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

Report of the Panel

Excerpted version prepared by Prof Daniel Gervais
for teaching purposes only.[1]

1. The United States claims that China has not provided for criminal procedures and penalties to be applied in cases of willful trademark counterfeiting or copyright piracy on a commercial scale that fail to meet certain thresholds. The United States claims that China's measures for disposing of confiscated goods that infringe intellectual property rights are inconsistent with China's obligations under the TRIPS Agreement. The United States claims that China is acting inconsistently with its obligations under the TRIPS Agreement by denying the protection of its Copyright Law to creative works of authorship (and, to the extent Article 4 of the Copyright Law applies to them, sound recordings and performances) that have not been authorized for, or are otherwise prohibited from, publication or distribution within China.

FINDINGS

COPYRIGHT LAW

2, This Section of the Panel's findings concerns China's Copyright Law. The claims concerning the Copyright Law address, in particular, the first sentence of Article 4. The parties agreed to translate that sentence as follows:

"Works the publication and/or dissemination of which are prohibited by law shall not be protected by this Law."[7]

Construction of the measure at issue

3. The Panel is obliged, in accordance with its mandate, to make an objective assessment of the meaning of the relevant provisions of that measure. In this context, the Panel is mindful that, objectively, a Member is normally well-placed to explain the meaning of its own law. However, in the context of a dispute, to the extent that either party advances a particular interpretation of a provision of the measure at issue, it bears the burden of proof that its interpretation is correct. The Panel emphasizes that it examines the measure solely for the purpose of determining its conformity with China's

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obligations under the TRIPS Agreement.

4. Article 4 provides *inter alia* that certain "works" shall not be protected by this Law. The term "works" (作品) is defined in the previous article, Article 3. The term "publication and/or dissemination" (出版、传播) was agreed between the parties as an appropriate translation. The parties had earlier used the phrases "publication or distribution" and "publication and dissemination". China alleges that the word translated as "dissemination" (传播) has a distinct, and wider, meaning than a word commonly used in its content review regulations, which may be translated as "distribution" (发行). The term "prohibited by law" (依法禁止), on its face, is not limited to any particular piece of legislation but could apply to any law that prohibits the publication and/or dissemination of a work. This phrase is examined in greater detail below. The phrase translated as "shall not be protected by this Law" (不受本法保护) does not include the word "shall" in the original, as it uses no modal verb. However, it is not disputed that Article 4(1) of the Copyright Law is mandatory. The reference to "this Law" (本法) is evidently a reference to the Copyright Law. On its face, it refers to the protection of the Copyright Law and not to any subset of its protection.

5. The Panel finds that the Copyright Law is sufficiently clear, on its face, to show that Article 4(1) denies the protection of Article 10 to certain works, including those of WTO Member nationals, as the United States claims. This interpretation is consistent with, and clarified by, the view expressed by the Supreme People's Court of China in the course of domestic litigation in 1998, to which the Panel will refer as "the *Inside Story* case". That case concerned a book, the publication of which violated administrative regulations but the content of which did not violate any laws. The Court ruled that it was correct for the courts of the first and second instances to provide protection under the Copyright Law to the book at issue for the following reason:

    a. "The *Inside Story* was originally 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."

6. The Panel finds that the Supreme People's Court letter confirms that Article 4(1) of the Copyright Law denies copyright protection and clarifies that Article 4(1) applies where the publication and/or dissemination of a work is prohibited due to its content.

Criteria for prohibited works

7. The Panel will now consider the range of works that are subject to Article 4(1) of the Copyright Law. The Panel recalls its finding above that that term, on its face, is not limited to any particular law.

8. The [finding] from the Supreme People's Court of China in the *Inside Story* case shows that Article 4(1) of the Copyright Law was considered inapplicable in that case because nothing was found in the text of the work at issue to violate "any laws".[76] The terms of the letter were not limited to any particular laws but appear to include any law that determines the legality of content.

9. For the above reasons, the Panel accepts that prohibited works for the purposes of Article 4(1) of the Copyright Law include works that contain content considered illegal, including [under] the content review regulations. The Panel finds that the class of works denied protection under Article 4(1) of the Copyright Law includes works that have failed content review and, to the extent that they constitute copyright works, the deleted portions of works edited to satisfy content review. The Panel considers that the United States has not made a prima facie case with respect to works never submitted for content review in China, works awaiting the results of content review in China and the unedited versions of works for which an edited version has been approved for distribution in China.

Article 5(1) of the Berne Convention (1971), as incorporated by Article 9.1 of the TRIPS Agreement

11. This claim is made under Article 9.1 of the TRIPS Agreement, insofar as it incorporates Article 5(1) of the Berne Convention (1971). Article 9.1 of the TRIPS Agreement provides as follows:

12. "Members shall comply with Articles 1 through 21 of the Berne Convention (1971) and the Appendix thereto. However, Members shall not have rights or obligations under this Agreement in respect of the rights conferred under Article 6*bis* of that Convention or of the rights derived therefrom."

13. The Panel notes that both sets of rights under Article 5(1) of the Berne Convention (1971) relate to "works" for which authors are protected under that Convention. The categories of "works" in respect of which authors shall enjoy the rights specially granted by the Convention vary according to the terms of each Article granting the relevant right. For example, the rights of reproduction (Article 9) and of broadcasting (Article 11*bis*) are granted to authors of "literary and artistic works". That expression is defined, in a non-exhaustive manner, in Article 2(1) of the Berne Convention (1971).

14. The Panel finds that the Copyright Law is sufficiently clear on its face for the United States to have established that the Copyright Law, specifically Article 4(1), is inconsistent with Article 5(1) of the Berne Convention (1971), as incorporated by Article 9.1 of the TRIPS Agreement. The Panel recalls its finding above and confirms that this conclusion does not apply to works never submitted for content review in China, works awaiting the results of content review in China and the unedited versions of works for which an edited version has been approved for distribution in China. China has an international obligation to protect copyright in such works in accordance with Article 5(1) of the Berne Convention (1971), as incorporated by Article 9.1 of the TRIPS Agreement.

