *supra* note 86.

incompatible with the Confucian explanation from culture, but which sees a different set of motivations, a different rationale at work in the Chinese IPR decision maker. The alternative is based on an explanation from economics.[179] My assumption is that by mapping a modest set of economic concepts onto the phenomenon of Chinese piracy, we will be better able both to explain what has happened and to predict what will happen if various actions are taken by public and private intellectual property actors in China and the United States.

*1. Making Decisions on the Basis of Costs and Benefits*

Now let *N* stand for an economic norm. A Chinese actor, *C*, has beliefs about the economic desirability of an action, *A*, and performs or refrains from performing *A* partly on the basis of those beliefs. The economic desirability of *A* is determined by its relative costs and benefits as determined by *C*. In this way, *C* makes a calculation, explicitly or otherwise, of the relative value of each possible action, whatever its content. *C*'s behavior is rule-governed insofar as *N*, the economic norm, consists of a rule which says that *C* should generally prefer and therefore perform the action that promises to bring greatest benefit to *C* at the least cost relative to other possible actions. I assume that if *C* is rational, and not suffering from weakness of the will,[180] *C* will, other things being equal, follow the rule of *N*. To the extent that *C*'s behavior does follow the rule of *N*, in the sense that *N* plays a causal role in bringing *C*'s actions about, the behavior will be rule-governed and to that extent nomological.

In this framework, however, the economic norm *N* cuts across other norms, including legal and cultural norms. That is, any action can be, and theoretically will be, valued in terms of costs and benefits to *C* even though the action on its face might concern, not the conduct of an economic transaction per se, but perhaps enforcing or declining to enforce a rule of law or maintaining or failing to maintain expected standards of friendship. In this way, the explanation from economics is not incompatible with other explanations, such as explanations from culture or law. When performing an action *A*, the actor *C* might describe the action in cultural terms (I am maintaining a personal relationship) while another might describe it in purely economic terms (*C* is creating future benefits for himself while giving present benefits to another with whom he expects to have an on-going exchange relationship) or legal terms (*C* is ignoring his duty to enforce the copyright law of the PRC).

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179. On the relationship between intellectual property and tangible property within the theoretical framework of the economic analysis of law, see RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 38–45 (4th ed. 1992), and William Landes & Richard Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 266–68 (1987); for valuable introductions to law and economics, see, generally, POSNER, *supra*, and A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS (1983).

180. Weakness of the will ("akrasia") occurs when, for example, *C* wants to *A*, *C* believes that *C* is able to *A*, and perhaps *C* even believes *C* should *A*, but ultimately *C* does not *A*. On "continence" and "incontinence", see ARISTOTLE, VII NICHOMACHEAN ETHICS (Richard McKeon ed., 1941). For the classic statement of the view that individuals behave rationally to maximize their utility, see JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES AND MORALS OF LEGISLATION 2 (Laurence J. Lafleur ed., 1948) (1789).

*2. Some Economic Underpinnings of Intellectual Property*[181]

Perhaps the most striking feature of the problem of intellectual property piracy is that in most cases the original products which are being pirated—movies, books, musical recordings, computer software, pharmaceuticals, well known brand names—are expensive to create but very inexpensive to copy. A movie might cost its producers US$50 million to make, and another $50 million to market, but making an illicit copy will cost little more than the price of a blank videotape, a little electricity and a few moments on some videorecording equipment. This is the "public good" aspect of intellectual property. Once an item of intellectual property is publicly available, it becomes relatively easy and cheap for users to make copies of it, whether authorized or not. If such users become retail pirates and begin selling their copies, they can make a profit simply by selling at a price barely greater than the cost of copying. The original producer, on the other hand, must recoup the costs of creation as well as copying, and so must sell the product at a price which covers those costs, and must sell at a still higher price to make a profit.

