

ANNEX A

SUBMISSIONS OF THE UNITED STATES

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ANNEX A-1

EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF THE UNITED STATES

I. INTRODUCTION

1. The conclusion of the *Agreement on the Trade-Related Aspects of Intellectual Property Rights* (the "TRIPS Agreement") represented an important step forward in the international work on intellectual property rights ("IPR") protection. As the agreement's preamble makes clear, WTO Members took account of the need to promote effective and adequate protection of these rights. They also recognized the need for new rules and disciplines concerning, *inter alia*, "the provision of effective and appropriate means for the enforcement of trade-related intellectual property rights, taking into account differences in national legal systems."

2. The United States recognizes that China undertook major revisions to its laws to create a modern IPR system in its effort to meet TRIPS Agreement standards before and after its WTO accession in 2001. At the same time, the United States considers that China's efforts have fallen short in certain areas. The claims before this Panel concern three such specific areas.

II. FACTUAL BACKGROUND

3. First, under Chinese law, neither criminal prosecution nor conviction for certain acts of IPR infringement is possible unless specific monetary or volume-based thresholds are met. China has established these thresholds through provisions in the *Criminal Law of the People's Republic of China* ("Criminal Law") as further defined by binding interpretations of that law jointly issued by the Supreme People's Court and the Supreme People's Procuratorate – the *Interpretation by the Supreme People's Court and the Supreme People's Procuratorate of Several Issues Concerning the Specific Application of Law in Handling Criminal Cases Involving Infringement of Intellectual Property Rights* ("December 2004 JI"); and the *Interpretation by the Supreme People's Court and the Supreme People's Procuratorate of Several Issues Concerning the Specific Application of Law in Handling Criminal Cases of Infringement of Intellectual Property Rights (II)* ("April 2007 JI").

4. Part Two, Chapter III, Section 7 (entitled "Crimes of Infringing on Intellectual Property Rights") of China's Criminal Law defines the acts of IPR infringement that are subject to criminal penalties in China. In that Section, Articles 213, 214, and 215 criminalize certain acts of trademark counterfeiting and Articles 217 and 218 criminalize certain acts of copyright piracy.

5. Not all acts of trademark counterfeiting and copyright piracy are subject to criminal penalties in China: criminal prosecution or conviction for an act of counterfeiting or piracy is only possible if additional prerequisites are met beyond the act of counterfeiting or piracy itself. The Criminal Law expresses certain of these prerequisites in general terms related to the quantity of monetary gains or seriousness. For example, the act of infringement must either involve "illegal gains" that are "relatively large" or "enormous," or must involve "circumstances" that are "serious" or "especially serious." The December 2004 JI and the April 2007 JI articulate the specific standards that must be met in order to trigger criminal prosecution or conviction for each of the offenses.

6. The December 2004 JI quantifies the prerequisites for criminal prosecution or conviction in the Criminal Law in three main ways. *First*, it defines some thresholds in terms of a specific minimum "illegal business volume" realized by the infringer. *Second*, the December 2004 JI defines some thresholds in terms of minimum amounts of "illegal gains" reaped by the infringer. *Third*, the December 2004 JI defines some thresholds in terms of minimum numbers of "illegal copies". The

April 2007 JI provides a lower threshold for the minimum number of copies than the December 2004 JI.

7. Accordingly, China's Criminal Law, combined with the December 2004 JI and April 2007 JI, creates specific quantitative or monetary thresholds that must be met before acts of copyright piracy or trademark infringement can be subject to criminal prosecution or conviction under Articles 213, 214, 215, 217, and 218 of the Criminal Law – the provisions in the Criminal Law directed against trademark counterfeiting and copyright piracy.

8. Second, China maintains a set of measures that collectively establish a clear hierarchy of rules governing the disposal of imported goods that Chinese Customs authorities confiscate as infringing intellectual property rights. Under those rules, the Customs authorities are only permitted to destroy the infringing goods as a last resort. Before they have the power to take this step they must first attempt to dispose of the goods in one of several other ways – by selling them to the right holder, transferring them to public welfare organizations, or auctioning off the seized goods following removal of infringing features.

9. The following measures create this compulsory scheme: the *Regulations of the People's Republic of China for Customs Protection of Intellectual Property Rights* ("Customs IPR Regulations"), the *Implementing Measures of Customs of the People's Republic of China for the Regulations of the People's Republic of China on Customs Protection of Intellectual Property Rights* ("Customs IPR Implementing Measures"), and *Announcement No. 16 of the General Administration of Customs* ("Customs Announcement No. 16").

10. Third, the *Copyright Law of the People's Republic of China* (the "Copyright Law") provides the legal basis within China for protecting and enforcing the copyrights of authors in their literary, artistic and scientific works, as well as the legal basis for protecting and enforcing "related rights". The first sentence of Article 4 provides that "[w]orks the publication or distribution of which is prohibited by law shall not be protected by this Law."

11. A number of Chinese laws and regulations prohibit the publication or distribution of works under various circumstances. These circumstances may relate to the contents of the work in question. They may also relate to the status of a work within the process through which the contents of a work must be reviewed and approved. For example, the *Regulation on the Administration of Films* generally governs the "production, import, export, distribution and screening of films within the territory of the People's Republic of China . . .". The Films Regulation provides that for some period of time after the creation of a film, until that film has been submitted for content review and has completed that review unchanged, the film cannot legally be imported, distributed or projected.

12. Similar content review systems, with similar prohibitions on publication or distribution in the absence of successful conclusion of the content review process, apply with respect to products other than films. Particularly affected are publications; audio and video products; and electronic publications. The relevant measures include: the *Regulation on the Management of Publications* which applies certain rules to publications such as newspapers, periodicals, books, audio and video products, and electronic publications; the *Regulation on the Management of Audiovisual Products*, which applies *inter alia* to the publishing, production, reproduction, import, wholesale, retail, and rental of recorded audio and video tapes, records, and audio and video CDs; and the *Regulations on the Management of Electronic Publications*, which applies to certain electronic publications.

III. CHINA'S THRESHOLDS FOR CRIMINAL PROCEDURES AND PENALTIES ARE INCONSISTENT WITH CHINA'S OBLIGATIONS UNDER ARTICLES 61 AND 41.1 OF THE TRIPS AGREEMENT

13. The thresholds in China's Criminal Law and the December 2004 and April 2007 judicial interpretations (collectively China's "criminal thresholds") do not meet the minimum standard in the TRIPS Agreement because they prevent criminal procedures and penalties from being applied in many cases of wilful trademark counterfeiting and copyright piracy on a commercial scale. China's measures are therefore inconsistent with Article 61, first sentence, Article 61, second sentence, and Article 41.1 of the TRIPS Agreement.

A. ARTICLE 61, FIRST SENTENCE, OF THE TRIPS AGREEMENT

14. The first sentence of Article 61 of the TRIPS Agreement provides that "Members shall provide for criminal procedures and penalties to be applied at least in cases of wilful trademark counterfeiting or copyright piracy on a commercial scale." In this context, "provide for" means to "take appropriate measures in view of a possible event; make adequate preparation." The phrase "Members shall provide for . . ." thus means that Members have an obligation to include in their law criminal procedures and penalties that apply in cases of wilful commercial scale trademark counterfeiting and copyright piracy.

15. The first sentence of Article 61 also conveys the breadth of situations where the criminal procedures and penalties are to be provided for; i.e., "*at least* in cases of wilful trademark counterfeiting or copyright piracy on a commercial scale" (emphasis added). The words "at least" in Article 61, first sentence, make clear that Article 61 sets a floor for WTO Members: Members must provide for criminal procedures and penalties to be applied to the entire set of cases within this universe. Members are not required to provide for criminal procedures and penalties for other types of IPR infringement. However, only providing for criminal procedures and penalties to be applied *in some cases* of "wilful trademark counterfeiting and copyright piracy on a commercial scale," but not in others, does not fulfill the obligations in Article 61.

16. The term "trademark counterfeiting" is not defined in the TRIPS Agreement, although other provisions in the TRIPS Agreement help to clarify its meaning in Article 61. Article 15.1 of the TRIPS Agreement provides minimum standards for the subject matter of a trademark. The rights required to be conferred by a trademark are set out in TRIPS Agreement Article 16.

17. The ordinary meaning of "counterfeit," when used as an adjective, is "[m]ade in imitation, not genuine." As a verb, it means to "[i]mitate (an action, thing, etc.) with intent to deceive [or] [m]ake in fraudulent imitation of something else; devise (something spurious) and pass it off as genuine."

18. Footnote 14 to Article 51 of the TRIPS Agreement (on "Suspension of Release by Customs Authorities") offers additional insight as to the meaning of the noun "counterfeiting" in the context of the term "trademark counterfeiting," by setting out a definition of a term, "counterfeit trademark goods," that uses "counterfeit" as an adjective: "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."

19. Putting these definitional elements together, the term "trademark counterfeiting" in Article 61 can be properly understood as including the actions of using in the course of trade a trademark which is identical to, or cannot be distinguished in its essential aspects from, a validly registered trademark. The United States notes that although it has raised other concerns with respect to Articles 213 through

215 of the Criminal Law, the United States does not claim in this dispute that the coverage of these provisions fails to cover the full extent of the term "trademark counterfeiting."

20. The term "copyright piracy" likewise is not defined in the TRIPS Agreement, although other TRIPS Agreement provisions help clarify its meaning. As a preliminary matter, Section 1 in Part II of the TRIPS Agreement ("Copyright and Related Rights") provides certain minimum standards for the availability, scope, and use of copyright and related rights in the legal regimes of WTO Members. Specifically, Article 9.1 of the TRIPS Agreement provides, *inter alia*, that all WTO Members shall comply with Articles 1 through 21 of the Paris Act of July 24, 1971 of the *Berne Convention for the Protection of Literary and Artistic Works* (the "Berne Convention"). Further, Articles 14.1 and 14.2 of the TRIPS Agreement require Members to give performers, *inter alia*, the possibility of preventing certain acts, and to give producers of phonograms (sound recordings) the right to authorize or prohibit the direct or indirect reproduction of their sound recordings.

21. The scope of the word "copyright" in the term "copyright piracy" can be understood more fully by reference to footnote 14 to Article 51 of the TRIPS Agreement. Specifically, footnote 14 provides that "[p]irated 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."

22. The phrase "copyright piracy" (in Article 61) and "pirated copyright goods" (in footnote 14) are related linguistically. Moreover, a "pirated good" is one kind of physical product of "piracy". Therefore, the context provided by the reference to "a related right" in footnote 14 confirms that the term "copyright piracy" in Article 61 must be understood to extend to piracy that infringes either a copyright or a related right (such as the rights of performers and producers of phonograms). The United States notes that although it has raised other concerns with respect to Articles 217 and 218 of the Criminal Law, the United States does not claim in this dispute that the coverage of these provisions fails to cover the full extent of the term "copyright piracy".

23. The interpretation of the term "wilful" is not at issue in this dispute. The United States does not claim, in this dispute, that any state of mind requirements contained in Articles 213-219 of the Criminal Law and the December 2004 and April 2007 judicial interpretations are inconsistent with China's WTO obligations.

24. The ordinary meaning of the word "scale" varies depending on the context. Here, the context indicates that "scale" means "relative magnitude or extent" or "degree; proportion". It also can encompass "a standard of measurement, calculation, or estimation." It follows that an assessment of the "scale" of counterfeiting or piracy is an assessment of the magnitude, extent, or degree of counterfeiting or piracy, relative to some standard. Article 61 provides that standard by use of the word "commercial," whose ordinary meaning is "pertaining to, or bearing on commerce," "interested in financial return," "likely to make a profit," or "regarded as a mere matter of business."

25. Two points bear emphasizing here. *First*, by using the term "commercial scale," the TRIPS Agreement makes clear that WTO Members must criminalize acts that reach a certain extent or magnitude; in other words, that WTO Members must do so even where there is no evidence that the infringer has a commercial motive or purpose. *Second*, in using the term "commercial scale," the TRIPS Agreement draws a link to the commercial marketplace – where those "interested in a financial return" or engaged in "a matter of business" operate, and where business-minded IPR infringers take the fruits of their counterfeiting or piracy. Thus, the concept of "commercial scale" extends both to those who engage in commercial activities in order to make a "financial return" in the marketplace, and who are, by definition, therefore operating on a commercial scale, as well as to those whose

actions, regardless of motive or purpose, are of a sufficient extent or magnitude to qualify as "commercial scale" in the relevant market. That said, it is the former activity that forms the focus of the submission.

26. The first set of problems with China's criminal thresholds arises from their structure. Specifying certain levels of "illegal business volume," "illegal gains," or numbers of "copies" that must be met before criminal prosecution or conviction is possible, and then, in addition, dictating restrictive calculations of those thresholds, eliminates whole classes of commercial scale counterfeiting and piracy from risk of criminal prosecution and conviction.

27. Under Article 213 of the Criminal Law and the December 2004 JI, counterfeiting that involves use of an identical trademark on the same kind of commodities must meet one of the following two thresholds before criminal procedures or penalties can be available: an "illegal business volume" of more than RMB 50,000 (US\$6,925), or "illegal gains" of more than RMB 30,000 (US\$4,155).

