

***CHINA – MEASURES AFFECTING THE PROTECTION AND  
ENFORCEMENT OF INTELLECTUAL PROPERTY RIGHTS***

***(WT/DS362)***

**ORAL STATEMENT OF THE UNITED STATES OF AMERICA  
AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL**

**April 14, 2008**

1. Good morning, Mr. Chairman and members of the Panel. On behalf of the United States, we would like to begin by thanking the Panel and the Secretariat staff for taking on this task. Our delegation looks forward to working with you, and with the delegation of China, as you carry out your work.

## **I. Introduction**

2. We are here today because we have asked that you to help us resolve a dispute between the United States and China with respect to whether certain, specific Chinese measures are consistent with China's obligations under the TRIPS Agreement.

3. The United States recognizes that China undertook major revisions to its laws to create a modern system of intellectual property right ("IPR) protection in its effort to meet TRIPS Agreement standards before and after its WTO accession in December 2001. We appreciate China's commitment to improving its IPR regime, and we continue to place value on our IPR cooperation with China on many fronts. Regrettably, however, the United States considers that our IPR cooperation efforts have reached an impasse on the three specific sets of issues in this dispute. We are deeply concerned that the measures relevant to these issues are not consistent with China's obligations under the TRIPS Agreement.

4. Mr. Chairman and Members of the Panel, our statement this morning will highlight the evidence and arguments that the United States has presented in this dispute. We will also provide some comments on China's first submission. We will of course not be able to address every aspect of China's lengthy submission and its many exhibits this morning. We will be pleased to address them in more detail in our responses to your questions and in our second written submission.

5. With that as a backdrop, the first set of issues we have asked you to examine concerns China's thresholds for criminal prosecution and conviction of trademark counterfeiting and copyright piracy. The TRIPS Agreement states that "Members shall provide for criminal procedures and penalties to be applied at least in cases of wilful trademark counterfeiting or copyright piracy on a commercial scale." Yet China's laws establish safe harbors from criminal

liability for commercial-scale counterfeiting and piracy by prohibiting prosecution or conviction unless a case meets specific quantitative or value thresholds. These thresholds leave ample scope for many acts of commercial-scale piracy and counterfeiting. They provide counterfeiters a legally certain roadmap that allows them to enter the market while escaping criminal sanctions for their commercial-scale IPR infringement.

6. The second set of issues concern China's border measures for disposal of infringing goods. China's measures do not conform to the standards agreed upon in the TRIPS Agreement. These obligations require Chinese authorities to have the authority to order destruction of the goods, or their disposal outside the channels of commerce in a manner that avoids harm to the right holder. Yet China's Customs law turns the TRIPS Agreement requirements on their head by creating a three-step hierarchy that requires Customs authorities in many circumstances to permit certain infringing goods to enter the channels of commerce, or to take other steps that cause, rather than avoid, harm to the affected right holder.

7. The third set of issues concerns the denial of copyright protection to certain works in China. The TRIPS Agreement requires copyright protection to attach to a work upon its creation. The absence of these rights and the concomitant lack of enforceability of these rights opens the door to IPR infringement. Yet, China's laws do not provide copyright protection to movies, music, books, journals, and the like, whenever such works are prohibited from publication or distribution in China. The failure to afford copyright protection to these works allows pirates to exploit these unprotected works in China free of any fears of copyright enforcement and also denies compensation to the right holder when the works are often at the peak of their commercial value.

8. Before we begin, we would like to recall that various types of measures in China have a ranking of weight and authority. Paragraph 66 of the Working Party Report on China's Accession spells out the hierarchy of these various types of laws and regulations, as well as their terminology, and they have generally been followed by China at the WTO. Our first submission also explained

that the power to interpret national laws, which is vested in the Standing Committee of the National People’s Congress, may be exercised through judicial interpretations of the Supreme People’s Court and the Supreme People’s Procuratorate.<sup>1</sup> We will try to keep to the established terms for these legal concepts, and we hope that this will assist the Panel as it assesses China’s measures and prepares its report in this dispute.

## **II. China’s Criminal IPR Thresholds for Criminal Procedures and Penalties**

9. We will now turn to our first claim. Under Chinese law, criminal prosecution or conviction for certain acts of IPR infringement are impossible unless specific monetary or volume-based thresholds are met. As a result, these measures are inconsistent with the first and second sentences of Article 61 and Article 41.1 of the TRIPS Agreement.

### *Article 61, first sentence*

10. The United States recognizes that many participants in the Uruguay Round negotiations of the TRIPS Agreement had varying levels of ambition for the criminal enforcement provisions. The first sentence of Article 61 implements the consensus solution arrived at by the negotiators of the TRIPS Agreement: namely, that Members be required to provide for criminal procedures and penalties against wilful commercial-scale piracy and counterfeiting. This provision creates a minimum standard that all WTO Members must implement in their domestic IPR regime.

11. Article 61 is located in Section 5 of Part III of the TRIPS Agreement, which is entitled “criminal procedures.” While Part III of the TRIPS Agreement deals with a number of enforcement procedures, such as civil, border, and administrative measures, it is notable that Article 61 is the only provision that focuses on criminal penalties and procedures. And conversely that also means that only criminal penalties and procedures can fulfill the obligations in Article 61.

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<sup>1</sup> First Written Submission of the United States, para. 23.

12. The words “at least” in the first sentence make clear that Article 61 lays a floor for WTO Members: Members must provide for criminal procedures and penalties to be applied to the entire set of cases within this universe. This means that providing for criminal procedures and penalties to be applied *in some cases* of “wilful trademark counterfeiting and copyright piracy on a commercial scale,” but not in others, does not fulfill the obligations in Article 61.

13. Despite the minimum standard of application provided by Article 61, China appears to argue that this Panel’s scrutiny of its implementation of the TRIPS Agreement standards on criminal procedures and penalties is somehow inappropriate because it concerns criminal law.<sup>2</sup> However, like all WTO Members, when China agreed to become a Member of the WTO, it also agreed to ensure that its criminal laws against piracy and counterfeiting meets the standards in the TRIPS Agreement.

14. China also takes a novel approach in interpreting the minimum enforcement standards in the TRIPS Agreement. For example, it appears to argue that Article 1.1 and Article 41.5 permit it to “define” the standards of Article 61 based on its own method of implementation and its own enforcement resource constraints.<sup>3</sup> The implication of China’s argument, of course, is that these provisions permit China to adjust its TRIPS enforcement commitment it made to other WTO Members.

