

THE US-CHINA WTO CASES EXPLAINED

In August the WTO released its panel report on the second of two cases that the US brought against China in 2007. Peter K Yu explains what the cases mean for IP owners

In August 2009, the WTO dispute settlement body released a panel report concerning the US-China dispute over the trading rights and distribution services for publications, sound recordings and audiovisual entertainment products. Earlier this year, a different WTO panel addressed a related US-China dispute on the protection and enforcement of IP.

The recent decision provides an excellent opportunity to revisit the earlier decision, exploring its implications for IP protection and enforcement. That decision focuses on three main issues: the high thresholds for criminal procedures and penalties in the IP area; the failure of the Chinese authorities to properly dispose of confiscated infringing goods; and the denial of copyright protection to works that have not been authorised for publication or distribution within the country.

Thresholds for criminal procedures and penalties

Under the TRIPs Agreement, each WTO member is required to apply criminal procedures and penalties to cases involving “wilful trademark counterfeiting or copyright piracy on a commercial scale”. The US claimed that China failed to honour its TRIPs commitments by including in its IP laws high thresholds for criminal procedures and penalties. These thresholds, the US argued, provided a safe harbour for pirates and counterfeiters to avoid criminal prosecution.

China denied the charge by pointing out that the country had in place a parallel enforcement system that subjects all infringements to enforcement. Due to limited resources and a different socio-legal tradition, criminal enforcement handles serious cases, while administrative enforcement deals with low-scale infringements.

As China successfully pointed out, the calculation of thresholds is rather complicated. Unlike the simple thresholds alleged by the US, the thresholds at issue are calculated over a prolonged period of time—say, five years. Those thresholds also take into account Chinese criminal law on joint liability, criminal groups and accomplices.

The key to resolving this part of the dispute, ultimately, surrounds the term “commercial scale”, which is undefined in TRIPs and includes both qualitative and quantitative elements. Although the US proposed a definition based on its case law and recently negotiated free trade agreements, the panel rejected such a proposal and looked instead to the specific conditions of China’s marketplace. Because the US was only able to provide evidence in press articles, the panel found the evidence insufficient and held for China.

Disposal of infringing goods

The second claim concerned the ability of the Chinese Customs authorities to dispose of confiscated infringing goods properly. Under TRIPs, each member state is required to empower its judicial authorities to order the uncompensated destruction or disposal of those goods.

Targeting this empowerment obligation, the US argued that the Chinese Customs provisions introduced a “compulsory sequence” that took away the authorities’ discretion to order destruction or disposal of the seized goods. As the US claimed, the authorities could not destroy the infringing goods unless they found it inappropriate to donate the goods to charities, sell them back to the rights holders or auction them off after eradicating the infringing features.

China responded by pointing out that the sequence was flexible and merely expressed an official preference for disposal methods. China Customs, therefore, still has wide discretion to determine whether criteria are met.

Interestingly, because China extended border measures to all forms of infringement (as compared to only piracy and counterfeiting), the WTO panel found that China had provided more protection than was required by TRIPs. The panel also upheld the use of donations and sales, noting the flexibility for a WTO member to introduce additional measures not mentioned by the Agreement.

Nevertheless, the panel faulted China for the way it used auctions. As the TRIPs Agreement states clearly, “the simple removal of the trademark unlawfully affixed shall not be sufficient . . . to permit release of the goods into the channels of commerce”. Although China provided additional measures, such as the solicitation of comments from rights holders and the introduction of a reserve price, those measures, in the panel’s view, did not provide an effective deterrent to piracy and counterfeiting.

Copyright protection for censored works

The third claim concerned article 4 of the Chinese Copyright Law, which denies copyright protection to works that have been banned for publication, distribution or both. By denying protection to banned works, China, the US claimed, failed to offer protection to copyright holders as required by the Berne Convention and TRIPs. The provision also contravened the Convention by subjecting copyrighted works to the formalities of a successful conclusion of content review.

