A mixed result

The US has complained to the World Trade Organisation that China's IP rights protection and enforcement legislation violates international agreements. A WTO panel has presented its report and both sides are claiming victory. By Jan Bohanes and Adrian Emch, Sidley Austin, Geneva and Beijing.

Companies operating in China often complain of widespread violations of intellectual property rights (IPR).[1] Over the past few years, the United States government has put diplomatic pressure on China to remedy this situation, mainly by engaging in bilateral contact with Chinese authorities and officials. In April 2007, the US changed its approach and took its complaints to a multilateral forum – the World Trade Organisation (WTO).

The WTO is an international organisation built on a framework of agreements that cover a vast range of international commercial activities, including trade in goods and services. WTO law also establishes minimum standards for the protection of IPR. The *Agreement on Trade-related Aspects of Intellectual Property Rights* (TRIPs Agreement) obliges WTO members to create laws and regulations protecting defined categories of IPR – for instance, patents, trademarks, copyright, integrated circuits and trade secrets – and to establish legal mechanisms through which IP rights holders can enforce their rights in the domestic legal system.

To ensure compliance, the WTO also operates a powerful dispute settlement mechanism. This mechanism consists of a two-tiered international tribunal empowered to determine if violations of WTO law have occurred and to authorise trade sanctions against offenders who do not remedy their violations. If a WTO member believes that another member's conduct is in breach of WTO rules, it can bring its case to a panel of experts that adjudicates impartially on the basis of WTO law. Subsequently, an appeal against the panel's decision to the WTO's Appellate Body is possible.

On December 3 2007, such a panel was formed with the task of examining whether parts of Chinese legislation on IPR protection and enforcement violate the TRIPs Agreement. The panel published its report on January 26 2009.

THE PANEL'S FINDINGS

The panel accepted some of the United States' claims, but rejected others. Although both sides have claimed victory – a frequent phenomenon in the world of WTO litigation between sovereign governments – it is clear that the result is a mixed bag from the perspective of both parties.

China violates TRIPs provisions on copyright protection for certain qualifying works

The panel agreed with the US that China violated Article 9(1) of the TRIPs Agreement, which incorporates Article 5(1) of the Berne Convention for the Protection of Literary and Artistic Works, as well as Article 41(1) of TRIPs. These provisions require governments to grant copyright protection for qualifying works and establish procedures to enforce such protection. But Chinese law denies copyright protection to works that fail a review process conducted by the Chinese authorities. The review process determines whether the content of a work is prohibited under Chinese law on the grounds that, for instance, it is against the fundamental principles established in the Chinese Constitution, it is of a "superstitious" or "immoral" nature, or it propagates gambling or violence.[2] Works (or portions thereof) that fail the review process are denied copyright protection under Article 4(1) of the *PRC Copyright Law*.

China sought to justify the exclusion of copyright for prohibited works under Article 17 of the Berne Convention, incorporated by reference into TRIPs, which entitles a government to "permit, to control, or to prohibit … the circulation, presentation, or exhibition of any work … in regard to which the competent authority may find it necessary to exercise that right." The panel disagreed, however, that Article 17 authorises the denial of all copyright protection in any work.[3] It found that, while a government's rights under Article 17 may interfere with the exercise of certain rights by the copyright owner, censorship cannot legally eliminate those rights entirely for a particular work.[4]

Chinese measures on disposal of infringing goods violate TRIPs

The US challenged Chinese customs regulations that determine how customs authorities dispose of confiscated IPR-infringing goods – counterfeit brand-name clothing, for instance. Article 59 of the TRIPs Agreement requires WTO members to give government organs "the authority to order the destruction or disposal of infringing goods" outside the channels of commerce.

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Under the Chinese regulations at issue, Customs would either (a) give the goods to charitable organisations; (b) sell the goods to the IPR holder; (c) auction off the goods if the first two options are impossible and the infringing features of the goods can be eradicated; or (d) destroy the goods when none of the three preceding options is possible. The US argument was that, in particular circumstances, Chinese Customs was required to auction off the infringing goods. This would mean that, in these circumstances, Customs does not have "the authority to order the destruction or disposal" outside the channels of commerce, as required by Article 59.

The panel analysed the wording of the Chinese regulations and found that the US had not established that Customs was required to order the auction of infringing goods.[5] Instead, the auction was an optional course of action[6] and therefore does not violate Article 59. However, the panel agreed with the US that China violated Article 59 because, with respect to confiscated counterfeit trademark goods, China permitted the removal of a trademark and the subsequent sale into the channels of commerce – a course of action prohibited by Article 59, read together with Article 46 of the TRIPs Agreement.

Insufficient evidence for US claim against Chinese criminal law provisions

The US argued that the thresholds set out in Chinese law above which IPR-infringing behaviour was considered a criminal offence were too high and created a safe harbour for widespread commercial-scale infringement. The US therefore challenged certain Chinese criminal law provisions under Article 61 of the TRIPs Agreement, which provides that "at least in cases of wilful trademark counterfeiting or copyright piracy on a commercial scale" WTO members shall provide for criminal procedures and penalties. Chinese law defined, among others, numerical criteria such as the "business operation volume" or "amount of illegal gains" to delineate criminal from non-criminal IPR-infringement.

