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WTO Case Challenging Weaknesses in China's Legal Regime for Protection and Enforcement of Copyrights and Trademarks

What WTO commitments did China make?

When China joined the World Trade Organization (WTO) in 2001, it took on obligations under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) to protect and enforce the intellectual property rights (IPR) held by U.S. and other foreign companies and individuals in China. Among other things, the TRIPS Agreement sets minimum standards of protection for copyrights and trademarks as well as minimum standards for enforcement of those intellectual property rights in administrative, civil and criminal actions and actions at the border. The TRIPS Agreement also requires that, with very limited exceptions, WTO members provide national treatment to the nationals of other WTO members with regard to the protection and enforcement of those intellectual property rights.

What specific concerns does the United States have with the structure of China's IPR legal regime?

Thresholds for Criminal Liability

Excessively high legal thresholds for launching criminal prosecutions offer a safe harbor for pirates and counterfeiters. Under China's Criminal Law, piracy of copyrighted works and counterfeiting of trademarked goods are subject to criminal procedures and penalties only when the authorities find the amount of piracy or counterfeiting to be "serious," "especially serious," "relatively large," or "huge." These terms are defined in a Judicial Interpretation issued by China's Supreme People's Court and Supreme People's Procuratorate by reference to threshold amounts stated in terms of value, profit, or number of pirated or counterfeit copies. Pirates and counterfeiters who structure their operations to fit below those thresholds face no possibility of criminal sanction. China recently announced it has dropped its quantity threshold from 1000 to 500, an important recognition of this problem, but the reduced threshold still creates a major safe harbor problem.

The thresholds are so high that they appear to permit pirates and counterfeiters to operate on a commercial scale. For example, under the threshold for illegal copies, a retailer could stock 499 pirated DVDs and CDs in his store and face no possibility of criminal prosecution. A further problem is that the value thresholds are calculated based on the price of the pirated or counterfeit product as opposed to the price of the corresponding legitimate product. The lower the price of the pirated or counterfeit product, the more the infringer can sell or offer for sale without fear of criminal prosecution.

China's high enforcement thresholds appear to make it impossible as a matter of law to prosecute many commercial infringers of intellectual property rights. China thus seems to lack an effective criminal deterrent to significant commercial-scale piracy and counterfeiting, contrary to Articles 41 and 61 of the TRIPS Agreement.



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Disposal of Infringing Goods

China's Customs Regulations and Implementing Measures set forth rules for the disposal of imported goods the Customs authorities confiscate as infringing intellectual property rights. Under those rules, the Customs authorities often are required to allow seized goods back into the channels of commerce (for instance, through auctioning the goods following removal of infringing features, such as fake labels). This appears to be inconsistent with China's obligations under Articles 46 and 59 of the TRIPS Agreement, which ordinarily require these goods to stay out of commerce.

Denial of Copyright Protection to Works Awaiting Censorship Review

China's copyright law denies copyright protection to imported works waiting for approval to enter the Chinese market. (Domestic works do not require such pre-distribution review.) During the review period (and potentially forever for works that fail such review), unauthorized persons are able to put copies of works on the market without infringing copyright and thus without incurring civil or criminal copyright liability. This aspect of China's copyright law appears to be inconsistent with China's commitments under the TRIPS Agreement.

Scope of Criminal Law on Piracy

China's Criminal Law (Articles 217 and 218) appears to provide for the prosecution of unauthorized reproduction of certain copyrighted works only when accompanied by unauthorized distribution. A person that pirates copyrighted works without distributing the pirated works would not be subject to criminal sanction. Based on this law, it appeared that China may be failing to fulfill its obligations under Articles 41 and 61 of the TRIPS Agreement. However, China published a Judicial Interpretation April 7 that may be designed to address this problem. The United States would welcome this development and plans to discuss the new Judicial Interpretation with China during WTO consultations.

How are U.S. copyright and trademark holders harmed?

Although China's central government has displayed strong leadership in modifying a wide range of IPR laws and regulations in an effort to bring them into compliance with China's WTO commitments, some significant deficiencies in China's legal regime remain, and effective IPR enforcement has not been achieved, as IPR infringement remains a serious problem throughout China.

USTR's 2006 Report to Congress on China's WTO Compliance, issued on December 11, 2006, reports as follows on the impact on foreign right holders:

- Despite repeated anti-piracy campaigns in China and an increasing number of civil IPR cases in Chinese courts, overall piracy and counterfeiting levels in China remained unacceptably high in 2006. IPR infringement continued to affect products, brands and technologies from a wide range of industries, including films, music and sound recordings, publishing, business and entertainment software, pharmaceuticals, chemicals, information technology, apparel, athletic footwear, textile



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fabrics and floor coverings, consumer goods, food and beverages, electrical equipment, automotive parts and industrial products, among many others.