China countered that the Berne Convention did not affect a country’s sovereign right “to permit, to control, or to prohibit . . . the circulation, presentation, or exhibition of any work or production”. In addition, China claimed that public regulations have pre-empted private economic rights and that censorship laws offered more secure protection than copyright. Indeed, if a work is banned for distribution, the ban would apply to both the copyright owners and the potential infringers.

In the end, the WTO panel found article 4 of the Chinese Copyright Law inconsistent with TRIPs. As the panel explained, China cannot deny copyright protection to copyrighted works even though it has a sovereign right to prohibit the publication or distribution of those works. In addition, the panel found that China failed to provide sufficient evidence that the rights holders will obtain greater protection through censorship regulations than copyright law. It also stated that the availability of an alternative form of protection did not diminish a country’s TRIPs obligations.

Release of the panel report

Immediately following the release of the panel report, both sides were quick to declare success. As the Acting US Trade Representative, maintained: “These findings are an important victory, because they confirm the importance of IPR protection and enforcement, and clarify key enforcement provisions of the TRIPs Agreement.” The response by a spokesperson of the Chinese Ministry of Commerce, by contrast, was more subdued. Although he welcomed the report’s findings on criminal thresholds, he “expressed ‘regret’ about the unfavourable aspects of the ruling”.

While it is attractive to find winners and losers in a legal dispute, WTO panel decisions unfortunately do not lend themselves to such findings. In fact, by cutting the baby in half, the WTO panel successfully avoided picking a winner and a loser in this case. It is therefore no surprise that neither side appealed the decision to the Appellate Body.

An important question remains, however: Could the resolution of this dispute be translated into substantive improvements in IP protection and enforcement in China? The answer, unfortunately, is negative.

Limitations of the WTO panel decision

Even if the US had prevailed on all three claims—a rather unusual outcome in a WTO dispute—the victory would have been rather empty. The successful challenge to article 4 of the Chinese Copyright Law was at best a symbolic, if not academic, victory. Because the provision has not been used in any case before, its impact on IP rights owners is likely to be minimal. In fact, many Chinese commentators have already acknowledged that the provision was unnecessary.

With respect to the second claim, although the prohibition of auctions, on its face, has greatly strengthened protection for rights owners, the ruling, in reality, has only minimal impact on IP protection and enforcement. As the WTO panel acknowledged, the panel ruling concerns only imports, which represented a mere 0.15% by value of the infringing goods disposed of or destroyed in China between 2005 and 2007. Even more problematically, although the use of auctions constituted 2% of all disposals, none of the confiscated infringing imports were auctioned off.

Equally disturbing is the US’s eagerness to challenge the sequence in the Chinese Customs provisions. As experienced China businesspeople could attest, local protectionism remains one of the biggest enforcement challenges in China. The more discretion there is, the more likely local protectionism and corruption will occur.

With the ongoing decentralisation of the Chinese central government, measures that curtail discretion might be in the interest of rights owners, even if they sound draconian under US standards. Had the US succeeded in introducing more discretion at the local and provincial levels, they might have hurt rights holders without realising the potential harm.

Finally, a victory along the line of criminal procedures and penalties is not likely to benefit rights owners, unless criminal enforcement always provides a more effective deterrent than administrative enforcement. In China, for example, administrative enforcement can be more

effective than criminal enforcement under certain circumstances and outside the big cities, such as Beijing, Shanghai and Guangzhou. The latter is also cheaper, quicker, more flexible and less antagonistic.

Moreover, the presence of a parallel enforcement system may suggest limited new developments even if China failed to provide the required criminal measures. After all, TRIPs cannot prevent a WTO member from relabeling its administrative measures criminal. As Brazil rightly recognised in its third party submission, it is rather formalistic to require China to provide criminal enforcement in place of administrative enforcement.

Lessons for government

In my opinion, this WTO challenge was rather ill-advised. From the very beginning, many commentators, including myself, advocated against such a challenge. Nevertheless, the panel decision still offers some important benefits to both China and the US.