15. China maintains that public censorship renders private enforcement unnecessary, that it enforces prohibitions on content seriously, and that this removes banned content from the public domain more securely than would be possible through copyright enforcement. The Panel notes that these assertions, even if they were relevant, are not substantiated.

CUSTOMS MEASURES

16 This claim is made under Article 59 of the TRIPS Agreement, which provides as follows:

"Remedies

> Without prejudice to other rights of action open to the right holder and subject to the right of the defendant to seek review by a judicial authority, 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. In regard to counterfeit trademark goods, the authorities shall not allow the re-exportation of the infringing goods in an unaltered state or subject them to a different customs procedure, other than in exceptional circumstances."

17. Public Notice No. 16/2007 was notified by the General Administration of Customs in April 2007. Public Notice No. 16/2007 was notified in order *inter alia* to regulate the auction of infringing goods by Customs in accordance with Article 27 of the Customs IPR Regulations. The parties agreed to translate the operative paragraphs as follows:

> "1. Where the confiscated infringing goods are auctioned by Customs, Customs shall completely eradicate all infringing features on the goods and the packaging thereof

> strictly pursuant to Article 27 of the Regulations, including eradicating the features infringing trademarks, copyright, patent and other intellectual property rights. Any goods the infringing features of which cannot be completely eradicated shall be destroyed and shall not be auctioned.
>
> "2. Customs shall solicit comments from the holder of the intellectual property rights before the infringing goods are auctioned."

18. It is not disputed that these measures are all binding upon the General Administration of Customs.

19. The United States claims that the measures at issue are inconsistent with the principle in the fourth sentence of Article 46 because nothing suggests that the auctioning of goods after removal of the infringing mark is permitted only in "exceptional cases". China responds that, even if the fourth sentence of Article 46 set forth an independent obligation on Customs authorities, which it does not admit, China Customs would fulfil the obligation because they remove "all" infringing features, not just the trademarks, and solicit comments from the right holders. China argues that the use of the word "release" envisions a return to the infringer. Customs uses a reserve price at auction to ensure that infringers do not have the opportunity to purchase the seized goods at an unreasonably low cost and reaffix counterfeit marks. In China's view, this complies with the purpose of Article 46, which is to ensure that in the course of dealing with seized goods authorities deprive infringers of economic benefits from the goods. China also argues that the word "sufficient" indicates that release of goods into the channels of commerce is permitted by the fourth sentence of Article 46, and not only in exceptional cases. It also raises the possibility that China's use of auction is "exceptional" as it constitutes a mere 2 per cent of disposition outcomes.

20. This Article contains a number of key terms, such as "the right holder", "the defendant", "competent authorities" and "infringing goods" which are not defined in the Article itself but can only be understood by reading the whole Article in context.

21. Article 59 is found in Section 4 of Part III of the TRIPS Agreement on Special Requirements Related to Border Measures. Section 4 sets out procedures for the suspension at the border by the customs authorities of the release into free circulation of goods. Article 59 sets out the step in these procedures that applies after goods have been found to be infringing. As such, Article 59 forms part of a set of procedures and its key terms must be understood in that context.

22. The first sentence of Article 59 applies to "infringing goods". The ordinary meaning of these words is not limited to goods that infringe any specific rights. However, read in context, there are certain limitations. The first sentence of Article 51 provides for the relevant procedures to apply, as a minimum, to "the importation" of "counterfeit trademark or pirated copyright goods". Article 51 expressly allows Members to provide for procedures at the border for other infringing goods as well. The second and third sentences of Article 51 provide as follows:

> "Members may enable such an application to be made in respect of goods which involve other infringements of intellectual property rights, provided that the requirements of this Section are met. Members may also provide for corresponding procedures concerning the suspension by the customs authorities of the release of infringing goods destined for exportation from their territories."

23. Both these sentences use the word "may", indicating that they are optional provisions. The second sentence provides for an optional extension to "other infringements of intellectual property rights". This is a reference both to goods that infringe trademarks and copyright without constituting counterfeit trademark goods or pirated copyright goods, as well as to goods that infringe other categories of intellectual property rights, such as patents. The second sentence includes an express condition that applies where Members provide border measures for other infringements of intellectual property rights, namely "provided that the requirements of this Section are met". The requirements of that "Section" include those found in Article 59. Therefore, to the extent that a Member provides for such an application to be made in respect of

goods involving other infringements of intellectual property rights, such as patents, the obligation in Article 59 applies.

24. It is apparent that the intellectual property right infringements covered by the Customs measures include not only counterfeit trademark goods and pirated copyright goods, but certain other infringements of intellectual property rights, namely other trademark-infringing goods, other copyright-infringing goods, and patent-infringing goods. For the reasons set out above, the Panel finds that Article 59 applies to the Customs measures as those measures apply to all these infringements of intellectual property rights.

25. The obligation in the first sentence of Article 59 is that competent authorities "shall have the authority" to order certain types of remedies with respect to infringing goods. It is clear from the context within Section 4 that the obligations in Article 59 apply where customs authorities have suspended the release into free circulation of goods suspected of infringing intellectual property rights. The fact that Article 59 applies to "infringing goods" indicates that the obligations in this Article are triggered when competent authorities find that the goods subject to the suspension are infringing. The fact that Article 59 addresses the authority to order remedies implies that the obligations continue until the time that a remedy has been ordered. The text of the Article does not indicate any other limitation on the temporal scope of the obligations. Therefore, the obligation that competent authorities "shall have the authority" to make certain orders applies from the time that competent authorities find that goods subject to suspension at the border are infringing, right up until the time that a remedy is ordered.