Thus, there will typically be a considerable gap between the retail prices of the pirate and legitimate products which will enable the pirate to capture market share from the legitimate producer. This creates a downward market pressure which can ultimately reduce retail prices to nearly the cost of copying. In such a circumstance, the original producer can neither recoup the costs of creation, nor enjoy a profit. He may also be denied some measure of other ancillary benefits such as developing relationships with promoters, distributors and other commercial intermediaries; he may even suffer additional costs if, for example, his reputation is tarnished when his firm is erroneously assumed to be the source of inferior pirate products. In the aggregate, illicit copying creates a powerful disincentive to innovation: why should I invest money, time and creative energy in a project that is unlikely to bring net benefits?[182]

The leading solution to the general problem is the creation and enforcement of intellectual property rights. These will, in theory, safeguard incentives by safeguarding profits and thus promote creativity. But while systems of such rights prohibit others from making unauthorized copies of a legitimate owner's work, they are not cost-free. For example, to be effective they tend to require the creation of a fairly elaborate and expensive system of administration and enforcement; the Chinese experience is, in part, evidence of just how burdensome such a project can be. Furthermore, they grant effective monopolies. Such monopolies may create significant inefficiencies because they prevent others from creating new works which use, build upon and develop the

181. For some valuable analyses, see Landes & Posner, *supra* note 179, at 265; William Landes & Richard Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989); Kenneth Dam, *The Economic Underpinnings of Patent Law*, 23 J. LEGAL STUD. 247 (1994); Kenneth Dam, *Some Economic Considerations in the Intellectual Property Protection of Software*, 24 J. LEGAL STUD. 321 (1995).

182. Even when pirates are likely to copy one's product, there may be other reasons for the legitimate producer to make the requisite investment in research and introduce the product into commerce. For example, in some circumstances he may enjoy substantial benefits just by being first to market: since it takes time to make and distribute illicit copies, he may have the market to himself for some time, and so may be able to recover a portion of production costs by charging a high price. Moreover, he may be able to establish a standard of quality for the product such that when pirate versions do become available, they will appear to consumers to be of markedly inferior quality and so undesirable.

original.[183] They also keep prices higher and production lower, since they outlaw direct competition and weaken incentives to reduce production costs; if a consumer will not pay the going price of the legitimate producer's product, but would pay more than the simple cost of copying, this creates what the economists call a deadweight or social loss. What is needed is the right mix of access and protection, a mix that will encourage creativity and competition while insuring that rights-holders can appropriate the benefits of their labors.

The need for such a well-apportioned mixture is all the more critical in the context of lesser-developed countries with rampant piracy such as China. While new or "follow-on" creative products, as well as directly competitive products, can only be fashioned where industries exist to support appropriate research, lesser-developed countries tend to be lacking in just such industries. They want to develop them, at least in rudimentary forms (so-called "infant industries"), and want technology transfer from advanced countries to assist in the process. But lax enforcement of intellectual property rights creates a huge disincentive for advanced industries to invest in, and transfer technology to, states which tolerate or even sponsor piracy. Thus, in the developing country context, public and private actors would do well to foster institutions and practices that will generate respect for intellectual property rights, and encourage foreign investment by advanced intellectual property producers. In China, as we will see below, there have been encouraging signs that respect for such rights is growing and that the establishment of such institutions is being undertaken in earnest.

*3. Chinese Intellectual Property Actors*

Viewed retrospectively, the explanation from economics teaches that the past behavior of each Chinese IPR actor was partly a function of the system of costs and benefits in place, or believed by the actor to be in place, at the time the action was performed. Given China's overall record of poor enforcement, the benefits of indulging in piracy seem in the aggregate to have clearly outweighed its costs. Viewed prospectively, however, the explanation from economics predicts that adjustments in available costs and benefits can bring about a commensurate change in the behavior of IPR actors affected by those adjustments. If the costs of piracy rise, reducing net gain to the point at which alternative investments become more profitable, one would expect piracy to decline; correlatively, if the net benefits of IPR ownership and enforcement rise relative to costs, making IPR investment more profitable than alternative investments, one would expect to see an increase in IPR ownership and enforcement.

For example, if a Chinese citizen or legal person were to become the

183. The trade-off between access and monopoly is critically important in the areas of patent and copyright. As Professor Kenneth Dam puts it:

> If giving too broad protection today arrests future innovation, then we will not have an optimum rate of innovation over time, and the economy will suffer. This is particularly the case because in the overwhelming majority of instances each innovation builds on past innovations. Each innovator stands on the shoulders of the innovators of the past.... Hence, to obtain an appropriate balance between innovation today and innovation tomorrow, it is essential to allow access.

