

## STUDENT NOTE

# PAPER DRAGON: INADEQUATE PROTECTION OF INTELLECTUAL PROPERTY RIGHTS IN CHINA

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### INTRODUCTION

Beginning with overtures from President Nixon and Secretary of State Kissinger towards China in the 1970s, the U.S.-China relationship has been an endless source of fascination and tension. Trade between the United States and China accounts for much of this drama. Entrepreneurs have scrambled to make fortunes in China,<sup>1</sup> while the United States has advocated further market access for U.S. goods. Complaints that U.S. jobs have been lost to China contrast with higher than average domestic

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1. G. Pascal Zachary, *How Americans are Making Millions in China*, BUS. 2.0 MAG., Aug. 2005, at 58, 59.

wages for U.S. firms engaged in international trade or investment activities in China.<sup>2</sup> Meanwhile, U.S. government lawyers analyze trade data to support potential complaints against China in the World Trade Organization (WTO).<sup>3</sup>

The United States has benefited significantly from trade with China, gaining access to low-cost consumer and industrial goods, and achieving economic growth while maintaining stable inflation. The United States and China together represent approximately half of the global economic growth in the last four years.<sup>4</sup> In 2005, China was the fourth-largest export market for the United States. Only four years before that, China was the ninth-largest U.S. export market.<sup>5</sup> China now ranks with the European Union, Japan, and the NAFTA countries in trade with the United States. In July 2006, the U.S. Undersecretary of Commerce for International Trade predicted that China would soon be the third-largest market for U.S. goods and services.<sup>6</sup> Of total U.S. imports since 1995, China's share has increased from 5.8 percent to 14.6 percent.<sup>7</sup>

China's trade with the United States began at a modest 1.1 million dollars in 1978, with the United States exporting four-fifths of that to China.<sup>8</sup> By 1990, U.S.-China trade had reached twenty billion dollars, three-fourths of which China exported to the United States.<sup>9</sup> This trade explosion conflicted with public calls to halt trade relations with China after the Tiananmen Square episode the preceding year. The imbalance in trade in goods has increased dramatically—in 2005 the United States imported Chinese goods worth 243 billion dollars and exported goods worth forty-one billion dollars, resulting in a deficit of 202 billion dollars.<sup>10</sup> The 2006 deficit is well on its way to surpassing that of 2005, with the deficit at the end of June 2006 11.5 billion dollars higher than the same 2005 figure.<sup>11</sup>

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2. U.S. TRADE REPRESENTATIVE (USTR), U.S.-CHINA TRADE RELATIONS: ENTERING A NEW PHASE OF GREATER ACCOUNTABILITY AND ENFORCEMENT—TOP-TO-BOTTOM REVIEW 7 (2006) [hereinafter USTR 2006 TOP-TO-BOTTOM REVIEW].

3. *Id.*

4. *Id.* at 3.

5. *Id.*

6. U.S. *Sees China to be the Third Largest Export Market Soon*, THE CHINA PERSPECTIVE, July 25, 2006, <http://www.thechinaperspective.com/articles/usseeschinatobethethirdlargestexportmarketsoon/index.html>; see also *Sino-US Trade is Highly Reciprocal*, PEOPLE'S DAILY, April 26, 2000, [http://English.people.com.cn/English/200004/26/eng20000426\\_39771.html](http://English.people.com.cn/English/200004/26/eng20000426_39771.html).

7. USTR 2006 TOP-TO-BOTTOM REVIEW, *supra* note 2, at 4.

8. DAVID H. LAMPTON, SAME BED, DIFFERENT DREAMS: A HISTORY OF THE CHINESE AMERICAN BANK OF COMMERCE, 1919–1937, at 380, tbl.2 (2001).

9. U.S. Census Bureau, *Trade in Goods (Imports, Exports and Trade Balance) with China*, <http://www.census.gov/foreign-trade/balance/c5700.html#questions>.

10. *Id.*

11. *Id.*

Enforcement of intellectual property rights (IPR) in China has proven to be a formidable challenge and a top priority for U.S. policy-makers. Ambassador Rob Portman, the former United States Trade Representative (USTR), has likened IPR infringement in China to outright theft.<sup>12</sup> Congress, prompted by U.S. industry, frequently raises the issue of IPR infringement in China. Members of Congress have complained that reports of IPR infringement arrive almost daily and that little has been done about it.<sup>13</sup> Others allege corruption or foul play,<sup>14</sup> self-interested Chinese enforcement,<sup>15</sup> and outright attack on the U.S. entertainment industry.<sup>16</sup> Senator Gordon Smith has implied that if the United States had another chance at negotiating China's WTO entry, the outcome might be different.<sup>17</sup>

Such acrimony over Chinese IPR enforcement has the potential to undermine bipartisan support for trade agreements.<sup>18</sup> Prior to President Bush's visit to China in November 2005, the President received a letter from fourteen Senators asking him to take action against China's rampant IPR infringement.<sup>19</sup> The USTR has received individual communications from members of Congress on the IP issue as well.<sup>20</sup> In light of ongoing IP piracy in China and the obvious political importance of this issue in the United States, a review of China's obligations under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)—and its efforts to uphold those obligations—is in order.

This Note will explore the extent to which China is in violation of its obligations under TRIPs. Section I surveys the current state of IPR infringement in China. Section II analyzes relevant TRIPs provisions, case law, and treaties that supplement TRIPs provisions. Section III analyzes Chinese criminal law, the December 2004 Judicial Interpretation of

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12. *Nomination of Hon. Robert J. Portman to be U.S. Trade Representative: Hearing Before the S. Comm. on Finance, 109th Cong.* 15 (2005) [hereinafter *Portman Confirmation Hearing*].

13. *Id.* at 3.

14. *Id.* at 14.

15. *Id.* at 34.

16. *Id.* at 22.

17. *Id.*

18. *Nominations of Hon. James S. Halpern, to be Judge of the U.S. Tax Court; Hon. Karan K. Bhatia, to be Deputy U.S. Trade Representative, with the Rank of Ambassador; Hon. Susan C. Schwab, to be Deputy U.S. Trade Representative, with the Rank of Ambassador; Hon. Franklin L. Lavin, to be Under Secretary of Commerce for International Trade; and Clay Lowery, to be Deputy Under Secretary of the Treasury: Hearing Before the Sen. Comm. on Finance, 109th Cong.* 19 (2005) (statement of Sen. Gordon Smith).

19. *See* Letter from U.S. Senate to George W. Bush, President of the United States (Nov. 10, 2005) (on file with the Office of the USTR).

20. *See* Letter from Howard Berman, Congressman, to Robert Portman, USTR (Oct. 17, 2005) (on file with the Office of the USTR); letter from Mary Bono, Congresswoman, to Robert Portman, USTR (Oct. 27, 2005) (on file with the Office of the USTR).

Chinese criminal law, and Chinese IP law as they pertain to IPR infringement. Section IV outlines enforcement efforts in China against the backdrop of the law analyzed in the previous section. Section V evaluates these enforcement efforts given China's capabilities and obligations, and Section VI concludes that China would have difficulty defending against a TRIPs action in the WTO.

### I. THE *PIRATE'S* REPUBLIC OF CHINA?

China's IPR infringement extends beyond the familiar complaints of the U.S. entertainment industry. Clearly, counterfeit compact discs (CDs) and digital video discs (DVDs) reduce revenue for recording artists, producers, and actors, but infringement of IPR in China also includes industries such as automotive and aviation parts manufacturing and pharmaceuticals manufacturing.<sup>21</sup> IPR infringement therefore has the potential to affect health and safety, in addition to revenue streams, within and beyond China's borders.

IPR infringement is pervasive in China and exacerbates the U.S. trade deficit. If Chinese consumers purchased more legal copies of software and entertainment media, revenues from technology licenses, entertainment royalties, and publishing copyrights could relieve the trade deficit by as much as 2.5–3.8 billion dollars annually.<sup>22</sup> China's State Council estimated the 2001 value of pirated goods in China at between nineteen and twenty-four billion dollars,<sup>23</sup> which translates to approximately one-fourth of the 2001 U.S.-China trade deficit.<sup>24</sup> Assuming infringement was constant from 2001 through 2005, annual relief would represent potentially one-fifth of the 2005 U.S.-China trade deficit of 202 billion dollars. IPR infringement, however, appears to have worsened. Sixty-seven percent of IPR seizures by U.S. Customs in 2004—worth 134 million dollars—came from China, up from ninety-four million dollars worth in 2003, a forty-seven percent increase.<sup>25</sup> Piracy could therefore currently represent one-fourth or more of the U.S.-China trade deficit.