15. The United States notes that China is making efforts to address the rampant levels of piracy and counterfeiting that is taking place in its market. But, Article 1.1. deals with the *method* of implementing China’s TRIPS Agreement obligations, not *whether* they should implement them in the first place. And Article 41.5 is concerned with similar issues. Indeed, China may choose to implement Article 61 in Chinese law in any way that is consistent with its terms. However, that is a far cry from saying China may adopt any definition for Article 61 it chooses. Articles 1.1. and

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<sup>2</sup> See, e.g., First Written Submission of the People’s Republic of China, paras. 52-59.

<sup>3</sup> See, e.g., First Written Submission of the People’s Republic of China, paras. 92-101.

41.5 do not somehow alter the obligations provided by Article 61, and China, like all other WTO Members, must implement Article 61 in a way that respects its terms.

16. We would now like to turn to the term “on a commercial scale” in Article 61, and to summarize the U.S. approach to this issue, which we set out in more detail in our first submission.<sup>4</sup> In particular, we would like to highlight two features of the term. *First*, by using the term “commercial *scale*,” the TRIPS Agreement makes clear that WTO Members must criminalize acts of infringement that reach a certain extent or magnitude. *Second*, in using the term “*commercial scale*,” the TRIPS Agreement draws a link to the commercial marketplace – where business-minded IPR infringers take the fruits of their counterfeiting or piracy. Thus, the concept of “commercial scale” extends to those who engage in commercial activities, including retail sales and manufacturing.

17. China’s first submission misreads the U.S. view of “commercial scale.” According to China, the U.S. position is that commercial scale only means commercial purpose. That is not the U.S. view; indeed, such an interpretation would read the word “scale” out of the term. That said, an infringer that is engaged in pursuing financial gain in the marketplace is acting on a “scale” that is “commercial.” And, the “scale” of what is “commercial” in each market will necessarily vary by many factors, such as the object of the infringement and the market for the infringed items.

18. The Chinese submission alleges that we wrongly interpret “commercial scale” by looking at the ordinary meaning of the individual words “commercial” and “scale.”<sup>5</sup> To the contrary, the U.S. interpretation is based on the well-established principles that govern treaty interpretation in WTO dispute settlement pursuant to Article 3.2 of the DSU. These principles are the customary rules of interpretation of public international law reflected in the *Vienna Convention on the Law of Treaties*.

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<sup>4</sup> First Written Submission of the United States, paras. 108-110.

<sup>5</sup> First Written Submission of the People’s Republic of China, paras. 69-72.

19. By contrast, China’s proposed interpretation does not meet that interpretative standard. China has invited the Panel to replace the term “commercial scale” with a phrase that TRIPS Article 61 does not contain: “a significant magnitude of activity.”<sup>6</sup> China’s arguments do not withstand scrutiny. This proposal suffers from the same interpretive flaws that China incorrectly criticizes the United States for: namely, it reads “commercial” out of Article 61.

20. The principal evidence that China relies upon in support of its proposal for “commercial scale” is a discussion of this term in 1988 by a WIPO Committee of Experts on Counterfeiting and Piracy.<sup>7</sup> China points to a paragraph of the section on manufacturing in a document prepared by the International Bureau of the WIPO, which reads:

“‘Commercial scale’ is a notion which will have to be applied taking into account consideration of the circumstances accompanying the manufacture. The quantity of the goods manufactured, the way in which they were, or are intended to be used, and the will to make profit are among the factors that the courts will have to take into consideration.”

21. It is unclear what status this document has under the *Vienna Convention*. China has not claimed that it falls within the ambit of the general rules of treaty interpretation provided by Article 31. To the extent that the document could be considered a supplementary means of interpretation within the scope of Article 32 – a point which the United States does not concede – information related to the circumstances of a treaty’s conclusion can be taken into account only to confirm an interpretation or if needed where the rules have otherwise resulted in an absurd or unreasonable interpretation.

22. In this case, the WIPO Committee’s document provides confirmation of the interpretation suggested by the United States. The WIPO Committee discussions reflect that the concept of commercial scale could not be reduced to a value or volume metric. It included, but was not

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<sup>6</sup> First Written Submission of the People’s Republic of China, para. 72.

<sup>7</sup> See Exhibit CHN-43.

limited to, a variety of factors that should be taken into account by national courts. Such factors include “the will to make a profit” and the way that the goods “are intended to be used” in addition to the “quantity of goods.” China’s system of rigid numerical thresholds that ties the hands of its prosecutors and judges is far afield from the notion of a set of relevant factors that national courts should be able to take into account when determining whether an act of counterfeiting or piracy should be subject to remedies.

23. China also tries to limit the scope of Article 61 to only apply to industrial-scale activities, but of course, Article 61 refers to “commercial scale.” Moreover, the WIPO Committee’s work did not only deal with acts of counterfeiting or piracy involving manufacturing. In fact, the same document cited by China provides that retail sale can also be an act of counterfeiting or piracy.<sup>8</sup>

24. We would now like to describe how China’s criminal IPR thresholds are inconsistent with the standard in Article 61. There is no doubt that China’s IPR thresholds provide for criminalization of some counterfeiting and piracy on a commercial scale. However, in order to meet China’s obligations under Article 61, China must make criminal procedures and penalties available for all wilful trademark counterfeiting and copyright piracy on a commercial scale.

25. China fails to do so because its criminal IPR thresholds create a safe harbor for pirates and counterfeiters, meaning that criminal penalties and procedures are not available for a vast array of commercial-scale piracy and counterfeiting. This morning, we would like to touch briefly on two fundamental problems inherent in the way that China has structured its criminal IPR thresholds.

26. The first fundamental problem is that China’s thresholds are set at such a level, and calculated in such a way, that they do not permit prosecution or conviction of infringing activity involving values or volumes that are below the thresholds but are still “on a commercial scale.”

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<sup>8</sup> *Id.*, at pp. 11-12.



27. An example of this problem is provided by a review of the Article 213 thresholds for trademark counterfeiting. Under Article 213 of the Criminal Law and the 2004 Judicial Interpretation, counterfeiting that involves use of an identical trademark on the same kind of commodities must exceed an “illegal business volume” threshold of not less than RMB 50,000 – which is approximately \$6,900 – or an “illegal gains” threshold of not less than RMB 30,000 – which is approximately USD \$4,100. (We note that the U.S. currency conversions were performed in January of this year.)