Kenneth W. Dam, *Intellectual Property in an Age of Software and Biotechnology*, (Law & Economics Working Paper No. 35 (2d Series), The Coase Lecture, Spring 1995, The Law School, The University of Chicago).

beneficiary of a set of IPRs and then saw those IPRs infringed, one might reasonably expect that that citizen could, given an appropriate judicial infrastructure, anticipate greater net benefits than costs in the pursuit of an infringement action in China (and greater return on IPR investment relative to available alternatives). The Chinese IPR holder would stand in an adversarial relationship to the infringer, and the infringer would see the benefits of piracy decrease, since litigation and attendant infringement penalties would at least theoretically increase the net costs of piracy. With greater costs, and diminishing benefits (due to, for example, a shrinking consumer base for illicit products), the pirate would be proportionally less motivated to indulge in infringement activities. In this way, increasing costs would serve, to some extent, as a deterrent to piracy generally. Additional methods of increasing costs, through, for example, stiffer administrative fines, or the imposition of criminal penalties, would thus be welcome means of enhancing deterrence.

Likewise, additional methods of increasing IPR benefits through, for example, ownership or licensing, would be welcome means of enhancing incentives. Before IPRs (or the broader institutions of private property) were theoretically made available to the general population under Deng's reforms,[184] most Chinese actors may well have been allied as infringing pirates or as unwitting consumers of pirated materials. They might, therefore, have stood in an adverse relation only with a rights holder. In such a situation, the enforcer's decision to refrain from an enforcement action would have benefited all local parties concerned, and the near-term costs of refraining from enforcement would have been shifted to the non-local, typically foreign actor, viz., the owner of the property being infringed; the long-term costs would theoretically have been partly borne locally if declines in revenue due to piracy ultimately extinguished investment activity in, or distribution in China of, the product in question. But once Chinese parties obtain significant IPR stakes, the cost and benefit calculations of consuming and pirating Chinese parties, as well as those of government enforcers, will begin to shift with some of the significant costs of non-enforcement being borne locally by Chinese stakeholders. In this way, when Chinese actors are put in a position, relative to other available investments, to increase significantly their net potential gains through either IPR ownership, licensing or litigation, the economic explanation predicts that they will, in fact, tend to choose to increase and protect those gains.

From a collective action perspective, the behavior of Chinese IPR actors vís-a-vís these various economic, legal and cultural norms is proving especially difficult to manage. China is in the middle of a complex transformation from a system of norms which effectively subsidizes piracy and taxes adherence to law, to one which effectively subsidizes adherence to law and taxes piracy. Where

184. China's economic reforms began with, and have continued to center around, far reaching if largely de facto changes in property rights. From a theoretical point of view, these changes have extended exclusive ownership rights from the state, which had previously held a virtual monopoly of such rights, to individuals (thus permitting private as well as state ownership) and also collectives (thus permitting a somewhat novel form of Chinese communal ownership). They have embraced a liberalization of user-rights (rights to transform assets), income rights (rights to earn income from assets and contract over terms) and, to an extent, transfer rights (rights to transfer permanently ownership rights of an asset). For an analysis of changing property rights in Eastern European economies, see *Property Rights, Agency and Economic Organization, in* THRÁINN EGGERTSON, ECONOMIC BEHAVIOR AND INSTITUTIONS 33–75 (1990).

the collective adopts the legal norms of the West, the collective will enjoy substantial benefits over the long term as long as its members adhere to those norms. But for any individual member, the incentives to defect from the norms will be great since the individual who does defect by indulging in piracy will very often be better off in the short term than if he does not; this, of course, accounts to some extent for China's persistent vertical IPR problems. Where defection is widespread, however, the legal norms may collapse in deference to cultural norms favoring piracy. Thus, if one wants to sustain the legal norms, it will very much be in the collective interest to see to it that members are sufficiently monitored and defectors adequately penalized.

*4. Intellectual Property Litigation in China*

These various economic ideas find some support in recent Chinese court data which suggest that only recently there has evolved among contemporary Chinese a clear willingness to litigate. According to PRC government figures, China's court system was hearing "economic" cases at the rate of 86,000 a month through the first eight months of 1995, up from no cases at all in 1978; and of 697,000 cases heard by August 31, 1995, 596,000 had been resolved.[185] China's official intellectual property courts, too, are doing a brisk business. By March 1994, the Beijing IPR courts, established in August of 1993, had heard 125 cases and ruled on 87, while the courts in Shanghai and Xiamen, established only in February 1994, had handled more than 600 and 47 cases, respectively.[186] Ren Jianxin, President of the Supreme People's Court, has reported that China's IPR courts collectively heard 1662 cases in 1994.[187] And by August of 1996, China's eighteen national IPR courts were reported to have collectively heard 2,500 cases.[188]