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21. USTR, 2004 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE 63 (2004).

22. *Id.*

23. USTR, 2005 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE 76 (2005), available at [http://www.ustr.gov/assets/Document\\_Library/Reports\\_Publications/2005/asset\\_upload\\_file293\\_8580.pdf](http://www.ustr.gov/assets/Document_Library/Reports_Publications/2005/asset_upload_file293_8580.pdf).

24. The 2001 U.S.-China deficit was approximately \$83.6 billion. Robert E. Scott, *U.S.-China Trade 1989–2003: Impact on Jobs & Industries, Nationally and State-by-State 4* (Econ. Policy Inst. Working Paper No. 270, 2005), [http://www.epinet.org/workingpapers/epi\\_wp270.pdf](http://www.epinet.org/workingpapers/epi_wp270.pdf).

25. USTR, 2005 SPECIAL 301 REPORT 2 (2005) [hereinafter 2005 SPECIAL 301 REPORT].

*A. Software, Songs, and Silver Screens*

A five-minute stroll through city streets in China yields significant evidence of the production and distribution of pirated media. Entertainment and software industries face a staggering piracy rate of between eighty-five and ninety-five percent. U.S. copyright associations<sup>26</sup> estimate total losses to piracy in 2004 in excess of 2.5 billion dollars.<sup>27</sup> These figures suggest that at this point virtually no legitimate market exists for the entertainment and software industries in China. Equally striking is the fact that China is the world's sixth-largest market for personal computers, while it ranks twenty-sixth for legitimate software sales. The stark contrast explains why U.S. business software publishers lost 1.47 billion dollars to IPR infringement in 2004.<sup>28</sup>

China's WTO commitments under the General Agreement on Trade in Services (GATS) allow for *twenty* foreign films to be imported annually;<sup>29</sup> U.S. film producers export less than that number to China. Non-quota films are thus in high demand, a demand that pirates supply. Until the twenty quota films pass censorship processes, pirates supply those films as well.<sup>30</sup> Eighty-three government-licensed optical disc factories in China produce pirated DVDs.<sup>31</sup> The price differential between pirated and legitimate products ensures that once a pirated film reaches the market, its legitimate counterpart will not be able to compete.

Any reduction in IPR infringement has been negligible. The Recording Industry Association of America (RIAA) reported that the piracy rate in China decreased from ninety percent in 2003 to eighty-five percent in 2004. The Motion Picture Association reported that during the first three quarters of 2003, customs officials in the United Kingdom

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26. Examples of such associations are the Business Software Alliance, the Motion Picture Association of America, and the Association of American Publishers and the Recording Industry Association of America.

27. *Intellectual Property Protection as Economic Policy: Will China Ever Enforce Its IP Laws?: Roundtable Before the Congressional-Executive Commission China*, 109th Cong. 7 (2005) [hereinafter *CECC IP Roundtable*] (testimony of Eric H. Smith, President, International Intellectual Property Alliance).

28. *Id.* at 2.

29. WTO General Agreement on Trade in Services Communication, Schedule of Specific Commitments on Trade in Services, P.R.C., § D, GATS/SC/135 at 21 (Feb. 14, 2002) [hereinafter *China's GATS Commitments*].

30. *2004 Transitional Review Mechanism: Hearing Before the Council on the Trade-Related Aspects of Intellectual Property*, ¶ 203, IP/C/M/46 (2005) [hereinafter *2004 TRMs*] (meeting minutes). See detailed discussion on the 2003–05 TRMs, *infra*, Section IV.

31. *CECC IP Roundtable*, *supra* note 27, at 7.

seized over 79,000 Chinese origin DVDs.<sup>32</sup> Pirated Chinese exports reach over twenty industrialized and developing countries.<sup>33</sup>

### B. Auto and Aviation Parts

Chinese IPR infringement affects the auto and aviation industries as well.<sup>34</sup> The Motor and Equipment Manufacturers Association (MEMA) estimates that counterfeiting costs the auto industry twelve billion dollars annually.<sup>35</sup> Safety is an even greater concern than the economic losses of counterfeit auto or aviation parts. The Federal Aviation Administration (FAA) estimates that over 500,000 airline parts sold each year are counterfeit, representing two percent of total parts sold annually.<sup>36</sup> A Norwegian airliner crashed in 1989 due to counterfeit parts—all fifty-five aboard died when the aircraft disintegrated 22,000 feet above the North Sea.<sup>37</sup> Counterfeit propellers, propeller pitch-control units, and engine bearings all have led to fatal crashes.<sup>38</sup> Brian Duggan of MEMA recounted a fatal 2004 vehicle fire in which the counterfeit brake pads had been lined with dried grass.<sup>39</sup> In 1987, seven children died when the bus they were in flipped over because, even though the brakes had a well-known trademark affixed to them, they were made of sawdust.<sup>40</sup>

MEMA estimates that almost seventy percent of counterfeit imports into the United States originated in China and an additional ten percent from Hong Kong.<sup>41</sup> In February 2005 Chinese authorities seized 1.2 million dollars of counterfeit auto parts bearing Japanese trademarks.<sup>42</sup> A global auto parts manufacturing company cited two cases in which a to-

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32. INT'L INTELLECTUAL PROP. ASS'N [IIPA], SPECIAL 301 REPORT ON GLOBAL COPYRIGHT PROTECTION AND ENFORCEMENT 34 (2004), [http://www.iipa.com/special301\\_TOCS/2004\\_SPEC301\\_TOC.html](http://www.iipa.com/special301_TOCS/2004_SPEC301_TOC.html).

33. Int'l Anticounterfeiting Coalition [IACC], Submission of the IACC to the USTR: Special 301 Recommendations, 13 (2005), [http://www.iacc.org/resources/2005\\_USTR\\_Special\\_301.pdf](http://www.iacc.org/resources/2005_USTR_Special_301.pdf).

34. U.S. Embassy in China, Industry Specific Issues, Automotive IPR Initiative, Dec. 5, 2005, <http://beijing.usembassy-china.org.cn/iprindustry.html>.

35. MOTOR AND EQUIP. MFRS. ASS'N, COUNTERFEITING: CRIME OF THE 21ST CENTURY 8, <http://www.mema.org/cmspages/getAttch.php?id=33>.

36. IACC, WHITE PAPER—THE NEGATIVE CONSEQUENCES OF INTERNATIONAL INTELLECTUAL PROPERTY THEFT: ECONOMIC HARM, THREATS TO THE PUBLIC HEALTH AND SAFETY, AND LINKS TO ORGANIZED CRIME AND TERRORIST ORGANIZATIONS 10 (2005) [hereinafter IACC WHITE PAPER].

37. Willy Stern, *Warning! Bogus Parts Have Turned Up in Commercial Jets. Where's the FAA?*, BUS. WK., June 12, 1996, <http://www.businessweek.com/1996/24/b34791.htm>.

38. *Id.*

39. MOTOR AND EQUIP. MFRS. ASS'N, *supra* note 35, at 7.

40. IACC WHITE PAPER, *supra* note 36, at 10.

41. MOTOR AND EQUIP. MFRS. ASS'N, *supra* note 35, at 6. The data does not differentiate between auto and non-auto counterfeit items.

42. See *Details of 10 Major IPR Piracy Cases Released in China*, ASIA PULSE, Nov. 17, 2005.

tal of 68,000 counterfeit boxes were found, ready to receive counterfeit product.<sup>43</sup> Counterfeit plaques were also included to convince consumers that the products were certified. A total fine of 7,500 dollars was assessed, and no proceeds of the fines were shared with the company.

China is the fifth-largest auto parts supplier to the United States, with companies such as General Motors aiming to spend four billion dollars by 2009 for parts production and subsequent export from China.<sup>44</sup> With China-based production of such products comes the significant danger of information transfer, since much of China's counterfeiting arises from the process of reverse engineering—the part is purchased, disassembled, copied, and then reassembled. Such methods of information transfer are generally not considered protected by intellectual property law.