28. Turning first to the RMB 50,000 (US\$6,925) "illegal business volume" threshold, the December 2004 JI makes clear as an initial matter that meeting this threshold requires finding evidence of "manufacture, storage, transportation, or sales" of infringing products. If this activity does not reach the threshold, it is completely shielded from the possibility of criminal counterfeiting prosecution or conviction that would be triggered by this test. The extent or magnitude of "manufacture, storage, transportation, or sales," when carried out by businesses, is "on a commercial scale" because it is these kinds of activities, when undertaken by businesses for a particular market, that provide a basis for assessing what constitutes "commercial scale" for that market. By setting an exemption from criminal prosecution and conviction for counterfeiting activities when there is less than RMB 50,000 in "illegal business volume," China has exempted businesses from criminal procedures and penalties for counterfeiting where those businesses' activity of "manufacture, storage, transportation, or sales" realizes less than that amount.

29. Moreover, the calculation methodology required for such "illegal business volume" creates added barriers to prosecution of commercial scale counterfeiting and piracy (whether carried out by businesses or others) because it is not a calculation of the value of the legitimate non-infringing goods with which the counterfeit goods compete; instead, it is a calculation based on the prices through which the counterfeit goods undercut legitimate merchandise. Thus, the value of "illegal business volume" for a quantity of counterfeit merchandise can be far less than the value of an equivalent quantity of legitimate merchandise.

30. In addition, for at least some types of products — such as personal care products or small electronics — many commercial activities take place on a scale where the value of *legitimate* goods involved is less than RMB 50,000 (US\$6,925) (the "illegal business volume" threshold). It follows that commercial scale buying and selling activities involving *counterfeit* goods of these types will involve values below that threshold.

31. The RMB 30,000 (US\$4,155) "illegal gains" or "amount of profit" threshold is also problematic for two reasons. *First*, a business should *not* have to be profitable in order to be viewed as operating on a "commercial scale". Requiring a minimum profit level of RMB 30,000 thus will not capture all relevant counterfeiting activity. *Second*, because the "illegal gains" threshold requires a calculation that shows profits, *i.e.*, revenue minus expenses, of at least RMB 30,000, the revenue realized must exceed RMB 30,000. Since the revenue calculation in turn is based on sales at prices likely to be deeply discounted to undercut sales of legitimate goods, the situation replicates the problems described above. Indeed, the "illegal gains" threshold for many low-margin products is in fact *higher* than the RMB 50,000 "illegal business volume" threshold. The lower the profit margin is for a product, the higher the volume of products needed to meet the "illegal gains" threshold.

32. Under Article 214 of the Criminal Law and the December 2004 JI, the sale of goods bearing counterfeit trademarks must meet a threshold of RMB 50,000 (US\$6,925) in "amount of sales" before criminal procedures or penalties can be available. Pursuant to the December 2004 JI, the "amount of sales" refers to "all the illegal income gained or due to be gained from selling the goods that bear counterfeit trademarks." By only focusing on the income gained or due to be gained from sales of the counterfeit goods, the "amount of sales" value threshold appears to apply to an even smaller subset of transactions than the "illegal business volume" threshold under Article 213 (which includes other activities, such as the manufacture, storage, and transportation of infringing goods).

33. Under Article 215 of the Criminal Law and the December 2004 JI, the forging or unauthorized reproduction of another's registered trademark must meet one of the following three thresholds before criminal procedures or penalties can be available: an "illegal business volume" of more than RMB 50,000 (US\$6,925); "illegal gains" of more than RMB 30,000 (US\$ 4,155); or 20,000 copies. Because the "illegal business volume" and "illegal gains" thresholds are the same as for Article 213, the problems identified with respect to those thresholds apply with similar force. The copy threshold of 20,000 likewise provides no means to capture all commercial scale counterfeiting. To the contrary, it provides an exceedingly high threshold. A factory could store 19,999 counterfeit logos of a designer brand, and still evade the application of the Article 215 copy threshold.

34. Under Article 217 of the Criminal Law and the December 2004 JI, copyright or related rights infringement committed for the purpose of making profits must meet one of three thresholds before criminal procedures or penalties can be available under Article 217: an "illegal business volume" of more than RMB 50,000 (US\$6,925); "illegal gains" of more than RMB 30,000 (US\$4,155); or 1,000 copies. (The April 2007 JI amended the December 2004 JI by providing a copy threshold of 500 copies for Article 217 violations.)

35. The RMB 50,000 (US\$6,925) "illegal business volume" threshold presents analogous problems to Articles 213 and 215 above, thereby shielding substantial piracy operations from the threat of criminal sanction under the thresholds. Moreover, the "illegal business volume threshold" can shelter commercial scale activities from criminal prosecution, regardless of how it is calculated. Sales activities involving *legitimate* DVDs, software, music CDs, or books, can take place beneath this threshold. If commercial activities involving legitimate DVDs, CDs, software, or books would not meet the "illegal business volume" threshold, commercial scale activities involving *pirated* goods will be far less likely to meet it.

36. The RMB 30,000 (US\$4,155) "illegal gains" threshold in Article 5, first paragraph, of the December 2004 JI also presents real barriers to capturing all commercial scale piracy. The problems posed directly parallel the problems in the counterfeiting context described above.

37. Likewise, despite a new, lower threshold of 500 copies under Article 217, the copy threshold continues to exclude acts of commercial scale piracy. For example, if a copyright pirate makes 499 reproductions or a retailer stocks 499 copies in a store, they could not be prosecuted or convicted under Article 217 of the Criminal Law based on the copy threshold, because the relevant threshold of 500 copies provided by the April 2007 JI would not be met.

38. Under Article 218 of the Criminal Law and the December 2004 JI, specific sales of infringing reproductions for the purpose of making profits must meet a threshold of RMB 100,000 (US\$13,850) in "illegal gains" before criminal procedures or penalties can be available under Article 218. The problems identified in the paragraphs above apply with even greater force in this case.

39. The second set of problems with China's criminal thresholds stems from the fact that Chinese authorities must rely on this very limited set of one-size-fits-all numerical tests to find commercial scale counterfeiting and piracy that can be subject to criminal prosecution or conviction. By focusing

solely on business volume, copy, and profit thresholds that can only be met by counting finished goods, China's criminal thresholds require Chinese law enforcement officials to disregard other specific, telling indicia of commercial scale piracy and counterfeiting— from relevant physical evidence of a commercial scale pirating or counterfeiting operation to consideration of the impact the piracy or counterfeiting has on the commercial marketplace and by extension, right holders.

40. For example, China's thresholds rely solely on *finished* counterfeit or pirated goods to determine whether the thresholds are met; they do not consider *components* of counterfeit or pirated products. These components include packaging used for pirated CDs or DVDs, fabrics used for designer products, cartridge housings for video games, and other materials used to make counterfeit products. Seizure data collected in the course of Nintendo of America's anti-counterfeiting campaign in China confirms this problem. The data indicate that, in many instances, a meaningful proportion of the seizures includes components of finished video game products, such as cartridge housings, cases and packaging, and other related materials and implements, such as hardware and manuals.

41. Indeed, as demonstrated above, China's criminal thresholds permit commercial scale counterfeiting and piracy operations to continue in a safe harbor, without threat of criminal prosecution or conviction, so long as the pirates arrange their commercial activities to avoid meeting the very specific threshold tests that China uses.

42. Seizure data compiled by certain right holders regarding their anti-piracy and anti-counterfeiting efforts in China provide a vivid illustration of the problems the Chinese thresholds have created. The *Report on Copyright Complaints, Raids and Resulting Criminal Actions in China* ("CCA Report") was prepared by the China Copyright Alliance ("CCA"). The CCA Report summarizes seizure data relating to administrative raids of suspected infringing products in retail markets in four major cities in China: Beijing, Shanghai, Shenzhen, and Guangzhou. The data were collected over a two-year period (January 2006 - November 2007).

43. In the aggregate, the CCA seizure data show that significant quantities of retail sales of infringing product takes place in China at levels below China's thresholds. Indeed, less than 20% of retail establishments selling copyright-infringing music CDs or DVDs met the lowest relevant threshold. Therefore, the vast majority of retail outlets – a classic example of commercial scale activity – faced no possibility of criminal prosecution or conviction under the Chinese criminal thresholds.

44. Moreover, the CCA seizure data collected since the copy threshold for copyright piracy was changed to 500 copies in April 2007 confirm how rapidly counterfeiters and pirates respond to changes in China's criminal thresholds. A striking congruence becomes evident when comparing the two sets of "below-the-thresholds" seizure data (i.e., for calendar year 2006 and for the period from April 5, 2007 to November 30, 2007), where the copy thresholds were 1000 and 500, respectively. More than 80% of all administrative raids in both of these two time periods netted evidence falling *below* the thresholds in effect at the time.

B. ARTICLE 61, SECOND SENTENCE, OF THE TRIPS AGREEMENT

45. The second sentence of Article 61 provides that "[r]emedies available shall include imprisonment and/or monetary fines sufficient to provide a deterrent . . .". However, as noted, the criminal thresholds create a safe harbor that precludes the availability of these criminal remedies in many instances of wilful trademark counterfeiting and copyright piracy on a commercial scale. Accordingly, China's thresholds are also inconsistent with China's obligations under the second sentence of Article 61. When the conduct is not even subject to criminal prosecution or conviction, the law neither makes "available" a remedy nor creates any "deterrent".

C. ARTICLE 41.1 OF THE TRIPS AGREEMENT

46. As a result of the criminal thresholds, China fails "to provide for" criminal procedures and penalties to be applied in cases of wilful trademark counterfeiting or copyright piracy on a commercial scale as required by Article 61, first sentence. Consequently, China's measures at issue are also inconsistent with China's obligations under Article 41.1 of the TRIPS Agreement to make these enforcement procedures "available" under its law.

IV. CHINA'S MEASURES FOR DISPOSING OF CONFISCATED GOODS THAT INFRINGE INTELLECTUAL PROPERTY RIGHTS ARE INCONSISTENT WITH CHINA'S OBLIGATIONS UNDER ARTICLE 59 OF THE TRIPS AGREEMENT

47. The second set of US claims concerns how the Chinese customs authorities must handle infringing goods seized at the border. The United States requests that the Panel find that (1) the compulsory sequences of steps set out in the Chinese measures at issue mean that Chinese customs authorities lack the authority to order destruction or disposal of infringing goods in accordance with the principles set out in Article 46 of the TRIPS Agreement, and (2) the measures at issue are therefore inconsistent with China's obligations under Article 59 of the TRIPS Agreement.

48. Part III, Section 4, of the TRIPS Agreement imposes obligations related to border measures in the context of enforcement of intellectual property rights. In particular, the first sentence of Article 59 provides that "[w]ithout prejudice to the 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.*" (Emphasis added).

49. Article 46 of the TRIPS Agreement is contained in Section 2 ("Civil and Administrative Procedures and Remedies") of Part III of the TRIPS Agreement. The first and fourth sentences of Article 46 are pertinent to the obligation in Article 59. The first sentence discusses both "destr[uction]" and "dispos[al]," the two terms in Article 59. By its terms, Article 46 requires that the judicial authorities of a Member "shall have" the authority to destroy infringing goods or to dispose of them outside the channels of commerce so as to avoid causing harm to the right holder. Transposing this requirement to the context of Article 59, the applicable principle must be that a Member's competent authorities for border enforcement "shall have" the authority to destroy infringing goods or to dispose of them outside the channels of commerce so as to avoid causing harm to the right holder.

50. The fourth sentence of Article 46 elaborates on the requirement that a judicial authority shall have the authority to dispose of infringing goods outside the channels of commerce. In particular, for counterfeit trademark goods, removing the unlawfully affixed trademark will not suffice to permit release of the good into the channels of commerce, other than in exceptional cases. Thus, in the context of Article 59, the applicable principle must be that a Member's competent authorities for border enforcement shall not permit release of seized counterfeit trademark goods into the channels of commerce if the unlawfully affixed trademark is removed, other than in exceptional cases.

51. The border measures that govern the disposal and destruction of goods found to infringe intellectual property rights are described above. In particular, Article 27 of the Customs IPR Regulations and Article 30 of the Customs IPR Implementing Measures mandate a compulsory sequence of steps (or "items") that Chinese Customs must take in deciding how to treat goods seized at the border that it has determined infringe intellectual property rights.

52. First, neither of the two components of the compulsory first "item" accords with Article 46 principles. The first item contains two parts. Customs ascertains whether the infringing goods can be used for "public good"; if so, Customs gives the goods to the relevant "public welfare organization".

Customs may also allow the right holder to purchase the goods "for compensation" – i.e., Customs offers the right holder the opportunity to buy the goods that infringe on the right holder's intellectual property rights. The option under which a right holder can buy the infringing goods is not disposal "in such a manner as to avoid any harm caused to the right holder": anyone who has to pay for goods that violates his or her own patent, trademark or copyright is harmed in the amount of the payment.

53. The second component of the first "item" – where Chinese Customs gives infringing goods to "public welfare organizations" – may or may not be available in a given case. Where a donation to a charity is an option, and the donation has the right-holder's consent, this may be a socially beneficial disposition of infringing goods that also observes the principles of Article 46. On the other hand, allowing counterfeit goods to be used, even for "public good," can be harmful to a right holder in certain cases.

54. Second, where the public welfare organization transfer is unavailable, and the right holder does not elect to purchase the infringing goods, the Customs authorities must turn to the second "item" relating to auction of the confiscated goods. This second "item," which is also compulsory (once the first "item" has not led to disposal of the goods), likewise does not comport with the principles of Article 46. Putting the seized goods up for auction obviously both precludes destroying them, and introduces them into commerce. Moreover, taking this action without the right holder's consent can cause great harm to the right holder.