28. If a case fails to meet at least one of these two thresholds, that fact will preclude criminal prosecution and conviction. By virtue of setting these thresholds, China has exempted any activity that is below the thresholds from criminal penalties and procedures under Article 213. The thresholds therefore will not apply to any counterfeiting activity that does not reach these Article 213 thresholds.

29. But, there are many classes of commercial scale activity that take place under these thresholds. If one examines some of the ways that China has structured the Article 213 thresholds, this fact becomes apparent. For example, the calculation methodology required for the “illegal business volume” thresholds is not a calculation of the value of the legitimate non-infringing goods with which the counterfeit goods compete. Instead, Chinese prosecutors and judges are directed by default to base this calculation on the prices through which the counterfeit goods undercut legitimate merchandise. China does not contest that a court will only turn to prices of the legitimate goods as a last resort.

30. The value of “illegal business volume” for a quantity of counterfeit merchandise can be far less than the value of an equivalent quantity of legitimate merchandise. For example, this is often true in the case of personal care products or small electronics. Many commercial activities in these legitimate markets take place on a scale where the value of the goods involved is less than the RMB 50,000 thresholds. It follows that commercial scale buying and selling activities involving *counterfeit* goods of these types will routinely involve values below that threshold.

31. Another example of the exclusion of certain classes of commercial scale activity is demonstrated by the RMB 30,000 “illegal gains” threshold.<sup>9</sup> China has confirmed that illegal gains refers to profits.<sup>10</sup> In our submission, the United States has demonstrated that this threshold can miss many classes of commercial scale activity. For example, to calculate profits, one must subtract expenses from any revenues obtained from the counterfeiting activity. Therefore, in order to reach the RMB 30,000 “illegal gains” threshold, the amount of revenue must necessarily exceed that level. And additionally, given that counterfeit products can be sold at low prices compared to the legitimate products, these goods will have low margins. Consequently, the lower the margin for a product, the higher the volume of products that will be needed to meet the “illegal gains” threshold. Thus, requiring a profit level of RMB 30,000 will not capture all “commercial scale” activities.

32. Similar safe harbor problems are seen under the thresholds for Article 214 and Article 215 of China’s Criminal Law. For example, Article 215 criminalizes forged or unauthorized reproductions of a registered trademark. The copy threshold of 20,000 under Article 215 provides no means to capture all commercial scale counterfeiting. To the contrary, it provides an exceedingly high threshold, as a factory could store 19,999 counterfeit logos of a designer brand, and still evade the application of the Article 215 copy threshold.

33. The structure of China’s criminal thresholds for copyright piracy present comparable safe harbor problems to those for trademark counterfeiting. For example, under Article 217 of China’s Criminal Law and the 2004 and 2007 Judicial Interpretations, copyright or related rights infringement committed for the purpose of making profits must meet one of three thresholds before criminal procedures or penalties can be available: an “illegal business volume” of not less than RMB 50,000 (approximately \$6,900); “illegal gains” of not less than RMB 30,000 (approximately \$4,100); or 500 copies.

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<sup>9</sup> See Exhibit US-2, pp. 1-4.

<sup>10</sup> First Written Submission of the People’s Republic of China, para. 20.

34. The illegal business volume and illegal gains thresholds for Article 217 provide analogous problems for capturing commercial scale piracy to the ones we have just discussed. Likewise, the 500 copy threshold under Article 217 also excludes acts of commercial scale piracy. For example, if a copyright pirate makes 499 reproductions or a retailer stocks 499 copies in a store, the safe harbor afforded by the threshold would ensure that he or she could not be prosecuted or convicted on the basis of that evidence under Article 217 of the Criminal Law based on the 500 copy threshold.

35. There is a second fundamental problem with the thresholds as well. This problem stems from the fact that Chinese authorities must rely on a limited set of one-size-fits-all tests to find commercial scale counterfeiting and piracy that can be subject to criminal prosecution or conviction. A range of considerations should be probative of “commercial scale,” but China’s rigid criminal thresholds preclude their use.

36. In this connection, the thresholds fail to reach some classes of commercial-scale piracy and counterfeiting not only because of their magnitude, but also because of what they do – and do not – measure. The thresholds do not measure other reliable indicia of a commercial scale piracy or counterfeiting operation, such as “worn molds” for pressing pirated products or counterfeit marks or other materials and implements of such an operation. Indeed, the thresholds reduce the entire universe of commercial activity to a flat value or volume metric. As we demonstrate in our submission, this metric is ill-adapted to the diversity of commercial activity in China and provides many ways for commercial scale counterfeiting and piracy to escape prosecution.<sup>11</sup>

37. China does not directly contradict the U.S. position that its thresholds fail to reach all commercial scale counterfeiting and piracy. Rather, China argues that they “best capture the points at which intellectual property infringement . . . warrants criminal enforcement.”<sup>12</sup> While

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<sup>11</sup> See First Written Submission of the United States, paras. 137, 140, and 156.

<sup>12</sup> First Written Submission of the People’s Republic of China, para. 137.

that may be China’s view, it neither explains nor justifies how the boundaries of criminal liability that China has chosen in fact capture all counterfeiting and piracy that is “on a commercial scale” in the sense of Article 61. Moreover, what China chooses to do with its domestic *non-IPR* criminal thresholds has no bearing on this Panel’s assessment of whether China meets its international obligations under *Article 61 of the TRIPS Agreement*.

38. Similarly, China’s attempts to show that the RMB 50,000 “illegal business volume” (approximately \$6,900) threshold for piracy and counterfeiting covers “commercial scale” fails to withstand scrutiny.<sup>13</sup> The United States would commend to the Panel Canada’s citation to China’s estimated per capita gross domestic product in Canada’s Third Party Submission. We see that China’s estimated GDP per capita over 2007 was approximately \$5,300.<sup>14</sup> The United States fails to see how the \$6,900 “illegal business volume” thresholds would be appropriate to commercial scale in light of a *yearly* per capita income of \$5,300.