### C. Drugs

The production, distribution, and export of counterfeit pharmaceutical products is another area of significant IPR piracy in China.<sup>45</sup> Counterfeit Chinese pharmaceuticals have reached fifty countries.<sup>46</sup> In November 2002, the Chinese State Drug Administration closed 1,300 illegal factories and examined drugs worth fifty-seven million dollars.<sup>47</sup> As many as 192,000 people may have died in China due to counterfeit drugs in 2001.<sup>48</sup> To the credit of the Chinese authorities, this figure was featured on the Shenzhen Evening News. Infants were the victims of a 2004 scheme of counterfeit formula that resulted in dozens of deaths.<sup>49</sup> In

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43. *Pirates of the 21st Century: The Curse of the Black Market: Hearing Before the Subcomm. on Oversight of Government Management, the Fed. Workforce, and the District of Columbia of the Sen. Comm. on Homeland Security and Governmental Affairs*, 108th Cong. (2004) (statement of Phillip Rotman, Assistant Patent & Trademark Counsel, Dana Corp.) [hereinafter Rotman Statement], available at <http://www.hsgac.senate.gov/index.cfm?Fuseaction=Hearings.Testimony&HearingID=169&WitnessID=610>.

44. U.S. EMBASSY IN CHINA, *supra* note 34.

45. Counterfeit drugs can include drugs with nongenuine but harmless ingredients, drugs with nongenuine and dangerous ingredients, or drugs with an increased (and thus unsafe) dosage level of genuine ingredients. Examples of harmless ingredients can include talcum powder or sugar. False and dangerous ingredients have included an antifreeze ingredient instead of normal ingredients in cough syrup (which killed infants in Haiti and India in 1995 and 1998, respectively). See World Health Organization [WHO], *Substandard and Counterfeit Medicines*, Fact Sheet No. 275, Feb. 2006, <http://www.who.int/mediacentre/factsheets/fs275/en/>.

46. Anne Stevenson-Yang & Ken DeWoskin, *China Destroys the IP Paradigm*, FAR E. ECON. REV., Mar. 2005, at 9, 11.

47. WHO, *supra* note 45.

48. MICHELE FORZLEY, INT'L INTELLECTUAL PROP. INST. [IIP], COUNTERFEIT GOODS AND THE PUBLIC'S HEALTH AND SAFETY 33 (2003), [http://www.iipi.org/reports/Counterfeit\\_Goods.pdf](http://www.iipi.org/reports/Counterfeit_Goods.pdf).

49. See IACC WHITE PAPER, *supra* note 36, at 13, n.48.

Japan, “diet pills” from China led to four deaths and over 150 cases of illness.<sup>50</sup> Johnson & Johnson has pursued thirty-eight criminal cases in China against counterfeit products that copied the Johnson & Johnson brand name.<sup>51</sup>

Industry experts estimate that China is responsible for thirty percent of the world’s counterfeit drug trade.<sup>52</sup> Joint sting operations in 2005 resulted in seizures valued at 9.3 million dollars.<sup>53</sup> The concern is serious enough that Pfizer opened a testing facility in Dalian, China, to monitor counterfeiting.<sup>54</sup> Chinese stores sell versions of Viagra named Vyagra King and USA Vager 777, which store owners claim are seventy percent “real.”<sup>55</sup> The difference in sales of Viagra between the United States and China underscores the extent of the counterfeit drug problem. The United States, with approximately one-fourth of China’s population, purchased almost 900 million dollars of Viagra in 2004. That same year, China purchased only five million dollars worth. Counterfeit drugs are at least partly responsible for that gap.<sup>56</sup>

## II. WTO TRIPS LAW AND SUPPORTING TEXTS

### A. *DEER Rights*

Article 41 of the WTO TRIPS Agreement provides the main thrust of IPR enforcement requirements. Specifically, Article 41(1) indicates that:

Members shall ensure that enforcement procedures as specified in this Part are available under their law so as to permit effective action against any act of infringement of intellectual property rights covered by this Agreement, including expeditious remedies to prevent infringements and remedies which constitute a deterrent to further infringements. These procedures shall be applied in such a manner as to avoid the creation of barriers to

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50. *Chinese Diet Pill Casualties Mount*, CNN.COM, July 21, 2002, <http://archives.cnn.com/2002/WORLD/asiapcf/east/07/21/japan.pills/>.

51. IACC WHITE PAPER, *supra* note 36, at 8.

52. David Griesing & Bruce Japsen, *Pharmaceutical Companies Feeling Potent Effect of Fakes*, CHI. TRIB., Nov. 20, 2005, at C5.

53. *Id.*

54. *Id.*

55. *Id.*

56. *See Details of 10 Major IPR Piracy Cases*, *supra* note 42.

legitimate trade and to provide for safeguards against their abuse.<sup>57</sup>

The key elements of Article 41 are deterrence, enforcement and expeditious remedies (“DEER” rights). DEER rights ensure that a rights holder can rely on a WTO member’s justice system to enforce IPR protections. DEER rights are fundamental to attracting and retaining durable foreign direct investment. Furthermore, the WTO considers DEER rights mutually exclusive and nonredundant.<sup>58</sup> This conveys to WTO members the clear message that significant efforts are expected to establish robust DEER rights.

WTO panels and the Appellate Body have construed the provisions of Article 41 within the spirit of the entire TRIPs Agreement. In *United States—Section 211 Omnibus Appropriations Act of 1998*, the panel commented on the necessary availability of civil judicial procedures as an element of TRIPs Articles 41 and 42.<sup>59</sup> The Appellate Body advanced the panel’s finding in ruling that the availability of civil judicial procedures meant that they must be “obtainable” and “within one’s reach.”<sup>60</sup> This interpretation invokes the judicial procedural requirements of Article 42 in support of the general conditions of enforcement and expeditious remedies for protection in Article 41.

In *European Communities—Protection Of Trademarks And Geographical Indications For Agricultural Products And Foodstuffs*,<sup>61</sup> the panel reiterated that Article 41 encompasses nonredundant IPR provisions and provides support to the Article 62(4) provision for acquisition and maintenance of IPR as well as *inter partes* procedures regarding IPR. The WTO has provided little further guidance on the descriptions and definitions of Article 41 DEER rights, which is due in part to the lack of disputes centered on Article 41. The *WTO Analytical Index* also does not provide further clarifications on Article 41’s DEER rights.

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57. Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, art 41(1) (1994) [hereinafter TRIPs].

58. Panel Report, *European Communities—Protection Of Trademarks And Geographical Indications For Agricultural Products And Foodstuffs*, ¶ 7.48, WT/DS290/R (Mar. 15, 2005).

59. Panel Report, *United States—Section 211 Omnibus Appropriations Act of 1998*, ¶¶ 8.97, 8.111, WT/DS176/R (Aug. 6, 2001).

60. Appellate Body Report, *United States—Section 211 Omnibus Appropriations Act of 1998*, ¶¶ 214–17, WT/DS176/AB/R (Feb. 1, 2002).

61. Panel Report, *EC—Protection Of Trademarks*, ¶ 7.48, WT/DS290/R (March 15, 2005).

### B. Damages, Other Remedies

The TRIPs Agreement is, however, clear on how a WTO member should calculate damages. Article 45 indicates that damages must adequately remedy the rights holder's injury and should be calculated on the basis of the production cost and subsequent price of the genuine product.<sup>62</sup> "Adequate" damages under this formulation are delineated independently from the recovery of profits, and therefore clearly favor the rights holder. The second paragraph of Article 45 calls for the recovery of profits only in cases where the infringer unintentionally used or stole the intellectual property—profit seizure is justified *only* by the lack of mens rea on the part of the would-be pirate.

Article 46 expands on the concept of deterrence, identifying procedures necessary to stop pirates. It gives authorities the power to seize infringing goods and dispose them outside the channels of commerce, it rejects the mere removal of an unlawfully-affixed trademark and the subsequent release of goods into channels of commerce as adequate action, and it empowers authorities to seize the instruments predominantly used to produce infringing goods.<sup>63</sup> Similarly, Article 59 gives competent authorities the power to destroy or dispose of infringing goods.<sup>64</sup>

### C. Criminal Procedures

Lastly, TRIPs specifies that criminal procedures can (and sometimes must) be utilized and adjusted for effective deterrence. Article 61 indicates that:

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.<sup>65</sup>

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62. TRIPs, *supra* note 57, art. 45.

63. *Id.* art. 46.

64. *Id.* art. 59.

65. *Id.* art. 61.

Article 61's minimum standard for willful piracy is worth noting. Criminal authorities *must* hear cases and administer penalties for willful piracy on a commercial scale. The finality of this provision is unmistakable.