26. The Panel notes that the word "authority" can be defined as "power or right to enforce obedience; moral or legal supremacy; right to command or give a final decision." The obligation is to "have" authority not an obligation to "exercise" authority. The phrase "shall have the authority" is used throughout the enforcement obligations in Sections 2, 3 and 4 of Part III of the TRIPS Agreement, specifically, in Articles 43.1, 44.1, 45.1, 45.2, 46, 48.1, 50.1, 50.2, 50.3, 50.7, 53.1, 56 and 57. It can be contrasted with terminology used in the minimum standards of protection in Part II of the TRIPS Agreement, such as "Members shall provide" protection, or that certain material "shall be" protected.

27. Given the potential importance of this interpretation to the operation of Part III of the TRIPS Agreement, the Panel notes that it is confirmed by the circumstances of conclusion of the Agreement. One of the most important such circumstances was the fact that the pre-existing international intellectual property agreements contained comparatively few minimum standards on enforcement procedures beyond national treatment and certain optional provisions. One of the major reasons for the conclusion of the TRIPS Agreement was the desire to set out a minimum set of procedures and remedies that judicial, border and other competent authorities must have available to them. This represented a major advance in intellectual property protection. [ ] At the same time, the negotiators appear to have considered it unnecessary to state in either Article 46 or Article 59 that the authorities could not release goods that had been found infringing into the channels of commerce. This may have been due *inter alia* to the fact that such an action itself could constitute infringement or otherwise expose the authorities to liability. Such an action would not constitute infringement if the circumstances of disposal were non-commercial or if the state of the goods was altered so that the goods no longer infringed. The negotiators addressed both these issues: in the first sentence of Article 46, by providing for disposal outside the channels of commerce (and destruction) and, in the fourth sentence, in regard to counterfeit trademark goods, by setting a minimum degree of alteration of the state of goods before release into the channels of commerce.

28. In the Panel's view, an interpretation that applies the phrase "in such a manner as to avoid any harm caused to the right holder" to all authority to order remedies is based on a selective reading of Article 46. The requirement that authority to order a remedy be "in such a manner as to avoid any harm caused to the right holder" is linked in the text of Article 46 to one remedy only, namely disposal outside the channels of commerce. This does not exclude the possibility that other actions, notably release into the channels of commerce, may be subject to requirements, provided that those requirements are set out in the terms of Article 46 or Article 59.

29. The Panel will refer to "destruction" and "disposal" collectively as "disposition methods" for

ease of reference. It is not disputed that China's Customs measures provide the authority to order *destruction* of infringing goods in accordance with the principles set out in Article 46. However, the United States takes issue with what it considers the "highly limited circumstances" in which the Customs measures permit destruction. China does not deny that its authority to order destruction is, in principle, subject to certain limitations but argues that China Customs has considerable discretion to decide whether such limitations apply. The statistics show that, in practice, over half of infringing goods seized by Customs in terms of value are in fact destroyed. The Panel also notes that authority to order a disposition method within the scope of Article 59 will often be discretionary, as the obligation that Members' competent authorities "shall have the authority" to make particular orders applies to what those authorities are *permitted* to order by domestic law. Accordingly, the obligation in Article 59 is applicable to both mandatory and discretionary measures and, in principle, both mandatory and discretionary measures "as such" can be examined for conformity with that obligation.

"the principles set out in Article 46"

30. The first sentence of Article 59 provides that 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". The phrase referencing the principles set out in Article 46 attaches to "the authority to order the destruction or disposal of infringing goods". This directs the treaty interpreter to those principles in Article 46 that attach to such authority.

31. Article 46 of the TRIPS Agreement provides as follows:

"Other Remedies

> In order to create an effective deterrent to infringement, the judicial authorities 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. The judicial authorities shall also have the authority to order that materials and implements the predominant use of which has been in the creation of the infringing goods be, without compensation of any sort, disposed of outside the channels of commerce in such a manner as to minimize the risks of further infringements. In considering such requests, the need for proportionality between the seriousness of the infringement and the remedies ordered as well as the interests of third parties shall be taken into account. In 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."

32. Article 59 refers to the "principles" set out in Article 46. Therefore, it is necessary to determine what precisely that refers to in the first, third and fourth sentences of Article 46. The word "principles" can be defined as "a general law or rule adopted or professed as a guide to action." Each of these sentences of Article 46 contains language that is a guide to action by authorities and none dictate the precise terms of orders in specific cases.

33. The Panel does not consider that the choice of the word "principles" was intended to reflect a hierarchy of provisions within Article 46 that would include only the most general concepts and exclude the less general. There is a strong similarity in the language and purpose of the two provisions that both provide for authority to order destruction or disposal with respect to goods that have been found to infringe intellectual property rights at the conclusion of an enforcement procedure. Accordingly, for the purposes of Article 59, the Panel considers that the first sentence of Article 46 sets out the following "principles":

- authorities shall have the authority to order disposal or destruction in accordance with the first sentence "without compensation of any sort"; and

- authorities shall have the authority to order disposal "outside the channels of commerce in such a manner as to avoid any harm caused to the right holder";[258] or
- authorities shall have the authority to order destruction "unless this would be contrary to existing constitutional requirements".

34. The third sentence sets out the following principle that applies *inter alia* to the authority to order disposal or destruction of infringing goods under the first sentence:

> in considering such requests "the need for proportionality between the seriousness of the infringement and the remedies ordered as well as the interests of third parties shall be taken into account".

35. The fourth sentence sets out the following principle that attaches to the authority to order destruction or disposal of infringing goods under the first sentence:

> in 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.[259]

36. In the Panel's view, the above are the "principles set out in Article 46" incorporated by the first sentence of Article 59.

