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INTERNATIONAL NEGOTIATIONS

RELATED TO THE PROTECTION
OF INTELLECTUAL PROPERTY RIGHTS (IPR)

Country teams: People's Republic of China
United States of America
European Union
Switzerland

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Note: This simulation has been revised to reflect China's accession to the WTO

Monterey Institute of International Studies and
the International Commercial Diplomacy Project

INTERNATIONAL NEGOTIATIONS
RELATED TO THE PROTECTION OF
INTELLECTUAL PROPERTY RIGHTS
(China, USA, EU, Switzerland)

Simulation Exercise

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(Note: Each student will receive individual team assignments and confidential instructions prior to the commencement of the simulation. You should read these materials and the packet of other background articles BEFORE the simulation begins.)

INTRODUCTION

The following background information and instructions are designed to provide students with a working knowledge of international trade issues related to the protection of Intellectual Property Rights (IPR), and of the WTO Dispute Settlement Understanding (DSU).

For purposes of this simulation, certain factual information related to the practices of the negotiating parties has been intentionally developed as hypothetical information, e.g., certain facts and figures have been invented to facilitate a short-term negotiation simulation. The general background and information related to IPR laws, the DSU, trading regimes, and agreements is factual.**BACKGROUND**

The United States (US) and China have engaged in a series of negotiations since 1989 over the development and enforcement of Chinese intellectual property laws. China passed an initial copyright law in 1990, but it fell short of international standards. China was then party to a series of bilateral agreements - in 1992, 1995 and 1996 - which eventually led to the adoption in 1997 of a copyright law consistent with the Berne Convention, and forceful Chinese action against factories producing pirated CD's, video tapes and software.

The United States and the European Union (EU) each continued bilateral negotiations with China on IPR related issues leading up to China's entry into the WTO in 2001. China, in joining the WTO, was required to bring its domestic laws governing IPR protection into compliance with the WTO Agreement on TRIPs, or the Trade-Related Aspects of Intellectual Property Rights. Doing so also bound China to submit itself to the WTO's dispute settlement regime in the event that its trading practices or level of IPR protection was deemed by other WTO members to have fallen below the standard set by its commitments under TRIPs.

This simulation is organized around a scenario based on real-world IPR compliance concerns raised by China's trading partners in mid-2002, taking into account China's commitments to IPR protection at the time of its WTO accession. The key parties in the simulation are China, the US, the EU, Switzerland and mediators from the WTO Secretariat. The factual scenario, while based on real-world trade data and some factual bilateral meetings between China and its trading partners, reflects a plausible scenario, but is not patterned on any specific bilateral meetings. Some trade data and some interest groups, as noted in the simulation, are fictitious, and are intended to enhance the simulation.

The historical sequence of events as reported by the International Intellectual Property Alliance is as follows:

After USTR placed China on the Priority Watch List in both 1989 and 1990 to encourage it to commence a law reform process, China passed a new copyright law in September 1990 (effective June 1, 1991). That law was incompatible with the Berne Convention and had numerous other defects, and as a result of these inadequacies as well as

high and growing losses due to copyright piracy, USTR named China a Priority Foreign Country in April 1991. In January 1992, China and the US settled the resulting Section 301 action by entering into a Memorandum of Understanding (MOU).

This MOU committed China to adopt Berne-compatible regulations to its copyright law and to join the Berne Convention (which China did, effective October 15, 1992) and the Geneva Phonograms Convention (which it also did, effective June 1, 1993). US works became fully eligible for protection under the 1992 MOU, and China was consequently placed on the Watch List in April 1992. On September 30, 1992, China's Berne-compatible regulations went into effect (but only applied to foreign works, leaving domestic Chinese with less protection for their works than that enjoyed by foreign right holders). China remained on the Watch List in 1993 with IIPA and USTR pushing for passage of legislation to make copyright piracy a criminal offense, as well as to beef up enforcement measures. On November 30, 1993, Ambassador Kantor elevated China to the Priority Watch List due to China's failure to enforce its laws.

In February 1994, IIPA reported significantly increased trade losses, up to \$823 million for 1993. Due to the absence of criminal penalties and a total lack of enforcement, USTR once again named China as a Priority Foreign Country in June 1994. Though the National People's Congress, through a "Decision" of the Standing Committee, adopted criminal penalties for copyright piracy in July 1994, it was not until 1995 that the Decision was implemented by a set of "Interpretations" issued by the Supreme People's Court. Meanwhile, US trade losses continued to mount.

On February 4, 1995, the US government announced its intent to impose \$1.08 billion in retaliatory tariffs to compensate for trade losses due to copyright piracy in China. This prompted China to take the two-prong approach of threatening its own retaliatory measures, and to begin going after domestic violators. The result of China's renewed efforts was uninterrupted trade with the US, and a temporary dip in recorded IPR violations.

As part of China's WTO accession agreement in 2001, it brought its IPR-related laws into general compliance with the TRIPs Agreement, but enforcement remained shoddy. Chinese growing economy and lax enforcement led to estimates by the IIPA of trade losses exceeding \$1.5 billion by rights holders, and put greater pressure on the US Trade Representative to act decisively. Arguing that un-enforced laws for IPR protection, and continuing barriers to entry for legitimate rights holders, was a violation of the spirit of China's accession agreement, the US government called on China to step up enforcement and to meet its market opening concessions. The Chinese government claimed that it was in the process of educating officials throughout the country about its WTO commitments, and that it would take time to bring its market to full compliance.