While there is an unfortunate dearth of WTO case law surrounding the above articles, their message is unequivocal: members must adjust punishments to guarantee Article 41 DEER rights. In doing so, members must be mindful of the rights holder's interests. The rights holder's perspective is crucial to any action against IP piracy, including calculating damages, administering appropriate penalties, seizing pirated goods and instruments used in production, destroying pirated goods or removing them from channels of commerce, and issuing criminal punishments.<sup>66</sup> All actions are meant to fulfill the letter and spirit of a member's Article 41 DEER responsibilities.

#### *D. Other Trade Agreements and Commentary*

Other IPR-related trade provisions can serve as guides for enforcement and deterrence. The North American Free Trade Agreement (NAFTA) provides virtually identical language on DEER rights and judicial powers to deter IP piracy. NAFTA Article 1714 outlines provisions for DEER rights,<sup>67</sup> and Article 1715(2) requires NAFTA parties to give judicial authorities the power to issue orders to desist and to dispose of or prevent entry of infringing goods to the channels of commerce.<sup>68</sup> Article 1717 articulates the criminal procedures a party may utilize, including both imprisonment and monetary fines "sufficient to provide a deterrent" to IP piracy.<sup>69</sup>

The U.S.-Jordan Free Trade Agreement also provides helpful language on IPR enforcement. Going beyond the TRIPs Agreement's provisions for damages, Article 4 states:

Each Party shall ensure that its statutory maximum fines are sufficiently high to deter future acts of infringement with a policy of removing the monetary incentive to the infringer, and shall provide its judicial and other competent authorities the authority to order the seizure of all suspected pirated copyright and counterfeit trademark goods and related implements the predominant

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66. *Id.* arts. 45, 46, 61.

67. North American Free Trade Agreement, U.S.-Can.-Mex., arts. 1714(1), 1717(2), Dec. 17, 1992, 32 I.L.M. 289 [hereinafter NAFTA].

68. *Id.* art. 1715(2).

69. *Id.* art. 1717(1).

use of which has been in the commission of the offense, and documentary evidence.<sup>70</sup>

These approaches place particular importance on removing the monetary incentive for the infringer. They also calculate damages using the value of the genuine item, the suggested retail price of the legitimate product, or other equivalent measures established by the rights holder—key elements in protecting IP rights holders.

Various commentators have used piracy levels as the primary indicator of the effectiveness of a country's IPR enforcement regime. The International Intellectual Property Alliance (IIPA) states that any country with an audio or video piracy rate of over twenty-five percent or a software piracy rate of over forty percent has failed to address piracy adequately.<sup>71</sup> Richard M. Kruger, Vice President of Enforcement at the Business Software Alliance, has said that for deterrence measures to be deemed effective, "the public must understand and expect that meaningful sanctions will be imposed against those who engage in activities that rise to the level of criminal violations of the law."<sup>72</sup> These commentators agree that punishments for IPR infringement must include the possibility of imprisonment, without which deterrence is improbable.<sup>73</sup> Civil fines may only be perceived as a cost of doing business if penalties remain slight.

### III. CHINA'S RELEVANT INTELLECTUAL PROPERTY LAW

#### A. China's Criminal Law

Criminal law related to IPR infringement in China is problematic. The section on IPR contains vague terminology and ambiguous enforcement approaches, and it relies on profit motives and unclear thresholds for more severe penalties. While the U.S. legal system certainly uses some vague terminology, China's overall lack of transparency makes consistent application of such standards difficult and frustrates the

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70. U.S.-Jordan Free Trade Agreement, Oct. 24, 2000, 41 I.L.M. 63 (2002).

71. IIPA, *Estimates of 1995 U.S. Losses Due To Foreign Piracy and Levels of Foreign Piracy*, in INTERNATIONAL INTELLECTUAL PROPERTY 581 (Doris E. Long & Anthony D'Amato eds. 2000) (1997).

72. *Amendments to the Sentencing Guidelines: Hearings on the "No Electronic Theft Act of 1997," Pub. L. 105-147 (The NET Act) Before the U.S. Sentencing Commission 2* (2000) (testimony of Robert M. Kruger, Vice President of Enforcement, Business Software Alliance), [http://www.ussc.gov/AGENDAS/3\\_23\\_00/KrugerBSA.PDF](http://www.ussc.gov/AGENDAS/3_23_00/KrugerBSA.PDF).

73. Ralph Oman, *Intellectual Property After the Uruguay Round*, 42 J. COPYRIGHT Soc'y U.S.A. 18 (1994).

expectations of rights holders. WTO members are thus forced to hound China for clarity at WTO compliance hearings in Geneva.<sup>74</sup>

Article 213 of the Chinese criminal law addresses trademark counterfeiting, imposing a maximum prison sentence of “not more than three years” for crimes of “serious circumstances.”<sup>75</sup> A prison term of three to seven years is imposed for “especially/extremely severe circumstances.”<sup>76</sup> Article 214 addresses the sale of counterfeit trademarks and again imposes a maximum of up to three years in prison for “relatively large sales.”<sup>77</sup> Three to seven years is required for “huge” sales.<sup>78</sup> Article 217 addresses copyright violations, and while it employs similarly ambiguous language, it also requires that the pirate have a profit motive and incur relatively large gains in order to be prosecuted.<sup>79</sup>

### B. The December 2004 Judicial Interpretation

In December 2004, the Supreme People’s Court took an initial step toward enhanced criminal enforcement of IPR infringement. The court issued a Judicial Interpretation (the December 2004 JI) that aimed to clarify Chinese criminal law and extend the reach of China’s legal system to IPR pirates.<sup>80</sup> Some improvements included: 1) creating criminal liability for those who assist in piracy, including landlords and creditors; 2) counting the value of unsold and idle pirated stock towards sales calculations; and 3) counting advertising revenues as profits in the sector of Internet piracy.<sup>81</sup> In direct contrast to these three improvements, however, the December 2004 JI also imposed criminal thresholds more severely for business units than for individuals,<sup>82</sup> penalized copyright infringers

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74. See the discussion of the 2003–05 WTO Transitional Review Mechanism Hearings (TRMs), *infra* Part IV.

75. See Criminal Law (promulgated by the Nat’l People’s Cong., Mar. 14, 1997, effective Oct. 1, 1997), arts. 213–220 (P.R.C.) (section of criminal law addressing “Crimes Of Infringing On Intellectual Property Rights”), available at <http://www.abailaw.com/xingfa/xingfaxiu.htm>, translated at <http://english.people.com.cn/data/laws/detail.php?id=4>.

76. Translated from the Chinese by the author. The same English translations are used for the December 2004 JI.

77. See Criminal Law (promulgated by the Nat’l People’s Cong., Mar. 14, 1997, effective Oct. 1, 1997) (P.R.C.), translated at <http://english.people.com.cn/data/laws/detail.php?id=4> (English).

78. *Id.*

79. *Id.*

80. See Interpretation of the Concrete Application of the Law in Handling Criminal Cases of Intellectual Property Infringement (issued by the Jud. Comm. of the Sup. People’s Ct., Nov. 2, 2004 & the Procuratorial Comm. of the Sup. People’s Procuratorate, Nov. 11, 2004, effective Dec. 22, 2004.) (P.R.C.) [hereinafter December 2004 JI], <http://www.chinaipr.com/english/laws/laws20.htm>.

81. *Id.* arts. 11–12, 16.

82. *Id.* art. 15. Ironically, this gives pirating businesses the leeway to invest in infrastructure and stay in business, as long as piracy levels are kept below the generous threshold.

only if they sought profit,<sup>83</sup> and used the price of *infringing* goods rather than legitimate goods as the basis for determining whether criminal thresholds have been met.<sup>84</sup>

The December 2004 JI offered numerical thresholds to clarify the Chinese criminal code's arbitrary language. The following numerical thresholds apply to copyright piracy:<sup>85</sup>

<i>Individuals</i>	<i>Business Units</i>	<i>Profit Gain</i>	<i>Punishment</i>
over 1,000 copies	over 3,000 copies	over RMB30,000	not more than 3 years' imprisonment
over 5,000 copies	over 15,000 copies	over RMB250,000	3–7 years' imprisonment

The JI offered the following thresholds for trademark piracy:<sup>86</sup>

<i>Individuals</i>	<i>Business Units</i>	<i>Profit Gain</i>	<i>Punishment</i>
over 20,000 copies	over 3,000 copies	over RMB30,000	not more than 3 years' imprisonment
over 100,000 copies	over 15,000 copies	over RMB150,000	3–7 years' imprisonment

The December 2004 JI is problematic for other reasons. Article 12 defined “copy” strictly in reference to trademark copies and not in relation to copyright or patent infringement. Production levels, costs, and profit projections—and thus the value of the original item—can certainly differ if the copy is that of a music CD, film DVD, or entertainment or business software. Critics also point to the arbitrary thresholds and note that business units can manufacture 2,950 copies of pirated media and yet escape criminal sanction.