55. Third, for counterfeit trademark goods, the auction provision is also inconsistent with the principle in the fourth sentence of Article 46, under which goods can be introduced into the channels of commerce after removal of the unlawfully affixed trademarks only "in exceptional cases". Nothing about the Chinese customs measures suggests that the auctioning of these goods after removal of the infringing mark is permitted only in "exceptional cases". Indeed, under China's customs measures, Chinese customs authorities never have the authority to destroy goods whose infringing features can be removed.

56. Finally, as explained above, the first and second "items" are compulsory prerequisites to the third item (destruction). Accordingly, where any of the options in the first or second "item" is available, Chinese customs authorities are not, as a matter of Chinese law, authorized to destroy the infringing good or otherwise dispose of the good in a way that either is outside of the channels of commerce or handled in a manner that avoids harm caused to the right holder. Consequently, in all those circumstances, the Chinese customs authorities lack the authority to order the destruction or disposal of infringing goods in accordance with the principles of Article 46 of the TRIPS Agreement. As a result, China's measures are inconsistent with Article 59 of the TRIPS Agreement.

V. CHINA'S DENIAL OF COPYRIGHT AND RELATED RIGHTS PROTECTION AND ENFORCEMENT TO WORKS THAT HAVE NOT BEEN AUTHORIZED FOR PUBLICATION OR DISTRIBUTION WITHIN CHINA IS INCONSISTENT WITH THE TRIPS AGREEMENT

57. Under the Berne Convention and the TRIPS Agreement, with very limited exceptions, a work acquires copyright protection immediately and automatically. Copyright arises immediately upon a work's creation and, unlike patent rights and trademark rights, which may be (and often are) made conditional upon application and registration, copyright protection cannot be conditioned on the successful completion of any formalities, but instead arises automatically.

58. Because of the first sentence of Article 4 of the Copyright Law, however, China's copyright regime does not meet this standard. Article 4 of the Copyright Law provides that "[w]orks the publication or distribution of which is prohibited by law shall not be protected by this Law. Copyright owners, in exercising their copyright, shall not violate the Constitution or laws or prejudice

the public interests." On its face, the first sentence of this provision denies immediate, automatic protection to certain works of creative authorship.

59. This provision of China's Copyright Law has important negative consequences. By denying copyright protection to works that should have it, Article 4 allows copyright infringers to profit at the expense of the legitimate rightholder, without fear of being subjected to enforcement procedures and remedies for copyright infringement. Indeed, works that have already been created but cannot legally be published or distributed are denied copyright protection at a time when they most need it: when they cannot access the market, but when illegitimate copies are available. Pirated copies of films, publications, music, and other creative works are widely available in China. Furthermore, pirated copies often reach the market before legitimate copies do. Pirates, of course, do not wait for the results of content review or other regulatory approvals.

60. Article 9.1 of the TRIPS Agreement provides that all WTO Members shall comply with Articles 1 through 21 of the Berne Convention, except that WTO Members do not have rights or obligations under the TRIPS Agreement in respect of the rights conferred under Article 6*bis* of the Berne Convention or of the rights derived therefrom. In addition, China and the United States are both parties to the Berne Convention.

61. Several of the Berne Convention articles with which China must comply pursuant to TRIPS Article 9.1 are relevant in this dispute. To begin with, Article 5(1) of the Berne Convention provides that "[a]uthors shall enjoy, in respect of the works for which they are protected under this Convention, in countries of the Union other than the country of origin, the rights which their respective laws do now or may hereafter grant to their nationals, as well as the rights specially granted under this Convention." Furthermore, Article 2 of the Berne Convention defines the "works for which [authors] are protected under this Convention," as that phrase is used in Article 5(1).

62. The "rights specially granted under [the Berne Convention]," as mentioned in Article 5(1), refer to the various minimum rights required under the Berne Convention, including the exclusive right to authorize: the reproduction of protected works; translation of protected works; adaptations, arrangements and other alterations of protected works; and public performance and communication to the public. In this connection, it is important to emphasize that the exclusive right to authorize such economic activities is also the right to prohibit them; that is, the holder of these exclusive rights has the right to prevent others from exploiting the work (for profit or otherwise) without permission. Additionally, Article 5(2) of the Berne Convention provides, in relevant part, that "[t]he enjoyment and exercise of these rights [*i.e.*, the rights mentioned in Article 5(1)] shall not be subject to any formality"

63. First, contrary to China's obligations under Article 9.1 of the TRIPS Agreement (and the provisions of the Berne Convention referenced in Article 9.1), the first sentence of Article 4 of the Copyright Law denies copyright protection to works that are entitled to such protection. Article 4 of the Copyright Law excludes from copyright protection an entire category of works – "works the publication or distribution of which is prohibited by law" – but that exclusion from protection is not permitted or even contemplated by the Berne Convention. Berne Convention Article 2(1) makes clear that the works protected by the Convention include "every production in the literary, scientific and artistic domain, whatever may be the mode or form of its expression" (emphasis added), and Article 2(6) further makes clear that these works must enjoy copyright protection everywhere that the Berne Convention applies. The exclusion from protection contained in Article 4 of the Copyright Law is contained nowhere in the Berne Convention. That exclusion, therefore, is prohibited by the Berne Convention.

64. Moreover, Article 4 denies to the authors of such works the broad set of rights enumerated in Article 10 of the Law. The rights in Article 10 largely encompass the rights contemplated by the

provisions of the Berne Convention. Authors of the works that are denied the protection of the Copyright Law also do not benefit from the remedies specified in Articles 46 and 47 of the Copyright Law, which provide civil liability (and in some case, administrative and/or criminal liability) for copyright infringement.

65. Consequently, by denying the protection of Articles 10, 46 and 47 of the Copyright Law to certain works, the first sentence of Article 4 of the Copyright Law means that the authors of those works do not enjoy the minimum rights that are "specially granted" by the Berne Convention. As a result, Article 4 of the Copyright Law does not comply with the requirements of Article 5(1) of the Berne Convention, and thus it also does not comply with China's obligations under Article 9.1 of the TRIPS Agreement

66. Furthermore, as noted above, Article 5(2) of the Berne Convention prohibits subjecting the enjoyment and exercise of the rights mentioned in Article 5(1) to any formality. However, China has made protection and enforcement under the Copyright Act dependent on the formality of successful conclusion of content review. The Copyright Law's protection attaches only after such a work has been submitted for content review, and, if it passes that review unchanged, an authorization to publish and distribute the work has issued. As a formal matter, therefore, copyright protection is dependent, in part, on the issuance of the authorization to publish and distribute resulting from successful conclusion of the content review process.

67. To condition copyright rights on the successful completion of the content review process is to make those rights "subject to a formality," as that term is interpreted in accordance with the customary rules of interpretation of public international law. In this context, "subject" can be defined to mean "dependent or conditional upon, resting on the assumption of"; and "formality" can be defined as "a formal or ceremonial act; a legal, authorized or customary procedure."

68. Because content review is a formal, legally required procedure in China, and because the exercise and enjoyment of copyright rights are, for many works, dependent upon submission to and successful completion of content review, the content review process makes the exercise and enjoyment of copyright "subject to a formality" within the meaning of Article 5(2). By making protection under the Copyright Law dependent on successful completion of content review, China's law thus is inconsistent with China's obligations under Article 5(2) of the Berne Convention. China's law therefore is also inconsistent with China's obligations under Article 9.1 of the TRIPS Agreement.

69. It is also important to emphasize that these inconsistencies with the TRIPS Agreement do not arise because China prohibits certain works from being published or distributed in China. The TRIPS Agreement does not obligate China, or any other WTO Member, to permit all works to be published and all works to be distributed. Instead, the inconsistencies arise from China's decision to deny copyright protection and enforcement to the works that it prohibits.

70. Second, depending on the construction given to Article 4, its first sentence may also be inconsistent with China's obligations under Article 14 of the TRIPS Agreement. Article 14.1 of the TRIPS Agreement requires WTO Members to give performers, *inter alia*, the possibility of preventing certain acts, and Article 14.2 of the TRIPS Agreement requires WTO Members to give producers of phonograms (sound recordings) the right to authorize or prohibit the direct or indirect reproduction of their sound recordings. The Copyright Law furnishes the legal basis within China for protecting these so-called "related rights" of performers and sound recording producers.

71. It is unclear whether Article 4 of the Copyright Law operates to deny the protection of the Law to performances (or their fixations) and sound recordings whose publication or distribution is prohibited. Article 4 uses the term "works," a term that is defined in Article 3 of the Copyright Law. Sound recordings and performances (and their fixations) do not appear, strictly speaking, to be

"works" within the meaning of Article 4. The United States is not certain that Article 4 is meant to be limited to "works" that are the subject matter of copyright, as opposed to encompassing as well the subject matter of related rights (such as performances and sound recordings). Therefore, to the extent that Article 4 of the Copyright Law is interpreted as applying to performances (or their fixations) and to sound recordings, it is also inconsistent with China's obligations under Article 14 of the TRIPS Agreement.

72. Third, as a consequence of the foregoing, China fails to ensure that enforcement procedures as specified in Part III of the TRIPS Agreement are available to copyrighted works that should be protected upon creation in order to permit effective action and expeditious remedies against copyright infringements. Among other problems, China fails to provide for criminal procedures and penalties to be applied in certain cases of willful copyright piracy on a commercial scale. China is therefore not in compliance with its obligations under Article 41.1 and Article 61, first and second sentence, of the TRIPS Agreement.

73. The first sentence of Article 41.1 of the TRIPS Agreement provides that "Members shall ensure that enforcement procedures as specified in this Part [*i.e.* Part III of the TRIPS Agreement, which comprises Articles 41 through 61] 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." The "enforcement procedures as specified in this Part" include, *inter alia*, a number of civil judicial procedures concerning the enforcement of copyright and related rights. To the extent that these procedures are made available in Chinese law, it is Chapter V of the Copyright Law ("Legal Liability and Enforcement Measures") that does so.

74. However, because of Article 4 of the Copyright Law, the enforcement provisions of Chapter V of the Copyright Law are unavailable for works, whose distribution or publication is not authorized or otherwise prohibited in China. Therefore, as a result of Article 4 of the Copyright Law, China fails to ensure that enforcement procedures as specified in Part III of the TRIPS Agreement are available under its law so as to permit effective action against infringements, including expeditious remedies to prevent infringement of copyrights and (to the extent covered by Article 4) related rights with respect to certain works, performances and sound recordings.

75. Additionally, because criminal procedures under Article 47 of the Copyright Law are not available at all with respect to works whose distribution or publication in China is prohibited, no criminal procedures or remedies are available when piracy of those works occurs on a commercial scale. Consequently, notwithstanding the provisions of TRIPS Agreement Article 61, first and second sentence, China does not provide for or make available criminal procedures and penalties to be applied in certain cases of wilful copyright piracy on a commercial scale.

VI. CONCLUSION

76. For the reasons set forth in the submission, the United States respectfully requests the Panel to find that China's measures, as set out in the US panel request, are inconsistent with China's obligations under the TRIPS Agreement. The United States further requests, pursuant to Article 19.1 of the DSU, that the Panel recommend that China bring its measures into conformity with that Agreement.

ANNEX A-2

**EXECUTIVE SUMMARY OF THE ORAL STATEMENT OF
THE UNITED STATES AT THE FIRST SUBSTANTIVE MEETING**

I. CHINA'S CRIMINAL IPR THRESHOLDS FOR CRIMINAL PROCEDURES AND PENALTIES

1. While Part III of the TRIPS Agreement deals with a number of enforcement procedures, such as civil, border, and administrative measures, Article 61 is the only provision that focuses on criminal penalties and procedures. And conversely that also means that only criminal penalties and procedures can fulfill the obligations in Article 61.

2. The words "at least" in the first sentence of Article 61 lay a floor for WTO Members. Providing for criminal procedures and penalties to be applied *in some cases* of "wilful trademark counterfeiting and copyright piracy on a commercial scale," but not in others, does not fulfill the obligations in Article 61. China appears to argue that this Panel's scrutiny of its implementation of the TRIPS Agreement standards on criminal procedures and penalties is somehow inappropriate because it concerns criminal law. However, like all WTO Members, China has agreed to ensure that its criminal laws against piracy and counterfeiting meet TRIPS Agreement standards.

3. China also appears to argue that Article 1.1 and Article 41.5 permit it to "define" the standards of Article 61 based on its own method of implementation and its own enforcement resource constraints. Article 1.1 deals with the *method* of implementing China's TRIPS Agreement obligations, not *whether* they should implement them in the first place. Article 41.5 is concerned with similar issues. Articles 1.1 and 41.5 do not alter the obligations in Article 61, and China must implement Article 61 in a way that respects its terms.

4. Turning to "on a commercial scale" in Article 61: *First*, by using the term "commercial scale", the TRIPS Agreement makes clear that WTO Members must criminalize acts of infringement that reach a certain extent or magnitude. *Second*, in using the term "*commercial* scale," the TRIPS Agreement draws a link to the commercial marketplace – where business-minded IPR infringers take the fruits of their counterfeiting or piracy.

5. According to China, the US position is that commercial scale only means commercial purpose. That is not the US view; indeed, such an interpretation would read the word "scale" out of the term. That said, an infringer engaged in pursuing financial gain in the marketplace is acting on a "scale" that is "commercial". And, the "scale" of what is "commercial" in each market will vary by many factors, such as the object of the infringement and the market for the infringed items.