Until recently, of course, there were no litigation vehicles, nor were there any IPRs in Chinese hands. Today there are both, accompanied by a growing interest in law and litigation remedies, even though the historico-cultural thread linking today's Chinese to their Confucian past remains as intact as it ever was. The growing interest in law is partly a function of the growth of the legal system itself. China's legal system was effectively destroyed during the 1966–76 Cultural Revolution, when all law faculties were closed and all lawyers were denounced, but the system has been slowly revived under Deng's leadership. First allowed to resume practice in 1978, Chinese lawyers numbered only 2,000 by 1980. In the next five years, five law schools and

185. Geoffrey Crothall, *Courts Swamped by Economic Disputes*, SO. CHINA MORNING POST, Sept. 27, 1995, at 11, *available in* LEXIS, NEWS Library, SCHINA File. The Beijing Court System alone handled 8.7 times more cases in 1994 than in 1978, the initial year of Deng's reforms. *Beijing Reorganizes Courts to Cope with Growing Workload*, Deutsche Press-Agentur, Apr. 14, 1995, *available in* LEXIS, NEWS Library, DPA File.

186. Ma Chenguang, *More Courts to Protect Trademarks and Patents*, CHINA DAILY, Mar. 29, 1994, *available in* LEXIS, NEWS Library, TXTNWS File. Sheng Liangang, president of the Beijing Municipal Higher People's Court, told a recent meeting of city party chiefs that from 1985 to August 1995, Beijing courts had tried 1,045 cases involving intellectual property rights, and that the number heard from 1990 accounted for 89% of the total. P.T. Bangsberg, *Violence Erupts as China Hits Counterfeiters*, UPI, Nov. 21, 1995, *available in* LEXIS, NEWS Library, UPI File.

187. *China-IPR Protection: China to Enhance Protection of IPR*, Xinhua News Agency, Mar. 13, 1995, *available in* LEXIS, NEWS Library, WIRES File (No. 0313045).

188. Geoffrey Crothall, *Courts Swamped by Economic Disputes*, SO. CHINA MORNING POST, Sept. 27, 1995, at 11, *available in* LEXIS, NEWS Library, SCHINA File.

thirty-one university law departments were opened or reopened, and the number of lawyers grew to 18,000.[189] By 1990, there were 50,000 practicing lawyers, though only 30,000 worked full-time, most in one of 3700 government law firms; and the number of students enrolled in "law and politics" courses in Chinese colleges and universities stood at 30,000.[190] In 1993, the government admitted 20,000 citizens to practice, and hatched plans to admit roughly 15,000 more every year until reaching a goal of 150,000 lawyers in the year 2000, "roughly equivalent to all such personnel in Germany, France, the Benelux nations and Denmark".[191]

Moreover, the government has formulated legislation permitting Chinese lawyers to accept non-government employment, to establish their own law firms, and to join lawyers' associations which will oversee lawyer registration, codes of practice and the safeguarding of lawyers' rights. In fact, some Chinese lawyers have been practicing independently since at least 1993 in various parts of China, and in the Shenzhen Special Economic Zone as many as sixty percent of law firms are believed to be privately owned.[192]

### *B. Incentives*

If the explanation from economics is correct in its assumptions, then, simply put, the Chinese can be expected to enforce IPRs when it is in their economic interest to do so. This will be true of the central goverment, too: over the long term, the costs to the government of creating a system of rights administration and enforcement will be swallowed by the potentially enormous gains to be had from growing a domestic intellectual property industry. The greater the Chinese stake is in protecting IPRs, and the greater the ability is of Chinese institutions to carry out enforcement work, the greater will be the overall enforcement levels under the MOU.[193]

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189. Rick Gladstone, *Shackles of Tradition Bruise China's Legal System*, THE RECORD (PEKING), Apr. 21, 1985, at A33, *available in* LEXIS, NEWS Library, ARCNWS File.

190. *Id.*; CHINA DAILY, Dec. 14, 1990.