The negotiation simulation is designed to take place during the month of August 2002, following a U.S. threat to seek resolution via the WTO's Dispute Settlement system, but prior to the actual imposition of sanctions. The EU and Switzerland, believing that China's efforts in the area of IPR protection fall short of its WTO commitments, have asked to join the negotiations. All parties wish to avoid the issue rising to the level of a WTO dispute and would prefer bilateral and plurilateral negotiations.

DEFINITIONS:

Intellectual Property Rights- Intellectual property refers to a broad collection of rights relating to products of human inventiveness and creativity. It comprises two main branches: first, industrial property, covering inventions, trademarks, and industrial design; and, second, copyright.

Patent- A patent is a governmental grant of a property right to the inventor of a product or process which is new and has utility, that is, it has industrial application. A patent provides the inventor or the inventor's successor in title, the exclusive right to the invention for a limited time. This right generally enables the patentee to exclude others from making, using or selling the invention. As a consequence, the patentee can also grant licenses to third parties, letting them exploit the invention on such terms as the patent may prescribe. The Uruguay Round TRIPS Agreement requires that a patent must be valid for a minimum of 20 years from the filing date of the application.

Trademark- A trademark is any word, symbol, design or device used to identify a product. Service marks involve similar descriptors to identify a service. The purpose of a trademark or service mark is to identify goods put on the market, thereby distinguishing them from other goods and services, and to indicate their source or origin. These marks enable consumers to recognize products they have previously purchased so that they can exercise their preference to purchase them again. Accordingly, trademark owners usually make every effort to maintain or improve the quality of their goods. To a large extent, therefore, trademarks have become a guarantee of quality. Protection of a trademark means that no person or enterprise other than its owner may use it—or any other trademark so similar to it that its use would lead to confusion in the minds of the public. The TRIPS Agreements, for example, provides that initial registration of a trademark must be valid for a period of at least seven years, and that registration is renewable indefinitely.

Copyright- Copyright usually refers to "literary and artistic works". Copyright laws cover some or all of the following subject matter: literary works (which include computer software), musical works, including accompanying words, dramatic works, including accompanying music, pantomimes and choreographic works, pictorial, graphic and sculptural works, motion pictures and other audiovisual works (videos), sound recordings (compact discs, laser discs, cassettes, tapes, vinyl, etc), and architectural works. Works that do not fall in these specific categories may be protected as well.

Copyright protection means that certain uses of a work are lawful only if made with the authorization of the owner of the copyright. The owner of a right may generally transfer a right, or license certain uses of the work. U.S. copyright law grants the owner exclusive rights to reproduce a work, to prepare a derivative works based on it (e.g., to base a film on a book or play), and to distribute copies to the public by sale or other transfer of ownership, or by rental, lease or lending, to perform the work publicly (the exception of sound recordings), and to display certain categories of works publicly. The U.S. law, consistent with the Berne Convention and the TRIPS Agreement, protects a copyrighted work for the term of the author's life, plus 50 years.

WTO- The World Trade Organization is the organization that succeeded the General Agreement on Trades and Tariffs (GATT) as a result of the successful completion of the Uruguay Round of GATT negotiations. The WTO was established to oversee the global trading system and monitor the implementation of trade accords. The WTO includes stronger dispute resolution provisions than its GATT predecessor.

TRIPs Agreement- Trade Related Intellectual Property Rights (TRIPS) - Issues involving the treatment of intellectual property owned by foreigners. The U.S. and other WTO members have focused on preventing piracy of intellectual property in foreign countries. Improved protection of intellectual property has been an objective of the United States in section 301 cases and in the Uruguay Round negotiations. Specific areas covered by the Uruguay Round agreement on TRIPs include copyrights, patents, trademarks, industrial designs, design of integrated circuits, and anti-competitive practices in licensing.

Section 301 of the U.S. Trade Act of 1974 permits companies to complain about a foreign country's trade policies or practices that are harmful to U.S. commerce. This section empowers the U.S. Trade Representative (USTR) to investigate the allegations and to negotiate the removal of any trade barriers. If the USTR determines that the investigation involves examination whether the policies in question violate a trade agreement with dispute settlement provisions such as the GATT/WTO or NAFTA, then Section 301 requires the USTR to invoke the applicable dispute settlement procedures. If the investigation does not involve a trade agreement with dispute settlement procedures, then the USTR is required to resolve the matter through negotiations. The USTR has a maximum of one year to reach a negotiated solution. If negotiations fail, the USTR must determine if an action such as retaliation is appropriate. Section 301 empowers the USTR to withdraw concessions or restrict imports (e.g., by imposing prohibitive tariffs) from countries that violate trade agreements, discriminate against U.S. exports, or engage in other unjustifiable or unreasonable practices that burden or restrict U.S. trade. If the investigation is covered by an agreement with dispute settlement provisions, then the USTR is authorized to retaliate if the dispute settlement panel finds a violation of a trade agreement and the other country does not bring its practice into compliance with the agreement.