39. China also appears to claim that its “evidentiary” provisions under the measures at issue should not be subject to scrutiny under Article 61, as they are not relevant to the substantive legal obligation.<sup>15</sup> That distinction does not withstand scrutiny. Whatever the label ascribed to China’s measures, the way in which they are calculated, including evidentiary requirements, reinforces the commercial scale safe harbor because the thresholds limit the legal bases on which a criminal conviction can be achieved. Indeed, what China calls “evidentiary” rules are, in fact, very relevant to whether China meets the Article 61 obligation: they cause “criminal procedures” and “criminal penalties” not to be “applied” in some cases of wilful trademark counterfeiting and copyright piracy.

40. In that connection, China appears to claim that the cumulative calculation of the thresholds decreases the chances that China’s safe harbors would shelter some of the examples of commercial activity noted by the United States. Whether calculated over one hour or over many years, China’s

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<sup>13</sup> First Written Submission of the People’s Republic of China, paras. 133-137.

<sup>14</sup> Third Party Submission of Canada, Exhibit CDA-1.

<sup>15</sup> First Written Submission of the People’s Republic of China, paras. 140-141.

thresholds create a safe harbor whereby pirates and counterfeiters can conduct their commercial scale operations, immune from criminal prosecution. Furthermore, China concedes that if an administrative penalty in a prior seizure action or case is applied (which China admits is often its preferred remedy), it would wipe the slate clean and those prior seizures could not be counted on to meet the thresholds, leaving prosecutors to start their calculations over again.<sup>16</sup>

41. The United States has provided a concrete illustration of how the structure of the thresholds leads to counter-productive results. The United States has submitted a report prepared by a right holder group called the China Copyright Alliance, or CCA for short, in the course of their IPR enforcement efforts in China. It focuses on enforcement raids of a variety of retail operations involving recorded music and audiovisual products undertaken by Chinese administrative officials. The CCA Report is a compelling empirical study that pulls together raw data from several hundred enforcement actions in four major Chinese cities.

42. We have attached two pie charts from the CCA Report in Annex A and B. The pie chart in Annex A catalogues the administrative seizures for calendar year 2006, when the Article 217 1,000 copy threshold was in effect and the pie chart in Annex B catalogues the seizures from April to November 2007, when the lower 500 copy threshold was in effect. In both pie charts, the administrative seizures that netted copies below the thresholds appears in the color green.

43. The CCA Report illustrates that the existence of China's arbitrary criminal thresholds creates a safe harbor. While the Report is described in fuller detail in our submission,<sup>17</sup> we would like to outline three key features that become apparent from the data. First, the CCA Report is an example of the scale of commerce in China for certain pirated products. It shows that pirates and counterfeiters can conduct their commercial scale activities below the reach of China's thresholds.

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<sup>16</sup> First Written Submission of the People's Republic of China, para. 30.

<sup>17</sup> First Written Submission of the United States, paras. 151-161.

44. Second, the CCA Report demonstrates the safe harbor because significant quantities of retail sales of infringing product take place in China at levels below China’s thresholds. That means that the vast majority of retail outlets in each pie chart faced no possibility of criminal prosecution or conviction under China’s criminal IPR laws.

45. Third, if you compare the two sets of “below-the-thresholds” seizure data in both charts – again marked in the color green – you will see that more than 80% of all administrative raids in both of these two time periods netted evidence falling *below* the thresholds in effect at the time. This demonstrates that despite the lower 500 copy threshold that was in effect during the second time period, piracy and counterfeiting continued to flourish in the safe harbor below the thresholds.

*Article 61, Second Sentence and Article 41.1 of the TRIPS Agreement*

46. China’s criminal IPR thresholds are also inconsistent with the second sentence of Article 61 and Article 41.1. China confirms that if the Panel finds that China’s criminal IPR thresholds are inconsistent with the first sentence of Article 61, it must also find an inconsistency with the second sentence of Article 61 and Article 41.1.<sup>18</sup>

47. In closing our discussion of our Article 61 claim, we note that China argues that the United States bears an “especially high burden of proof in advancing this claim.”<sup>19</sup> We disagree with this unsupported assertion. China has cited no provision of the Dispute Settlement Understanding or of the TRIPS Agreement standing for this proposition, nor could it: the DSU and the TRIPS Agreement do not impose any special burden of proof for this claim.

48. To summarize: the United States has demonstrated that China fails to provide for criminal procedures and penalties to be applied in at a great number of instances of commercial-scale

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<sup>18</sup> First Written Submission of the People’s Republic of China, para. 150.

<sup>19</sup> First Written Submission of the People’s Republic of China, para. 49.

trademark counterfeiting and copyright piracy. We therefore request that this Panel find China's IPR thresholds are inconsistent with China's obligations under the first and second sentences of Article 61, and Article 41.1, of the TRIPS Agreement.

### **III. China's Border Measures for Disposal of Confiscated Goods**

49. Now we would like to turn to our second claim. The three sets of measures at issue in our second claim are: (1) China's State Council Regulations for Customs Protection of Intellectual Property Rights,<sup>20</sup> (2) the measures issued by China Customs to implement the State Council regulations,<sup>21</sup> and (3) Announcement No. 16 of the General Administration of Customs.<sup>22</sup> These measures collectively establish a clear hierarchy of rules governing the disposal of imported goods that Chinese Customs authorities confiscate as infringing intellectual property rights.

50. Under these Chinese measures, the Customs authorities are only permitted to destroy the infringing goods as a last resort, and they do not have the power to dispose of goods outside the channels of commerce in a manner that avoids any harm to the rightholder. Customs' rules require them to attempt to dispose of the goods in accordance with a strict hierarchy – first, by either transferring them to public welfare organizations or selling them to the right holder; if this is not feasible, they must take the second step and auction off the seized goods following removal of infringing features, if this is possible. And, if Customs can take any of these actions, Customs does not ever acquire the power to destroy the goods. These measures are inconsistent with China's obligations under Article 59 of the TRIPS Agreement.

#### *Article 59 of the TRIPS Agreement*

51. The first sentence of Article 59 provides in pertinent part that the “competent authorities shall have the authority to order the destruction or disposal of infringing goods in accordance with the principles set out in Article 46.” As we have discussed in our submission, for the purposes of

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<sup>20</sup> Exhibit US-5.

<sup>21</sup> Exhibit US-6.

<sup>22</sup> Exhibit US-7.

this dispute, this requires focus on two of the sentences in Article 46. First, a Member’s competent authorities for border enforcement “shall have the authority to order that goods that they have found to be infringing be, without compensation of any sort, disposed of outside the channels of commerce in such a manner as to avoid any harm caused to the right holder, or, unless this would be contrary to existing constitutional requirements, destroyed.” Second, “[i]n regard to counterfeit trademark goods, the simple removal of the trademark unlawfully affixed shall not be sufficient, other than in exceptional cases, to permit release of the goods into the channels of commerce.”

