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

(WT/DS363)

EXECUTIVE SUMMARY OF THE SECOND SUBMISSION OF THE UNITED STATES OF AMERICA

September 8, 2008

I. INTRODUCTION

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

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

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

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

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

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

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

7. China's trading rights regime for reading materials, AVHE products, sound recordings, and films for theatrical release is inconsistent with China's obligations contained in paragraphs 5.1, 5.2 and 1.2 of the Accession Protocol, as well as in paragraphs 83 and 84 of the Working Party Report. While China has advanced several arguments responding to this claim, none of them succeed.

A. Goods vs. Services

8. China makes a number of erroneous arguments that films for theatrical release, unfinished AVHE products, and unfinished sound recordings, are not goods, and are not subject to the trading rights disciplines. China's reasoning would transform all goods commercially exploited through a series of associated services into services themselves. As the United States has demonstrated, these products are goods subject to the trading rights disciplines, and the relevant measures challenged by the United States run afoul of China's trading rights commitments.

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

10. First, the product that is the subject of the U.S. trading rights claim is tangible, hard-copy cinematographic film that can be used to project motion pictures in a theater. Even if, assuming *arguendo*, China were correct that "goods" must be tangible to qualify as goods, the product relevant to the U.S. trading rights claim – *i.e.*, hard-copy cinematographic film – is tangible.

11. Second, China also unsuccessfully contends that films for theatrical release are not goods because they are exploited through a series of services. China argues that because the "delivery materials" containing film are mere accessories of such services, films are not goods. If accepted, China's argument would have serious systemic implications. Because the vast majority of goods are commercially exploited through a series of associated services, China's argument would transform virtually all goods into services. China's own customs regime also demonstrates that China itself treats films as goods.

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

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

affect trade in goods. In fact, China's measures themselves refer to the importation of the good separate from and in addition to the provision of services using the good.

14. China's argument that films for theatrical release are not goods is also belied by the text of the GATT 1994. Article III:10 and Article IV of the GATT 1994, part of the Multilateral Agreements on Trade in *Goods*, deal with cinematographic films, and demonstrate a long history of treating films as goods in the multilateral trading system.

15. Third, contrary to China's contentions, international classifications of films demonstrate that films for theatrical release are goods. The Harmonized Commodity Description and Coding System (HS), which only covers goods, describes products under heading 3706 as follows: "cinematographic film, exposed and developed, whether or not incorporating sound track or consisting only of sound track." Similarly, the United Nations' Central Product Classification (CPC) *does* classify cinematographic film as a good in Subclass 3895, in addition to classifying the associated services (in subclass 96113).

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

17. The fact that these tangible goods carry content does not take them out of the category of goods. The fact that certain provisions of the relevant measures may regulate copyright licensing does not mean that other provisions of the same measures do not regulate the importation of the goods themselves; indeed, other provisions do just that. Finally, the 2007 Harmonized System (implemented under the Harmonized System Convention, to which China has been a party since 1993) makes clear that unfinished AVHE products and unfinished sound recordings are goods.

18. China's tariff schedule addresses these items in HS heading 8524. The term "unfinished AVHE products" is intended to capture master copies of *inter alia* videocassettes, VCDs, and DVDs to be used to publish and manufacture copies for sale in China. These products would be covered by the broad description for HS heading 8524 because these master copies are "records, tapes and other recorded media for sound or other similarly recorded phenomena."

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

20. China concedes that it does charge customs duties for "hard-copy audiovisual product (including sound recordings) intended for publication." Moreover, Article 2 of the AV Import Rule defines "audiovisual products" as "audio tapes, video tapes, records, and audio and video CDs which have recorded content." The measure then cross references the HS codes for these "products," included in Annex 1 to the measure. The CPC also classifies "recorded media for sound or other similarly recorded phenomena" other than films under goods subclass 47520.