China also continues to use profits as the basis for criminal liability. Articles 1–3 of the December 2004 JI used profit thresholds of 50,000–250,000 renminbi (approximately 6,200–31,000 dollars), implying that if the amount of illegal business is under 50,000 renminbi, nothing will be done. China and Vietnam are the only countries that use this method of criminal IPR enforcement.<sup>87</sup> Moreover, profits are calculated using the pirated value, not the genuine value of the goods.<sup>88</sup> Industry leaders have noted that such methods are ineffective and do not protect the rights

83. *Id.* arts. 5–6.

84. *Id.* art. 9.

85. *Id.* art. 5.

86. *Id.* art. 5.

87. IACC WHITE PAPER, *supra* note 36, at 8.

88. December 2004 JI, *supra* note 80, art. 15.

holder, who is forced to calculate profit and loss margins on the basis of genuine product value.<sup>89</sup>

### C. China's Trademark, Copyright, and Patent Laws

China's IP laws do not send a clear message to pirates or rights holders. This ambiguity assists pirates more than IP rights holders. Article 56 of the Chinese Trademark Law states that the infringer's profit is used to calculate damages,<sup>90</sup> leaving the investment in infringing infrastructure untouched. Article 59 allows prosecution of pirates where the case is "so serious as to constitute a crime,"<sup>91</sup> which simultaneously implies that IP piracy and criminality can be mutually exclusive and fails to establish a threshold for criminality.

China's Patent Law goes slightly further in definition but achieves little clarity. Article 58 restricts any fine to no more than three times the pirate's illegal income. The fine can be imposed in addition to any calculated damages.<sup>92</sup> Article 60 uses either the losses suffered by the patentee or the pirate's profits in calculating damage amounts.<sup>93</sup> Neither category is given priority over the other. Article 58 also invokes the dichotomy between infringement and crime that appeared in the Trademark Law.<sup>94</sup> China's Copyright Law is similar. Article 47 authorizes seizure of illegal income<sup>95</sup> and prosecution when and if the copyright infringement constitutes a crime. It also authorizes the seizure of materials, tools, and equipment used to manufacture the infringing copyright material. No seizure of the actual infringing products is mentioned, nor is illegal income defined anywhere in the law. China also issued Computer Software Protection Regulations in 2001 that have been labeled inadequate.<sup>96</sup> Specifically, the regulations imply that temporary copies of software are not protected, they allow for liability exceptions where the corporate end-user claims ignorance, and they protect the infringer if great loss is suffered due to destruction of the illegally utilized software.<sup>97</sup>

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89. Cf. Rotman Statement, *supra* note 43.

90. Trademark Law (as amended by the Standing Comm. Nat'l People's Cong., Oct. 27, 2001) (P.R.C.), available at <http://www.chinaiprlaw.com/english/laws/laws11.htm>.

91. *Id.* art. 59.

92. Patent Law (as amended by the Standing Comm. Nat'l People's Cong., Aug. 25, 2000) (P.R.C.), <http://www.chinaiprlaw.com/english/laws/laws4.htm>.

93. *Id.* art. 60.

94. *Id.* art. 58.

95. Copyright Law (as amended by the Standing Comm. Nat'l People's Cong., Oct. 27, 2001) (P.R.C.), <http://www.chinaiprlaw.com/english/laws/laws10.htm>.

96. See *CECC IP Roundtable*, *supra* note 27, at 75-76 (excerpts of AmCham-China and AmCham-Shanghai's Draft 2005 White Paper concerning Intellectual Property Rights issues).

97. *Id.*

## IV. GOOD COP OR BAD COP? CHINESE ENFORCEMENT OF IP RIGHTS

*We don't want to ignore counterfeiting, but for those foreign companies, when they enter the Chinese market, I'm afraid they should also pay some cost due to the realities of China.*

—Gao Feng, head of China's anticounterfeiting police unit.<sup>98</sup>

Enforcement of IP rights in China has been inconsistent and has yielded mixed results at best. In a 2004 survey of American Chamber of Commerce members, two-thirds of respondents stated that China's IPR enforcement efforts were ineffectual.<sup>99</sup> In another survey by the U.S.-China Business Council, almost half of the respondents said that the Judicial Interpretation of 2004 improved IPR enforcement somewhat, while almost the same number responded that the Judicial Interpretation did not help at all. No respondents said that the Judicial Interpretation helped in any major way.<sup>100</sup> In an April 2004 U.S.-China Joint Commission on Commerce and Trade (JCCT) meeting, Chinese Vice-Premier Wu Yi promised a substantial reduction in IPR infringement, improved legal measures, and increased enforcement activities.<sup>101</sup> To verify Vice-Premier Wu's promises, the Bush Administration conducted an out-of-cycle review to evaluate China's implementation of its IPR commitment. This 2005 "Special 301 Report" gave China a failing grade.<sup>102</sup> Meanwhile, transfers of IPR piracy cases from administrative authorities to criminal authorities in China have steadily decreased.<sup>103</sup> This might confirm Senator Max Baucus' comment during Ambassador Portman's

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98. *60 Minutes II: The World's Greatest Fakes* (CBS television broadcast Jan. 28, 2004), summary available at <http://www.cbsnews.com/stories/2004/01/26/60II/main595875.shtml>.

99. *China's Compliance with the WTO Agreement: Hearings Before the U.S. Trade Representative 3* (2005) (testimony of Jeffrey Bernstein, Chairman, American Chamber of Commerce Testimony) [hereinafter USTR Compliance Hearings].

100. *Id.* at 7 (testimony of U.S.-China Business Council).

101. *Id.*

102. 2005 SPECIAL 301 REPORT, *supra* note 25, at 7. See also U.S. TRADE REPRESENTATIVE, 2005 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE 63-75 (2005), available at [http://www.ustr.gov/assets/Document\\_Library/Reports\\_Publications/2005/asset\\_upload\\_file293\\_8580.pdf](http://www.ustr.gov/assets/Document_Library/Reports_Publications/2005/asset_upload_file293_8580.pdf). Some industries submitting responses for the 2005 Report included AmCham Shanghai, American Apparel and Footwear Association, Coalition of Service Industries, Dewey Ballantine LLP, International Intellectual Property Alliance, National Association of Manufacturers, the Northern Mariana Islands, Pharmaceutical Research and Manufacturers of America, Stewart & Stewart LLP, U.S.-China Business Council, U.S. Chamber of Commerce, U.S. Grains Council, U.S. Information Technology Office, and the U.S. Council for International Business.

103. 2005 SPECIAL 301 REPORT, *supra* note 25, at 5. Transfers declined from eighty-six in 2001 to fifty-nine in 2002, forty-five in 2003, and only fourteen in the first half of 2004.

confirmation hearings in April 2005 that he once spoke to Vice-Premier Wu about China's IPR problem, but she "shrugged off" his concerns.<sup>104</sup>

Upon WTO accession, China agreed to submit to annual compliance hearings in Geneva, called the Transitional Review Mechanism (TRM). These hearings provide a forum for WTO members to ask China about IPR enforcement efforts. China continuously points out that it has had only twenty years to develop an IPR regime, but many WTO members have expressed dissatisfaction with Chinese efforts in the TRM hearings.<sup>105</sup> A survey of the 2003–2005 TRM hearings yields a disparate outlook on Chinese IPR enforcement. At the 2003 TRM hearings, China admitted that its legal and judicial infrastructure reduced the probability that criminal IPR enforcement would follow administrative punishment.<sup>106</sup> Only twenty-two private criminal actions were initiated in 2003, of which only eighteen related to producing and selling counterfeit products.<sup>107</sup> The Chinese delegate also stated that China was considering criminalizing copyright violations not pursued for profit—he noted that many WTO members did not have such a profit prerequisite for criminal liability.<sup>108</sup> China has reported no follow-up on this assertion.