191. *See* William P. Alford, *Tasselled Loafers for Barefoot Lawyers: Transformation and Tension in the World of Chinese Legal Workers*, 141 CHINA Q. 22, 23 (1995); *see also Law Firms: The China Case Book*, ECONOMIST, June 24, 1995, at 60. China introduced a lawyers' qualifying exam in 1986, by means of which 60,000 lawyers entered practice in the ensuing decade; however, different "districts" were allowed to have different scores on that exam, and in January 1995, the government announced that it would attempt to standardize the exam by imposing a uniform minimum score. In 1994, the last year before standardization, 11% of 93,000 candidates passed the exam with a score of at least 180 points. Under standardization, the minimum score was set at 240 points. *China Reforms Lawyer Qualifying System*, Xinhua News Agency, Jan. 24, 1995, *available in* LEXIS, NEWS Library, XINHUA File (No. 0124225).

192. Chan Wai-Fong, *Law On Lawyers' Independence Due Early Next Year*, SO. CHINA MORNING POST, May 9, 1994, at News 10, *available in* LEXIS, NEWS Library, SCHINA File.

193. Some believe that China's leadership is beginning to realize that counterfeiting damages China's reputation abroad and may be the cause of significant future trouble in China's trading relations with the rest of the world. According to Alix Parlour of the Business Software Alliance, "[d]ifferent interest groups are beginning to rub up against each other," such that "[c]ounterfeit trade may bring instant money to some local governments, but it emasculates Beijing's efforts to promote hi-tech exports." *China Condemns U.S. Decision to Cite Its Shortcomings on Intellectual Property*, Int'l Trade Daily (BNA) (July 5, 1994), *available in* LEXIS, BNA Library, BNAITD File. Even Deng Xiaoping's daughter Deng Rong, is said to have been furious when she discovered that her biography of her father was being distributed in a Chinese pirate edition. *Digital Banditry in China*, ECONOMIST, Apr. 23, 1994, at 70. She, too,

The development of a private and public sector Chinese stake will generate, willy-nilly, a reasoned reliance on, and a commensurate respect for, legal institutions and the rule of law generally. This will promote confidence among foreign intellectual property producers in the Chinese legal system, and increase their willingness to market their products in China and to enter into technology transfer agreements with Chinese partners. Moreover, any residue of xenophobia will likely vanish quickly within the framework of a prosperity borne of robust international IPR trade.

From a planning point of view, to motivate such developments one would theoretically do well to encourage private U.S. industry programs and U.S. government policies that create incentives appropriate to these goals. Such programs and policies would work to increase Chinese ownership of or benefits from IPRs, and facilitate, in ways envisioned by the 1995 Agreement, Chinese government enforcement abilities. As for specific methods of enhancing the Chinese stake, U.S. industries could increase their efforts to license their products in the PRC, and to enter into joint ventures with Chinese partners,[194] thus creating incentives for the partners to defend their mutual IPR interests as well as the interests of the partnership generally.[195] At the same time, U.S.

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resorted to the Beijing IPR court to stop the piracy of her book. *New Criminal Penalties*, *supra* note 147.

194. In all industrial categories, as of October 1990, the PRC had 12,000 fully operational joint ventures, and another 12,000 in the start-up phase, while new government approvals were being granted the rate of 42 per day. CHINA DAILY, ANNIVERSARY SUPPLEMENT, Oct. 1, 1990. By August 1992, the Chinese government reported that the total number of "foreign-funded" enterprises (i.e. either joint ventures or wholly foreign-owned enterprises) stood at 49,000. Xinhua Gen'l Overseas News Serv., Aug. 3, 1992. For 1993 alone, Foreign Trade Minister Wu Yi announced that China had approved 83,265 foreign investment projects with a contractual value of US$110.85 billion. *Chinese Official Expects GATT Accession by End of 1995, Promises More Tariff Cuts*, Int'l Trade Daily (BNA) (Feb. 2, 1994), *available in* LEXIS, BNA Library, BNAITD File. By early 1995, according to official Chinese estimates, over 200,000 foreign-funded enterprises had been established and over US$200 billion had been pledged by foreign investors. Sun Hong & Wang Hong, *China: US Urged to Reopen Talks, Head Off Trade Skirmish*, CHINA DAILY, BUSINESS WEEK SUPPLEMENT, Jan. 8, 1995, *available in* LEXIS, NEWS Library, TXTNWS File. On joint ventures in China, see EQUITY JOINT VENTURES WITH CHINESE PARTNERS (Standing Committee for Standard Contracts of the European Association for Chinese Law eds., 1991); ALFRED HO, JOINT VENTURES IN THE PEOPLE'S REPUBLIC OF CHINA: CAN CAPITALISM AND COMMUNISM COEXIST? (1990); MARGARET PEARSON, JOINT VENTURES IN THE PEOPLE'S REPUBLIC OF CHINA: THE CONTROL OF FOREIGN DIRECT INVESTMENT UNDER SOCIALISM (1991); DONG SHIZHONG ET AL., TRADE AND INVESTMENT OPPORTUNITIES IN CHINA (1992); JARI VEPSALAINEN, FOREIGN INVESTMENT IN THE PEOPLE'S REPUBLIC OF CHINA (1989); CHENG YUAN, EAST-WEST TRADE: CHANGING PATTERNS IN CHINESE FOREIGN TRADE LAW AND INSTITUTIONS (1991).