52. Contrary to Article 59, however, China’s Customs authorities do not have the authority to order the destruction or disposal of infringing goods in accordance with these Article 46 principles. This is because Article 30 of the Customs IPR Implementing Measures, which implements Article 27 of the State Council Customs IPR Regulation, sets out a compulsory sequence of steps that Chinese Customs must follow in deciding how to treat goods seized at the border that it has determined infringe intellectual property rights.

53. In its submission, China states that Article 59 of the TRIPS Agreement does not require a grant of unconditional authority to its agencies. The Chinese submission also takes issue with how the United States characterizes its compulsory sequence, claiming that Chinese Customs authorities do possess the “authority” to choose to destroy or dispose of goods outside channels of commerce in a manner that avoids any harm to the right holder.<sup>23</sup>

54. Article 59 plainly requires “authority” to be granted to dispose of or destroy confiscated infringing goods in accordance with the principles of Article 46. Article 46 in turn does not limit the authority it provides in its principles to only a subset of the circumstances where Customs officials must decide what to do with infringing goods they have confiscated. Accordingly, the

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<sup>23</sup> First Written Submission of the People’s Republic of China, para. 175



relevant government actors must have the authority to effectuate these principles whenever they are responsible for disposal or destruction of these infringing goods.

55. The United States is not arguing that TRIPS rules *require* China to destroy or dispose of all such goods in accordance with the principles in the first sentence of Article 46. The pertinent issue is what decisions China Customs is permitted by law to make in particular circumstances. “Authority” means that China Customs should have the *power* to choose among any of the options – including destruction or disposal outside the channels of commerce in accordance with the principles of Article 46 – from the outset when the goods are found to be infringing, and thereafter until the goods are finally dealt with.

56. China’s measures demonstrate the compulsory nature of its disposal hierarchy and thereby demonstrate the inconsistency with Article 46 principles. China’s measures require Customs to mechanically follow a series of sequential rules. Specifically, the Customs Implementing Measures set out a detailed, step-by-step process governing exactly how Customs must proceed in handling the disposal of confiscated goods. The Implementing Measures were issued by China’s General Administration of Customs and bind customs officials across China.<sup>24</sup>

57. Given how central the Customs Implementing Measures are to the U.S. claim, we were surprised to see that China’s First Submission did not address this measure when discussing whether Chinese authorities are required to take actions that do not comply with Article 59 obligations.

58. To show more specifically how the Chinese measures operate to deny Customs the authority to destroy or dispose of goods in a TRIPS-consistent fashion, we would like to walk through each of the steps in the hierarchy mandated by the Customs Implementing Measures. In the initial step, Customs must decide whether the infringing goods can be used for “public good.”

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<sup>24</sup> See Exhibit US-6.

If the answer is yes, Customs must either give the goods to a “public welfare organization” or Customs may instead allow the right holder to purchase the goods “for compensation” – in other words, Customs offers the right holder the opportunity to buy the very goods that infringe on the right holder’s intellectual property rights.

59. With respect to Customs’ donation of infringing goods to “public welfare organizations,” China has confirmed that this disposal option will not be available if the goods are unsuitable for donation. In cases where the goods are suitable, the United States is pleased to learn that China Customs has donated seized goods to charities such as the Red Cross of China. We are also pleased to learn that some of the examples cited by China appear to feature the right holders’ consent to such actions. Obtaining right holders’ approval ensures that right holders are not harmed by Customs’ actions.

60. China further argues that it has a legal obligation to ensure that the goods are not moved back into the channels of commerce after they have been donated to such an organization, based in part on citation to a general obligation to “implement necessary supervision” when goods are used for “social welfare purposes.”<sup>25</sup> China also provides a Memorandum of Cooperation that it negotiated with the Red Cross of China in support of its claim. This Memorandum contains a provision obligating the Red Cross to ensure that the goods do not enter into the channels of commerce.

61. While this is notable, the United States continues to have concerns about the TRIPS consistency of China’s measures, given certain provisions in the Law on Donation for Public Welfare, a measure that China cited in its First Submission. China included selected provisions of this law as an exhibit, but did not include the entire measure. The United States has obtained a copy of the entire law from China’s Ministry of Commerce website, and submits it here as Exhibit US-59.

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<sup>25</sup> First Written Submission of the People’s Republic of China, para. 164

62. Article 17 of this law specifically authorizes public welfare organizations to sell donated goods on the market if certain circumstances are present. This confirms the United States' concerns that Customs' delivery of infringing goods to public welfare organizations, under Chinese law, does not ensure that the goods will remain outside the channels of commerce and avoid any harm to the right holder.

63. Moving beyond the issues surrounding donation to public welfare organizations, there are a number of circumstances where donation is not appropriate – as China itself states.<sup>26</sup> In these circumstances, Chinese authorities must offer the infringing goods for sale to the right holder. This mandated action does not permit disposal “in such a manner as to avoid any harm caused to the right holder,” as Article 46 requires. Indeed, right-holders are faced with a dilemma. They can pay for the infringing goods to ensure that they are destroyed or removed from commerce, but suffer financial harm in the form of a payment for goods that infringe rights that they own. Or, on the other hand, they can refuse to purchase the goods and face the prospect that the goods could be released into the channels of commerce by public auction.

64. Where the transfer to a public welfare organization is unavailable, and the right holder does not elect to purchase the infringing goods, the Customs authorities must turn to the next compulsory step under the Customs Implementing Measures. This step involves the public auction of the confiscated goods. China's public auction likewise does not comport with the principles incorporated into Article 59. Putting the seized goods up for public auction introduces them into the channels of commerce and does not dispose of them in a manner that avoids any harm to the right holder. A mandated auction under the Customs Implementing Measures, of course, also precludes Customs from having the authority to destroy these products.

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<sup>26</sup> See, e.g., First Written Submission of the People's Republic of China, paras. 173, 204.

65. China does not contest that its public auction is introduction into the channels of commerce. On these grounds alone, however, the mandatory auction provided by China's measures is inconsistent with the principles of Article 46.