Addressing the profit thresholds, the Chinese delegate somewhat vindicated the policy. He stated that the threshold figure could take into account money or commodities, whether they counted for sales volume, goods value and illegal profits, or damages.<sup>109</sup> This implied that the value of unsold goods could be counted towards the threshold.<sup>110</sup> The delegate also offered unexceptional but promising data regarding criminal IP infringement cases. In 1998, Chinese authorities handled 301 persons and 128 cases.<sup>111</sup> In 2000 this number rose to 379 persons and 248 cases, and in 2002 the numbers jumped considerably to 702 persons and 408 cases. Also, in 2002 Chinese customs seized 95.62 million renminbi worth of counterfeit and pirated goods (as of December 31, 2002, roughly 11.6 million dollars).<sup>112</sup> It remains unclear, however, how Chinese authorities arrived at this figure. If they used the price of the pirated goods, as is common practice, then the legitimate price (and thus value) could be far higher.

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104. *Portman Confirmation Hearing*, *supra* note 12, at 40.

105. *2004 TRMs*, *supra* note 30, ¶¶ 268–281.

106. *2003 Transitional Review Mechanism: Hearing Before the Council on the Trade-Related Aspects of Intellectual Property*, ¶ 80, IP/C/M/42 (2004) [hereinafter *2003 TRMs*] (meeting minutes).

107. *Id.* ¶ 64.

108. *Id.* ¶ 70.

109. *Id.*

110. December 2004 JI, *supra* note 80, art. 12 (confirming this issue).

111. *2003 TRMs*, *supra* note 106, ¶ 74.

112. *Id.* ¶ 79.

In 2003 the National Copyright Administration of China (NCAC) launched a “special” strike against piracy that coincided with the World Intellectual Property Organization (WIPO) Leader’s Meeting. The strike collected data from fourteen provinces and the four major centers of Beijing, Shanghai, Tianjin, and Chongqing. This strike imposed a total fine of 1.34 million renminbi (16,900 dollars), transferred a total of five cases to judicial authorities, and investigated only one underground compact disc press. These fines and enforcement actions resulted from a strike that covered almost the entire country and investigated 2,588 markets, thirty schools, seventy-seven “enterprises,” and 1,430 infringing or pirating entities. The Japanese and U.S. delegations expressed their displeasure over the laxitude of these measures at the 2003 TRM hearings.<sup>113</sup> Both delegations stated that deterrence was low in China and that improvement of enforcement was of greatest importance to combating counterfeiting in China.

The responses of Chinese authorities to questions at the 2003 TRM hearings underscore the degree to which IPR enforcement in China remains weak. Chinese authorities auction seized pirated goods and never disclose where the proceeds go. In defense of such practices, a Chinese official stated that destroying confiscated goods would waste natural resources and cause environmental pollution.<sup>114</sup> Instead, the Chinese official stated that auctioning confiscated goods would “make full use of them,” and that indicators of piracy would be removed to protect the rights holder. The official did not explain how making “full use” of fake goods provides any durable example of enforcement or deterrence, how signs of piracy can be completely removed, or how the entire process protects the rights holder and instills trust in the Chinese IPR enforcement system.<sup>115</sup>

The 2004 TRM hearings were marked by similarly chaotic data, adding more color to the already confusing canvas of Chinese IPR enforcement. A “special” IPR protection campaign had again yielded 4,036 trademark infringement cases with a total fine of nearly thirty million renminbi (3.6 million dollars).<sup>116</sup> Copyright enforcement personnel investigated 8,000 software and audiovisual dealers and confiscated over 1.5 million pirated discs. Administrative enforcement measures yielded 472 trademark infringement cases and ninety-five copyright infringement cases.<sup>117</sup> The Chinese delegate reported in the next paragraph that the

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113. *Id.* ¶¶ 83, 90.

114. *2004 TRMs*, *supra* note 30, ¶ 47.

115. *2005 Transitional Review Mechanism: Hearing Before the Council on the Trade-Related Aspects of Intellectual Property*, ¶ 4, IP/C/M/49 (2006) [hereinafter *2005 TRMs*] (meeting minutes).

116. *Id.* ¶ 197.

117. *Id.* ¶ 242.

Administrations of Industry and Commerce had handled a total of 51,411 cases of infringement during 2003 and early 2004.<sup>118</sup> Almost 100 million instances of illegal trademark usage had been seized or removed, the total value of which was 694 million renminbi (eighty-four million dollars). Still, these massive seizures resulted in only fifty-nine cases transferred for criminal liability.

Other questions about Chinese enforcement efforts went unanswered at the 2004 TRM hearings. Similar cases were cited in different numerical contexts, still with no mention of finality in criminal proceedings. 2,118 criminal suspects were arrested and 1,522 of those were prosecuted, but there was no indication of the success of those prosecutions. Other cases were mentioned as a “priority,” and there had been “approval” to arrest 483 additional suspects. As with the 2003 TRMs, Japan and the United States were the most vocal in claiming that Chinese IPR enforcement and deterrence was ineffectual against the backdrop of skyrocketing losses.<sup>119</sup> The United States pointed out that China’s criminal law raised significant TRIPs issues by requiring a showing of profits for certain IPR offenses.

Most revealing at the 2004 TRM hearings was the example of the Beijing Silk Market. The Chinese delegate commented on the infamy of the Beijing Silk Market and how the market was renowned for fake products.<sup>120</sup> The Beijing Administration of Industry and Commerce issued a decree banning all sales of high-profile luxury goods such Prada and Burberry in all markets of Beijing. The delegate then stated that “[v]endors continuing to sell such commodities would be investigated as suspected trademark infringers.”<sup>121</sup> But did conditions really change “dramatically,” as the delegate claimed?<sup>122</sup> The delegate used these measures as examples of China’s strong commitment to combating IPR offences, but the ban was obviously ineffective. The Silk Market was forced to close down later in 2004, but a new five-story Silk Market opened next to the old site, with inspectors finding infringing goods on opening day.<sup>123</sup> Prada, Chanel, Louis Vuitton, Gucci, and Burberry recently won a case in the Beijing High People’s Court against the Silk Market.<sup>124</sup>

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118. *Id.* ¶¶ 242–43.

119. *Id.* ¶¶ 272–74.

120. For a description of the market, see China Hotel Guide, <http://www.chinatour.com/attraction/xiushuidongjie.htm>.

121. 2004 TRMs, *supra* note 30, ¶ 197.

122. *Id.*

123. Chinatour.com, Xiushui Dongjie Market (Silk Alley), Beijing, <http://www.china-tour.com/attraction/xiushuidongjie.htm>. See generally TheBeijingGuide.com, Silk Market Beijing, <http://www.thebeijingguide.com/shopping/silk-market.html> (offering streaming photos of the new market that display brands such as The North Face, Calvin Klein, Lee, and Levis).

124. See *Silk Street Market Loses Appeal in Trademark Case*, CHINA DAILY, Apr. 19, 2006.

Despite the pervasiveness of infringement against non-Chinese trademarks, only 10.6 percent of trademark investigations in 2004 involved such trademarks.<sup>125</sup> Indeed, over ninety-eight percent of China's administrative copyright cases were on behalf of Chinese rights holders.<sup>126</sup> Still, even if China's courts appear receptive to Chinese IPR cases, they may not be adequately effective in handling them, as evidenced by the fact that Chinese companies initiate trademark suits in U.S. courts.<sup>127</sup>

The 2005 TRMs yielded little new data, as China chose to release figures ahead of time within the TRM regime.<sup>128</sup> The release is peculiar, as it repeats all figures from 2004. Only one paragraph is dedicated to 2005 data, which shows a mid-year seizure of 1.33 billion renminbi (161 million dollars) and "redemptive" economic losses of up to 420 million renminbi (50.8 million dollars).<sup>129</sup>

#### V. CHINA'S FAILURE TO UPHOLD ITS WTO OBLIGATIONS

China does not meet the letter or spirit of Article 41's DEER rights. This failure is evident in the ineffectiveness and imprecise language of the criminal law, the arbitrary criminal thresholds of the December 2004 JI, and the lack of significant criminal liability throughout Chinese IP law.