Special 301- Section of U.S. Trade Act requires the U.S. Trade Representative to conduct an annual review to determine the condition of intellectual property protection with U.S. trading partners. Companies impacted by violations of IPR may make submissions to the USTR in connection with the annual review. The USTR will publicly identify countries that flagrantly engage in unfair trade practices and categorize those countries as (1) Priority Foreign Countries (the most egregious), (2) the Priority Watch List, or (3) the Watch List. The USTR is required to initiate a section [Special??] 301 investigation of any country that is determined to be a Priority Foreign Country. If the egregious practices are not covered by a trade agreement with dispute settlement provisions, the investigation must be completed within 6 months (or 9 months if an extension is justified).

Piracy- The illegal or unauthorized taking of intellectual property rights including the

unauthorized use of patented materials, trademarks, and/or copyrighted materials. Piracy may be for the purpose of individual use, reproduction, resale, export, or other uses without the express permission of the owner(s) of the patent, trademark, or copyright.

FACTUAL BACKGROUND COMMON TO ALL PARTIES FOR THE SIMULATION:

The facts common to all parties in this international negotiation simulation exercise revolve around the history of international trade with the Peoples Republic of China (PRC) and the documentation of the violations of intellectual property rights, such as: design theft, false trademark usage, reproduction, sale, or export of products without the permission of the lawful owners of the IPR.

The PRC has recently acceded to the WTO, and is presently attempting to both bring domestic law into compliance and at the same time to enforce those laws. Prior to its admission to the WTO, however, the PRC signed agreements and made commitments to respect and protect intellectual property rights. But, one of the continuing issues that both China and its trading partners have to face is whether China has made a good faith effort to combat domestic IPR violations. Undeniably, despite China's efforts to combat IPR violations, the illegal industry has continued to flourish. For this reason, China's trading partners will seek to negotiate a tougher stance vis-à-vis IPR violations from China's government, and are prepared to take their case to the WTO if they are not satisfied with China's response.

This simulation focuses on the period, after China's accession to the WTO, during which the United States, the European Union (EU), Switzerland, and other nations have sought to enforce their Intellectual Property Rights in China and to prevent the piracy of goods and products including but not limited to the following:

1) Videos (VHS, VCD and DVD); 2) Compact discs (CDs - music); 3) Cassette tapes; 4) Pharmaceutical products; 5) Computer software and hardware; 6) Designer luggage (trademarks); 7) Watches and other time pieces (trademarks and origin labels); 8) Garment design and products (trademarks); 9) Automotive and motorcycle parts (trademarks and patents) 10) Agricultural and chemical products; 11) And other products.

The time frame for these negotiations is mid-2002. In the period from 1990-2002, the US, EU, Switzerland and other countries documented the Chinese government's failure to enforce IPRs to the detriment of specific manufacturers, designers, and exporters. In addition, these countries complained of China's denial of market access for these products for sale in China. At issue in bilateral negotiations between affected countries and China were the following:

- 1) Operation of factories engaged in the piracy of identified products;
- 2) Failure to detain, impound, or confiscate the import of machinery used for the piracy of products;
- 3) Failure to detain, impound, or confiscate pirated products exported to foreign countries for

sale or resale;

- 4) Failure to establish enforcement protocols to implement prior agreements on IPR including but not limited to the US-China IPR Agreement of 1992;
- 5) Failure to fully comply with WTO commitments as set out in its accession schedules, including improved market access, enhanced IPR protections, marketing and distribution rights for western media in China (films, music, etc.)

Much of the documented piracy and export of products has taken place on China's eastern coast. The International Intellectual Property Alliance (IIPA) estimates that during 2001, Chinese enterprises were operating as many as 72 CD factories where legal copyrighted CDs, VCDs, DVDs, laser discs, and CD-ROMs are produced. These factories are largely in the south and central China. With a known annual production capacity of 567 million CDs, China's production capacity has grown ten-fold in less than a decade. Booming domestic demand now absorbs most of that production, whereas in 1996, much of it was destined for export. However, a whopping 80% of plants in China are engaged in the production of at least some pirated material, and the Motion Picture Association of America (MPAA) estimates that 900 of its DVD titles are pirated in China.

Piracy of other audiovisual works, particularly audiocassettes, videos, and video games in China, runs close to 100%--with little evidence of effective controls to date. Piracy of other U.S. copyrighted products, particularly computer software, runs at about 94%--and 100% in CD ROMS.

Piracy of trademarks from EU and Swiss products include (a) the use of counterfeit trademark labels and markings to identify clothing, including Adidas shoes, Versace, Gucci, Christian Dior, and Pierre Cardin clothing, and (b) counterfeit or unauthorized use of the watch trademark Rolex, and the use of country of origin label "Swiss Movement" to describe Chinese manufactured watches as Swiss made watches.

The administrative apparatus in China for policing copyright piracy is extremely weak. The National Copyright Administration offices (of China) are located in fewer than half of China's provinces, and have few qualified personnel and no real authority to take effective action against offenders. The courts, which have real authority, have yet to issue substantial judgments in civil cases against Chinese defendants. In many cases, a judgment by a Beijing court in favor of a foreign plaintiff will be ignored by the local government in whose jurisdiction the violating factory is located, possibly because the violator creates jobs and represents an important source of revenue in the town where it is located. Indeed, many violators appear to be protected by local governments, which quite often turn out to be investors in the very factories accused of IPR violations. Until recently, the military was heavily involved in both smuggling and producing media and other products. The central government forced the divestiture of these military-owned businesses in 1997 and 1998, but production continues under different owners.