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

21. With respect to the remaining products at issue – *i.e.*, reading materials, finished AVHE products, and finished sound recordings – China concedes that it places limitations on its trading rights commitments, but contends that these limitations are justified. China submits that its right to regulate trade in a manner consistent with the WTO Agreement permits restrictions on its trading rights commitments that are consistent with Article XX of the GATT 1994. China, however, has failed to sustain its arguments with respect to the right to regulate and Article XX.

22. Contrary to China's reading of the first clause of paragraph 5.1 of its Accession Protocol, the right to regulate trade in a manner consistent with the WTO Agreement applies to measures regulating goods that are traded, and not to measures regulating whole categories of traders engaged in the importation of goods.

23. During China's accession negotiations, WTO Members agreed to specific limitations on China's trading rights commitments with respect to a set of listed goods. That is, only state trading enterprises are allowed to import the goods enumerated in Annex 2A1 and only designated importers were permitted to import the goods enumerated in Annex 2B until December 2004. China did not list the goods at issue in this dispute in either Annex, and China's trading rights commitments do not authorize China to add to these limitations after accession. Interpreting the first clause of paragraph 5.1 concerning the right to regulate trade, as justifying the measures at issue would render Annexes 2A and 2B redundant.

24. China further contends that the measures at issue are justified by Article XX(a) of the GATT 1994 and that they are applied in a manner consistent with the *chapeau* of Article XX. As a threshold matter, it is not necessary to determine whether Article XX applies to China's commitments contained in the Accession Protocol and Working Party Report. When faced with a similar situation in *U.S. – Shrimp Bonding*, the Appellate Body examined the measure at issue on an *arguendo* basis, and after finding this measure did not satisfy the requirements of Article XX, concluded that it did not need to express a view on the question of whether Article XX is available as an affirmative defense for a measure found to be inconsistent with the *Anti-Dumping Agreement*. Similarly, China's measures reside well outside of the parameters of Article XX(a), and their application fails to meet the requirements contained in the *chapeau* of Article XX.

25. Without prejudice to whether Article XX applies to China's commitments contained in the Accession Protocol and Working Party Report, China has not met its burden to establish that the measures at issue satisfy this exception.

26. The trading rights prohibitions found in China's measures are not "necessary" within the meaning of Article XX(a). As the Appellate Body has explained, "a 'necessary measure is . . . located significantly closer to the pole of 'indispensable' than to the opposite pole of simply 'making a contribution to'." China has failed to establish a nexus between prohibiting all foreign importers and all privately-owned Chinese importers from importing the goods at issue and achieving its content review goals. Restricting trading rights to only a single, or a select few, Chinese state-owned importers is nowhere near "indispensable" to content review, and thus the restrictions on trading rights are not "necessary" under Article XX(a).

27. The Appellate Body has also not found a measure to be necessary where there is a "reasonably available WTO-consistent alternative". In this dispute, China has numerous alternatives to achieve its content review objectives that do not restrict the right to import. For example, foreign-invested enterprises could conduct the content review of reading materials, AVHE products, sound recordings and films for theatrical release, after developing the expertise to do so by training existing personnel or hiring experts as employees to conduct such review.

28. Moreover, China fails to show that the application of challenged measures is consistent with the *chapeau* of Article XX. China contends that "the administrative authorities (GAPP and MOC) need to make certain that the importation entities are able to participate effectively and efficiently in the content review process. This can only be achieved through a selection process". Indeed, the selection process produces results that are both arbitrarily and unjustifiably discriminatory and a disguised restriction on trade.

29. First, China's selection criteria in fact go well beyond the four factors China cited in its first written submission. China *a priori* requires applicants who want to engage in the importation/content review process for these products to be wholly state-owned enterprises.

30. Second, China's actual process for selecting import entities for these products involves a number of non-transparent, entirely discretionary Chinese government decisions that also contribute to the discriminatory application of this regime. To be successful, applicants subject to China's approval process must meet the requirements of a "State plan for the total number, structure and distribution of" importers. When the Panel asked China what the State plan is, China provided no insights (other than to say that it is not available in written form).