6. While China alleges that we wrongly interpret "commercial scale" by looking at the ordinary meaning of the individual words "commercial" and "scale", the US interpretation is based on the customary rules of interpretation of public international law.

7. China proposes to replace the term "commercial scale" with a phrase that TRIPS Article 61 does not contain: "a significant magnitude of activity," but this proposal reads "commercial" out of Article 61. China relies upon a discussion of this term by a WIPO Committee of Experts on Counterfeiting and Piracy in 1988. It is unclear what status this document has under the *Vienna Convention* rules; and in any case, the WIPO Committee's document provides confirmation of the interpretation suggested by the United States.

8. China fails to make criminal procedures and penalties available for all wilful trademark counterfeiting and copyright piracy on a commercial scale because its criminal IPR thresholds create a safe harbor for pirates and counterfeiters. The first fundamental problem is that China's thresholds are set at such a level, and calculated in such a way, that they preclude prosecution or conviction of infringing activity involving values or volumes that are below the thresholds but are still "on a commercial scale."

9. With respect to the Article 213 trademark counterfeiting thresholds, there are many classes of commercial scale activity that take place under those thresholds. Indeed, the "illegal business volume" threshold directs Chinese prosecutors and judges to base this calculation on the prices of counterfeit goods as a default. As many commercial activities in legitimate markets, such as personal care products, take place where the value of the goods involved is less than the RMB 50,000 "illegal business volume" thresholds, the commercial scale activities involving *counterfeit* goods of these types will routinely involve values below that threshold.

10. Another example is demonstrated by the RMB 30,000 "illegal gains" threshold. This threshold can similarly miss many classes of commercial scale activity, and thus, requiring a profit level of RMB 30,000 will not capture all "commercial scale" activities.

11. Similar safe harbor problems exist with the Articles 214 and 215 thresholds as well as China's thresholds for copyright piracy. For example, the Article 217 500-copy threshold excludes acts of commercial scale piracy, as a copyright pirate that makes 499 reproductions or a retailer that stocks 499 copies in a store could not be prosecuted or convicted on that basis under Article 217.

12. The second fundamental problem is that Chinese authorities must rely on a limited set of one-size-fits-all tests to find commercial scale counterfeiting and piracy that can be subject to criminal prosecution or conviction. A range of considerations should be probative of "commercial scale," but China's rigid criminal thresholds preclude their use. They are ill-adapted to the diversity of commercial activity and allow commercial scale counterfeiting and piracy to escape prosecution.

13. China does not explain or justify how its boundaries of criminal liability capture all commercial-scale counterfeiting and piracy. China's choices for its *non-IPR* criminal thresholds has no bearing on this Panel's assessment of whether China meets its obligations under *Article 61 of the TRIPS Agreement*. China's argument that its "evidentiary" provisions should not be subject to Article 61 scrutiny is without merit; whether calculated over one hour or over many years, China's thresholds create a safe harbor. China concedes that if an administrative penalty in a prior seizure action is applied (often China's preferred remedy), it wipes the slate clean and those prior seizures could not be counted on to meet the thresholds.

14. The CCA Report submitted by the United States illustrates the safe harbor created by China's thresholds. *First*, it provides an example of the scale of commerce in China for certain pirated products. *Second*, it shows significant quantities of retail sales of infringing product take place in China at levels below China's thresholds. *Third*, a comparison of two sets of "below-the-thresholds" seizure charts in the US submission shows more than 80% of all administrative raids in both of these two time periods netted evidence falling *below* the thresholds in effect at the time.

15. China's criminal IPR thresholds are also inconsistent with the second sentence of Article 61 and Article 41.1. China confirms that if the Panel finds that China's criminal IPR thresholds are inconsistent with the first sentence of Article 61, it must also find an inconsistency with the second sentence of Article 61 and Article 41.1. We also disagree with China's unsupported assertion that the United States bears an "especially high burden of proof in advancing this claim."

II. CHINA'S BORDER MEASURES FOR DISPOSAL OF CONFISCATED GOODS

16. Article 59 provides in pertinent part that the "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." For the purposes of this dispute, this requires focus on two of the sentences in Article 46. *First*, a Member's competent authorities for border enforcement "shall have the authority to order that goods that they have found to be infringing be ... disposed of outside the channels of commerce in such a manner as to avoid any harm caused to the right holder, or ... destroyed." *Second*, "[i]n 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."

17. Contrary to Article 59, China's Customs authorities lack the requisite authority to order the destruction or disposal of infringing goods in accordance with these Article 46 principles. This is because Article 30 of the Customs IPR Implementing Measures, which implements Article 27 of the State Council Customs IPR Regulation, sets out a compulsory sequence of steps that Customs must follow in deciding how to treat seized goods that it determines infringe intellectual property rights.

18. China states that Article 59 does not require a grant of unconditional authority to its agencies. However, the TRIPS rules do not *require* China to destroy or dispose of all such goods in accordance with the principles in the first sentence of Article 46. The pertinent issue is whether Customs is permitted by law to make decisions in particular circumstances. "Authority" means that China Customs should have the *power* to choose among any of the options – in accordance with the Article 46 principles – from the outset when the goods are found to be infringing, and thereafter until the goods are finally dealt with.

19. In the initial step of the compulsory hierarchy, Customs must decide whether the infringing goods can be used for "public good." If the answer is yes, Customs must either give the goods to a "public welfare organization" or Customs may instead allow the right holder to purchase the goods "for compensation."

20. China has confirmed that donation to "public welfare organizations" will not be available if the goods are unsuitable for donation. In cases where the goods are suitable, the United States is pleased to learn that China Customs has donated seized goods to charities such as the Red Cross of China. China further cites to a general obligation to "implement necessary supervision" when goods are used for "social welfare purposes." However, Article 17 of the Law on Donation for Public Welfare (Exhibit US-59) authorizes public welfare organizations to sell donated goods on the market in some cases. This demonstrates that China's donation option does not ensure that the goods remain outside the channels of commerce and avoid harm to the right holder.

21. Where donation is not appropriate, Chinese authorities must offer the infringing goods for sale to the right holder. This mandated action does not permit disposal "in such a manner as to avoid any harm caused to the right holder," as Article 46 requires, as by paying for such goods, right holders will suffer financial harm in the form of payment for goods that infringe their rights.

22. Where transfer to a public welfare organization is unavailable, and the right holder does not purchase the infringing goods, the Customs authorities must turn to the public auction step. China's public auction does not comport with the principles incorporated into Article 59. Putting seized goods up for public auction introduces them into the channels of commerce and does not dispose of them in a manner that avoids any harm to the right holder. China does not contest that its public auction is introduction into the channels of commerce. On these grounds alone, however, the mandatory auction provided by China's measures is inconsistent with the Article 46 principles.

23. China asserts that right-holders' formal right to comment before the auction assists in avoiding harm to the right holder. However, that is not a right to *prevent* the goods from being auctioned. A public auction can cause great harm to the right holder, since the infringer or importer can simply purchase the seized goods at the auction.

24. With respect to counterfeit trademark goods in particular, this public auction step is also inconsistent with the principle in the fourth sentence of Article 46, which provides that goods can be introduced into the channels of commerce after removal of the unlawfully affixed trademarks only "in exceptional cases." China's claim that the obligation is not a principle within the meaning of Article 59, is at odds with its plain meaning. China does not cite limiting language in Article 59 that selectively incorporate the obligations in Article 46.

25. Only if auction is not possible does China Customs gains the power to destroy the infringing goods. We recall that China's measures ensure this step will not be reached if any of the previous options are available. Therefore, in those situations, Chinese customs authorities are not, as a matter of Chinese law, authorized to destroy the infringing good.

26. China argues that it has "substantial discretion" to determine that an infringing good is not suitable for the disposal options and therefore has authority to order destruction. However, China's Customs Implementing Measures states that when certain facts are present, Customs officials must dispose of the goods only in the manner stipulated. In each of those circumstances, Chinese customs authorities lack the authority to order the destruction of infringing goods.

III. ARTICLE 4 OF CHINA'S COPYRIGHT LAW

27. Article 4, first sentence, provides that "[w]orks the publication or distribution of which is prohibited by law shall not be protected by this Law." China's first submission has not resolved a number of concerns about the *legal* operation of Article 4 – the text of which provides a clear and straightforward denial of copyright protection. China's focus on the actions of its NCAC leaves unresolved the concerns that, as a matter of law, the first sentence of Article 4 denies copyright protection to works whose content is still being reviewed.

28. Most importantly, the Chinese submission appears to concede that Article 4 is TRIPS-inconsistent. China admits that the first sentence of Article 4 denies protection to works whose contents are prohibited. Moreover, the NCAC confirms that, for the purpose of administrative proceedings, Article 4 denies copyright protection to "works whose contents are illegal." China therefore appears to confirm that it denies copyright protection to works containing illegal content that Chinese authorities determine is prohibited by law.

29. Indeed, contrary to China's obligations under TRIPS Article 9.1 (and the provisions of the Berne Convention referenced in Article 9.1), Article 4 denies copyright protection to works that are entitled to such protection. Berne Article 2(1) states that works protected by the Convention include "*every* production in the literary, scientific and artistic domain . . ." (emphasis added), and Article 2(6) further states that these works must enjoy copyright protection everywhere that the Berne Convention applies. Article 4's blanket exclusion for certain illegal works, therefore, is inconsistent with the Berne Convention.

30. Moreover, because Article 4 denies copyright protection to certain works, the set of exclusive rights in Article 10 of China's Copyright Law are also denied to such works. As a result, Article 4 does not comply with the requirements of Berne Article 5(1), which specifies certain guaranteed exclusive rights. And indeed, without copyright protection, right holders cannot enforce their rights in the work. Therefore, authors of the works also do not benefit from the remedies for infringement

specified in Articles 46 and 47 of the Copyright Law. Accordingly, China is not in compliance with its obligations under Article 41.1 and Article 61, first and second sentence, of the TRIPS Agreement.

31. China has not addressed the US concerns about the impact of content review on copyright protection. *First*, the United States is not in a position to accept that the NCAC's actions are a definitive interpretation of Article 4, at least with respect to China's TRIPS obligations to afford criminal and civil remedies for copyright infringements heard by the courts and procuratorate. *Second*, with respect to the *Zheng Haijin* case, it is not clear why this document is responsive to the US arguments; according to the NCAC, the publisher in question had violated Chinese laws on book publication numbers, not Chinese laws regarding content. *Third*, courts apply the law in cases under adjudication, and not the NCAC. In fact, China's Supreme People's Court issued a guidance document (Exhibit US-60) in this case, and appears to have considered that copyright protection was contingent on the work's successful completion of content review.

32. To the extent that the first sentence of Article 4 makes the exercise and enjoyment of copyright rights in civil and criminal matters dependent upon the successful completion of some type of content review, Article 4 appears also to be inconsistent with Berne Article 5(2), and thus, inconsistent with Article 9.1 of the TRIPS Agreement for that reason as well.

ANNEX A-3

**CLOSING ORAL STATEMENT OF THE UNITED STATES AT THE
FIRST SUBSTANTIVE MEETING**

1. On behalf of the United States, we would like to begin by thanking the Panel, the Secretariat staff, and the delegation of China for their time and attention during our session this week.

I. INTRODUCTION

2. At the end of this first meeting of the Panel, taking into account the submissions and statements that have been provided by both the Parties and the Third Parties, we would like to offer some observations.

3. In our view, the meeting this week has provided useful discussions to assist the Panel's assessment of whether the three sets of China's measures that we have challenged are consistent with the TRIPS Agreement.

4. First, we commend to the Panel the views expressed by Third Parties that there is no special burden of proof required for this dispute. Indeed, like all disputes, the burden of proof provided by the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") governs here. We are pleased to note that China now appears to agree that no higher burden of proof applies for any of the claims in this dispute.¹

5. We believe that the meeting this week confirms that the United States has fully demonstrated that the Chinese measures at issue are inconsistent with the relevant provisions of the TRIPS Agreement.

**II. CHINA'S CRIMINAL IPR THRESHOLDS FOR TRADEMARK COUNTERFEITING
AND COPYRIGHT PIRACY**

6. The obligations in Article 61 are straightforward and unambiguous. Members must criminalize all wilful commercial-scale trademark counterfeiting and copyright piracy. WTO Members must implement this minimum standard in their domestic IPR regimes.

7. We would commend in particular to the Panel the views expressed by a number of the Third Party WTO Members that the minimum enforcement standards established by Article 61 for all WTO Members are not modified by Article 1.1 or Article 41.5 of the TRIPS Agreement. To the contrary, the United States recalls the language of the first sentence of Article 1.1; that China must "give effect" to the obligations of Article 61.

8. Turning to Article 61, it is unfortunate that China's oral statement repeats the misreading of the position of the United States regarding the proper interpretation of "on a commercial scale" in Article 61. As we set out in paragraph 108-110 of our first submission and paragraph 17 of the US oral statement, commercial scale does not mean commercial "purpose" or commercial "intent".

9. Please allow me to clarify the US position again. The US position is based on the well-established principles that govern treaty interpretation in WTO dispute settlement pursuant to Article 3.2 of the DSU. Those who are engaging in commercial activities (and thus do have a profit

¹ China's first oral statement, para. 39.

motive) are acting on a "scale" that is "commercial". But, that is not the end of the analysis. The "scale" of what is "commercial" in each market will necessarily vary by many factors, including the object of the infringement and the market for the infringed items.