"outside the channels of commerce in such a manner as to avoid any harm caused to the right holder"

37. The Panel notes that this principle, by its terms, relates to disposal of goods "outside" the channels of commerce, and not into the channels of commerce. It is not disputed that this principle is applicable to donations (i.e. gifts) to social welfare bodies for their own use or for charitable distribution. However, if the social welfare bodies later *sell* goods donated to them by Customs for charitable distribution, even to raise money for charitable aims, the goods are not in fact disposed of outside the channels of commerce but *into* the channels of commerce. If the social welfare bodies charitably distribute goods donated to them by Customs but the goods later find their way back into the channels of commerce, this does not alter the fact that the goods were disposed of outside the channels of commerce, in the ordinary sense of "disposal". Instead, the later sale of the distributed goods is relevant to the assessment of whether the disposal outside the channels of commerce was "in such a manner so as to avoid any harm caused to the right holder". It must be recalled that disposal of infringing goods outside the channels of commerce, in context, is an alternative to destruction of the goods. In the Panel's view, this implies that any inherent risk of harm due simply to the fact that the goods have not been completely destroyed is insufficient to disqualify a disposal method, as it would nullify the choice between disposal and destruction. However, more specific concerns linked to harm caused to the right holder by a particular manner of disposal are relevant in assessing conformity with the principle that disposal outside the channels of commerce be "in such a manner as to avoid any harm caused to the right holder".

38. The Panel finds confirmation of this interpretation within Article 46. The fourth sentence of Article 46 expressly provides that simple removal of the trademark unlawfully affixed is not sufficient to permit release of counterfeit trademark goods *into* the channels of commerce other than in exceptional cases. In contrast, the first sentence of Article 46 contains a more general requirement that the requisite authority to order disposal of goods outside the channels of commerce shall be "in such a manner as to avoid any harm caused to the right holder".

39. China has provided evidence of cases of donation of infringing goods by Customs to the Red Cross Society. In one case, Customs donated infringing goods to the Red Cross that were allocated to people in areas struck by natural disasters such as typhoons, rainstorms and floods. The goods all infringed trademark rights and consisted of sport shoes, bags of rice noodles, washing powder, air- cooled chillers and kerosene heaters. There is no evidence on the record that Customs has failed to discharge its responsibility to ensure that the use of such infringing goods is not

circumvented and that goods do not find their way back into the channels of commerce. The Panel considers the Customs – Red Cross Memorandum particularly relevant to its assessment of Customs' authority to dispose of infringing goods by donation because the Red Cross Society of China is the recipient of the overwhelming majority of goods donated under the measures at issue. The statistics show that the Red Cross Society of China was the recipient of 91 per cent by value of the infringing goods donated by Customs in the years 2005 to 2007. In fact, no infringing goods destined for importation have ever been donated to any social welfare body besides the Red Cross Society of China under the measures at issue during the period for which statistics are available.

40. The burden now shifts to the United States to show why, in light of this legal structure, the three Customs measures at issue "provide no discretion" to Customs to determine that transfer to a social welfare body is not appropriate in circumstances where the right holder would be harmed. The United States has not established that, with respect to the donation of infringing goods to social welfare bodies under the measures at issue, Customs lacks authority to order disposal of infringing goods in accordance with the principles set out in the first sentence of Article 46.

41. The Panel will now consider Customs' authority to order that infringing goods be auctioned. Auction is the third disposal method set out in the measures at issue. Auction is not a form of destruction, and it is undisputed that auction is *not* a form of disposal outside the channels of commerce. Accordingly, this disposal method is clearly *not* required by Article 59.

42. The Implementing Measures on their face provide for the destruction of such goods only where the infringing features cannot be eradicated. The statistics show that, among goods dealt with under items (2) and (3) of the Implementing Measures, the following decisions were in fact made in terms of the number of shipments and the relative value of the infringing goods:

		2005	**2006**	**2007**	**Total**
By shipment[338]					
Exports + imports	Auctioned	4	7	1	12
	Destroyed	143	227	248	618
By value					
Exports + imports	Auctioned	7.10%	3.54%	0.59%	3.70%
	Destroyed	92.90%	96.46%	99.41%	96.30%
Imports only	Auctioned	0%	0%	0%	0%
	Destroyed	100.00%	100.00%	100.00%	100.00%

43. It is apparent that the number of shipments destroyed far exceeds the number of shipments auctioned, and that in three years Customs has only decided to auction goods twelve times. In fact, no infringing goods destined for importation have ever been auctioned under the measures at issue during the period for which statistics are available. Customs evidently has little, if any, difficulty in choosing to destroy goods, which is consistent with the view that it has wide authority to do so.

44. The very low rate of auctions is consistent with the view that auctions are not mandatory. It could be consistent with the view that the auction method is mandatory if there were some indication that the infringing features cannot be eradicated from an exceedingly large number and proportion of goods confiscated by Customs. However, in the absence of such evidence, and in light of the other evidence discussed above, the Panel does not accept that view. For the above reasons, the Panel finds that the United States has not established that the authority to order auction of infringing goods under the Customs measures precludes authority to order destruction of infringing goods in accordance with the principles set out in the first sentence of Article 46.

45. The Panel recalls its findings and concludes that the United States has not established that the Customs measures are inconsistent with Article 59 of the TRIPS Agreement, as it incorporates the principles set out in the *first* sentence of Article 46 of the TRIPS Agreement.

Auction and "simple removal of the trademark unlawfully affixed"

46. The fourth sentence of Article 46 reads as follows:

> "In 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."

47. It is undisputed that in all cases in which Customs auctions goods that it has confiscated under the measures at issue, Customs first removes the infringing features. It is clear from the measure on its face that the phrase "infringing features" refers to features that infringe any intellectual property rights covered by the measures, including not only trademarks, but also copyright and patents. With respect to counterfeit trademark goods, it seems obvious that the infringing features will comprise the counterfeit trademarks. Therefore, insofar as the state of the counterfeit trademark goods is concerned, the only action taken prior to auction is the removal of the trademark. The question arises whether this constitutes "simple" removal of a trademark within the meaning of the fourth sentence of Article 46 of the TRIPS Agreement.