66. With regard to the need to "avoid any harm caused to the right holder," China asserts that right-holders' formal right to comment before the auction meets this commitment. However, a right holder's ability to "comment" on China's measures is not a right to *prevent* the goods from being auctioned, and the right to prevent an auction is the only means to ensure that the authorities act in a manner that avoids any harm to a right holder. A public auction can cause great harm to the right holder, since the infringer or importer whose goods have been confiscated can simply purchase the seized goods at the auction, re-affix the infringing features, and proceed to distribute the goods.

67. With respect to counterfeit trademark goods in particular, this public auction step is also inconsistent with the principle in the fourth sentence of Article 46, which provides that goods can be introduced into the channels of commerce after removal of the unlawfully affixed trademarks only "in exceptional cases."

68. China claims that this obligation is not a principle within the meaning of Article 59, and as such, is not incorporated into Article 59. In the alternative, China does not read the text of the obligation in the last sentence of Article 46 to bar the release of seized counterfeit goods into the channels of commerce, except in exceptional cases. Instead, China claims the principle only means that the "removal of the trademark is not sufficient" to permit release. It then asserts that right holders' ability to comment on (but not prevent) an auction go beyond removal of the trademark, and therefore Chinese measures meet the TRIPS standard.<sup>27</sup>

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<sup>27</sup> First Written Submission of the People's Republic of China, paras. 215, 223-225.

69. China’s argument that the fourth sentence of Article 46 is not incorporated into Article 59 is at odds with the plain meaning of Article 59. China has not pointed to any limiting language in Article 59 that would only selectively incorporate the obligations in the first sentence of Article 46. Indeed, the word “principle” does not even appear in Article 46. If the negotiators of the TRIPS Agreement had intended to carve out specific obligations in Article 46 from being transposed to Article 59, they would have done so.

70. The ordinary meaning of Article 46 in its context is that it is impermissible to release the goods into the channels of commerce after removal of an unlawful trademark, unless exceptional circumstances are present.

71. Returning to the mandatory hierarchy of actions China Customs must take to deal with confiscated infringing goods, if an auction is not possible, then and only then, China Customs gains the power to destroy the infringing goods. We recall that China’s measures ensure this step will not be reached if any of the previous options are available – either mandatory step one: donation with possible resale rights or sale to the right holder; or mandatory step two: the public auction. In those situations, Chinese customs authorities are not, as a matter of Chinese law, authorized to destroy the infringing good – or otherwise dispose of the good in a way that is both outside of the channels of commerce and handled in a manner that avoids any harm to the right holder.

72. China argues that it has “substantial discretion” to determine that an infringing good is not suitable for the disposal options and therefore has authority to order destruction. However, China’s Customs Implementing Measures states that when certain facts are present, Customs officials must dispose of the goods only in the manner stipulated. In each of those circumstances, Chinese customs authorities lack the authority, as a matter of Chinese law, to order the destruction of infringing goods.

73. To summarize: China's border measures do not provide Chinese border officials with the authority required under TRIPS Article 46 principles, and thus are inconsistent with China's obligations under Article 59. The United States requests that the Panel find that (1) the compulsory sequences of steps set out in the Chinese measures at issue mean that Chinese customs authorities lack the authority to order destruction or disposal of infringing goods in accordance with the principles set out in Article 46 of the TRIPS Agreement, and (2) the measures at issue are therefore inconsistent with China's obligations under Article 59 of the TRIPS Agreement.

#### **IV. Article 4 of China's Copyright Law**

74. This brings me to our third and final claim. This claim is centered on the first sentence of Article 4 of China's Copyright Law. Article 4, first sentence, provides that "[w]orks the publication or distribution of which is prohibited by law shall not be protected by this Law."

75. As we have more fully set out in our first submission, a denial of copyright protection has important consequences. By denying copyright protection to works that should have it, the provision allows copyright infringers to profit at the expense of the legitimate rightholder, without fear of being subjected to enforcement procedures and remedies for copyright infringement.

76. We have therefore been seeking information about the operation of Article 4 from China bilaterally for some time. Up to now we had unfortunately received only very limited replies to our inquiries. The United States therefore read this portion of China's first submission with great interest. Our initial reaction to what we have read, however, is mixed.

77. On the one hand, there are a number of welcome statements in the Chinese submission. In particular, right holders world-wide will be pleased to hear China's statement that the National Copyright Administration of China (NCAC) supports using its administrative enforcement authority to pursue infringements and infringers, regardless of the content review status of the work being infringed.

78. At the same time, however, China’s first submission has not resolved a number of concerns about the *legal* operation of Article 4 – the text of which provides a clear and straightforward denial of copyright protection. China’s focus on the actions of its NCAC leaves unresolved the concerns that, as a matter of law, the first sentence of Article 4 denies copyright protection to works whose content is still being reviewed – that is, works for which relevant Chinese authorities are still verifying whether or not the contents fall within one of the prohibited categories. There are several reasons why China’s first submission has failed to address this issue and answer the U.S. concerns.

79. Most importantly, the Chinese submission appears simply to concede that Article 4 of China’s Copyright Law is inconsistent with China’s obligations under the TRIPS Agreement. This is because China admits that the first sentence of Article 4 denies protection to works whose contents are prohibited.<sup>28</sup> Moreover, the NCAC has confirmed that, for the purpose of administrative proceedings, Article 4 denies copyright protection to “works whose contents are illegal.”

80. China therefore appears to confirm that it denies copyright protection to works containing illegal content that Chinese authorities determine is prohibited by law. This also confirms that Article 4 is inconsistent with China’s obligations under the TRIPS Agreement.

81. In the first place, contrary to China’s obligations under Article 9.1 of the TRIPS Agreement (and the provisions of the Berne Convention referenced in Article 9.1), the first sentence of Article 4 of the Copyright Law denies copyright protection to works that are entitled to such protection. Berne Convention Article 2(1) makes clear that the works protected by the Convention include “*every* production in the literary, scientific and artistic domain, whatever may be the mode or form of its expression” (emphasis added), and Article 2(6) further makes clear that these works must enjoy copyright protection everywhere that the Berne Convention applies. The

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<sup>28</sup> See First Written Submission of the People’s Republic of China, para. 243.

Article 4.1 blanket exclusion for certain illegal works, therefore, is inconsistent with the Berne Convention.