10. Indeed, while the TRIPS Agreement obligation to provide for criminal procedures and penalties for acts of "commercial scale" trademark counterfeiting and copyright piracy remains unchanged, the factual situations that represent "commercial scale" may indeed change over time, as technologies and market conditions evolve.

11. On the other hand, the TRIPS Agreement deals with *non-criminal* remedies in other sections of Part III of the TRIPS Agreement. Therefore, a Member's *non-criminal* remedies are neither the subject of Section 5 of the TRIPS Agreement obligations concerning "criminal procedures," nor are they relevant in dealing with a Members' compliance with those obligations.

12. When we apply the Article 61 standard, it is evident that China's measures do not provide for criminal penalties and procedures for all wilful commercial-scale counterfeiting and piracy.

13. The *first* fundamental problem is that China's thresholds are set at such a level, and calculated in such a way, that they do not permit prosecution or conviction of infringing activity involving values or volumes that are below the thresholds but are still "on a commercial scale".

14. The *second* fundamental problem is that the structure of the thresholds requires Chinese authorities to rely exclusively on a limited set of one-size-fits-all tests for counterfeiting and piracy that can be subject to criminal prosecution or conviction under Chinese law. A range of factors are capable of being probative of "commercial scale," but China's rigid criminal thresholds preclude their use. In this connection, the United States would note the many potentially relevant factors raised by several third party WTO Members.

15. Mr. Chairman, and Members of the Panel, the United States appreciates the sincere efforts of dedicated law enforcement officials throughout China who are trying to fight counterfeiting and piracy. Unfortunately, in this instance, the law is an obstacle.

16. It is regrettable that, under China's criminal IPR thresholds, its prosecutors and judges cannot, as a matter of law, reach the acts of "commercial scale" piracy and counterfeiting that fall in the safe harbor from criminal procedures and penalties that are below the thresholds' flat volume or value metric. This state of the law is also inconsistent with China's obligations under the TRIPS Agreement.

III. CHINA'S BORDER MEASURES FOR DISPOSAL OF CONFISCATED GOODS

17. With regard to our second claim, as explained in our first submission and our oral statement, China's Customs regulations create a mandatory hierarchy of actions that binds China's Customs authorities. The rigidity of this system constrains Chinese Customs authorities, so that in many circumstances, they do not have the authority, much less the discretion, to act in accordance with the principles in the first sentence of Article 46 concerning proper disposal or destruction of goods.

18. We note in this regard that China has not contested the relevance or compulsory language of the Customs IPR Implementing Measures.² Rather, China now asserts that China Customs has sufficient discretion to act in accordance with Article 46 principles. It does so by characterizing Customs' fact finding obligations, which determine which step in the hierarchy is applicable, as "discretion". However, this assertion ignores the plain text of China's measures.

² Exhibit US-6

19. When China Customs reaches a given step in its hierarchy, if a particular fact situation is presented, the Customs IPR Implementing Measures require Customs to take certain prescribed actions that do not satisfy the principles of Article 46. Yet Article 59 obligates Members to provide authority consistent with these principles.

20. The rigid Chinese system likewise prevents Chinese authorities from meeting the principle in the last sentence of Article 46, since once auction becomes the required step in China's hierarchy, China Customs is required, where feasible, to auction goods after the infringing mark has been removed.

IV. ARTICLE 4 OF CHINA'S COPYRIGHT LAW AND THE DENIAL OF COPYRIGHT PROTECTION

21. The text of Article 4.1 is straightforward. Article 4, first sentence, provides that "[w]orks the publication or distribution of which is prohibited by law shall not be protected by this Law."

22. Nothing China has presented overcomes the plain meaning of that provision – that Article 4.1 denies copyright protection to content that has not been approved. As we note in our oral statement, China's reliance on the NCAC administrative actions does not demonstrate that Article 4.1 operates contrary to its text. Accordingly, the evidence continues to indicate that China does not satisfy its TRIPS obligations (including those incorporated from the Berne Convention) to provide the full range of rights and to provide those rights upon the creation of the work without the imposition of formalities. Moreover, this means that China does not afford civil and criminal remedies for infringements heard by the courts.

23. In light of the foregoing, the United States believes that Article 4.1 of China's Copyright Law is inconsistent with China's obligations under the TRIPS Agreement.

V. CONCLUSION

24. Mr. Chairman, and Members of the Panel, we would again like to thank you, and the Secretariat staff assisting you, for your efforts on this dispute, and for your time and attention this week. We look forward to receiving the written version of your questions, and to filing our responses and our rebuttal submission. We also look forward to seeing you again in June.

ANNEX A-4

EXECUTIVE SUMMARY OF THE REBUTTAL SUBMISSION
OF THE UNITED STATES

I. INTRODUCTION

1. This submission will show how China's arguments in its first written submission, oral statement at the First Panel Meeting, and Responses to the Panel's Questions fail to rebut the demonstration in the US first submission that China's measures in certain areas are inconsistent with its obligations under the TRIPS Agreement.

II. CHINA'S THRESHOLDS FOR CRIMINAL PROCEDURES AND PENALTIES FOR TRADEMARK COUNTERFEITING AND COPYRIGHT PIRACY ARE INCONSISTENT WITH CHINA'S OBLIGATIONS UNDER ARTICLES 61 AND ARTICLE 41.1 OF THE TRIPS AGREEMENT

2. The United States has met the burden of proof by successfully demonstrating that China's measures are inconsistent with China's obligations under the first and second sentences of Article 61 and Article 41.1 of the TRIPS Agreement. The United States, and a number of third parties, have provided numerous concrete illustrations of how China's thresholds permit wilful trademark counterfeiting and copyright piracy on a commercial scale to exist. China has not disputed that acts of "wilful trademark counterfeiting and copyright piracy" occur in many cases without triggering these criminal thresholds, and as the US has demonstrated, China does not provide criminal penalties and procedures for many of these acts that are "on a commercial scale".

A. ARTICLE 61, FIRST SENTENCE, OF THE TRIPS AGREEMENT

3. The obligation in the first sentence of Article 61 is comprised of a number of elements. China "shall provide for" criminal procedures and penalties "to be applied" "at least" in cases of "wilful trademark counterfeiting and copyright piracy" "on a commercial scale". China observes that the core aspect of this claim is the meaning of the term "on a commercial scale". The United States agrees and has provided an interpretation for "commercial scale" that accords with the customary rules of interpretation reflected in the *Vienna Convention*.

4. The US explanation of the term "commercial scale" is set out in detail in the US first submission. In particular, two features emerge from the ordinary meaning of the term. First, by using the term "commercial *scale*," the TRIPS Agreement makes clear that WTO Members must criminalize acts of infringement that reach a certain extent or magnitude. Second, in using the term "*commercial scale*," the TRIPS Agreement draws a link to the commercial marketplace – where business-minded IPR infringers take the fruits of their counterfeiting or piracy. Thus, it is clear that the ordinary meaning of "commercial scale" extends to those who engage in commercial activities, including manufacturing, distribution, and retail sales.

5. China claims that the US position is that commercial scale only means commercial purpose. That is demonstrably not the US view. That said, an infringer seriously engaged in pursuing financial gain in the marketplace is *necessarily* acting on a "scale" that is "commercial," and therefore falls within the ordinary meaning of the term. However, the meaning of the term "commercial scale" does not depend on the intent of the infringer. An infringer with a different intent may or may not be acting on a "scale" that is "commercial".

6. China also alleges that the United States wrongly interprets the ordinary meaning of the term "commercial scale" by looking at the meaning of the individual words "commercial" and "scale". However, that is a completely acceptable method for interpreting a term and is similar to that followed by past panels and the Appellate Body.

7. China invites the Panel to ignore the ordinary meaning of "commercial scale," as explicated by the United States, and instead substitute a concept that China has labeled "significant magnitude of activity" which is not consistent with the *Vienna Convention* customary rules. *First*, China's proposed interpretation is at odds with the ordinary meaning of "commercial scale". Its reads "commercial" out of Article 61, by essentially replacing "commercial" with "significant" and further, the word "scale" means a "*certain* extent or magnitude," not a "*significant* extent or magnitude". While China claims that its proposed meaning derives from "common usage" and from "statements of the TRIPS negotiating parties," China provides no evidence that the Uruguay Round negotiations distilled any sort of prevailing understanding of "commercial scale" from the unrelated sources cited by China. These isolated references are clearly insufficient to constitute any sort of "common usage". In these other sources, where "commercial scale" is used in the context of "production" or "manufacturing" there is no suggestion that "commercial scale" would not apply to other acts – for example, retail sale. Further, Article 61 does not contain references to "manufacturing" or "production" – it refers instead simply to "counterfeiting" and "piracy".

8. China's reliance on a 1988 WIPO Committee of Experts on Counterfeiting and Piracy document and accompanying discussions does not provide support for its proposed interpretation of Article 61 on numerous grounds. First, it is unclear what status this document has under the *Vienna Convention* – as China has not argued that it should be taken into account pursuant to Article 31 or Article 32 of the *Vienna Convention*. In fact, this WIPO document does not constitute an appropriate "supplementary means of interpretation" within the scope of Article 32 of the *Vienna Convention* for many reasons. The WIPO Committee proceedings were independent of the TRIPS negotiations, there was no consensus on the document, and the WIPO Committee of Experts (much less the country members of WIPO) did not adopt the document China has cited.

9. Even assuming that the document could be considered as a "supplementary means of interpretation," the normal application of the *Vienna Convention* principles to the term "commercial scale" does not leave its meaning "ambiguous or obscure" or leads to "manifestly absurd or unreasonable results". Therefore, it could only be properly used to confirm an interpretation reached by means of the rules in Article 31 of the *Vienna Convention*.

10. In this context, the WIPO document serves to confirm the US interpretation, as it underscores the US view that the scope of commercial scale cannot be reduced merely to a value or volume metric. Instead, a variety of open-ended factors would need to be taken into account: including the "circumstances" surrounding the manufacture, as well as "the will to make a profit" and the way that the goods "are intended to be used," in addition to the "quantity of goods". China's rigid and high numerical thresholds is far from these open-ended set of factors. The United States, supported by a number of third parties, believes that a range of quantitative and qualitative factors should be taken into account to ensure that all "commercial scale" activities are subject to this discipline.

11. Furthermore, the WIPO Committee's "definition" of "commercial scale" did not form the basis of the negotiations on TRIPS Article 61. There was no "definition" adopted by the WIPO Committee; and even though China is correct that the WIPO Committee's Model Provisions were brought to the attention of the TRIPS negotiation participants, the particular concept of "on a commercial scale" in Article 61 emerged in the TRIPS negotiations. The focus of the initial discussions cited by China differs sharply from the context in which the term "commercial scale" ultimately was used by the TRIPS negotiators, i.e., to define which acts of trademark counterfeiting and copyright piracy must be subject to criminal procedures and penalties.

12. China also fails in its attempt to use the WIPO document as support for its efforts to limit the scope of Article 61 to only "larger-scale" activities such as the manufacture of infringing goods. Nothing in the ordinary meaning of "commercial" implies that it is limited to the industrial context. Had the TRIPS negotiators intended the obligations to apply only to industrial-level production, they presumably would have used the term "industrial scale" and not commercial scale. In any event, the reference to "manufacturing on a commercial scale" was not included in the final text of Article 61. The omission of "manufacture"—where it was present in the WIPO document—tends to confirm that other commercial activity, such as retailing and wholesaling, is included in the meaning of "on a commercial scale" in Article 61. Furthermore, the document also provides that retail sale can also be an act of counterfeiting or piracy, referring back to the principles in the manufacturing section to incorporate the concept of "commercial scale" into the retail context.

13. The WIPO Committee discussions also do not provide support for China's proposed interpretation of "commercial scale" as "broad and flexible standard". China's arguments is misplaced to the extent that China is claiming that this discussion demonstrates a consensus for variable meaning to this term as used in Article 61, or provides a basis for China not to comply with the obligation in that Article. The meaning of this term in Article 61 is clear and its application is uniform across all WTO Members.

14. *Second*, China's purported context for interpreting Article 61 is also unavailing. China's argument that Articles 1.1 and 41.5 allow China to define for itself the obligations of Article 61 is contrary to plain text of these provisions. First, as made clear by the text of the final sentence, Article 1.1 deals with the *method* by which a Member implements TRIPS Agreement obligations, not *whether or to what extent* a Member should implement them in the first place. While during the TRIPS negotiations, WTO Members expressed diverse views on various draft provisions of the TRIPS Agreement, the negotiators coalesced around the final text of the TRIPS Agreement. The first sentence of Article 1.1 states that Members shall "give effect to these provisions" and therefore because Article 1.1 does not alter the obligations in Article 61, China must implement Article 61 in a manner that reflects its terms.

15. Likewise, Article 41.5 deals with the implementation of a Member's Part III enforcement obligations, not the substance of the obligations themselves. The thrust of the second sentence of Article 41.5 concerns the distribution of enforcement resources between the enforcement of the law in general and the enforcement of intellectual property rights. Article 41.5 does not provide an exception or affect the scope of the substantive obligations of Article 61. The United States is not arguing that China should alter how China enforces its laws in general; rather, the United States argues that China's criminal thresholds fall short of the minimum standards in Article 61.

16. Whether China chooses to actually prosecute relatively smaller cases of wilful trademark counterfeiting or copyright piracy "on a commercial scale" is not at issue in this dispute. Consequently, the level of resources China chooses to dedicate to such prosecution is, from the perspective of the legal claims in this dispute, beside the point.