For example, the US sent an effective signal to China about its willingness to use the WTO process, which in turn might lead to further negotiations both within and without the IP area. The US also learned more about China's legal reasoning, its WTO strategies and how the WTO panels would look at China's unique legal structure and measures (such as judicial interpretations). Most importantly, the US and its rights holders successfully obtained detailed information about how the censorship process and Customs procedures work in practice.

Meanwhile, China understood better its TRIPs obligations through the eyes of a neutral third party. For the reformist fractions within the Chinese leadership, the panel decision provided an important push for stronger reforms within the country. Most importantly, China's participation in the WTO process helped the country raise what some might call its "WTO game". Learning how to play this game well is particularly important, because the present dispute is likely to be the first of a long series of IP-related challenges the US intends to initiate against China in the near future.

Lessons for IP owners

The panel decision also provided valuable lessons to IP owners. First, enforcement is controversial at both the domestic and international levels. It is no coincidence that minimum international enforcement standards were not introduced into any multilateral agreement until the signing of TRIPs. It is also no surprise that developing countries remain reluctant to explore stronger enforcement standards at both the WTO and WIPO. Indeed, the enforcement issue was so controversial that developing countries pushed for a provision in TRIPs that states explicitly that WTO members are not required to devote more resources to IP enforcement than other areas of law enforcement.

Second, stronger enforcement cannot be developed out of IP laws alone. It requires the development of what I have called "an enabling environment for effective intellectual property protection". Such an environment includes key preconditions for successful IP reforms, such as a consciousness of legal rights, a respect for the rule of law, an effective and independent judiciary, a well-functioning innovation and competition system, sufficiently developed basic infrastructure, established business practices and a critical mass of local stakeholders.

Third, the WTO dispute settlement process has its limits. Although US industries have high hopes that this mandatory process will provide the needed antidote to the decade-old piracy and counterfeiting problems in China, WTO decisions are lengthy, complex and detailed. Each party in the dispute is likely to score some important points. A better and more reliable solution, therefore, is to focus on the bottom-up developments in the country and to facilitate greater collaboration between US industries and Chinese stakeholders.

Fourth, rights holders need to be proactive if IP protection in China is to be strengthened. There is only so much a government can do on their behalf. For all the complaints they made, the US Trade Representative obtained only 34 submissions pursuant to its initial request for comments on China's compliance with WTO commitments. It is no wonder that the US was unable to muster up sufficient evidence to challenge the thresholds for criminal procedures and penalties.

The market access challenge

Most recently, the WTO dispute settlement body released a report concerning the US-China dispute over the trading rights and distribution services for publications, sound recordings and audiovisual entertainment products. That report faulted China for its failure to open up the market for cultural and entertainment products. Its findings provide not only hope for IP owners in the publishing and entertainment industries, but also additional lessons on how to strengthen protection for IP interests in China.

Although IP protection and enforcement remains inadequate in China, strengthening protection is not the only, or even the most preferable, route to protecting these interests. If the ultimate objective of the WTO challenge is to increase market access—as is often the case in US-China IP negotiations—it may be more advisable to push China to honour the market access commitments it made before the WTO accession. After all, any unfavourable findings by WTO panels in the IP area will affect not only China but also the European Communities and other developing countries.

Moreover, the fact that governments might find it ill-advised to launch a WTO challenge against China on IP enforcement grounds does not mean that they would hold the same view toward a similar challenge on market access grounds. Indeed, it is not unusual to find both Chinese leaders and commentators bitterly divided over those two issues. It therefore may not be a good strategy to lump the two issues together, even though both issues are equally important to IP owners.

The WTO panel decisions provide some helpful protections for IP owners. The market access decision, in particular, helps open up the Chinese market for publications, sound recordings and audiovisual entertainment products. Nevertheless, the IP landscape in China remains largely unchanged. If IP protection and enforcement in the country is to be improved dramatically, it needs more than a single WTO challenge in the IP area.

As Managing IP went to press, an official at China's WTO mission confirmed that China will appeal the August 2009 WTO panel decision on market access for publications, sound recordings and audiovisual products.

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