Piracy of trademarks is also rampant, especially in south China. Enforcement, while effective in some locales, is sporadic at best. China currently fails to protect well known marks or to offer adequate and effective protection for service marks and other trademarks.

However, there is new pressure coming from within China to shore up these protections, as well-known Chinese brands seek legal protection from domestic competitors who knowingly steal their intellectual property.

China has made certain commitments to expand its enforcement mechanisms. Chinese actions to date this have involved primarily the confiscation of goods from retailers, and increasingly, the seizure of production lines from offending factories. According to the IIPA, a total of 133 replication lines have been seized since the 1995 US-China Bilateral IPR Agreement, but this has done little to slow the estimated dollar value of losses to copyright holders, which have nearly tripled in the same period. The IIPA states that in 2001 alone, over 20,000 raids at the production, wholesale, and retail levels netted over 55 million pieces of pirated media, which is only a small fraction of the total annual production.

As per its WTO accession commitments, China currently permits the importation of only twenty (20) foreign films per year, which are shown on a revenue-sharing basis. Top run films have done well when allowed into the Chinese market, but have faced competition from more inexpensive pirated versions.

Software products have also been widely pirated throughout China. The Business Software Association (BSA), an association of major U.S. software manufacturers, estimates that China is the world's second largest offender in business software piracy, after Vietnam, with a 92% rate of business software piracy. China comes in third place in estimates of total losses of \$1.7 Billion. By comparison, the US, which has a more respectable 25% rate of software piracy but a much larger market for business software, represents \$1.8 Billion in losses.

Pirated copies of U.S. and European software packages are freely sold on the streets and in stores in China. The popular Windows operating system, produced by Microsoft, can be purchased in stores throughout China for about \$1. The store owners will in some cases even copy the software onto a blank CD-ROM while the customer waits in the store. Even copies of the operating manuals have been illegally reproduced and sold with the pirated software. Chinese government agencies have equipped their office computer networks with pirated software products, although many US and European companies operating in China recently admitted to similar conduct. However, since joining the WTO, the Chinese government has begun to address this problem. Microsoft and other software companies are also signing agreements with Chinese computer makers to ensure that new computers are sold with only licensed software pre-installed.

The impact of this piracy is to prevent the rights holders in the US, EU, Switzerland, and other countries from marketing their legitimate product in markets where Chinese-made pirated goods are present. Bringing about a change in the present market conditions will require a concerted effort from the Chinese government, as well as the rights holders, to both educate the public and to crack down on IPR violators.

PARTIES TO THE NEGOTIATIONS

Parties to these negotiation simulations will include country teams and interest groups within the country teams:

Peoples Republic of China (PRC)

- 1) Ministry of Foreign Trade and Economic Cooperation (MOFTEC) - primary governmental ministry representing the PRC in international negotiations
- 2) Representatives of Beijing's WTO Center
- 3) Association of Chinese Entrepreneurs represented by the Office of the Mayor of Shanghai
- 4) Representative of Haier

United States of America (USA)

- 1) U.S. Trade Representative's Office (USTR) - primary U.S. government agency representing U.S. interests
- 2) Motion Picture Association of America (MPA)
- 3) Music Industry Association of America (MIA)
- 4) Business Software Alliance (BSA)
- 5) Microsoft Corp.

European Union (EU)

- 1) Director General of the EU for External Relations (EUDG)
- 2) European Clothing Design and Manufacturers Association (ECDMA)
- 3) European Intellectual Property Rights Association (EIPRA) (established by members including computer, movie, music, and clothing manufacturers.)
- 4) Vivendi Group – Owner of French and American music and film production companies

Government of Switzerland

- 1) Office of the Foreign Ministry for Trade (OFMT)
- 2) Federation of Swiss Watch Industry (FSWI)
- 3) Intellectual Property Rights Association of Switzerland (IPRAS)

THE NEGOTIATION PROCESS

The parties to these negotiations will be provided with individual team instructions and facts common to each country team's interests.

Individual interest groups (e.g., associations, government agencies, etc.) will meet first to review facts, develop team negotiating goals and strategies, assign research and negotiating roles, and to document all negotiating sessions.

All interest groups will then meet with their country team members. (Country team members may or may not share common interests, goals, etc.) Lead government agencies will seek to reconcile differences and to advance a unified voice in the bilateral or multilateral sessions.

All teams will seek to advance specific negotiating goals and interests. For example, it can be assumed that China seeks acceptance **in the** international trading community, that it would like to avoid a dispute in the WTO, and that it is committed to an increased level of enforcement in the area of intellectual property rights. Similarly, it can be assumed that the US, EU, and Swiss governments and constituent manufacturing groups seek enforcement of IPR laws in China and greater access to the Chinese market. Interest groups may differ, however, on appropriate timetables, implementation mechanisms, and enforcement.

All parties will want to consider some or all of the following:

- 1) Documentation of the scope of the problem;
- 2) Specific agreements to implement reforms including, but not limited to rules, regulations, monitoring devices, enforcement mechanisms, legal remedies, etc;
- 3) Timetables for implementation of agreements reached;
- 4) Criteria in the field of IPR for Chinese accession to the WTO.