17. China's other contextual arguments for "commercial scale" are similarly unavailing. China's arguments that the TRIPS Agreement and Berne Convention "do not set forth a definition of infringement" are simply beside the point because the United States does not claim in this dispute that, leaving aside the thresholds, there are substantive types or categories of acts constituting "wilful trademark counterfeiting or copyright piracy" (as those terms are used in Article 61) for which China has failed to make criminal procedures and penalties available under Articles 213, 214, 215, 217, and 218. Rather, it is that China does not make them available for all acts of "wilful trademark counterfeiting or copyright piracy" that are "on a commercial scale".

18. Furthermore, China's accusation that the US is "impos[ing] a fixed, concrete international standard" of "commercial scale" is also misplaced. Establishing an obligation concerning the minimum enforcement provisions of WTO Members must have in place is precisely what the TRIPS Agreement does. Additionally, China's assertions that Article 61 lacks "specificity" gain China no ground. No amount of comparison to other provisions in the TRIPS Agreement and other WTO Agreements assist China in escaping the requirements of Article 61.

19. *Third*, China's claims regarding the object and purpose of the TRIPS Agreement are unavailing. A fair reading of the Preamble does not support China's position. Moreover, giving meaning to Part III of the TRIPS Agreement, including Article 61, is not "harmonizing" legal systems. China is free to provide an enforcement regime consistent with, for example, systems in effect in countries of the "civil law" traditions.

20. *Fourth*, China's resort to the subsequent actions of Members provisions do not provide any evidence of "subsequent practice in the application of the treaty" under Article 31(3) of the *Vienna Convention* establishing any agreement by WTO Members regarding the interpretation of Article 61. The provisions of US free trade agreements are not relevant to this Panel's interpretation of the covered agreement, i.e., the TRIPS Agreement. Similarly, China fails in its attempts to claim that practices by certain third parties to the dispute are some type of "subsequent practice" within the meaning of the *Vienna Convention*. These claims are refuted by those third parties.

21. *Fifth*, China also hints at the argument that "commercial scale" might have a special meaning provided for under Article 31(4) of the *Vienna Convention*. However, there is no evidence, either in the Chinese submissions or elsewhere, of a "special meaning" for "commercial scale".

22. *Sixth*, China's reliance on the negotiating history of the TRIPS Agreement is also unavailing. For the reasons stated above, China's claims that the negotiating record of the TRIPS Agreement provides confirmation for its view of the "commercial scale" standard ("counterfeiting and piracy of a significant scale") is incorrect and supports the US position.

23. Finally, China's arguments that deference to its criminal law should also be disregarded. China's arguments amount to an invitation to the Panel to abandon the treaty interpretation principles that WTO Members have agreed shall govern this Panel's work. These arguments regarding the special nature of criminal law have no bearing on the core question: whether China has fulfilled its obligations under Article 61. When China became a WTO Member, it also agreed to ensure that its criminal laws against piracy and counterfeiting meet the standards in the TRIPS Agreement. Furthermore, while China urges the Panel to take into account "*in dubio mitius*," in this case, there is no need to rely on this concept, as the meaning of "commercial scale" is reached through the general rules of interpretation reflected in Article 31 of the *Vienna Convention*.

B. CONTRARY TO ARTICLE 61, CHINA'S MEASURES FAIL TO PROVIDE CRIMINAL PROCEDURES AND PENALTIES FOR WILFUL TRADEMARK COUNTERFEITING AND COPYRIGHT PIRACY ON A COMMERCIAL SCALE

24. China's criminal thresholds create a safe harbor, preventing criminal procedures and penalties from being available for all instances of commercial scale counterfeiting and piracy. Instead of denying this core safe harbor problem, China attempts to disagree with the *degree* but not the *reality* of the inconsistency. The first fundamental problem with China's thresholds is that they do not permit prosecution or conviction of infringing activity involving values or volumes below the thresholds but that are still "on a commercial scale". At no point does China claim that criminal prosecution or conviction under Articles 213, 214, 215, 217, and 218 is possible for any trademark counterfeiting or copyright piracy below the thresholds themselves. Indeed, China does not rebut the core issue raised

by the US with respect to the Article 61 claim: that if a case fails to meet at least one of the thresholds, that fact will preclude criminal prosecution and conviction.

25. China takes a different tack: it attempts to whittle away at the size of the safe harbor. First, China seizes on certain US explanations regarding the nature of the thresholds and attempts to show that "commercial scale" activity can be captured in some circumstances. However, the application of *any or all* of the alternative thresholds still leaves much commercial-scale piracy and counterfeiting immune from criminal prosecution or conviction. Furthermore, China concedes that in calculating certain thresholds the price of the legitimate good is used by courts only as a last option. This valuation methodology exacerbates the safe harbor problem by creating a larger safe harbor than would exist if China used a methodology based on the prices of legitimate goods.

26. Second, China takes issue with the US characterization of the operation of the thresholds and mistakenly appears to argue that the provisions concerning the calculation of the thresholds under the measures at issue should not be subject to scrutiny under Article 61. What China calls "evidentiary" standards are, in fact, relevant to whether China meets the Article 61 obligation: they cause "criminal procedures" and "criminal penalties" not to be "applied" in some cases of wilful trademark counterfeiting and copyright piracy. Indeed, China's thresholds provide a substantial safe harbor *capable* of sheltering commercial operations, thus inviting counterfeiters and pirates to structure their commercial operations in a way take advantage from the thresholds.

27. China's arguments about the operation of the thresholds, including that the thresholds can be calculated over a prolonged period of time and can count goods in other warehouses, likewise do not overcome the US case. First, Article 12 of the December 2004 JI makes clear that the values of "illegal business volume," "illegal gains" and "amount of sales" can only be cumulated if engaging in such acts has not resulted in the imposition of an administrative penalty or criminal punishment. China admits that the imposition of administrative penalties is often its preferred remedy. Second, the "illegal business operation" threshold is structured so as to exclude many cases of "commercial scale" piracy and counterfeiting – regardless of whether goods at other warehouses or in transportation can be counted.

28. The second set of problems with respect to China's thresholds stems from the fact that Chinese authorities must rely on a very limited set of one-size-fits-all numerical tests. A range of considerations should be probative of "commercial scale," but China's rigid criminal thresholds preclude their use; the thresholds fail to reach some classes of commercial-scale piracy and counterfeiting not only because of their magnitude, but also because of what they do – and do not – measure. The thresholds do not measure reliable indicia of a commercial-scale piracy or counterfeiting operation, such as "worn molds" for pressing pirated products or counterfeit marks or other materials and implements of such an operation.

29. China argues around the issue of whether its thresholds can reach beyond the metrics of "illegal business volume," "illegal gains," "amount of sales," or "copies" to capture cases of commercial-scale piracy and counterfeiting that are probative of "commercial scale" but do not neatly fit under these categories. First, while China claims that criminal measures are available for the crimes of attempt and preparation, this does not address the concerns of the United States. Worn molds and similar reliable evidence would be evidence of a completed crime; that is, the worn mold supports the conclusion that commercial-scale infringement *already has* occurred. Attempt and preparation are "inchoate" or uncompleted crimes and despite the probative value of this evidence for proving a particular completed crime, evidence such as worn molds, which are implements used to commit the crime, unfinished products and non-infringing packaging is not cognizable under the metrics of China's thresholds.

30. But even if certain near-finished products can be counted against the thresholds in some cases, China's arguments still miss the point. Its thresholds will still exclude commercial-scale piracy and counterfeiting. For example, 499 unfinished copies of a video game not yet bearing an infringing trademark still qualify as evidence of a "commercial scale" operation, just as much as 499 finished video games bearing such a trademark. Further, contrary to China's assertion, the cases included in China's first written submission that involved conviction under the crime of "attempt" only involved convictions based on "unsold" but finished products and did not involve a situation where unfinished products or non-infringing packaging were used by the court for that conviction. Additionally, the cases that China claims counted "unfinished" goods do not assist China: the reasoning in the first case, involving washing powder, is quite confused, and the case appears to be an outlier and the second case involving game cartridges, is inapposite, and the case did not involve the Article 213 thresholds established by the December 2004 JI.

31. China also does not rebut the conclusions reached in the CCA Report on actual enforcement efforts. Rather, China argues that the "statistical trends" from the data are not meaningful and that "the US has failed to present the correct conclusions from the data." Contrary to China's assertions, the United States does not advance any predictive theories from the CCA Report. The CCA Report is a compelling empirical study that pulls together raw data from actual conduct that occurred in the past. The conclusions are plain to see: the vast majority of traditional retail outlets selling recorded music and/or home video products – a classic example of commercial scale activity – faced no possibility of criminal prosecution or conviction under China's criminal thresholds.

32. China's attempts to cast doubt on the conclusions from the empirical study are unpersuasive. Rather than focus on the below-the-thresholds data at the heart of this dispute, China instead focuses on trying to construct a US "hypothesis" based on activity happening above the thresholds – activity which is by definition criminalized and not the subject of this dispute. Moreover, China's argument that there is no "dramatic shift" in infringing activity between the two time periods simply misses the point. Despite the lower 500 copy threshold that was in effect during the second time period, piracy and counterfeiting continued to flourish in the safe harbor below the thresholds.

33. China's criticism of other US exhibits, such as articles in newspapers and magazines that illustrate the safe harbor problem is puzzling, as when the United States attempted to obtain information from China pursuant to TRIPS Article 63.3, China declined to provide information but stated that relevant information was publicly available through official websites, newspapers, magazines, and other proper channels.

34. Based on its flawed interpretation of Article 61, China attempts to justify its TRIPS-inconsistent regime and asserts that it has "imposed criminal penalties for wilful infringement that involves a *significant magnitude of activity*" (its erroneous interpretation, emphasis added) that is (a) appropriate within the legal structures of China, and (b) appropriate within the commercial context of China. These arguments are without merit.

35. *First*, whether China's criminal IPR thresholds are appropriate within the context of China's domestic law is irrelevant. What China chooses to do with its domestic *non-IPR* criminal thresholds has no bearing on this Panel's assessment of whether China meets its international obligations under the first sentence of *Article 61 of the TRIPS Agreement*. China appears to confuse its ability to determine what constitutes a "commercial crime" in its domestic law with its obligation to comply with the first sentence of TRIPS Article 61. In this dispute, the United States is seeking to ensure that a criminal law regime is in place where Article 61 requires China to have one (and where China, at the moment, does not).

36. *Second*, China's arguments that its thresholds are reasonable "in terms of the scale of commerce in China" fail to withstand scrutiny. China neither explains nor justifies how the

boundaries of criminal liability that China has chosen in fact capture all counterfeiting and piracy that is "on a commercial scale" under Article 61. China's thresholds are not appropriate to the scale of commerce in China, as they miss many types of "commercial scale" activity and offer one size for all cases; they do not accommodate the realities of the marketplace. Further China's statistics regarding the purported reasonableness of its "illegal business operation" threshold concedes that there is some "commerce" that falls below the thresholds and they do not shed any real light on the scope and scale of commerce in China.

37. The inappropriateness of China's thresholds is borne out by other illustrations including Canada's citation to China's estimated per capita gross domestic product. It is clear that "commercial scale" counterfeiting and piracy is not limited to large-scale or industrial-scale enterprises – on the contrary, the growth of the Internet and digital technological advancements permit commercial-scale piracy and counterfeiting to occur with a computer in a small space. While China also argues that it does not have an obligation to consider the "commercial impact of the intellectual property infringement when setting its thresholds," advances in digital technology and the Internet, among other market conditions, enable piracy and counterfeiting to take place in situations that escape the reach of China's thresholds, even though they can have a large (and commercial) impact and are on a large (and commercial) scale.

38. China's other arguments regarding the implementation of Article 61 are unavailing. First, China's arguments regarding the ability of private parties to bring prosecution of certain criminal acts are of little relevance to the Panel's consideration of whether China's criminal thresholds are consistent with China's obligations under Article 61. China's assertion that lowering its thresholds "could unleash a large volume of private enforcement actions" is unsubstantiated. Second, China's administrative enforcement regime has no bearing on whether China meets the obligations of the first sentence of Article 61. Part III of the TRIPS Agreement deals with a number of enforcement procedures. Section 2 pertains to "Civil and Administrative" procedures and Section 5, where Article 61 can be found, pertains to "Criminal" procedures. It is notable that Article 61 is the only provision that focuses on criminal penalties and procedures. Conversely, that also means that only criminal penalties and procedures can fulfill the obligations in Article 61.

C. CHINA'S CRIMINAL IPR THRESHOLDS ARE ALSO INCONSISTENT WITH ARTICLE 61, SECOND SENTENCE AND ARTICLE 41.1 OF THE TRIPS AGREEMENT

39. The United States has also demonstrated why China's criminal IPR thresholds are also inconsistent with the second sentence of Article 61 and Article 41.1. China acknowledges that if the Panel finds that China's criminal IPR thresholds are inconsistent with the first sentence of Article 61, it must also find an inconsistency with the second sentence of Article 61 and with Article 41.1.