31. Further, China imposes a completely discretionary "designation" process to select importers of most of the products, and in some cases, this process entirely supersedes the "approval" process based on the four selection criteria that China described. Only importers of books and electronic publications are simply "approved" by GAPP. Finally, China's contention that domestic producers of the goods at issue are subject to content review requirements comparable to those applied to importers is inaccurate for several reasons, and is, moreover, besides the point in a trading rights claim.

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

32. Despite China's market access and national treatment commitments in the distribution services and audiovisual services sectors of its Services Schedule, China imposes discriminatory prohibitions and requirements on foreign service suppliers seeking to engage in the distribution of reading materials, AVHE products, and sound recordings. These measures are inconsistent with China's obligations contained in Articles XVI and XVII of the GATS.

A. Reading Materials

33. China imposes discriminatory prohibitions and requirements on foreign-invested reading material wholesalers that modify the conditions of competition in favor of wholly Chinese-owned reading material wholesalers.

1. Discriminatory Prohibitions

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

35. First, China prohibits foreign-invested enterprises from wholesaling imported newspapers and periodicals, as well as imported books and electronic publications in the "limited distribution category". China's measures at issue do not fall within the terms, limitations, conditions or qualifications on market access or national treatment that China has specified in its Services Schedule. Accordingly, the measures at issue are inconsistent with China's obligations under Article XVII. China does not contest this U.S. claim.

36. Second, China denies foreign-invested enterprises the right to engage in the wholesaling of imported books and electronic publications in the "non-limited distribution category". As the United States has explained, and China has confirmed, the Foreign-Invested Sub-Distribution Rule ". . . makes clear that only books [, newspapers and periodicals] *published in China* are eligible for distribution by FIEs." China's prohibition is, therefore, inconsistent with China's obligations under Article XVII. Again, China does not contest this U.S. claim.

37. Third, China also prohibits foreign-invested enterprises from engaging in the master distribution of all books, newspapers and periodicals, whether imported or domestic. Master distribution falls within the meaning of "distribution services" under Annex 2 to China's Services Schedule, and is covered by China's commitments under Sector 4 of its Services Schedule. Accordingly, China's measures are inconsistent with China's market access and national treatment commitments inscribed under mode 3 of Sector 4 of its Services Schedule.

38. China itself concedes that master distribution is a type of distribution service. Indeed, according to Annex 2 of China's Services Schedule, the "principal service" involved in a distribution service that falls under Sector 4 is "reselling merchandise". As China has explained, master distributors, when they are separate entities from publishers, themselves sell reading materials, and are not agents of publishers. This of course means that master distributors are reselling reading materials purchased from publishers through an initial sale.

39. China's contention that it did not intend to include master distribution within its distribution services commitments is also unpersuasive. If indeed it was China's intention to exclude master distribution from its distribution services commitments in Sector 4 of its Services Schedule, it should have done so with a limitation to the effect. China inscribed no such limitation with respect to master distribution under Sector 4.

40. Master distribution includes wholesaling. China itself has stated that master distribution is synonymous with "master wholesale". Moreover, China has confirmed that master distribution involves specific services that qualify as "wholesaling" as defined in Annex 2 of China's Services Schedule. Annex 2 provides: "wholesaling consists of the sale of goods/merchandise to retailers to industrial, commercial, institutional, or other professional business users, or to other wholesalers and related subordinated services." China has already explained that master distributors engage in the sale of reading materials to industrial,

commercial, institutional and other professional business users. China's measures also make clear that master distributors can also resell reading materials to "other wholesalers", as provided for in the definition of "wholesaling" in Annex 2.

41. Moreover, to the extent that master distribution also could be considered to involve retailing, master distribution is also covered by China's commitments under mode 3 of Sector 4C of China's Services Schedule. China has stated on numerous occasions that master distribution also involves retailing, including of primary and middle school textbooks.