48. Removal of a counterfeit trademark would ensure that the goods do not infringe the exclusive rights set out in Article 16 of the TRIPS Agreement. However, the fourth sentence of Article 46 provides that that shall *not* be sufficient, other than in exceptional cases. The fact that the negotiators included an additional requirement shows that this principle is intended to achieve more than simply the cessation of an infringement.

49. The Panel notes that the fourth sentence of Article 46, by its specific terms, is not limited to an action to render goods non-infringing, which the simple removal of the trademark would achieve. Rather, the fourth sentence of Article 46 imposes an additional requirement beyond rendering the goods non-infringing in order to deter further acts of infringement with those goods. Therefore, it is insufficient, other than in exceptional cases, to show that goods that have already been found to be counterfeit are later unmarked.

50. China alleges that auctions of goods confiscated by Customs are subject to a reserve price that ensures that infringers do not have the opportunity to purchase the seized goods at an unreasonably low cost and reaffix counterfeit marks. The Panel does not agree. As China itself stated in its rebuttal submission, "the very principle of trademark protection is that a trademark distinguishes a good and allows for a significant market premium". The Panel points out that a counterfeit trademark is designed to obtain some or all of that economic premium. When the counterfeit trademark is removed, the value of the good is diminished and is less than its market value if it is resold with a counterfeit trademark reaffixed. In other words, it remains economically viable for the importer or a third party to purchase the goods at auction and reaffix the trademarks in order to infringe again. [ ] Therefore, the Panel considers that, in regard to counterfeit trademark goods, China's Customs measures provide that the simple removal of the trademark unlawfully affixed is sufficient to permit release of the goods into the channels of commerce.

CRIMINAL THRESHOLDS

51. This Section of the Panel's findings concerns criminal thresholds established by the following measures. China's Criminal Law was adopted by the National People's Congress; the Interpretation of the Supreme People's Court and the Supreme People's Procuratorate Concerning Some Issues on the Specific Application of Law for Handling Criminal Cases of Infringement of Intellectual Property Rights (Interpretation No. 19 [2004] of the Supreme People's Court) ("Judicial Interpretation No. 19 [2004]") adopted in November 2004; and the Interpretation of the Supreme People's Court and the Supreme People's Procuratorate

Concerning Some Issues on the Specific Application of Law for Handling Criminal Cases of Infringement of Intellectual Property Rights – II (Interpretation No. 6 [2007] of the Supreme People's Court) ("Judicial Interpretation No. 6 [2007]") adopted in April 2007.

52. Article 1 of Judicial Interpretation No. 19 [2004] interprets the phrase "the circumstances are serious" in Article 213 of the Criminal Law and may be translated as follows:

> "Whoever, without permission from the owner of a registered trademark, uses a trademark which is identical with the registered trademark on the same kind of commodities, in any of the following circumstances which shall be deemed as 'the circumstances are serious' under Article 213 of the Criminal Law, shall be sentenced to fixed-term imprisonment of not more than three years or criminal detention for the crime of counterfeiting registered trademark, and shall also, or shall only, be fined:
>
> - the *illegal business operation volume* of not less than 50,000 Yuan or the
>   - *amount of illegal gains* of not less than 30,000 Yuan;
> - in the case of counterfeiting two or more registered trademarks, the *illegal business operation volume* of not less than 30,000 Yuan or the *amount of illegal gains* of not less than 20,000 Yuan;
> - other serious circumstances." (emphasis added)

53. Article 2 of Judicial Interpretation No. 19 [2004] interpreted the phrase "the amount is relatively large" under Article 214 of the Criminal Law and may be translated as follows:

> "Whoever sells commodities, knowing that such commodities bear counterfeit registered trademarks, with the amount of sales of not less than 50,000 Yuan, this shall be deemed as 'the amount is relatively large' under Article 214 of the Criminal Law, and the offender shall be sentenced to fixed-term imprisonment of not more than three years or criminal detention for the crime of selling commodities bearing a counterfeit registered trademark, and shall also, or shall only, be fined."

54. Article 3 of Judicial Interpretation No. 19 [2004] interpreted the phrase "the circumstances are serious" under Article 215 of the Criminal Law and may be translated as follows:

> "Whoever forges or, without the authorization of another person, makes representations of that person's registered trademarks or sells such representations, in any of the following circumstances which shall be deemed as 'the circumstances are serious' under Article 215 of the Criminal Law, shall be sentenced to fixed-term imprisonment of not more than three years, criminal detention or public surveillance for the crime of illegally producing or selling illegally made representations of the registered trademark, and shall also, or shall only, be fined:
>
> - forging or, without the authorization, making representations of the registered trademarks or selling such representations of not less than 20,000 pieces, or with the *illegal business operation volume* of not less than 50,000 Yuan, or the *amount of illegal gains* of not less than 30,000 Yuan;
> - forging or, without the authorization, making two or more kinds of representations of the registered trademarks or selling such representations of not lessthan 10,000 *pieces*, or with the *illegal business operation volume* of not less than 30,000 Yuan, or the *amount of illegal gains* of not less than 20,000 Yuan;
> - other serious circumstances." (emphasis added)

55. The United States submits that, in light of the above, the Judicial Interpretations at issue in this dispute are binding and have the force of law. China submits that the Judicial

Interpretations are issued "in order to ensure a uniform understanding and application of the law". China does not disagree with the United States' description of the legal basis and binding nature of the Judicial Interpretations at issue as set out in the United States' first written submission.