The panel rejected the US claim for lack of sufficient evidence. It considered that the concept of counterfeiting or piracy on a commercial scale refers to counterfeiting or piracy that reflects the magnitude or extent of typical or usual commercial activity for a given product in a given market.[7] The US did not provide sufficient data or evidence for products, markets or other factors that would demonstrate what constituted "commercial scale" in China's marketplace.[8] The US relied to a large extent on press articles that, in the panel's view, were either anecdotal or not sufficiently specific. The US also argued that China failed to consider other, non-quantitative factors in distinguishing "commercial scale" from "non-commercial scale" piracy: for instance evidence such as the presence of unfinished products or packaging materials. The panel again rejected the US argument for lack of evidence.

With respect to this third claim, it is important to note that the US did not challenge how the Chinese authorities intervene against IPR violations on a day-to-day basis. In other words, the US did not, in this WTO proceeding, accuse China of inadequately enforcing its laws, for example by tolerating activities of IPR-offending companies. Instead, the US challenged the Chinese laws on the books, which is dubbed an "as such"-claim in WTO jargon.

POTENTIAL IMPLICATIONS

The panel's decision can be appealed to the Appellate Body by either party within 60 days. Appellate review is a speedy process, with a decision published within 90 days of the date of appeal. In the absence of an appeal, the panel's decision becomes binding upon "adoption" – a largely formal act. While it may therefore be too early for a final assessment, certain potential implications of the panel ruling are already apparent.

Easing of tensions

The panel report may help smooth the friction between the US and Chinese governments in the field of IPR protection, which has persisted since the US filed the WTO action.[9] This is because, on the one hand, the panel report puts an end to this particular WTO proceeding – provided that the panel's decision is not appealed and that China complies with the ruling. On the other hand, the fact that both sides won parts of their arguments may actually make future co-operation easier. For instance, as noted below, China's obligation to make changes to its IPR legislation may provide an occasion for the US to engage China in a broader discussion on other aspects of Chinese IPR legislation that the US considers inadequate. China did not lose face, but the panel did not clear China of all charges, either. Its findings may prove to be just the right mix: they give the Chinese government some scope for manoeuvre but at the same time emphasise the need for compliance with TRIPs.

Revision of PRC Copyright Law

The panel unambiguously condemned Article 4(1) of the PRC Copyright Law. If the panel decision is not appealed or is upheld by the Appellate Body, an amendment of that provision is inevitable, which requires launching the standard legislative process. This in turn makes it possible that the Chinese legislator will engage in a comprehensive reform of the Copyright Law – beyond the mere amendment of Article 4(1). China's recently issued Outline on the National IP Strategy recognises that the Copyright Law, too, "needs to be promptly revised"[10], and the issuance of the panel report may mean that time is ripe for this revision. If so, the amendment of the Copyright Law would be made in parallel with the patent law reform, which was concluded in December 2008.[11] Companies in China should start thinking about the issues that such a reform needs to address in their view.

Evidence threshold for WTO challenges under TRIPs Article 61

The panel's dismissal of the third US claim – concerning IPR violations "on a commercial scale" under Article 61 of the TRIPs Agreement – makes it clear that a WTO challenge can only be won when sufficient evidence is presented. In this case, the US presented only limited evidence, mainly because it took the view that any commercially motivated IPR infringement is "on a commercial scale". The panel disagreed with the US interpretation and interpreted Article 61 to require a product- and market-specific demonstration of what constitutes an operation on a "commercial scale".

Against this background, companies may wish to play a more active role in assisting WTO challenges brought by their governments. Their support of cases may be crucial. Companies in China should keep records of IPR infringements and other possible WTO violations, and provide input to industry associations, chambers of commerce and governments where appropriate. Helpdesks and contact points for industry input may become valuable assets.[12]

If properly channelled, active industry input may allow WTO litigation to fulfil its potential as a highly successful means to bring about change in China's legislation and enforcement practice.

Endnotes

1. See for example *World Trade Organisation, Trade Policy Report: China 2008*, WT/TPR/S/199, paragraph 241; United States Trade Representative, *2008 USTR Report to Congress on China's WTO Compliance*, at 77; Office of the United States Trade Representative, *2008 Special 301 Report*, at 19 et seq.
2. Panel Report, China – IPR, paras. 7.72 – 7.82.
3. Ibid, para. 7.127.
4. Ibid, para. 7.132.
5. Ibid, para. 7.343.
6. Ibid, paras. 7.336 – 7.342.
7. Ibid, para. 7.577.
8. Ibid, para. 7.614.
9. See for example United States Trade Representative, *2008 USTR Report to Congress on China's WTO Compliance*, at 74.
10. *Outline of the National Intellectual Property Strategy*, State Council, June 5 2008, para. 8.
11. Full text translation is available in CLP February 2009, p.60.
12. See, for example, http://www.china-iprhelpdesk.eu