42. Fourth, foreign-invested enterprises are also deprived of the right to engage in the master wholesale and wholesale of electronic publications. China responds that it has removed the prohibition on foreign-invested enterprises from engaging in the wholesale of electronic publications and has rendered the master wholesale of electronic publications obsolete. While the United States accepts that the *Provisions on the Administration of Publishing Electronic Publications* repealed the Electronic Publication Regulation in 2008, the *Provisions* only address the production, publishing and importing of electronic publications and are wholly silent with respect to distribution (including wholesale and master wholesale).

43. According to China, the distribution of electronic publications is governed by the Publication Market Rule and the Foreign-Invested Sub-Distribution Rule. However, these measures also prohibit foreign-invested enterprises from engaging in the master wholesale and wholesale of electronic publications. As China itself concedes that these two measures represent the complete set of rights granted to foreign-invested enterprises with respect to the distribution of electronic publications, those enterprises are only permitted to sub-distribute books, newspapers and periodicals published in China. The right of foreign-invested enterprises to master wholesale and wholesale electronic publications is not provided for in either measure.

44. The United States continues to seek a finding from the Panel with respect to the Electronic Publications Regulation even though it has been repealed by the *Provisions on the Administration of Publishing Electronic Publications* (2008). Moreover, the United States seeks a finding with respect to the Foreign-Invested Sub-Distribution Rule as it also prevents foreign-invested enterprises from master wholesaling and wholesaling electronic publications.

2. Discriminatory Requirements

45. In the limited arena where foreign-invested enterprises may engage in reading material distribution – *i.e.*, the sub-distribution of books, newspapers and periodicals published in China – China imposes numerous discriminatory requirements that deprive foreign-invested wholesalers of national treatment. China discriminates against foreign-invested wholesalers through requirements regarding: (1) operating terms; (2) registered capital; (3) pre-establishment legal compliance; (4) examination and approval; and (5) GAPP decision-making criteria.

46. Foreign-invested enterprises are limited to a 30-year operating term, while their wholly Chinese-owned competitors are free of any term limitations. This places foreign-invested wholesalers at a significant competitive disadvantage as their continued operations are subject to the discretion of government authorities, and because any extension of the operating term requires the agreement of all investors and all Board Directors, and must comply with the laws, regulations and policies on foreign investment. Under Chinese law, each of these parties holds a

veto on extension and can use that leverage to extract concessions from the foreign-invested parties. China's contention that the term extension is "non-discretionary, automatic and simplified" is contradicted by Chinese law. In fact, four Chinese measures cited by China state explicitly that extension depends on approval by the examining authority.

47. China's registered capital requirement also modifies the conditions of competition in favor of wholly Chinese-owned sub-distributors of books, newspapers and periodicals. China does not contest that foreign-invested wholesalers of books, newspapers and periodicals published in China must have RMB 30 million in registered capital, while their wholly Chinese-owned competitors need only RMB 2 million. China argues, however, that this disparity does not result in less favorable treatment because foreign-invested enterprises can contribute their registered capital in installments, while wholly Chinese-owned enterprises must contribute their registered capital prior to establishment. This argument fails, however, since wholly-Chinese owned enterprises are also permitted to contribute their registered capital in installments.

48. China's discriminatory pre-establishment legal compliance requirement likewise accords further less favorable treatment to foreign-invested wholesalers than to domestic suppliers. Pursuant to this requirement, foreign-invested enterprises are prohibited from engaging in the wholesale distribution of books, newspapers and periodicals published in China if they have any record of legal non-compliance in the three years prior to their application to engage in such services. Wholly Chinese-owned wholesale distributors of reading materials, however, are not subject to this requirement. While China argues that a similar requirement is imposed on wholly Chinese-owned wholesalers of reading materials. – *i.e.*, curbing domestic suppliers' freedom of action only for violations of one measure that result in "the administrative punishment of revocation of [the entity's] license" – the requirement applicable to foreigners totally bars market entry for <u>any</u> "law or regulation violations" or "other bad offenses".