82. Moreover, because Article 4 denies copyright protection to certain works, the broad set of exclusive rights enumerated in Article 10 of China’s Copyright Law are also denied to such works. As a result, Article 4 of the Copyright Law does not comply with the requirements of Article 5(1) of the Berne Convention, which specifies certain guaranteed exclusive rights.

83. And indeed, when there is no copyright protection, a right holder cannot seek to enforce his or her rights in the work. Therefore, authors of the works also do not benefit from the remedies specified in Articles 46 and 47 of the Copyright Law, which provide civil liability (and in some cases, administrative and/or criminal liability) for copyright infringement. China therefore fails to ensure that enforcement procedures as specified in Part III of the TRIPS Agreement are available to copyrighted works that should be protected upon creation in order to permit effective action and expeditious remedies against copyright infringements. China is therefore not in compliance with its obligations under Article 41.1 and Article 61, first and second sentence, of the TRIPS Agreement.

84. In addition to effectively conceding that Article 4 is TRIPS-inconsistent, China’s first submission has not addressed the U.S. concerns about the impact of content review on copyright protection, for several reasons.

85. *First*, as explained in the U.S. first submission,<sup>29</sup> in China, the power to interpret Chinese law rests with the Standing Committee of the National People’s Congress. With respect to judicial and procuratorial (prosecution) work, the Standing Committee has delegated a portion of that interpretive power to the Supreme People’s Court and the Supreme People’s Procuratorate for matters under judicial [*sifa*] review. Administrative agencies (such as the NCAC), however, do

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<sup>29</sup> First Written Submission of the United States, para. 23.



not have such delegated authority for cases under judicial review, and thus cannot – as a matter of Chinese law – issue interpretations of Chinese law for purposes of civil or criminal matters heard by the courts or being considered by the procuratorate.

86. Thus, while welcoming the actions taken by the NCAC to protect works of foreign authors, the United States is not in a position to accept that those actions represent a definitive interpretation of Article 4 of the Copyright Law, at least with respect to China’s TRIPS obligations to afford criminal and civil remedies for copyright infringements heard by the courts and procuratorate (as opposed to the distinctive administrative remedies enforced by NCAC or, sometimes, local copyright bureaux).

87. *Second*, the United States is not convinced by China’s discussion of the *Zheng Haijin* case. China notes that in that case, the NCAC replied to a question from the Supreme People’s Court by drawing a distinction between works whose content is illegal (such works are denied copyright) and works for which certain publication formalities have not been respected (such works, according to the NCAC, have copyright protection). It is not at all clear why China considers that this NCAC document responds to the U.S. claims about content review; according to the NCAC, the publisher in question had violated Chinese laws regarding book publication numbers, not Chinese laws regarding content.

88. *Third*, with respect to the *Zheng Haijin* case itself, it is of course the courts that apply the law in cases under adjudication, and not the NCAC. In fact, China’s Supreme People’s Court issued guidance in this case when it was under review by the Hunan High Court. The letter to the Hunan High Court, which the Supreme People’s Court issued after receiving the NCAC guidance that we discussed a moment ago, was subsequently redistributed by the Supreme People’s Court in 2000. A copy of the Supreme People’s Court letter is attached as Exhibit US-60. That letter provides, in relevant part, as follows:

It is this Court’s position after review: The *Inside Story* was initially published in the magazine “Yanhuang Chunqiu” (1994, No.2). In May of the same year, the United Front Department of the Sichuan Provincial Communist Party Committee reviewed the book and approved its publication. Nothing was found in the text of the Inside Story to violate any laws. *Therefore*, it is correct for the courts of the first and second instances to provide it protection under the Copyright Law.<sup>30</sup>

Thus, in this guidance document, the Supreme People’s Court appears to have considered that copyright protection was contingent on the work’s successful completion of content review.

89. The United States recalls that Article 5(2) of the Berne Convention provides that the “enjoyment and exercise of these rights shall not be subject to any formality . . . .” To the extent that the first sentence of Article 4 of the Copyright Law makes the exercise and enjoyment of copyright rights in civil and criminal matters dependent upon the successful completion of some type of content review, Article 4 appears also to be inconsistent with Article 5(2) of the Berne Convention, and thus, inconsistent with Article 9.1 of the TRIPS Agreement for that reason as well.

90. To summarize: In its submission, China appears to have conceded that the first sentence of Article 4 of its Copyright Law operates to deny copyright protection to works containing prohibited content. Therefore, we respectfully ask that this Panel conclude that China is acting inconsistently with its obligations under the TRIPS Agreement.

## **V. Conclusion**

91. Mr. Chairman and Members of the Panel, we would like to again emphasize our support for, and appreciation of, the extensive IPR-related legislative changes that China has made during and after WTO accession. However, IPR infringement in China remains at levels that are unacceptably high and continues to severely impact the market for legitimate products, brands, and technologies from a wide range of industries. In light of the extensive scope of this problem,

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<sup>30</sup> Exhibit US-60, emphasis added.