195. In one recent licensing case, American publishers found that a Chinese publisher in Sichuan province, who had acquired a license to publish the novel *Scarlett*, defended his license to the point of forcing the Chinese, who had been responsible for a competing pirate edition of the work, out of business. IIPA, 1993 SPECIAL 301, *supra* note 15, at 41–42. In 1994, Microsoft Corporation began working with Hong Kong-based Legend Holdings on a Chinese version of the MS-DOS operating system, and with the Great Wall Computer Group on an improved Chinese version of its Windows Operating System. It also began aggressively investing in up to 20 joint ventures devoted to building manufacturing enterprises, research and development projects, and training programs at universities in Beijing, Shanghai, Shenzhen and Guangzhou. The Microsoft strategy is that if it builds friendships with various Chinese ministries and large Chinese computer manufacturers, they will become more committed to working with Microsoft in the future and to supporting Microsoft operating systems. Charles Stevens, Microsoft Far East Vice-President for Development, has made the Confucian observation that "[s]trong relationships are more important in China than probably anywhere else

industries could provide information, advice and even resources to independent Chinese businesses producing indigenous Chinese products that must themselves fight the competition of Chinese pirates.[196]

As regards aid to Chinese government enforcement efforts, since all indications are that the relevant Chinese administrative agencies and their local and regional analogues are short of resources, U.S. government offices and IPR-based businesses would do well to provide them with as much technical, logistical, and personnel support as is practicable. There are encouraging signs that programs already underway are good beginnings in this direction.[197]

### *C. Conclusion*

In the words of Gilbert Donahue, "a conceptual corner was turned" when the Chinese agreed to sign the 1992 MOU.[198] That signature, and its

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in the world." Dusty Lee, *Microsoft to Open US$100m China Window*, SO. CHINA MORNING POST, Nov. 9, 1994, at Business 1, *available in* LEXIS, NEWS Library, SCHINA File. By June 13, 1996, the Chinese government reported that Microsoft had 300 authorized sales agents in China, and had established 30 training centers and four cooperative publishing houses. *Microsoft to Increase Share of Market in China*, Xinhua News Agency, June 13, 1996, *available in* LEXIS, NEWS Library, XINHUA File (No. 0613236); and on June 28, 1996, Microsoft Chairman Bill Gates personally introduced a Chinese language version of Microsoft's Windows NT 3.51 software in Shanghai. *Microsoft Introduces New Chinese Software*, Xinhua News Agency, June 28, 1996, No. 0628282, *available in* LEXIS, NEWS Library, XINHUA File.

196. For example, legitimate Chinese recording companies, some of whom have found of late that up to 50% of their market has been captured by Chinese pirates, would probably benefit from the assistance of their U.S. counterparts. IIPA, 1993 SPECIAL 301, *supra* note 15, at 40.