It will also be important to determine the interests of your counterparts including adversaries and allies. You will want to try to build alliances within your country and with other country governments or individual interest groups.

CONFIDENTIAL PARTY INSTRUCTIONS

Each individual team (interest group) will be provided with further confidential instructions issued from the perspective of a superior corporate, governmental, or military officer. You are to design your negotiating strategy in accord with the instructions. Questions regarding instructions or the terms of agreements reached can be reviewed with one of the instructors.

HYPOTHETICAL V. FACTUAL INFORMATION AND FURTHER RESEARCH

All information presented in the factual background and supplemental facts is based on actual figures with the exception of the following:

- 1) Facts provided for piracy of Rolex watches (trademark) and for designer clothing and clothing products are invented in terms of the estimated numbers of counterfeit products. Data was not discovered to place an actual figure on the number of counterfeit copies; 2) Students may work from the factual information presented. You may also supplement the information with research on the Internet. Data should focus on the time frame of December 2001 to mid-2002, i.e., violations which have occurred since China acceded to the WTO. If you obtain supplemental factual information, you should cite the source and make available to your country team associates and present in negotiations to the extent the data supports your positions and proposals.

NEGOTIATING SKILLS AND TECHNIQUES

- 1) Teams should engage in "brainstorming" sessions to identify and articulate your interests and those of your counterparts including the listing of potential **OPTIONS** for an agreement and the use of **OBJECTIVE CRITERIA** for the structuring and implementation of agreements;
- 2) Teams should elect a **LEAD NEGOTIATOR** for each negotiating session. It is important for team members to defer to a lead negotiator and to **SPEAK WITH ONE VOICE**. Lead negotiators may invite the participation of team members on specific issues, areas of expertise, etc.
- 3) Teams should use **CAUCUSES** (private team meetings) to review proposals, formulate counter-proposals, or to review the status of the negotiations; Remember to **LISTEN** to your counterparts and **ASK QUESTIONS** to learn what their needs are. What do they want? Can you fashion an agreement or the provision of an agreement that will meet some if not all of their needs? Are your sessions **CONFIDENTIAL** or open to the press and public? Craft and utilize **SINGLE TEXT DOCUMENTS** to introduce proposed language on agreements, to capture agreements on procedure and/or substance that can be added to the text of a final agreement; Obtain **SIGNATURES** of counterparts on documents reflecting interim or final agreements; Consider future meetings, working groups, investigative teams, etc as means to keep the process moving forward and to avoid stalemates. Remember you are dealing with people. What are their needs within their organization, bureaucracy, company, etc. Can you help them to meet their needs? Establish a personal rapport. Be hard on the problem, be soft on the people. Consider a **JOINT MEDIA RELEASE OR CONFERENCE** to announce progress or a final agreement. Use the media to help solidify the parties' public commitment to the agreement.

RULES TO ENHANCE THE LEARNING GOALS OF THE SIMULATION

Because time is extremely limited, the instructors request that students abide by the following rules which have proven effective in other negotiation simulations:

- 1) Limit caucus sessions and breaks during negotiations to no more than five (5) minutes;
- 2) Country teams will have to negotiate an internal consensus among all interest groups BEFORE the commencement of official bilateral negotiations with national counterparts.
- 3) The parties will not be authorized to "walk-out" or otherwise boycott a negotiation session;
- 4) If negotiating teams reach an "impasse" (stalemate, dead-end, end point) they should work on another issue and/or seek the instructors' intervention;
- 5) No name calling, personal attacks, or insults will be permitted. (This is not good style in real world negotiations and is usually the result of ego, loss of emotional control, etc.)
- 6) Make use of charts, note-taking, printed exhibits, and printed documents to facilitate the recording of interim and/or final agreements.

LOCATION OF THE NEGOTIATIONS

As negotiating sessions are established, a home country will be identified. The home country should serve as the host of the negotiations. Hosts should welcome guests to their country and to the negotiation session. Introductions should be made before the parties proceed to substantive matters.

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INTERNATIONAL NEGOTIATIONS TO PROTECT INTELLECTUAL PROPERTY RIGHTS

SUPPLEMENTAL FACTUAL INFORMATION AND ASSUMPTIONS TO BE READ BY ALL PARTIES.

Students should first read the general background and instructions. The information provided here is available to all parties to the negotiation. Your country teams and individual interest groups will need to incorporate this information into your negotiation strategy.

You are expected to incorporate this common information in light of the specific team instructions to be distributed prior to negotiations.

For purposes of this simulation, assume the following facts and assumptions to be true.

Economic and Trade Information

From 1984 through 2001, U.S. yearly exports to China rose from \$3 billion to \$19.2 billion. In the same period, however, Chinese exports to the U.S. rose from \$3.1 billion to \$102.3 billion. This amounted to an approximately \$80 billion trade surplus, but it should be noted that no small percentage of China's exports to the US are manufactured by US and other foreign invested factories. In fact, approximately 50% of China's total worldwide exports come from foreign invested factories.

Estimated (by U.S. government) trade losses due to piracy in China in 2001 amounted to:

Motion pictures: \$160 million

Sound recordings and musical compositions: \$418 million (based at fair market prices)

Business software: \$714.6 million

Entertainment software: \$455 million

Books: \$130 million

The impact of this piracy directly impacts the domestic economies of the U.S., E.U. and other exporting nations who rely on the sale of copyrighted or trademarked materials.