Claim under the first sentence of Article 61 of the TRIPS Agreement

Nature of the claim

56. The United States' claim relates to cases of willful trademark counterfeiting and copyright piracy in respect of which China does not provide for criminal procedures and penalties to be applied but which the United States claims are "on a commercial scale". The claim is based on two alleged "fundamental problems" referred to in this Report as the two limbs of this claim. The first limb concerns the level and method of calculation of the thresholds. By specifying certain levels, the thresholds allegedly eliminate whole classes of counterfeiting and piracy from risk of criminal prosecution and conviction. The second limb concerns the limited set of numerical tests in the thresholds. By focusing solely on these tests, the thresholds allegedly require law enforcement officials to disregard other indicia of counterfeiting and piracy.

57. The Panel notes that the first limb of the claim addresses the numbers specified in the numerical tests, and the way in which some of them are calculated, in order to show that the thresholds are too high. These are quantitative issues. The second limb addresses certain factors that the numerical tests do not take into account. These are qualitative issues. Neither limb is a broad claim that numerical thresholds cannot capture all cases "on a commercial scale". In response to the Panel's requests for clarification of the claim after both the first and the second substantive meetings, the United States clarified that it did not object to the use of numerical thresholds *per se*. Accordingly, the Panel is not asked to consider whether numerical thresholds, as a matter of principle, can implement an obligation in terms of cases "on a commercial scale".

Nature of the obligation

58. Article 61 constitutes the whole of Section 5 of Part III of that Agreement and provides as follows:

"SECTION 5: CRIMINAL PROCEDURES

Article 61

Members shall provide for criminal procedures and penalties to be applied at least in cases of willful trademark counterfeiting or copyright piracy on a commercial scale. Remedies available shall include imprisonment and/or monetary fines sufficient to provide a deterrent, consistently with the level of penalties applied for crimes of a corresponding gravity. In appropriate cases, remedies available shall also include the seizure, forfeiture and destruction of the infringing goods and of any materials and implements the predominant use of which has been in the commission of the offence. Members may provide for criminal procedures and penalties to be applied in other cases of infringement of intellectual property rights, in particular where they are committed willfully and on a commercial scale."

59. The *first* sentence of this Article uses the word "shall", indicating that it is mandatory.

60. The Panel agrees with China that the first sentence of Article 61 contains a number of terms that are not defined by the Agreement and that this can affect the proper interpretation of the provision. [ ] [T]he standard of compliance with Article 61 is the minimum internationally agreed standard set out in that Article. The minimum standard in Article 61 does not defer to China's domestic practice on the definition of criminal liability and sanctions for other wrongful acts in areas not subject to international obligations under the TRIPS Agreement, unless it so states. For example, the second sentence refers to "crimes of a corresponding gravity" which might refer to domestic

practice in other areas. However, the *first* sentence of Article 61 does not make any such reference.

61. For the above reasons, the Panel confirms its view above that the first sentence of Article 61 of the TRIPS Agreement imposes an obligation. The terms of the obligation in the first sentence of Article 61 of the TRIPS Agreement are that Members shall "provide for criminal procedures and penalties to be applied". That obligation applies to "willful trademark counterfeiting or copyright piracy on a commercial scale". Within that scope, there are no exceptions. The obligation applies to *all* acts of willful trademark counterfeiting or copyright piracy on a commercial scale.

62. The Panel notes that the first sentence of Article 61 contains no fewer than four limitations on the obligation that it sets forth. These define the scope of the relevant obligation and are not exceptions. The first limitation is that the obligation applies to trademarks and copyright rather than to all intellectual property rights covered by the TRIPS Agreement. The fourth sentence of Article 61 gives Members the option to criminalize other infringements of intellectual property rights, in particular where they are committed willfully and on a commercial scale. Despite the potential gravity of such infringements, Article 61 creates no obligation to criminalize them. This can be contrasted with Sections 2 and 3 of Part III of the TRIPS Agreement, regarding civil and administrative procedures and remedies, which apply to any act of infringement of intellectual property rights covered by the Agreement. It can also be contrasted with Section 4 of Part III which attaches conditions to the option to apply its procedures to other infringements of intellectual property rights.

63. The second limitation in the first sentence of Article 61, which is related to the first, is that it applies to counterfeiting and piracy rather than to all infringements of trademarks and copyright. This can also be contrasted with Sections 2 and 3 of Part III of the TRIPS Agreement. This limitation, like the first, indicates an intention to reduce the scope of the obligation. Indeed, the records of the negotiation of the TRIPS Agreement confirm that the term "infringements of trademarks and copyright" on a commercial scale was considered in the draft provision on criminal procedures but ultimately rejected.

64. The terms "trademark counterfeiting" and "copyright piracy" are not defined in the TRIPS Agreement. They are distinct from the concepts of "trademark infringement" and "copyright infringement". They are similar to the terms "counterfeit trademark goods" and "pirated copyright goods" which are defined for the purposes of the TRIPS Agreement[6] in footnote 14 as follows:

> "For the purposes of this Agreement:
>
> i. 'counterfeit trademark goods' shall mean any goods, including packaging, bearing without authorization a trademark which is identical to the trademark validly registered in respect of such goods, or which cannot be distinguished in its essential aspects from such a trademark, and which thereby infringes the rights of the owner of the trademark in question under the law of the country of importation;
>
> ii. 'pirated copyright goods' shall mean any goods which are copies made without the consent of the right holder or person duly authorized by the right holder in the country of production and which are made directly or indirectly from an article where the making of that copy would have constituted an infringement of a copyright or a related right under the law of the country of importation."

65. The third limitation in the first sentence of Article 61 is indicated by the word "willful" that precedes the words "trademark counterfeiting or copyright piracy". This word functions as a qualifier indicating that trademark counterfeiting or copyright piracy is not subject to the obligation in the first sentence of Article 61 unless it is "willful". This word, focusing on the infringer's intent, reflects the criminal nature of the enforcement procedures at issue. It is absent from Section 4 of Part III, even though that Section is similarly limited, as a minimum, to counterfeit trademark goods and pirated copyright goods. The penalties for criminal acts, such as imprisonment, fines and forfeiture of

property, are relatively grave, as reflected in the second sentence of Article 61. There is no obligation to make such penalties available with respect to acts of infringement committed without the requisite intent.