49. Foreign-invested wholesalers also face a fundamentally discriminatory examination and approval process in order to enter this market. They must go through a six stage process that takes at least 90 days, whereas wholly Chinese-owned wholesalers are treated preferentially to a three stage process, which takes only 40 days. China contends that the MOFCOM approval process is non-discretionary, but the text of the Foreign-Invested Sub-Distribution Rule belies this claim – *i.e.*, no criteria or conditions govern how MOFCOM makes its approval decisions. China also argues unsuccessfully that its horizontal commitments inscribed in its Services Schedule preserve its right to maintain such discriminatory requirements. China's horizontal commitment, however, provides no such safe-harbor for its GATS-inconsistent examination and approval process. This inscription is a classic GATS Article XVI:2(e) limitation, restricting the types of entities through which a service supplier may supply a service.

50. Finally, GAPP's decision-making criteria for approving foreign-invested enterprises – which include friendliness, great capability, standardized management, advanced technologies and reliable foreign investment – modify the conditions of competition by subjecting foreign-invested applicants, but not wholly Chinese-owned applicants, to additional hurdles that must be overcome in order to enter the Chinese market place.

B. AVHE Products

51. China maintains several measures that are inconsistent with its market access and national treatment obligations for foreign-invested service distributors of AVHE products. These measures are therefore inconsistent with Article XVI:2(f) and Article XVII of the GATS.

1. Article XVI

52. China's measures are inconsistent with Article XVI of the GATS because: (1) China made a market access commitment in its Services Schedule under mode 3 that Chinese-foreign contractual joint ventures would be permitted to engage in the distribution of AVHE products upon China's accession; (2) China did not inscribe any limitations on the participation of foreign capital with respect to Chinese-foreign contractual joint ventures engaged in the distribution of AVHE products; and (3) China's measures limit the participation of foreign capital in Chinese-foreign contractual joint ventures engaged in the distribution of AVHE products.

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

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

2. Article XVII

55. China also fails to rebut the U.S. claim that China maintains discriminatory requirements on Chinese-foreign contractual joint ventures engaged in the distribution of AVHE products and that these discriminatory requirements are inconsistent with China's obligations under Article XVII of the GATS. China discriminates against foreign-invested distributors of AVHE products through requirements regarding: (1) equity participation limits; (2) operating term; (3) pre-establishment legal compliance; (4) examination and approval; and (5) decision-making criteria.

56. First, China provides discriminatory treatment to foreign service suppliers by requiring that the foreign party to a Chinese-foreign contractual joint venture hold no more than 49 percent of the shares while the Chinese party can hold up to 100 percent and no less than 51 percent of the shares. China repeats its argument that the measures identified by the United States actually regulate the rate of allocation of profit and loss. The inability to hold a majority position in a joint venture severely disadvantages foreign suppliers by depriving them of important control over the operation of the AVHE product distribution venture, while Chinese suppliers do not face such a disadvantage. China's restrictions on foreign capital participation in joint ventures engaged in the distribution of AVHE products have the potential to restrict foreign investors'

freedom to implement their strategic vision and realize their goals for the enterprise where the vision and goals are inconsistent with those of the Chinese party to the joint venture.

57. Second, China also requires that foreign-invested entities engaged in the distribution of AVHE products face a 15-year operating term while wholly Chinese-owned AVHE distributors are not subject to such a limitation. China does not dispute that foreign-invested entities are subject to a limitation on their operating term. Foreign-invested entities face greater uncertainty and cost in the continuity of their operations than wholly Chinese-owned entities. This operating term limitation also modifies conditions of competition to the detriment of the foreign-invested distributors because extension requires the agreement of all investors, all Board Directors and the laws, regulations and policies on foreign investment. Furthermore, extension is far from automatic and depends upon a new round of examination and approval, procedures under which government authorities have the authority to disapprove requests for extension.

58. Third, China also maintains discriminatory requirements with respect to pre-establishment legal compliance, which accord less favorable treatment to foreign-invested distributors than to like domestic service suppliers. Although China raises certain procedural arguments with respect to these measures, China does not dispute that these measures provide for discriminatory treatment for foreign-invested enterprises in breach of Article XVII.