Consider the following data supplied by the International Intellectual Property Alliance (IIPA):

In 2001, the core copyright industries contributed \$535.1 billion in value added to the U.S. economy, or approximately 5.24% of the Gross Domestic Product (GDP). According to the 2002 report prepared for IIPA by Economists, Inc., entitled [Copyright Industries in the U.S. Economy](#):

The 2002 Report, the core copyright industry's share of GDP grew at more than twice the rate of the economy as a whole between 1977 and 2001 (7% vs. 3%). Employment in the core copyright industries grew at more than three times the employment growth in the economy as a whole in the same period (5% vs. 1.5%). Over 8 million workers were employed by the "total" copyright industries, about 6% of the U.S. workforce, in 2001. The core copyright industries contributed an estimated \$88.97 billion in foreign sales to the U.S. economy in 2001, doubling the figure for 1994.

(The above data is instructive as to the importance of copyrighted materials production and sales to the U.S. economy. Piracy of these products has a direct and adverse impact on the U.S. economy, including jobs.)

Boeing Corporation – Aircraft exports to China:

Boeing has a 30+ year history in China, now including sales, maintenance, parts assembly, sourcing, and training. Boeing planes represent one of the most valuable exports for the United States economy and for the state of Washington. Due to Boeing's special relationship with China, and because of the extremely valuable trade data that its China office handles, Boeing was one of the first and only US companies to be permitted a secure communications uplink (for engineering plans and other data-intensive needs) by the Chinese government. Foreign news organizations and most other companies in China are not permitted to own or use satellite uplink equipment for "security" reasons.

In 1997, China placed a \$3 billion order for 50 airplanes - the largest order in history at that time. It is estimated that every \$1 billion in aircraft sales supports 11,000 jobs, so the 1997 order for \$3 billion in aircraft represented 33,000 jobs to Boeing and its suppliers.

By 1999, 324 of the 477 commercial jet aircraft in China are Boeing - market share is 68%. Boeing projects a total market for approximately 1,600 commercial jet aircraft sales in China worth \$120 billion over the next 20 years.

(The above data, although from 1997 and 1999, will be of importance in understanding divergent foreign business interests with respect to IPR issues in China. Boeing is one of China's most important suppliers of technology, and China is one of Boeing's most important clients. Both sides are keen to avoid disruption of trade ties.)

Microsoft Corporation – Software exports:

Microsoft and the Chinese government have suffered a love-hate relationship over the last decade. Where Microsoft largely ignored market development due to rampant piracy of its products and accused the Chinese government of ineffective anti-piracy efforts, the Chinese government lambasted Microsoft products for having security backdoors. However, due to rampant piracy and to a lack of suitable alternatives, Windows is the dominant operating system in China. In a change of strategy, Microsoft recently announced a \$750 million investment in China over the next 3 years, the largest ever by a software company, which will focus on training, development and outsourcing.

Chinese Exports

Information on Chinese exports will be important in the negotiations should the US/EU/Switzerland threaten trade sanctions AGAINST China in the form of sanctions on Chinese exports, e.g., higher tariffs and/or other trade restrictions. You will find some economic data in the hand-out materials which accompany the simulation exercise background and instructions. You may also want to research for further economic and export data to determine areas where trade sanctions might be imposed against China should a negotiated accord not be achieved.

Some Facts to be Assumed Regarding IPR violations in China

Chinese factories pirating movies, videos, CDs, and other recordings have been operating in Guangdong, Fujian, Hainan, and Jiangsu provinces, as well as Shanghai.

Assume that the domestic and export market for counterfeit CDs is booming. Both illegal and legitimate factories are manufacturing counterfeit CDs. The counterfeits are of high quality and difficult to differentiate from genuine product. (The good counterfeits even carry an SID code which is intended to identify a legal CD with the manufacturer's code.) Pirate CDs sell for a little as 80 cents (IJS). Best estimates are that there are 200 CD manufacturing lines in registered plants and at least 50 lines in underground plants. (A registered plant is legally established for the production of legal goods; they produce the counterfeit items to supplement production income.) Many of these plants were until 1998 under the control of the People's Liberation Army, but ownership is often not clear since the forced divestiture of 1997-1998. It is widely believed that local governments assumed ownership in 1998. Reluctant to lose an important source of revenue, they continue to operate in violation of Beijing's directives and are now a primary source of pirated CDs, VCDs, DVDs and CD-ROMs.

Foreign producers of CDs, videos, and software seek the following: an end to piracy of their products and improved access to produce and more unfettered access for their products in China.

China traditionally defended its restrictions on imports of music and movie products on the grounds that the content of these items may violate Chinese political and cultural norms. Now that China has joined the WTO, it has made a commitment to allow 20 films (for theatre release) per year. There are vague limits on distribution and sale of movies and music at the retail-level, and licensing procedures are both cumbersome and non-transparent. The interception and destruction of pirated goods has been enforced primarily at the retail level, and the penalties faced by producers and distributors have been light. It is estimated that over 20,000 showrooms display and sell illegal CDs, videos, & cassettes.