66. The fourth limitation in the first sentence of Article 61 is indicated by the phrase "on a commercial scale" that follows the words "trademark counterfeiting or copyright piracy". This phrase, like the word "willful", appears to qualify both "trademark counterfeiting" and "copyright piracy". The limitation to cases on a commercial scale, like the limitation to cases of willfulness, stands in contrast to all other specific obligations on enforcement in Part III of the TRIPS Agreement.[8]

67. The principal interpretative point in dispute is the meaning of the phrase "on a commercial scale". [ ] The two qualifications of willfulness and "on a commercial scale" indicate that Article 61 does not require Members to provide for criminal procedures and penalties to be applied to such counterfeiting and piracy *per se* unless they satisfy certain additional criteria. This is highlighted by the fourth sentence of Article 61, which allows Members to provide for criminal procedures and penalties to be applied in other cases of infringement, "in particular" where they are committed willfully and on a commercial scale. This indicates that the negotiators considered cases of willful infringement on a commercial scale to represent a subset of cases of infringement, comprising the graver cases.

"on a commercial scale"

68. The ordinary meaning of the word "scale" is uncontroversial. It may be defined as "relative magnitude or extent; degree, proportion. Freq. in *on a grand, lavish, small,* etc. *scale*". The ordinary meaning of the word includes both the concept of quantity, in terms of magnitude or extent, as well as the concept of relativity. Both concepts are combined in the notions of degree and proportion. Therefore, a particular "scale" compares certain things or actions in terms of their size. Some things or actions will be of the relevant size and others will not.

69. The relevant size is indicated by the word "commercial". The ordinary meaning of "commercial" may be defined in various ways. The following two definitions have been raised in the course of these proceedings:

> Engaged in commerce; of, pertaining to, or bearing on commerce.
> Interested in financial return rather than artistry; likely to make a profit;
> regarded as a mere matter of business."

70. The Panel considers the first definition to be apposite. It includes the term "commerce" which may, in turn, be defined as "buying and selling; the exchange of merchandise or services, esp. on a large scale". Reading this definition into the definition of "commercial" indicates that "commercial" means, basically, engaged in buying and selling, or pertaining to, or bearing on, buying and selling. A combination of that expanded definition of "commercial" and the definition of "scale" would render a meaning in terms of a relative magnitude or extent (of those) engaged in buying and selling, or a relative magnitude or extent pertaining to, or bearing on, buying and selling. This draws a link to the commercial marketplace.

71. The United States also submits that the word "commercial" scale draws a link to the commercial marketplace. However, it refers to elements of the first and third meanings in definition 3 but dismisses the relevance of the second meaning, "likely to make a profit", because it is different from the other two. The Panel notes that the third definition, which includes the qualifiers "rather than artistry" and "mere", refers to usages such as a "commercial artist", "commercial film" or "commercial writing" in the sense of those who are more interested in financial return than the artistic merit of a work, works that are of such a nature that they are likely to make a profit and works that are regarded as a mere matter of business rather than as expressions of other values. This definition is not apposite in the first sentence of Article 61.

72. Therefore, the Panel considers that the first definition set out above is appropriate. However, the combination of that definition of "commercial" with the definition of "scale" presents a problem

in that scale is a quantitative concept whilst commercial is qualitative, in the sense that it refers to the nature of certain acts. Some acts are in fact commercial, whilst others are not. Any act of selling can be described as commercial in this primary sense, irrespective of its size or value. If "commercial" is simply read as a qualitative term, referring to all acts pertaining to, or bearing on commerce, this would read the word "scale" out of the text. Acts on a commercial scale would simply be commercial acts. The phrase "on a commercial scale" would simply mean "commercial". Such an interpretation fails to give meaning to all the terms used in the treaty and is inconsistent with the rule of effective treaty interpretation.

73. In the Panel's view, the combination of the primary definition of "commercial" and the definition of "scale" can be reconciled with the context of Article 61 if it is assessed not solely according to the nature of an activity but also in terms of relative size, as a market benchmark. As there is no other qualifier besides "commercial", that benchmark must be whatever "commercial" typically or usually connotes. In quantitative terms, the benchmark would be the magnitude or extent at which engagement in commerce, or activities pertaining to or bearing on commerce, are typically or usually carried on, in other words, the magnitude or extent of typical or usual commercial activity. Given that the phrase uses the indefinite article "a", it refers to more than one magnitude or extent of typical or usual commercial activity. The magnitude or extent will vary in the different "cases" of counterfeiting and piracy to which the obligation applies. In the Panel's view, this reflects the fact that what is typical or usual varies according to the type of commerce concerned.

74. The evidence on the record includes many other uses of the words "commercial scale" and "on a commercial scale" in a variety of contexts. Accordingly, the Panel considers that the words "commercial" and "scale" provide important context for the ordinary meaning of each other when used together in the phrase "on a commercial scale" as in the first sentence of Article 61 of the TRIPS Agreement. The Panel finds that a "commercial scale" is the magnitude or extent of typical or usual commercial activity. Therefore, counterfeiting or piracy "on a commercial scale" refers to counterfeiting or piracy carried on at the magnitude or extent of typical or usual commercial activity with respect to a given product in a given market. The magnitude or extent of typical or usual commercial activity with respect to a given product in a given market forms a benchmark by which to assess the obligation in the first sentence of Article 61. It follows that what constitutes a commercial scale for counterfeiting or piracy of a particular product in a particular market will depend on the magnitude or extent that is typical or usual with respect to such a product in such a market, which may be small or large. The magnitude or extent of typical or usual commercial activity relates, in the longer term, to profitability.