59. Fourth, China also accords less favorable treatment to foreign-invested entities than wholly Chinese-owned entities engaged in the distribution of audiovisual products by placing more administrative burdens on foreign-invested entities as it relates to the examination and approval process.

60. While China's horizontal commitments in its Services Schedule provide a definition of foreign invested enterprises, those horizontal entries contain no language that qualifies or limits China's national treatment obligations. Nor does China's horizontal commitment provide any such safe-harbor for China's GATS-inconsistent examination and approval process. Indeed, as China itself recognizes, this type of entry fits within the scope of the market access provision of Article XVI:2(e) of the GATS. China's argument that the laws and regulations governing the approval process were in place at the time of China's accession is also unavailing as the relevant question is whether China currently maintains any measures that are inconsistent with China's GATS obligations.

61. China also disputes certain aspects of the approval process as set forth by the United States for Chinese-foreign contractual joint ventures engaged in the distribution of AVHE products. However, what China's argument betrays is that foreign-invested distributors face a more burdensome process for becoming an approved entity than wholly Chinese-owned entities. China also contends that the measures do not modify the conditions of competition to the detriment of foreign services or service suppliers. However, Article XVII:3 contains no safe harbor for discriminatory measures that only modify the conditions of competition in favor of domestic entities by a supposedly small amount.

62. Fifth, China also requires that the relevant authorities, in approving applications from foreign-invested joint ventures, give priority to foreign-invested enterprises displaying the friendliness, capital strength, management standardization, and technological advancement of foreign-invested applicants in making their determinations. These additional conditions are only

imposed on the approval process for foreign-invested entities and are not applicable to wholly Chinese-owned entities. China has elected not to advance substantive arguments with respect to these discriminatory requirements.

C. Sound Recordings

63. China has failed to establish that the electronic distribution of sound recordings is beyond the scope of its services commitments for sound recording distribution services. In Sector 2D of its Services Schedule, China scheduled no market access or national treatment limitations under mode 3 for Chinese-foreign contractual joint ventures engaged in sound recording distribution services. However, China maintains several measures that accord less favorable treatment to foreign-invested entities engaged in the electronic distribution of sound recordings. By doing so, these measures are inconsistent with Article XVII of the GATS.

64. China does not address the U.S. claims that the measures at issue treat foreign-invested enterprises differently from wholly Chinese-owned entities. Instead, China's defense to this claim rests on the argument that China did not undertake commitments in its Services Schedule with respect to the electronic distribution of sound recordings, but only with respect to distribution of hard-copy sound recordings. China's arguments are without merit.

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

66. Second, even if China were correct that it could not have been aware of electronic distribution of sound recordings as a commercial reality at the time of its WTO accession, China has failed to establish that the electronic distribution of sound recordings is more than a new means of supplying an existing service. China argues that the relevant question is not whether a service is "new" but rather whether it is "different" from services for which a Member has made commitments.

67. China goes on to argue that certain factors should be considered in determining whether a service is different. There is no textual basis in the GATS for the application of these factors to an analysis of the meaning of a Member's services commitment. In addition, the United States has set forth examples in previous submissions demonstrating the flaws in China's attempt to characterize the electronic distribution of sound recordings as different from distribution of sound recordings in hard-copy format.

68. China's proposed (but utterly non-textual) "criteria" fail to effectively distinguish among services, and thus these "criteria" fail to support China's argument. Indeed, many of China's arguments merely corroborate the conclusion that the electronic distribution of sound recordings is a different means of supplying sound recording distribution services, rather than an altogether different service. Since the electronic distribution of sound recordings is within the scope of China's sound recording distribution services commitments, China's measures according

discriminatory treatment to foreign service suppliers of such services are inconsistent with Article XVII of the GATS.