The Motion Picture Association (MPA) has documented the piracy of videos (movies) at an alarmingly high rate. In 2001, assume that Chinese raids closed 70 illegal production facilities. Assume that approximately 50-100 production facilities are still in operation.

Assume that based on information provided by authorities in Shanghai, 12 production facilities were raided and closed and that 400,000 pirated DVDs of MPA titles were

seized. In Beijing, over 200 retail outlets were raided and closed in 1994. MPA representatives argue that more titles of pirated movies are on the market than the number that they have been permitted to license. In essence, the market for pirated goods greatly exceeds – in scale and in scope of product offerings – the market for legitimate and licensed products. MPA seeks an expanded program of raids, prosecutions, and fines for those caught in the production or sales of pirated VCDs and DVDs.

A related problem includes the unauthorized showing of foreign copyrighted movies (videos) from Europe and the US in clubs, bars, hotels, and other public places. Assume that the Chinese government only approves 10 European and 10 US titles for foreign distribution and sale in China each year. High tariff and taxes on imported films make them difficult to sell, particularly since the same titles are available for less than a dollar from pirated production.

Assume that 50,000 watches bearing the Rolex trademark (Swiss) are sold in China each year. These watches are not manufactured by the Rolex company but are poor imitations that bear the Rolex identifying trademarks. Another 50,000-100,000 watches manufactured in Chinese factories bear a description on the watch face of "Swiss Movement" which is a protected country of origin label intended to indicate that the watch was manufactured within the borders of Switzerland. The watches are believed to be manufactured in watch factories which also produce domestic label watches for sale in China. It is suspected that many of the counterfeit labels are affixed to watches that are illegally exported to Hong Kong and other foreign markets. It is believed that officers of the People's Liberation Army (PLA) in China, and local governments, which own many businesses recently spun off by the PLA, are directly involved in the trademark infringement and exports. Chinese customs and export officials are suspected of receiving illegal payments to allow the shipments to leave China.

Assume that Chinese watch manufacturing plants are suspected of allowing the trademark infringement and participate in the illegal placement of the Rolex trademark. Two plants in Shanghai were operated under the supervision and control of the People's Liberation Army until 1998, but the ownership of the factories is no longer clear. The factories, which are still in operation, also produce watches for government officials, military personnel, and Chinese citizens. The Chinese watch makers have also illegally expropriated the "Swiss Movement", country-of-origin label by placing it on the face of counterfeit watches. Only watches which are assembled with Swiss manufactured parts can display the "Swiss Movement" country of origin markings.

Assume that five clothing plants in Shanghai province produce imitations of athletic shoes and designer clothing bearing the trademark emblems of Adidas (German), Gucci (Italian), and Versace (Italian), and Pierre Cardin (French). These factories were at one time known to be under the supervision and control of the People's Liberation Army which used the factories to produce shoes and uniforms for members of the People's Liberation Army, the Chinese Navy, and for factory workers. In many cases, it is unclear if the military, or other branches of the government, have any controlling interest in these companies.

Computer software copyrighted by US and European companies has also been pirated at

an alarming rate. The Chinese National Copyright Administration (CNCA) is the entity charged with enforcing rights in software and computer programs. The Chinese government acknowledges that this department is woefully understaffed, but believes that it is making a “good faith” effort to comply with its WTO commitments. Worldwide losses to the computer industry from piracy amount to approximately US\$10 billion annually - (this figure includes all producers primarily US and European). · Legal sales of US software in China amounted to less than \$US 10 million with over 150 million computers in operation in China. According to the Business Software Alliance, over 92% of all software used in China is illegally copied and resulted in losses of approximately US\$1.7 Billion in 2001 alone.

Chinese Law and Economic Development.

Assume that current Chinese law affords protection to copyright holders (including foreign copyrights), and that this protection is the same for state-owned and privately owned entities. Enforcement mechanisms have been enhanced since China’s accession to the WTO, but actual enforcement is still rather weak. Chinese law divides infringement of copyrights into two categories: ordinary infringement and serious acts of infringement. Remedies include making an apology and paying compensation for the damages to the copyright holder and the destruction of infringing software in appropriate cases. Enforcement of violations occurs through a formal court prosecution or a more informal mediation. The latter process is most commonly utilized. Fines levied against violators have been small.

While piracy is a problem acknowledged by the Chinese government, government officials are sensitive to demands to simply close all production facilities in China that may have the capacity to engage in piracy. The Chinese government and entrepreneurs seek to develop and expand their capacity for the legal production of clothing, watches, CDs, videos, software, hardware, etc. There is a record of strong opposition to any reforms that limit or curtail China's legitimate aspirations to expand its economic development.

The Mayor of Shanghai and the Shanghai Association of Entrepreneurs seeks to expand its export capacity, limit foreign tariffs and trade restrictions, and avoid the imposition of trade sanctions against China by the Swiss government, the EU, or the US as retaliation for IPR violations. The Mayor of Shanghai and the Shanghai Association of Entrepreneurs maintain close relations with MOFTEC in Beijing. Many of the Beijing-based economic and political (party) leaders are originally from Shanghai.

The Haier Group, one of China’s largest manufacturers of white goods, and a recent entrant in the cell phone and computer markets, is one of the world’s largest manufacturers of refrigerators. Haier holds many patents, and recently began export to the US under its own brand name. The company, one of China’s best known brands, is concerned about protecting its own Intellectual Property, as well as protecting its valuable brand from shoddy copycat products.