- U.S. industry in 2006 continued to estimate that levels of piracy in China across all lines of copyright business range between 85 and 93 percent, indicating little or no improvement over 2005. Trade in pirated optical discs continues to thrive, supplied by both licensed and unlicensed factories and by smugglers. Small retail shops continue to be the major commercial outlets for pirated movies and music (and a variety of counterfeit goods), and roaming vendors offering cheap pirated discs continue to be visible in major cities across China. Piracy of books and journals and end-user piracy of business software also remain key concerns. In addition, Internet piracy is increasing, as is piracy over enclosed networks such as universities.

China's widespread counterfeiting also touches many consumer products that can pose a direct threat to the health and safety of people in the United States, China and elsewhere. At the same time, the harm from counterfeiting is not limited to right holders and consumers. China estimated its own annual tax losses due to counterfeiting at more than \$3.2 billion in 2002, and this figure can only have grown in the ensuing years.

Why pursue WTO dispute settlement when the United States and China are working cooperatively on issues in the IPR area?

Dispute settlement and cooperative efforts complement one another in important ways. When cooperative efforts do not solve a particular problem, access to WTO dispute settlement provides a neutral forum to assist in resolving the specific disagreement and allows productive bilateral discussions to continue on other issues. Achieving effective IPR protection and enforcement is a complex challenge requiring intensive work by governments on many fronts.

Dual-Track Approach

Since the issuance of the Administration's "top-to-bottom" review of U.S.-China trade relations at the beginning of 2006, the United States has recognized that China's transition period as a new WTO member is over, and has begun to pursue a dual-track approach to resolving U.S. WTO concerns. The United States continues to seek cooperative and pragmatic resolutions through a variety of regular and ad hoc bilateral dialogues with China. However, when bilateral dialogue fails to succeed in addressing U.S. concerns, the United States will not hesitate to exercise its WTO rights through the initiation of dispute settlement against China, as it would with any other mature WTO member.

Cooperation on IPR

USTR and other agencies regularly engage in dialogue with China on IPR issues. Continued dialogue allows the development of a common understanding of certain IPR problems faced by right holders and the best way to address them. While the level of piracy and counterfeiting in China remains very concerning, China has made welcome progress addressing some aspects of this complex problem.

The U.S.-China Joint Commission on Commerce and Trade (JCCT), in conjunction with the high-level U.S.-China Strategic Economic Dialogue established in September 2006, are the main vehicles through



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which USTR, together with the Department of Commerce, cooperate with China on IPR issues. USTR and the U.S. Patent and Trademark Office co-chair the JCCT's Intellectual Property Rights Working Group (IPRWG) with China's Ministry of Commerce. U.S. and Chinese agencies responsible for IPR protection and enforcement meet regularly in the IPRWG to discuss IPR issues. The initiation of the Strategic Economic Dialogue (SED) provides a broader strategic framework for issues related to innovation and IPR, and strategic input to the JCCT process.

To date, the JCCT and the IPRWG have supported and facilitated China's decisions to take a number of important steps to amend or adopt a range of laws, regulations and other measures in the IPR area, including:

- Regulations to enhance protection for copyrighted works on the Internet, in preparation for China's recent accession to the WIPO Internet Treaties;
- Measures to protect intellectual property rights at trade fairs;
- New patent examination guidelines;
- New standards for the review of trademarks;
- New requirement that legal operating system software be installed on all computers manufactured in or imported into China, and requirement that government agencies at all levels purchase only such computers;
- Adoption of plan to encourage use of legal software by enterprises; steps to ensure government agencies use only legal software.

WTO Dispute Settlement

WTO dispute settlement rules have facilitated and are assisting the United States in the resolution of other trade disputes with China:

- March 2004 – After the United States filed a WTO dispute against China challenging value-added tax rebates that discriminated against imported semiconductors, the United States and China resolved the matter during the consultation phase, ensuring fair access to a market worth over \$2 billion to U.S. manufacturers and workers in the semiconductor industry.
- January 2006 – The United States and China resolved a dispute involving China's imposition of antidumping duties on kraft linerboard shortly after the United States informed China that it would soon be filing a request for WTO consultations. China eliminated the antidumping order on kraft linerboard, terminating the unfair barrier to U.S. paper products and benefiting U.S. kraft linerboard mills in 14 states.



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- March 2006 – The United States, the European Communities and Canada began panel proceedings at the WTO challenging Chinese regulations that impose de facto local content requirements in the auto sector through discriminatory charges on imported auto parts.
- February 2007 – The United States and Mexico have held joint WTO dispute settlement consultations regarding several export subsidy programs and import substitution subsidy programs, which appear to be prohibited under WTO rules. These widely available subsidies offer significant benefits, and the export subsidies alone potentially benefit nearly 60 percent of China's exports of manufactured goods.