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

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

A. Reading Materials

70. China treats imported reading materials less favorably than domestic reading materials. These measures: (1) confine most categories of imported reading materials to a single distribution channel; (2) impose onerous conditions on those seeking to obtain imported reading materials; and (3) strictly limit which enterprises are permitted to distribute imported reading materials. Domestic reading materials do not face these restrictions.

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

72. Second, China imposes higher burdens on those seeking to obtain imported reading materials, thereby treating imported reading materials less favorably than like domestic reading materials. Where imported and domestic reading materials are obtained through subscription, the requirements imposed on subscribers of imported reading materials are more onerous, requiring examination and approval of the subscriber, which delays and possibly prevents the receipt of the imported reading material by the subscriber.

73. Third, China restricts all imported newspapers and periodicals, as well as imported books and electronic publications in the "limited distribution category", to distribution by Chinese wholly state-owned distributors. Similarly, China restricts all imported books and electronic publications in the "non-limited distribution category" to wholly Chinese-owned distributors. In contrast, domestic reading materials can be distributed by a wide array of distributors that are best suited to the particular needs of the reading material in question. China has not provided any substantive arguments challenging this third aspect of the U.S. claim.

74. China contends that restricting these imported reading materials to distribution through subscription is non-discriminatory, because the "limited distribution category" includes reading materials with prohibited content used by certain government agencies and institutions for research purposes.

75. However, China provides no support for its assertion that the "limited distribution category" consists of reading materials with prohibited content. In fact, China's proposed interpretation is inconsistent with Chinese law, which makes distributing prohibited content in

China illegal. China also argues that the use of the term "entity" in the relevant measure supports its assertion that only government agencies and institutions are permitted to subscribe to reading materials in the "limited distribution category". China's interpretation of "entity" would mean that government agencies and institutions are the only wholly Chinese-owned entities permitted to obtain imported newspapers and periodicals in the "non-limited distribution category". China's newly minted defense would render China's subscription regime for imported reading materials more, rather than less, discriminatory.

76. China also argues that newspapers and periodicals in the "non-limited distribution category" are subject to "quasi-automatic subscription" with "no rejection of applications" and "without the involvement of state agencies". Despite this contention, China's argument conflicts with the express provisions of its own law. In addition, China fails to address the fact that imported newspapers and periodicals in the "non-limited distribution category" are only available to consumers through subscription, while domestic newspapers and periodicals are available through a myriad of channels.

B. Sound Recordings

77. China has failed to rebut the U.S. claim under Article III:4 of GATT 1994 relating to imports of sound recordings intended for electronic distribution. Contrary to China's obligations under Article III:4, China's measures impose a more onerous content-review regime on imports of sound recordings intended for electronic distribution than for domestic sound recordings.

78. First, China considers that the electronic distribution of sound recordings is not covered by the GATT 1994 because the GATT 1994 only covers trade in goods. In making this argument, China misunderstands the U.S. claim, which only applies to measures affecting imported hard-copy media containing sound recordings that are *intended for electronic distribution*. The U.S. claim does not include a challenge to any measure's treatment of services or service suppliers involved in the electronic distribution of sound recordings. Accordingly, China's discussion of the distinction between goods and services is not relevant to this claim.

79. China's statements regarding the nature of the products are likewise unavailing. The distribution of copyrighted materials – whether incorporated into hard-copy sound recordings sold in hard copy or distributed electronically – always involves one or more intellectual property rights with respect to the copyrighted material. This fact does not demonstrate that the products and measures fall outside the purview of Article III of the GATT 1994.

80. China also asserts that the challenged measures are "border measures" at the importation stage and therefore do not "affect[]" the distribution of products that have already been imported. This assertion is erroneous and ignores the Ad Note to GATT Article III. In this case, the measures impose a content review regime on all sound recordings intended for electronic distribution. For imports, the content review procedures are administered upon importation. This does not transform the measures into measures to which Article III:4 is inapplicable.