- If foreign governments impose trade sanctions against China in retaliation for Chinese IPR violations, China is prepared to impose counter sanctions against foreign imports

in the form of higher tariffs or outright trade bans. However, China would also like to avoid having a trade dispute rise to the level of the WTO.

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**NEGOTIATION SIMULATION:
INTELLECTUAL PROPERTY RIGHTS
PROTECTION.**

General Format for Simulations

The general format for the negotiation simulations related to the protection of intellectual property rights will be as follows:

Students will be divided into three autonomous groups. Groups I, II, & III.

Within each group there will be the following teams:

Country Teams

China USA EU Switzerland

Groups Represented on Country Teams

Country teams will include the following stakeholder groups:

China: Ministry of Foreign Trade and Economic Cooperation (MOFTEC), Mayor of Shanghai, the Shanghai Entrepreneurs Association, Representatives of the WTO Center in Beijing and Representatives of the Haier Group

(The MOFTEC team should be large enough so that simultaneous bilateral negotiations can be carried out with the official representatives of the EU, USA, and Switzerland.)

USA: United States Trade Representative's Office (USTR), Motion Picture Association of America (MPAA), Music Industry Association of America (MPAA), Business Software Alliance (BSA), Boeing Corporation and Microsoft Corporation

European Union (EU): Director General of the EU for External Relations (EUDG), European Clothing and Design Manufacturers Association (ECDMA), European Intellectual Property Rights Association (EIPRA) and Vivendi Group

Switzerland: Office of the Foreign Ministry for Trade (OFMT) Federation of Swiss Watch Industry (FSWI) Intellectual Property Rights Association of Switzerland (IPRAS)

Sequence of Meetings and Negotiations: [fix the negotiation schedule once participation sorted out]

Monday Afternoon:

Individual stakeholder groups meet to develop negotiation strategy.

Country teams meet to negotiate and develop country team negotiation strategy.

(Rule: Country teams will not be able to begin bilateral negotiations with other national representatives UNTIL they have reached a consensus on negotiating goals among all stakeholder groups within their country team.)

Tuesday Morning:

Bilateral Sessions: (China MOFTEC will assign team members to participate in following bilateral sessions with national representatives.)

China (MOFTEC) - EUDG China (MOFTEC) - USTR China (MOFTEC) - Swiss - OFMT

Shanghai Mayor's Office and Entrepreneurs with all IPR interest groups from US-EU-Switzerland.

WTO Center representatives with Boeing Corporation representatives

Haier Group representatives with Microsoft and Vivendi representatives

These bilateral sessions will continue until the late morning break. Country teams will then caucus with all stakeholders to determine progress, new options for consideration, etc.

After lunch break:

Resume bilateral sessions as in morning. Reach interim and/or final agreements

Afternoon Break:

Multilateral Working Group Session

Groups I, II, III reconvene in lecture hall for reports and evaluation of agreements reached.

BACKGROUND ON THE DISPUTE SETTLEMENT UNDERSTANDING (DSU)

The DSU is the primary mechanism for WTO members to resolve trade related disputes according to a common set of rules and principles. The primary components of the DSU include a framework for mediation, which can be entered into at any time that two parties request, and the Dispute Resolution Panel, which can be established 60 days after the request for consultations. The Panel allows trade-related disputes between WTO members to be adjudicated, and provides more sufficient enforcement “teeth” than under the previous GATT. One of the distinctions is that a country can request a panel be formed, unless there is a consensus NOT to form a panel. Furthermore, a decision rendered by the panel is accepted unless there is consensus NOT to accept it. This has the effect of ensuring that the process is less subject to interference by individual Members, decisions carry more weight, and that countries are more likely to resort to the panel process than to seek unilateral action when arbitration fails. The panel process ensures a greater equity to the WTO system, since both developed and developing countries are equal under WTO law and have equal access (in principle, at least) to the Dispute Resolution procedures.

After the panel is formed, the process begins 3-6 weeks later with the submission of a brief from the complaining party, followed within a couple weeks by the party being complained against. After a series of meetings and presentations before the panel by the various parties, followed by opportunities for rebuttal, a process that may extend nearly half a year, the panel will review their findings issue a report to the parties of the dispute.

ACRONYMS USED IN THIS INTERNATIONAL NEGOTIATION SIMULATION

The following acronyms will be used throughout this international negotiation simulation:

EU - European Union

EUDG - Director General of the EU for External Relations (Trade)

ECDMA - European Clothing Design and Manufacturers Association

EIPRA - European Intellectual Property Rights Association

IPR - Intellectual Property Rights

PRC - People's Republic of China

MOFTEC - Ministry of Foreign Trade and Economic Cooperation

PLA – People's Liberation Army

ACE - Association of Chinese Entrepreneurs (Shanghai)

MOS - Mayor's Office of Shanghai

USA - United States of America

USTR - United States Trade Representative

MPA or MPAA - Motion Picture Association of America

MIA or MIAA - Music Industry Association of America

BSA or BSAA - Business Software Association of America

BOEING - Boeing Corporation

MICROSOFT - Microsoft Corporation

WIPO - World Intellectual Property Organization WTO -World Trade Organization

(See definitions, supra.)

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