China essentially allows piracy not only to be affordable but also highly profitable. As indicated above, thresholds for criminal liability for piracy allow individual pirates to operate below the threshold and still escape prison. The December 2004 JI also inexplicably differentiates between individuals and business units, treating the latter more leniently than the former without any logical justification. Furthermore, even if the individual or the business is apprehended, the prices of the pirated goods will be used to calculate damages, a far lower overall value than the price of genuine goods.

China's IP laws deliver a clear message that IP piracy is not a crime *per se*. Again, no consistent guidance is available on when IP piracy

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125. Geoffrey Fowler, *China's Logo Crackdown*, WALL ST. J., Nov. 4, 2005, at B1. The figure of 10.6% could have different origins. It may be that Chinese cases backing up in Chinese courts mean foreign cases do not receive as much attention. Alternatively, the 10.6% figure may hint at a national treatment issue, with Chinese courts simply placing a higher priority on domestic trademark infringement. I am grateful to David Weller, former counsel at the USTR, Office of China Affairs, for this comment.

126. 2005 TRMs, *supra* note 115, ¶ 69.

127. See *Wuxi Multimedia, Ltd. v. Koninklijke Philips Elec.*, No. 04cv1136 DMS (BLM), 2006 U.S. Dist. LEXIS 9160 (S.D. Cal. Jan. 5, 2006) (order granting defendant's motion to dismiss second amended complaint).

128. See Council for Trade-Related Aspects of Intellectual Property Rights, Transitional Review Mechanism Council, *Communication from China*, IP/C/W/460 (Nov. 11, 2005).

129. *Id.*

crosses the boundary into criminal conduct. China's Trademark Law uses the pirate's profit to calculate damages, enabling the pirate to retain investments in infrastructure. China's Patent Law allows either the patentee's losses or the pirate's profits to be used as a basis for damage calculation, but it gives no further guidance on when either standard is to be used. The Copyright Law is mute on the seizure of infringing products, although it authorizes seizure of the instruments used to produce the infringing products. Nowhere in China's IP Laws is illegal income defined, and China's inherent bias toward profit suggests that infrastructure cost is left untouched, allowing pirates to make a comfortable livelihood.

The above ambiguities and biases directly conflict with the WTO TRIPs requirements for DEER rights, damages, supplemental remedies, and criminal procedures. Clear signals are given that 1) pirates can stay in business if they stay below the established unit thresholds (an Article 41 DEER rights violation); 2) the Chinese government will calculate damages with little regard for the interests of the rights holder (an Article 45 Damages violation); and 3) the Chinese government has not decided on whether piracy is actually a crime, *regardless* of profit motives (an Article 61 "least standards" violation). Moreover, the removal of infringing marks and "full use" of pirated products violates Article 46, which empowers judicial authorities to dispose of infringing goods outside the channels of commerce in order to create an effective deterrent to infringement. Article 46 suggests that, absent constitutional limitations, infringing goods should be destroyed. In any case, Article 53 of the Chinese Trademark Law<sup>130</sup> states clearly that once infringement has been established, the administrative authority *shall* confiscate and destroy the infringing goods. China's own IP laws as well as WTO law therefore preclude China from making "full use" of illegal products.

China also has failed to uphold its obligations under TRIPs Article 69 on international cooperation. This is evident not only in China's track record of enforcement highlighted above, but also in specific responses China has given outside the TRM hearings. In requests for transparency in legislation,<sup>131</sup> the United States asked China to provide a copy of the State Council's request to the Supreme People's Court to lower the thresholds for criminal copyright violations and to advise what steps the State Council would take to lower those thresholds (including requesting an interpretation from the National People's Congress, revising prior

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130. See Trademark Law (as amended by the Standing Comm. Nat'l People's Cong., Oct. 27, 2001) (P.R.C.), available at <http://www.chinaiprlaw.com/english/laws/laws11.htm>.

131. Council for Trade-Related Aspects of Intellectual Property Rights, *Review of Legislation: Responses from China to Questions Posed by Korea, Japan and the United States*, 10, IP/C/W/374/Add.2 (Oct. 14, 2002).

guidance on criminal prosecution, or requesting that the Supreme People's Procuratorate, Ministry of Public Security, and Supreme People's Court issue a revised interpretation regarding criminal thresholds).<sup>132</sup> In response, China simply replied that it had already given the recommendation to revise the judicial interpretation for criminal copyright violations to the Supreme People's Court.<sup>133</sup>

In another question posed to China, the United States asked whether the unauthorized creation of a copy of a copyrighted work, such as in the temporary memory of a computer in China, infringed the reproduction right provided for in Article 10(5) of China's Copyright Law.<sup>134</sup> China brushed off the question, stating that there was no such a term as "temporary memory" in the Copyright Law or TRIPS.<sup>135</sup> A substantive response would have been helpful in assessing China's e-piracy environment, especially with regard to temporary or trial versions of software offered on the Internet.

On November 14, 2005, the United States, along with Japan and Switzerland, issued a groundbreaking Request For Information Pursuant To Article 63.3 of The TRIPs Agreement (Article 63 Request).<sup>136</sup> In the request, the United States asked for information regarding specific IP piracy cases, methods of resolution, the nature of remedies, and the various products the IP piracy cases affected. For China's convenience, the United States cited specific documents submitted by China, provided examples of possible responses, and allowed flexibility as to how China could respond with statistical information.<sup>137</sup> China deflected the Article 63 Request by asking upon which of the only two Article 63 clauses the United States based its request. China then cited to TRIPs Article 63.3 in replying that while a WTO member had the right to request information, China was under no obligation to honor the request.<sup>138</sup> Yet Article 63.3 specifically requires WTO members to be prepared to supply information as requested by a WTO member.<sup>139</sup>

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132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. Council for Trade-Related Aspects of Intellectual Property Rights, *Request For Information Pursuant To Article 63.3 of the TRIPs Agreement—Communication from the United States*, IP/C/W/461 (Nov. 14, 2005).

137. The Article 63 Request merits considerable attention. In particular, the United States provided eleven lines of clarification on its request, including seven choices for how China could feasibly respond. *Id.* at n.3.

138. Council for Trade-Related Aspects of Intellectual Property Rights, *Response to a Request for Information Pursuant to Article 63.3 of the TRIPs Agreement—Communication from China*, ¶ 8, IP/C/W/465 (Jan. 23, 2006).

139. TRIPs, *supra* note 57, art. 41(5).

## VI. DEER IN THE HEADLIGHTS?

Unfortunately, examples of China's noncompliance with the WTO TRIPs Agreement are abundant. In one case, the Shenzhen Reflective Materials Institute was found to have pirated approximately 650,000 Microsoft holograms, normally used to identify legitimate Microsoft software discs. The damages resulting from the fraudulent placement of these holograms on copies of Microsoft software were estimated at 30–180 million dollars. Yet the Shenzhen Institute was ordered to pay damages of 260 dollars.<sup>140</sup> How can these trifling punishments prevent further infringements of DEER rights? What can China offer as a justification for its failure to protect such rights under TRIPs?

A. *Paper Defense*

China can bring forth little in its defense. The TRIPs Agreement provides scant cover for lackluster IPR enforcement. Article 73 (Security Exceptions) gives no indication that environmental concerns or natural resources are sound justifications for allowing pirated material to return to the channels of commerce.<sup>141</sup> Article 46 allows existing constitutional requirements and the interests of third parties to be accounted for when considering effective deterrents to infringement. It would be indeed difficult for China to point to Chinese citizens as third parties whose interests prevent the destruction of pirated goods. Perhaps a more tenable but nonetheless unconvincing argument would be for China to posit that the piracy industry employs its massive migrant population—which may number around 200 million, or one-sixth of the national population<sup>142</sup>—and that to put so many out of work would lead to nationwide chaos.

Could China claim there is an obsessive focus on its judicial system with regard to IP enforcement? TRIPs Article 41(5) states that general obligations of enforcement do not command any WTO member to distinguish between general law enforcement efforts and IP enforcement, nor must states distinguish in resource distribution between IP and general law enforcement.<sup>143</sup> China could credibly argue that its entire judicial system is undergoing monumental changes, and that IPR protection could be a temporary casualty while the judicial system completes this transformation.

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140. Glenn Butterson, *Pirates, Dragons and U.S. Intellectual Property Rights in China: Problems and Prospects of Chinese Enforcement*, 38 ARIZ. L. REV. 1081, 1099 (1996).

141. 2004 TRMs, *supra* note 30, at 47.