81. The hard-copy sound recording is often provided to an Internet Culture Provider ("ICP") or Mobile Content Provider ("MCP") who makes an additional copy in hard-copy format of the sound recording, transforms the sound recording into a format that can be transmitted electronically, and then transmits the reformatted sound recording electronically. Before

distributing a sound recording electronically, the ICP or MCP must go through the delay and administrative burden of a content review process that the ICP or MCP need not go through for domestic like products. Accordingly, the relevant measures affect the "sale, offering for sale, purchase, distribution or use" of such products within the meaning of Article III:4.

C. Films for Theatrical Release

82. China's regime for the sale, offering for sale, purchase, distribution or use of films for theatrical release likewise accords less favorable treatment to imported products within the meaning of Article III:4. China's measures provide that imported films can only be distributed by one of two state-controlled enterprises – China Film Group and Huaxia. Furthermore, commercial negotiations do not determine the terms of distribution or which of these two distributors will handle the imported film. Domestic films do not face these limitations.

83. China's principal argument with respect to the U.S. claim under Article III:4 for films for theatrical release is that such items are not goods subject to the GATT 1994 disciplines. As set forth in the U.S. first oral statement and above, China's contention that films are not goods is untenable. China also argues that films cannot be "distributed" within the meaning of Article III:4 because "distribution" is limited to the supply of goods to on-sellers or consumers. China's interpretation of the term "distribution" in Article III:4 is flawed. Accordingly, China has failed to establish that there is no distribution under the meaning of Article III:4.

84. China also argues that imported films for theatrical release are not subject to less favorable treatment. However, China's regime governing the distribution of films for theatrical release entails a number of significant disadvantages that accord imported films less favorable treatment than that accorded to domestic films.

85. While China contends that there is no mandatory duopoly for the distribution of imported films in China, it admits that only two entities are currently designated to distribute such films. Regardless of whether this duopoly is mandatory, it is discriminatory nonetheless. Further, China's contention that there is no mandatory duopoly does not withstand scrutiny. The Distribution and Projection Rule expressly provides for such a duopoly, and the Distribution and Exhibition of Domestic Films Measure confirms that China Film Group and Huaxia are the only two distributors of imported films in China.

86. China further submits that the number of approved distributors of imported films is limited by SARFT because the number of films imported into China is limited. China's attempt to justify its actions by suggesting there is a reasonable correlation between the quantity of films imported into China and the quantity of available distributors, however, only confirms that imported films receive less favorable treatment than that accorded to domestic films.

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

88. China goes on to argue that the trade impact of its discriminatory distribution regime does not rise to the level of less favorable treatment under Article III:4. However, consistency with Article III:4 is not determined on the basis of outcomes or trade effects. Article III:4 protects opportunities, not outcomes. Limiting imported films to two distributors, which do not permit negotiation on key commercial terms, while domestic films have access to all available distributors on commercial terms, is a fundamental denial of equal opportunity.

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

90. Finally, China submits that China Film Group and Huaxia are only obligated to comply with China's screen quota and that these two distributors are not required to support domestic films in any other way. China proffers no evidence to substantiate this contention, and China's position does not withstand scrutiny. China's requirement that China Film Group and Huaxia actively support domestic films is not limited to complying with the screening quota, and include metrics for supporting domestic films that have no direct relationship with the screening quota.

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

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

VI. THE PANEL'S TERMS OF REFERENCE

92. China also objects to the inclusion of several of its measures, as well as one of the U.S. claims, in the Panel's terms of reference. As explained in the U.S. first oral statement and the U.S. answers to the first set of Panel questions, China's objections are unavailing. For the reasons cited above and in previous U.S. submissions, the United States, respectfully requests that the Panel dismiss China's procedural objections and rule on these measures and this claim, which are all properly before the Panel and within its terms of reference.

VII. CONCLUSION

93. The United States respectfully requests the Panel to find that China's measures at issue are inconsistent with China's obligations under the Accession Protocol, the GATS and the GATT 1994. The United States further requests, pursuant to Article 19.1 of the DSU, that the Panel recommend that China bring its measures into conformity with its obligations under the Accession Protocol, the GATS, and the GATT 1994.