III. CHINA'S MEASURES FOR DISPOSING OF CONFISCATED GOODS THAT INFRINGE INTELLECTUAL PROPERTY RIGHTS ARE INCONSISTENT WITH CHINA'S OBLIGATIONS UNDER ARTICLE 59 OF THE TRIPS AGREEMENT

A. ARTICLE 59 OF THE TRIPS AGREEMENT

40. Article 59 provides in pertinent part that the "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." For the purposes of this dispute, the relevant authority needed under Article 59 is detailed in two sentences in Article 46. Read together, Article 46 and Article 59 require, first, that a Member's competent authorities for border enforcement "shall have the authority to order that goods that they have found to be infringing be 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." Second, "[i]n 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."

41. China advances a number of arguments that would minimize China's obligations under Articles 46 and 59. These arguments are without merit. *First*, China's arguments that Article 59 does not require that Members provide a broad grant of authority to agencies and that China's regime simply "stipulates conditions and sequencing for its exercise by domestic agencies" are unavailing. Article 59 plainly requires full authority to be granted to dispose of or destroy confiscated infringing goods in accordance with the principles of Article 46. The broad scope of Article 59 authority regarding infringing goods confiscated by border authorities is clear from the absence of any restrictions on this authority in Article 46. China Customs should have the *power* to choose among any legitimate options for dealing with these goods – in accordance with the principles of Article 46 – from the outset when the goods are found to be infringing, and thereafter until the goods are finally dealt with.

42. China's attempts to use TRIPS Article 1.1 to argue for the acceptability of its rigidly constrained disposal regime are unavailing as Article 1.1 does not exempt China from complying with these provisions of the TRIPS Agreement. China's references to other Members' copyright and trademark laws are similarly misplaced as this dispute concerns China's measures, not other Members' laws, and further, substantively, these laws do not resemble in any respect the problematic disposal hierarchy used by China.

43. *Second*, China also points to China Customs statistics showing the disposition of confiscated goods found to be infringing. Those figures, however, provide no response to the US claim; the United States is not arguing that the TRIPS Agreement obligations *require* China to destroy or dispose of all such goods in accordance with the relevant principles of Article 46.

44. *Third*, China's argument that the Article 46 principle to "avoid any harm caused to the right holder" only obliges China to "pay due regard to potential harms to the right-holder and to refrain from disposition methods that consistently or significantly harm the right-holder's interests" is contrary to the meaning of the provision. The obligation is not to "pay due regard" to the interests of a right holder and to tolerate intermittent or "non-significant" harm. The standard requires avoiding any harm to the right holder. Indeed, the definition China itself cites for the word "avoid" is "to keep away or refrain from; *prevent from doing or happening*."

45. *Fourth*, China's argument that the final sentence of Article 46 is not incorporated into Article 59 is at odds with the text of Article 59. There is no limiting language in Article 59 that would selectively incorporate only the obligations in the first sentence of Article 46. If the negotiators of the TRIPS Agreement had intended to carve out specific obligations in Article 46 from being transposed to Article 59, they would have done so.

46. Additionally, China's claim the principle in the last sentence of Article 46 only means that the "removal of the trademark is not sufficient" to permit this release is contrary to the language of Article 46, last sentence. China misreads the relationship between the phrases "removal of the trademark unlawfully affixed shall not be sufficient" and "exceptional cases". The phrase "other than in exceptional cases" means that only in exceptional cases may the competent authorities "permit release of the goods into the channels of commerce." Moreover, while China further claims that it complies with the purpose behind this principle, since China Customs removes all infringing features from the goods and takes other steps, the TRIPS Agreement does not provide for Members to only comply with what they identify to be a "purpose" behind a provision.

B. CONTRARY TO ARTICLE 59, CHINA'S CUSTOMS AUTHORITIES DO NOT HAVE THE AUTHORITY TO ORDER THE DESTRUCTION OR DISPOSAL OF INFRINGING GOODS IN ACCORDANCE WITH THE PRINCIPLES SET OUT IN ARTICLE 46

47. Article 30 of the Customs IPR Implementing Measures, which implements Article 27 of the State Council Customs IPR Regulation and binds Customs officials across China, sets out a compulsory sequence of steps that Chinese Customs must follow in deciding how to treat goods seized at the border that it has determined infringe intellectual property rights. While China claims that its Customs authorities have the "discretion" not to follow the prescribed steps in the hierarchy, the essential point in the US claim is that in circumstances where Customs makes a certain determination under its measures, it is compelled to follow the option set forth in the hierarchy. And in those circumstances, China Customs lacks the authority that the TRIPS Agreement requires to opt for destruction or disposal in accordance with Article 46 principles.

48. China also asserts that its rigid disposal regime somehow does not strictly constrain Customs officials' scope of action, because other generally applicable Chinese laws regarding such matters as safety also govern Customs authorities' decision making. However, in response to panel questions, China specifically concedes that Chinese Customs officials must make particular findings under its disposal regime, and once they have made them, they have no discretion as to their acts.

49. Neither alternative in the initial step of China's mandatory hierarchy – donation or sale to the right holder – meets the principles of Article 46. China Customs' donation of infringing goods to "public welfare organizations" under the measures at issue does not provide Customs with the authority to dispose of the confiscated goods "outside of the channels of commerce in such a manner as to avoid any harm caused to the right holder." First, while China claims that its Customs authorities only donate goods suitable for public welfare purposes, these standards would not prevent donation of usable but likely lower-quality counterfeit or pirated products that would be used by potential consumers of the genuine article and also could harm the right holder's reputation. Accordingly, the donation option in China's measures is inconsistent with the Article 46 principle concerning harm to the right holder.

50. Second, while China states its legal obligation to supervise the use of the donated goods ensures that they will not return to commerce, Article 17 of the Law on Donations specifically authorizes public welfare organizations to sell donated goods on the market if certain circumstances are present. While the Red Cross Memorandum does contain a provision obligating the Red Cross to "take effective measures ... entering into the channels of commerce," at the same time, the Law on Donations makes clear that donee organizations are not required to enter into these kinds of agreements, and when no agreement is in place, Chinese authorities have offered no legal argument that they can override the provisions of Article 17. Accordingly, for that reason, China is not meeting its obligations under Articles 59 and 46.

51. While China points to Article 18 of the Law on Donations in an attempt to dismiss the relevance of Article 17, selling the goods under Article 17 and ensuring the resulting funds continue to be put to the "use" prescribed in the donation agreement appears, on its face, to be an action consistent with the mandates of Article 18. Likewise, a general contractual commitment such as in the Red Cross Memorandum would not override rights provided under a national law.

52. Furthermore, China's claim that Article 30 of the Customs IPR Implementing Measures renders the resale option under Article 17 of the Law on Donations "null" is unavailing. Article 30 governs Customs' donations to a public welfare organization and Article 17 governs the donees' disposal of such goods after the donation, when the circumstances presented in Article 17 arise.

53. The second option at the initial step in China's disposal hierarchy, which allows Customs to sell the infringing goods to the right holder, does not permit disposal "in such a manner as to avoid any harm caused to the right holder," as Article 46 requires. In situations where donation is not appropriate, China's measures require Chinese authorities to offer the infringing goods for sale to the right holder. If right holders pay for infringing goods to ensure that they are destroyed or removed from the channels of commerce (such as, for example, by public auction), financial harm will result in the form of the payment. While China argues that the required efforts to sell infringing product to the right holder advance right holder's interests, this argument is without merit. It requires the untenable assumption that right holders are eager to buy extra product they have not ordered and whose production is outside the terms of their contract.

54. Where the transfer to a public welfare organization is unavailable, and the right holder does not elect to purchase the infringing goods, the Customs authorities must turn to the next compulsory step involving the public auction of the confiscated goods. China's public auction process for these goods likewise does not comport with the Article 46 principles incorporated into Article 59.

55. Because China's mandatory procedures strip Customs of the authority to prevent auction when this option becomes operative in the Customs hierarchy, the procedures are inconsistent with the first sentence of Article 46. A mandated auction under China's measures also precludes Customs from having the authority to destroy these products. While China argues that Article 59 does not obligate China to limit its customs agencies to disposal outside the channels of commerce, the US claim concerns the scope of authority under Article 59. Because China's mandatory public auction procedure does not permit China Customs to act in accordance with the Article 46 principles, it is inconsistent with China's obligations under the TRIPS Agreement.

56. China's arguments regarding how its public auction procedure avoids harm to the right holder should be disregarded. A public auction can cause great harm to the right holder, since the infringer whose goods have been confiscated can simply purchase the seized goods at the auction, re-affix the infringing features, and proceed to distribute the goods. While China focuses on the impact on the infringer, the Article 46 principle at issue concerns avoiding any harm to the right holder, not assessing the status of the infringer. Moreover, a right holder's ability to "comment" on China's measures is not a right to *prevent* the goods from being auctioned, and is not a means to ensure that the authorities act in a manner that avoids any harm to a right holder. Additionally, even if some "safety" concerns will prevent a public auction, in the many cases where the infringing features can be eliminated and the goods do not pose safety concerns, the measures mandate public auction – and thus, entry into the channels of commerce.

57. Further, with respect to counterfeit trademark goods, China's public auction step is also inconsistent with the principle in the last sentence of Article 46. Simply put, China does not confine its release of these goods into the channels of commerce to exceptional cases. China's focus on actions such as reserve prices and comments from the right holder are misplaced: the problem is that China's measures compel public auction if the infringing features of the products can be eliminated, assuming no safety defects.

58. In the final step of the mandatory hierarchy, if no earlier options prove feasible, then and only then, China Customs gains the power to destroy the infringing goods. In other words, this step will not be reached if any of the options higher in priority are available. In these situations, Chinese customs authorities are not, as a matter of Chinese law, authorized to destroy the infringing good (or otherwise dispose of the good in a way that is both outside of the channels of commerce and handled in a manner that avoids any harm to the right holder).

59. China does not deny that China Customs only possesses the authority to destroy the goods when the other options in its disposal hierarchy (i.e., donation, sale to the right holder, public auction)

are not available. Indeed, the cases China cites where China Customs destroyed infringing goods do not contradict the mandatory nature of the Customs disposal hierarchy. The text of China's Customs IPR Implementing Measures state that when certain facts are present, Customs officials have no discretion, i.e., they must dispose of the goods only in the manner stipulated. In each of those circumstances, Chinese customs authorities lack the authority, as a matter of Chinese law, to order the destruction of infringing goods.

IV. CHINA'S DENIAL OF COPYRIGHT PROTECTION AND ENFORCEMENT TO CERTAIN WORKS IS INCONSISTENT WITH THE TRIPS AGREEMENT

60. In its submissions, China admits that it denies copyright protection to certain works whose contents Chinese authorities determine are prohibited by law. Moreover, the National Copyright Administration of China (NCAC) has confirmed that Article 4 denies copyright protection to "works whose contents are illegal." Therefore, contrary to China's obligations under TRIPS Article 9.1 (and the provisions of the Berne Convention referenced in Article 9.1), Article 4.1 on its face denies copyright protection to works that are required to be afforded protection.

61. *First*, Article 4 of the Copyright Law excludes from copyright protection an entire category of works – "works the publication or distribution of which is prohibited by law" – but that exclusion from protection is not permitted by the Berne Convention. Pursuant to Berne Convention Article 2(1) and Article 2(6), China's Article 4.1 blanket exclusion for certain works is inconsistent with the Berne Convention as incorporated into the TRIPS Agreement.

62. While China asserts that under Article 2 of the Copyright Law, Chinese law "protects copyright from the time a work is created" as "copyright vests upon creation," China concedes that Article 4.1 denies protection to certain works. Thus, China already admits that *some* subject matter does not receive protection at all since it is denied such protection as a matter of law. While courts and/or competent authorities may *confirm* what is illegal after the fact, such confirmation is not a prerequisite for concluding as a legal matter that content is not protected by copyright. Additionally, Article 2 of the Copyright Law cannot, by the terms of Article 4, apply to certain works. The Berne Convention (or the TRIPS Agreement) does not permit copyright to be extended initially, but then rescinded for the reasons stated in Article 4.

63. *Second*, because Article 4 denies copyright protection to certain works, the exclusive rights enumerated in Article 10 of China's Copyright Law, and all the protections of the law, are also denied to such works. As a result, Article 4 of the Copyright Law does not comply with the requirements of Berne Article 5(1), which specifies certain guaranteed minimum copyright protection for works, including a minimum set of exclusive rights.

64. China's attempts to distinguish "copyright" and "copyright protection" are unavailing. The relevant provisions of the Berne Convention provide that China has obligations with respect to "protection" of copyright, thus, the existence of what China calls "Article 2 copyright" – whatever that could mean in the absence of protection under China's Copyright Law – is not relevant to the analysis of whether Berne Convention-mandated "protection" is afforded.

65. China's arguments regarding the limited "marketplace effect" of Article 4.1 should be disregarded, as the denial of copyright protection in China has significant real-world impact, including commercial uncertainty for right holders and permitting copyright pirates to profit at the expense of the legitimate rightholder. Furthermore, if right holders cannot enforce their copyright against pirated products manufactured in China, then this deprives them of a critical mechanism for preventing the export of such products.

66. *Third*, the United States has also demonstrated in its first submission that first sentence of Article 4 makes copyright protection subject to a formality that is inconsistent with Berne Article 5(2), and therefore also inconsistent with TRIPS Article 9.1.