142. Embassy of the P.R.C. in the U.S., *Migrant Workers Gaining Improved Status*, Feb. 3, 2006, <http://www.china-embassy.org/eng/gyzg/t233671.htm>.

143. TRIPs, *supra* note 57, art. 41(5).

Still, China easily defends its own intellectual property, and so far authorities have been extremely effective in minimizing piracy for sales of Beijing 2008 Olympic merchandise.<sup>144</sup> China has even passed a separate law governing protection of Olympic IPR.<sup>145</sup> The law contains higher punishments than other IP laws, imposes fines even when no illegal income is seized,<sup>146</sup> and calculates damages with the *original Olympic item's licensing fee*, instead of the pirate price. This regulation indicates that authorities are indeed capable of instituting meaningful and effective IP protection,<sup>147</sup> but the disparity between it and Chinese law that applies to non-Chinese IP is a stark indication of Chinese bias in IPR enforcement and an apparent violation of the national treatment requirement in TRIPs Article 3.<sup>148</sup>

In addition to the will, China possesses the means to combat IP piracy. China's 2004 GDP was 1.65 trillion dollars and the 2005 figure was approximately 2.26 trillion dollars.<sup>149</sup> According to the World Bank, China is a lower-middle income country<sup>150</sup> and is now the world's fourth largest economy.<sup>151</sup> China's foreign currency reserves are quickly approaching one trillion dollars, more than *five times* that of the United States.<sup>152</sup> China's exports of 593 billion dollars in 2004 surpassed those of Japan and are quickly catching up to U.S. global exports. These economic data suggest China will not long be able to invoke its status as a developing country as an excuse for weak IPR enforcement.

It is notable that China sometimes takes full credit for IPR enforcement where only partial credit is due. A 2005 IP piracy case involved two

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144. Fowler, *supra* note 125.

145. See Regulations on the Protection of Olympic Symbols (promulgated by Decree No. 345 of the State Council of the P.R.C., Feb. 4, 2002, effective Apr. 1, 2002), available at <http://www.chinaiprlaw.com/english/laws/laws21.htm>.

146. *Id.* art. 10.

147. The Deputy Director of Legal Affairs for the Beijing Olympic Committee has admitted that the Committee has no fixed assets, and thus the logo itself is the most valuable asset the Committee owns. Chinese retailers also admit that the deterrent effect of punishments for pirating Beijing Olympics logos and products prevents them from selling illegal Olympic products. Fowler, *supra* note 125.

148. TRIPs, *supra* note 57, art. 3(1).

149. See Hong Kong Trade Dev. Council, *Market Profile on Chinese Mainland*, <http://www.tdctrade.com/main/china.htm#1>.

150. World Bank Group, Country Groups, <http://www.worldbank.org> (click "Data & Statistics"; then "Data"; then "Country Classification"; then "View All Groups" hyperlink) (last visited Dec. 1, 2006).

151. See WORLD BANK GROUP, WORLD BANK 2005 GDP RANKINGS (2005); see also CENTER FOR STRATEGIC & INTERNATIONAL STUDIES (CSIS) & INSTITUTE FOR INTERNATIONAL ECONOMICS (IIE), CHINA: THE BALANCE SHEET 4 (2006).

152. WORLD BANK GROUP, WORLD BANK 2004 GDP-PPP RANKINGS 7 (2004).

U.S. citizens, Randolph Guthrie and Abram Thrush (the Guthrie case).<sup>153</sup> The case started in the United States at a flea market when U.S. Immigration and Customs Enforcement (ICE) personnel purchased pirated movies. The case finally closed in a Shanghai court, where both U.S. citizens and their Chinese accomplices were sentenced to imprisonment and fines. In the 2005 TRM hearings, the Chinese delegate claimed that the Guthrie case investigation and apprehension was the result of “well-designed Chinese IPR laws and regulations.”<sup>154</sup> What the Chinese delegate neglected to mention was that the case began in the United States, and Chinese authorities received most of their information from U.S. ICE agents, the Beijing ICE Attaché, and the Motion Picture Association of America.

Will the United States take Beijing to Geneva? The USTR recently issued a “Top-to-Bottom Review” entitled *U.S.-China Trade Relations: Entering a New Phase of Greater Accountability and Enforcement*.<sup>155</sup> In this release, the USTR signaled that patience with China is indeed running thin. The USTR labeled the current period of U.S.-China trade relations as the “third phase,”<sup>156</sup> in which the United States will employ greater monitoring, enforcement, and accountability standards toward China. Through these efforts, the United States clearly aims to expand multilateral cooperation, strengthen U.S. interagency efforts, and increase the effectiveness of U.S.-China dialogue.<sup>157</sup> The USTR also has created a China Enforcement Task Force, headed by a Chief Counsel for China Trade Enforcement.<sup>158</sup> This task force will “focus on the preparation and handling of potential WTO cases with China.”<sup>159</sup>

In June 2006, the U.S.-China Economic and Security Review Commission held a hearing on “China’s Enforcement of Intellectual Property Rights and the Dangers of the Movement of Counterfeited and Pirated Goods into the United States.”<sup>160</sup> Timothy Stratford, Assistant U.S. Trade Representative for China, indicated that a WTO IPR case was in the advanced stages of discussion.<sup>161</sup> Stratford reiterated that the United States has not seen a significant shift towards Chinese criminal enforcement of

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153. Press Release, U.S. Immigration and Customs Enforcement, Two Americans Convicted In China of Operating Major Counterfeit Motion Picture Network (Apr. 19, 2005), <http://www.ice.gov/doclib/pi/news/newsreleases/articles/20050419washington.pdf>.

154. 2005 TRMs, *supra* note 115, ¶ 74.

155. USTR 2006 TOP-TO-BOTTOM REVIEW, *supra* note 2.

156. *Id.* at 10.

157. *Id.* at 5–6.

158. *Id.* at 24.

159. USTR 2006 TOP-TO-BOTTOM REVIEW, *supra* note 2, at 24.

160. For the full agenda of the hearing, including testifying officials, see [http://www.uscc.gov/hearings/2006hearings/hr06\\_06\\_08\\_09.php](http://www.uscc.gov/hearings/2006hearings/hr06_06_08_09.php).

161. Doug Palmer, *WTO Case Against China Piracy “very possible,”* REUTERS, June 7, 2006.

IPR and that Chinese officials still depend on administrative channels.<sup>162</sup> Other U.S. trade officials echo these sentiments. Chris Israel, U.S. Coordinator for International Intellectual Property Enforcement, stated to the commission that the United States is the only country to have filed a WTO case against China, and “is again left with no choice but to consider filing another complaint against China this time for inadequate enforcement of IPR.”<sup>163</sup>

In some ways, the intellectual property rights stolen by China’s pirates could be compared to the claws and fangs that Chairman Mao hoped to take away from United States, which he called a Paper Tiger.<sup>164</sup> Senator Carl Levin used the same moniker at the abovementioned hearing to criticize the lack of action by the United States against China in the WTO.<sup>165</sup> The United States could shed its image as a Paper Tiger by taking the Paper Dragon to task for blatant TRIPs violations.

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162. *Hearing on China’s Enforcement of Intellectual Property Rights and the Dangers of the Movement of Counterfeited and Pirated Goods into the United States Before the U.S.-China Economic & Security Review Comm.*, June 7–8, 2006 [hereinafter *Hearing on China’s Enforcement*] (statement of Timothy P. Stratford, Assistant U.S. Trade Representative at 7), available at [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_06\\_07wrts/Stratford\\_timothy.pdf](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_06_07wrts/Stratford_timothy.pdf).

163. *Id.* (statement of Chris Israel, U.S. Coord. for International Intellectual Property Enforcement at 7), available at [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_06\\_07wrts/06\\_06\\_07\\_8\\_israel\\_chris.php](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_06_07wrts/06_06_07_8_israel_chris.php).

164. See Mao Ze Dong, *U.S. Imperialism is a Paper Tiger* (July 14, 1956), available at [http://www.marxists.org/reference/archive/mao/selected-works/volume-5/mswv5\\_52.htm](http://www.marxists.org/reference/archive/mao/selected-works/volume-5/mswv5_52.htm).

165. *Hearing on China’s Enforcement*, *supra* note 162 (statement of Sen. Carl Levin, at 3), available at [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_06\\_07wrts/06\\_06\\_07\\_8\\_levin\\_carl.pdf](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_06_07wrts/06_06_07_8_levin_carl.pdf).