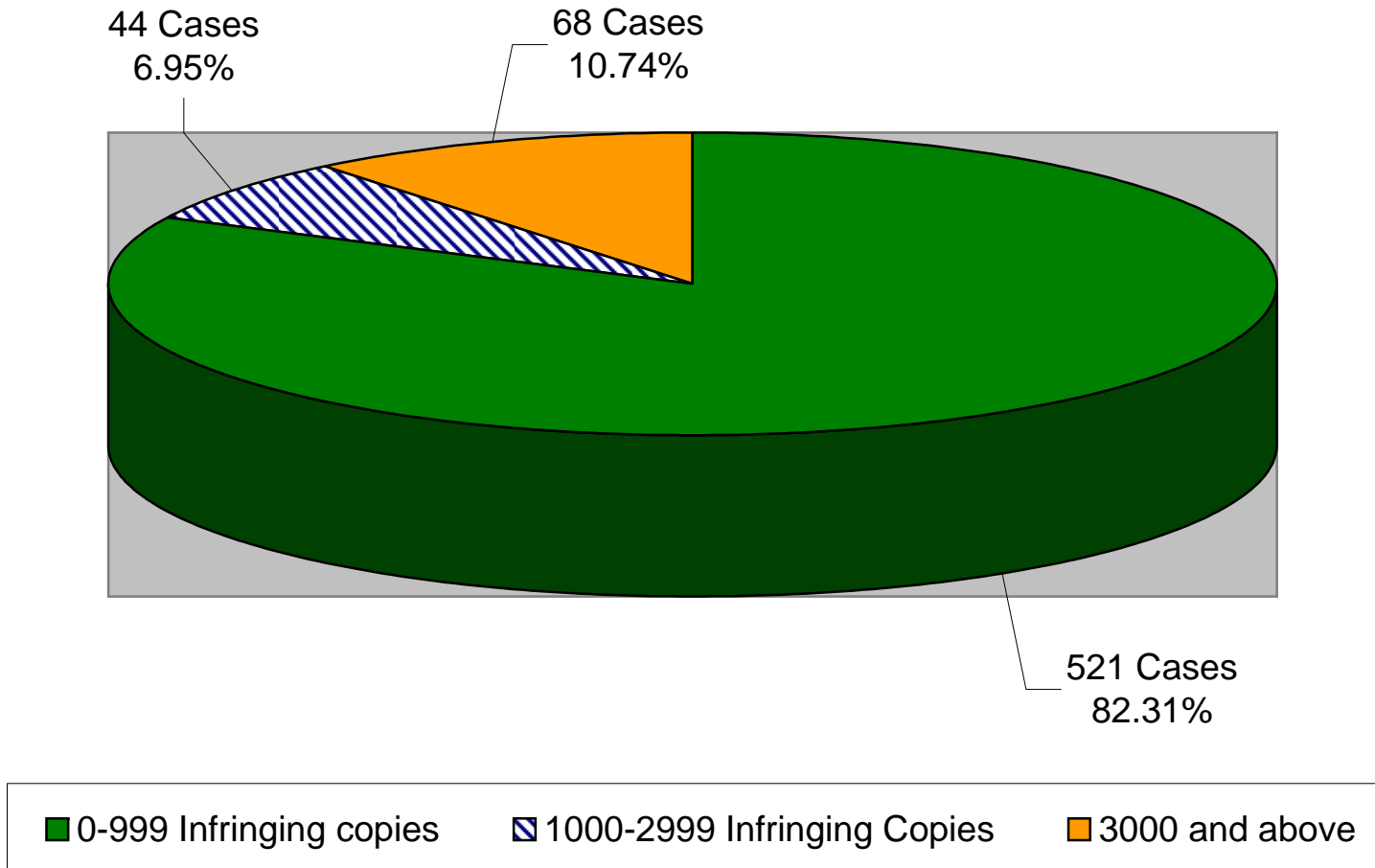
China's decision to limit the reach of its IPR protection and enforcement measures in the ways that the United States has described this morning, is regrettable.

92. At this point, I would like to bring our opening statement to a close. We look forward to working with you over the coming days to address your questions. Thank you again for your time and attention.

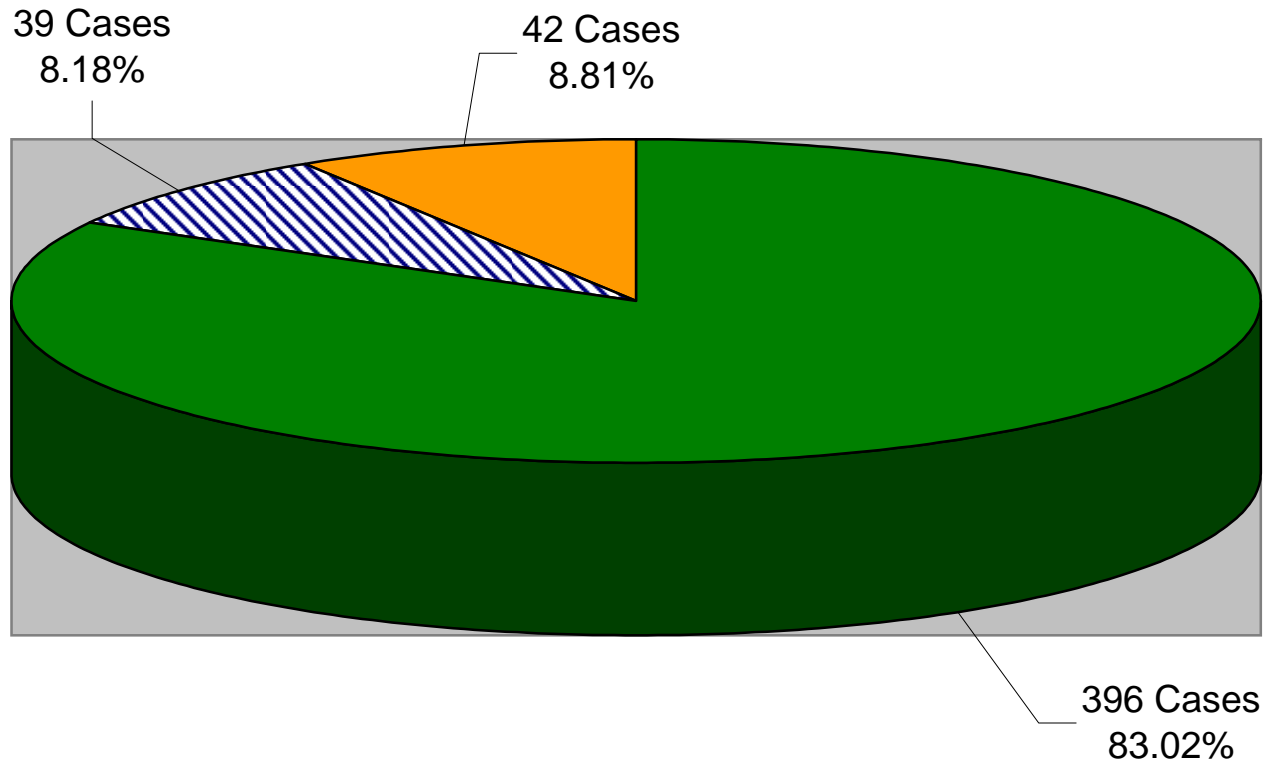
**TABLE OF EXHIBITS**

<b>U.S. Exhibit No.</b>	<b><u>Description</u></b>
US-59	Law of the People's Republic of China on Donations for Public Welfare ( <i>full Chinese version; English excerpt</i> )
US-60	Letter of Supreme People's Court on the Copyright Infringement Dispute Case, <i>Zheng Haijin vs. Xu Zheng Xiong and Tianjin People's Publishing House</i> , March 9, 2000, Zhi Jian Zi, [1998] No. 33

**Music and Motion Picture Copyright Administrative Raids in China:  
Number of Cases by Copies Seized  
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