75. The Panel notes that it is the standard in the treaty obligation that varies as applied to different fact situations, and not necessarily the means by which Members choose to implement that standard. The Panel recalls that the third sentence of Article 1.1 of the TRIPS Agreement provides as follows:

> "Members shall be free to determine the appropriate method of implementing the provisions of this Agreement within their own legal system and practice."

76. This provision confirms that the TRIPS Agreement does not mandate specific forms of legislation. The Panel may not simply assume that a Member must give its authorities wide discretion to determine what is on a commercial scale in any given case, and may not simply assume that thresholds, including numerical tests, are inconsistent with the relative benchmark in the first sentence of Article 61 of the TRIPS Agreement. As long as a Member in fact provides for criminal procedures and penalties to be applied in cases of willful trademark counterfeiting or copyright piracy on a commercial scale, it will comply with this obligation. If it is alleged that a Member's method of implementation does not so provide in such cases, that allegation must be proven with evidence. Therefore, the Panel will assess whether the evidence shows that China fails to provide for criminal procedures and penalties to be applied in any such cases.

77. The Panel begins with the first limb of the claim. In the first limb of the claim, the United States challenges the *levels* at which certain thresholds are set. Having chosen to challenge the level of a series of numerical thresholds as compared to a relative standard, it is necessary for the United States to demonstrate that the levels are higher than that standard as applied in certain factual situations. That calls for quantitative evidence. Later, the Panel will address the second limb of the

claim, in which the United States challenges the *factors* taken into account by the criminal thresholds. That calls for qualitative evidence.

78. The Panel has reviewed the evidence in support of this assertion. The evidence comprises a quote from a short article from a US newspaper, the *San Francisco Chronicle*, titled *"30,000-Store Wholesale Mall Keeps China Competitive"* regarding the number of stores in a particular mall in Yiwu and the physical dimensions of some stalls ; a statistic quoted from an extract from a management consultant report titled *"The 2005 Global Retail Development Index"* that the top ten retailers in China hold less than 2 per cent of the market, and another statistic that the top 100 retailers have less than 6.4 per cent; and a quote from an article in *Time* magazine titled *"In China, There's Priceless, and for Everything Else, There's Cash"* that a shopping mall in Luohu spans six floors of small stores. The Panel finds that, even if these sources were suitable for the purpose of demonstration of contested facts in this proceeding, the information that was provided was too little and too random to demonstrate a level that constitutes a commercial scale for any product in China.

79. The United States also submitted other press articles to illustrate points in its first written submission, particularly regarding the calculation of certain thresholds. China objected at the outset arguing that "[t]he Panel can afford little or no weight to such anecdotal and potentially misinformed reports". The United States was puzzled by China's concern at its recourse to newspapers or other media. The Panel has reviewed the press articles and notes that none of them are corroborated, nor do they refer to events or statements that would not require corroboration. [ ] The Panel emphasizes that, in the absence of more reliable and relevant data, it has reviewed the evidence in the press articles with respect to a central point in this claim that is highly contested. The credibility and weight of that evidence are therefore critical to the Panel's task. For the reasons set out above, the Panel does not ascribe any weight to the evidence in the press articles and finds that, even if it did, the information that these press articles contain is inadequate to demonstrate what is typical or usual in China for the purposes of the relevant treaty obligation.

80. For the above reasons, the Panel finds that the United States has not made a prima facie case with respect to the first limb of its claim under the first sentence of Article 61 of the TRIPS Agreement. The Panel will now turn to the second limb of the claim.

Other indicia – physical evidence

81. With respect to the second limb of this claim, the United States alleges that China's value and volume thresholds are tied to finished goods and therefore ignore other indicia of commercial scale operations, such as the presence of unfinished products and fake packaging.

82. The Panel notes that in a case referred to by China the court took into account packaging and tools as evidence of the intended use of product components seized on site, so that the value of the product components was included in the assessment of illegal business operation volume. The tools, though relevant, did not substitute for the thresholds. In any event, the Panel considers that the United States' allegation regarding physical evidence relates to the evidence sufficient to initiate a criminal prosecution more than to the definition of the crime itself. Article 61 of the TRIPS Agreement does not address evidence. The first sentence of Article 61 addresses the infringing activity in respect of which the minimum standards must apply. Evidence, including in criminal procedures, is mentioned in Article 41.3, but that provision has no bearing on this claim. [ ]The Panel does not consider that the United States has made a prima facie case with respect to other indicia of infringement, such as physical evidence including product components, packaging and materials or implements.

CONCLUSIONS AND RECOMMENDATION

a. For the reasons set out in this Report, the Panel concludes as follows:

   i. the Copyright Law, specifically the first sentence of Article 4, is inconsistent with China's obligations under:

      1. Article 5(1) of the Berne Convention (1971), as incorporated by Article 9.1 of the TRIPS Agreement; and

      2. Article 41.1 of the TRIPS Agreement;

   ii. with respect to the Customs measures:

      1. Article 59 of the TRIPS Agreement is not applicable to the Customs measures insofar as those measures apply to goods destined for exportation;

      2. the United States has not established that the Customs measures are inconsistent with Article 59 of the TRIPS Agreement, as it incorporates the principles set out in the *first* sentence of Article 46 of the TRIPS Agreement; and

      3. the Customs measures are inconsistent with Article 59 of the TRIPS Agreement, as it incorporates the principle set out in the *fourth* sentence of Article 46 of the TRIPS Agreement; and

   iii. the United States has not established that the criminal thresholds are inconsistent with China's obligations under the first sentence of Article 61 of the TRIPS Agreement.

b. In light of these conclusions, the Panel recommends pursuant to Article 19.1 of the DSU that China bring the Copyright Law and the Customs measures into conformity with its obligations under the TRIPS Agreement.