197. In addition to the U.S. government assistance called for under the terms of the 1995 Agreement, the International Federation of the Phonographic Industry (IFPI), which is the international counterpart of the Recording Industry Association of America (RIAA), has opened offices in Beijing, Guangzhou and Shanghai to help monitor infringement activities. As a way of targeting the specific problem of pirate compact disc production, most of which seems to be located in Guangdong province adjacent to Hong Kong, the IFPI signed a Memorandum of Understanding with Guangdong province which calls for the establishment of a "Social Culture Task Force". Partly financed by the IFPI, the Task Force will in effect police against copyright infringement by monitoring and conducting raids. IIPA, 1994 SPECIAL 301, *supra* note 14, at 3. Inasmuch as organized crime elements seem to be involved in Chinese piracy, attempts to police it are not without significant risk, especially to foreigners. The IFPI Guangdong office was forced to close temporarily in December of 1995 due to death threats. *See* Faison, *supra* note 86; *see also* IIPA, 1996 SPECIAL 301, *supra* note 80, at 5. In the area of trademark infringement, Reebok International, Ltd., has had extraordinary success working with the Chinese Administration for Industry and Commerce (AIC) which has helped it seize more than 120,000 pairs of counterfeit Reebok footwear and nearly 30,000 components from over 45 factories in 1994; the footwear was earmarked for distribution in China as well as Russia, Hungary and Spain. Most of the raids were carried out in conjunction with the AIC at factories in the coastal provinces of Shandong, Zhejiang, Fujian and Guangdong. Reebok, whose worldwide 1993 sales were US$2.9 billion, manufactured more than 25% of its footwear and apparel products at factories in Guangdong and Fujian provinces in 1994. *Reebok Works with Chinese Government Agencies to Seize Counterfeit Footwear*, Reuter Textline Business Wire, Jan. 5, 1995, *available in* LEXIS, NEWS Library, TXTNWS File. On the private policing front, in July 1994, a new joint venture was formed to help businesses in China protect their intellectual property rights. IP Protective Services (China), in which Hong Kong and Chinese partners hold equal stakes, is staffed by retired senior officers from the Ministries of Justice and Public Security in Hong Kong, and has the support of the Chinese State Council, and the nominal cooperation of such key Chinese government units as the Public Security Bureau, the People's Court, the Ministry of Justice, and the Patent, Copyright and Trademark Offices. The firm has already serviced such clients as the Walt Disney Company and the Burroughs–Welcome pharmaceutical company. Carrie Lee, *HK Brightest Help Protect Copyright*, SO. CHINA MORNING POST, May 6, 1994, at Business 5, *available in* LEXIS, NEWS Library, SCHINA File.

198. Gilbert Donahue, Office of the United States Trade Representative (personal

counterpart on the 1995 Agreement, provided strong encouragement that the explanation from culture, if not largely inaccurate in its assumptions, would at least not prove to be a theoretical obstacle to IPR reform at the highest levels of the Communist Party bureaucracy. In reply, the skeptic may well ask whether China has created, or at least begun to create, a legal consciousness beyond that bureaucracy. The answer, properly qualified, is certainly affirmative. What we have seen as a sequel to the 1992 MOU and the 1995 Agreement are the effects predicted by the explanation from economics, including a form of legal consciousness among ordinary Chinese. But while law may well become increasingly prevalent in Chinese dispute settlement, especially in IPR matters, it will be the economic tail that wags the legal dog: decision making consciousness will be structured in legal terms but will be driven by economic concerns. Owing to a readjustment of economic interests, Chinese citizens may begin finding—some may already be finding—greater value in the rule of law than in *guanxi*. To the extent that there has been a recrudescence of law under Deng Xiaoping, Legalist thought may be enjoying a revival at the expense of Confucianism. The Legalists at least believed, as Alice Tay points out, that "politics and administration should be impartial—based on rules and principles, not personal relationships."[199]

Despite the relative growth of piracy and deep-rooted cynicism about law, there is today reason for optimism. With the creation and ongoing development of Chinese IPR courts, and the acquisition by ordinary Chinese of intellectual property rights (in addition to other property rights) that may be asserted and defended in those courts, as well as the emergence of a private bar that is more than nominally independent of government, we may have turned not just a "conceptual" but also now a "practical corner" on the road to more vigorous IPR practices and institutions in China. I am inclined to agree with Yu Yingzhong, who, writing about "legal pragmatism" in the PRC, has observed that

> [p]eople's indifference to and mistrust of law can only be reversed with the creation of a true legal consciousness. Creating this legal consciousness necessarily involves bringing citizens into the process of making law and building legal institutions that can be relied upon, which are important components of the transformation from a society ruled by men to a society ruled by law.[200]

communication).

199. Tay, *supra* note 164.

200. Yu Xingzhong, *Legal Pragmatism in the People's Republic of China*, 3 J. CHINESE L. 29 (1989).