67. China's submissions do not address the US concerns that the impact of content review on copyright protection constitutes a "formality" under Article 5(2). First, while China asserts that copyright protection and content review are separate and that the effect of a content review process does not deny copyright, this is contradicted by China's own statements. China acknowledges that it maintains pre-publication review with respect to the publication and distribution of certain kinds of works including films and audiovisual products and admits that in certain cases, it does not permit publication until content has been approved. China's own admissions related to the content review regulations confirm that works that have been found to contain such prohibited content would clearly come under the ambit of Article 4.1, as they are "unconstitutional". Therefore, by analogy, where pre-publication review is required and publication is prohibited until the completion of a successful review, Article 4 denies copyright to such works. This means that copyright protection is subject to the results of that review – i.e., to a formality.

68. Second, China's arguments regarding the alleged separation between the content review authorities and NCAC do not accord with the fact that Article 4 of the Copyright Law refers to other laws and regulations in China that prohibit the publication or distribution of works. First, China's current position does not sit well with the position that China expressed to WTO Members *before* having to respond in this dispute: during the 2002 WTO Review of Legislation in the TRIPS Council, China explained that the copyright denial in Article 4 is the result of prohibitions in other laws, not a separate assessment by NCAC. Second, prominent Chinese copyright scholars writing at the time of the adoption of Article 4 have confirmed that the intended purpose of promulgating Article 4.1 was to deny copyright protection to works for which the publication or distribution of which are prohibited by other laws.

69. Third, the power to interpret Chinese law rests with the Standing Committee of the National People's Congress. Because the NCAC does not have delegated authority by the Standing Committee, its actions do not represent a definitive interpretation of Article 4, at least with respect to China's TRIPS obligations to afford civil and criminal remedies for copyright infringements heard by the courts and procuratorate.

70. Moreover, China's discussion of a NCAC reply in the *Zheng Haijin* case fails to show that the content review process is separate from copyright in the work. The guidance issued by China's Supreme People's Court (SPC) in this case appears to demonstrate that the SPC considered that copyright protection was contingent on the work's successful completion of content review. China's answer to the Panel's question regarding this SPC guidance document, however, is confusing. First, China's response acknowledges that, in the *Zheng Haijin* case, the SPC "endorsed the finding that there was no basis to deny the protection of the copyright law to the work." If China is stating that the SPC was endorsing a "finding" of the *content review* authority with respect to the *copyright law*, then that confirms the US view.

71. However, if China is suggesting that the SPC was merely endorsing a lower court's finding, then that suggestion sits very uneasily with what the SPC actually said. The SPC states that "*therefore*" (i.e., for those reasons stated in the document) the lower court's protection of copyright was correct. The United Front Department's review and approval were indispensable to the court's opinion. Additionally, China's assertion in its answer that the "not yet been approved for publication" defense would fail is unsupported by the *Zheng Haijin* case, as the case demonstrates that, even where book numbers rather than content are at issue, courts examine the content of a publication before deciding whether or not copyright is protected.

72. China claims that Article 4 "would not remove the "residual copyright under Article 2," but rather, would "deny the particularized rights of private copyright enforcement" to works that are determined to be prohibited by law. However, Berne Article 5(2) states that both "the enjoyment and exercise of rights shall not be subject to any formality." Therefore, a content review that affects the exercise of an author's rights still would impose a "formality" under the Berne Convention.

73. *Fourth*, a consequence of the China's denial of copyright protection under Article 4 is that the provisions of Chapter V of China's Copyright Law are unavailable with respect to such works. Therefore, authors of such works do not benefit from the remedies specified in Articles 46 and 47 of this law which provide civil liability (and in some cases, administrative and/or criminal liability) for copyright infringement. Moreover, authors cannot take advantage of other remedies provided by Articles 48 and 49 of this law that, respectively, provide for monetary damages and the ability to seek a court order to stop an infringement that is being committed.

74. China is therefore not in compliance with its obligations under TRIPS Article 41.1 to ensure that enforcement procedures as specified in Part III of the TRIPS Agreement (including those provided by Articles 42, 44.1, and 45.1) are available to copyrighted works in order to permit effective action and expeditious remedies against copyright infringements. Furthermore, because criminal procedures under Article 47 of the Copyright Law are not available at all with respect to works whose distribution or publication in China is prohibited, no criminal procedures or remedies are available when piracy of those works occurs on a commercial scale. China is thus not meeting its obligations under TRIPS Article 61, first and second sentence.

75. Finally, Berne Article 17 does not authorize a content review system that denies enforceable copyright protection (including denial of protection of the rights of reproduction, adaptation, etc.) to all works that have not been approved for publication or distribution. The United States challenges the TRIPS-inconsistent copyright consequences of Article 4.1. That is, the content review measures do not create the TRIPS-inconsistency; rather they provide one important basis for the Article 4.1 denial of copyright protection.

V. CONCLUSION

76. The United States respectfully requests the Panel to find that China's measures, as set out in the US panel request and discussed in the submissions of the United States, are inconsistent with China's obligations under the TRIPS Agreement. The United States further requests, pursuant to Article 19.1 of the DSU, that the Panel recommend that China bring its measures into conformity with the TRIPS Agreement.

ANNEX A-5

EXECUTIVE SUMMARY OF THE ORAL STATEMENT OF THE UNITED STATES
AT THE SECOND SUBSTANTIVE MEETING

I. CHINA'S CRIMINAL IPR THRESHOLDS FOR CRIMINAL PROCEDURES AND PENALTIES

1. The United States and a number of third parties have provided concrete illustrations of how China's thresholds permit wilful trademark counterfeiting and copyright piracy on a commercial scale to exist. The United States has faithfully used the customary rules of interpretation reflected in the *Vienna Convention* to explain the meaning of "commercial scale". First, by using the word "*scale*" in the term "commercial scale," the TRIPS Agreement makes clear that WTO Members must criminalize acts of infringement that reach a certain extent or magnitude. Second, in using the word "*commercial*" in the term "commercial scale," the TRIPS Agreement draws a link to the commercial marketplace – where business-minded IPR infringers take the fruits of their counterfeiting or piracy. Accordingly, an infringer seriously engaged in pursuing financial gain in the marketplace is *necessarily* acting on a "scale" that is "commercial," and therefore falls within the ordinary meaning of the term. However, the meaning of the term "commercial scale" does not depend on the intent of the infringer.

2. Could a single sale of an infringing product qualify as "commercial scale" under this interpretation? That is a question that China repeatedly raises. The answer is that it is possible, but – as the United States has consistently emphasized – it would depend on the circumstances, including consideration of relevant factors noted by the United States and third parties.

3. China invites the Panel to substitute a concept that China has labeled "significant magnitude of activity," but this ignores the ordinary meaning of the term. *First*, China now reveals that it believes "commercial scale" is a measure of "significant business activity." Of course, neither "scale" nor "commercial" leads to "significant". Further, use of the term "commercial scale" sets up a contrast between "commercial" and "non-commercial" magnitudes of activity. And so the question is what is "non-commercial" scale, not what qualifies as "significant commercial-scale activity."

4. China provides no evidence that the Uruguay Round negotiators distilled a prevailing understanding of "commercial scale" from the unrelated sources cited by China; they are not "common usage" and are not a "special meaning" under the *Vienna Convention*. China also no longer asks this Panel to incorporate the definitions in the draft model provisions prepared by the WIPO International Bureau into Article 61. In our view, China should not be permitted to selectively refer to one aspect of that WIPO document – the mention of manufacturing – and then ignore the rest of the concept. (In that context, China now recognizes that "commercial scale" can be met by retail sales.) The document can *at most* be considered as a supplemental means of interpretation under the customary rules of interpretation; and when so considered, the document confirms the US interpretation.

5. *Second*, China's efforts to persuade the Panel that "commercial scale" is a "broad and flexible" standard is fundamentally unsound. Article 61 must be interpreted in accordance with the customary rules of treaty interpretation; those rules do not divide treaty provisions into categories such as "broad" and "narrow". Moreover, nothing about the ordinary meaning of the term "commercial scale" leads to ambiguous interpretations. Any variation in third party views does not mean that "commercial scale" is susceptible to interpretations other than the US interpretation. Indeed, many third parties have expressed views consistent with the United States – and noting that it may be

necessary to consider multiple factors to decide whether a particular infringement is "on a commercial scale" in no way creates ambiguity or conflicts with the US views.

6. *Third*, China now agrees that Article 1.1 and Article 41.5 do not allow WTO Members to ignore explicit TRIPS obligations. Moreover, the second sentence of Article 61 does not change how the first sentence should be interpreted; it only addresses the relative severity of the criminal remedies that must be available, whereas the first sentence addresses the floor ("on a commercial scale") of what must be criminalized in the first place. *Fourth*, while China claims that criminal penalties must be actually applied to fulfill the first sentence of Article 61, US practice is not at issue in this dispute, nor does it constitute "subsequent practice" in the application of the TRIPS Agreement by WTO Members. Similarly, whether or not China chooses to actually prosecute relatively smaller cases of wilful trademark counterfeiting or copyright piracy "on a commercial scale" is not at issue here.

7. *Fifth*, China also continues to seek special deference because of its non-common law legal system, but this tack should not be countenanced. China is free to provide an IPR enforcement regime consistent with, for example, systems in effect in countries with a civil law tradition. China also repeatedly mis-states the basis for *in dubio mitius* in its second submission. In fact, the Appellate Body has found that *in dubio mitius* applies when the meaning is "ambiguous," and in this case there is no need to rely on this concept.

8. Even under China's mistaken interpretation of "commercial scale," China's regime would still have to be considered inconsistent with its obligations under the TRIPS Agreement. For example, while China claims that the RMB 50,000 "illegal business volume" threshold is less than 30% of the annual revenue of households engaged in retail trade, it is difficult to imagine four months of retail activity not being "significant" infringement activity.

9. China's thresholds are set at such a level, and structured in such a way, that they do not permit prosecution or conviction of infringing activity involving values or volumes that are below the thresholds but are still "on a commercial scale." At no point does China claim that criminal prosecution or conviction under Articles 213, 214, 215, 217, and 218 is possible for any trademark counterfeiting or copyright piracy below the thresholds. China does not rebut the core issue: if a case fails to meet at least one of the thresholds, that fact will preclude criminal prosecution and conviction. China essentially concedes the existence of a safe harbor for some commercial-scale counterfeiting and piracy, and instead only attempts to chip away at the size of it. China's new arguments are without merit.

10. *First*, even China cannot say that it reaches all of the examples of counterfeiting and piracy cited by the United States and others – the best that China can assert is that it reaches "most" of it. *Second*, the existence of China's valuation methodology as a component of its thresholds is fully relevant; it creates a safe harbor, whether it is based on the value of the infringing goods or the legitimate goods. By relying on prices of infringing products, China contributes greatly to the capacity of the safe harbor to shelter commercial-scale counterfeiting and piracy.

11. *Third*, while China asserts that its thresholds can cover an extended time-frame of infringement, to the extent that China's IPR regime requires not just commercial-scale activity, but *sustained* commercial scale activity, that additional requirement does not comport with Article 61. *Fourth*, China's claims that certain "general provisions" of its Criminal Law – namely inchoate crimes and joint liability – can establish criminal procedures and penalties are without merit. That "inchoate" crimes can be used to address evidence of *potential* infringement is beside the point. The inconsistency with Article 61 arises because China's thresholds rule out criminal liability based on evidence of *actual* infringement that does not meet the metrics; *i.e.*, some *actual* infringement is exempted. China's argument regarding "joint liability" is of no consequence with respect to infringers

who work alone. China's reference to the *Zhao Chaoying* case (Exhibit CHN-12) does not demonstrate that below-the-thresholds activity can be captured.

II. CHINA'S BORDER MEASURES FOR DISPOSAL OF CONFISCATED GOODS

12. The first sentence of Article 59 provides in pertinent part that the "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." For the purposes of this dispute, this requires focus on the first and fourth sentences in Article 46. China's Customs authorities do not have the authority to order the destruction or disposal of infringing goods in accordance with the Article 46 principles.

13. The United States has demonstrated the deficiencies in China's broad claims of compliance with Article 59 and Article 46. For example, the China Customs statistics do not demonstrate that Chinese officials are able to exercise full Article 46 authority in dealing with such goods. China also fails in arguing that the authority to take action in accordance with Article 46 can be "reasonably conditioned" and that China simply includes certain "factors for discretion" in its Customs disposal regime. Article 46 describes the required scope of authority both to dispose of goods and to destroy goods – and nowhere includes the many obstacles and conditions present in the Chinese legal regime.

14. China's view acting with a high "probability" that harm to the right holder will be avoided is enough does not accord with the text of Article 46. Authority to dispose of goods "in such a manner as to avoid any harm caused to the right holder" requires a structure and process that – as the text plainly states, actually "avoids any harm caused" – not that has *good prospects* for avoiding harm.

15. Further, China continues to pursue a number of arguments that misread the text of the last sentence of Article 46. *First*, while China claims that actions, such as reserve prices and comments from the right holder, qualify as more than the "simple removal" of the trademark, thus justifying its auctions under Article 46, the word "simple" in the phrase means what it says: Customs may not just remove the offending trademark from the goods and release such goods into the channels of commerce, *other than in exceptional cases*. (China concedes that, under its measures, in the case of counterfeit trademark goods, it only removes the infringing trademark.) *Second*, China's reading of the term "release" in the last sentence of Article 46 is contrary to the text of Article 46, which says release into "channels of commerce" – not "return of the goods to the infringer."

16. China concedes that when Customs finds certain facts are present, it is compelled to follow the particular step set forth in its measures. This is the core of the US concern. The flowchart (Exhibit US-68) illustrates that in each of the circumstances denoted with the word "yes," Customs lacks the required authority under the TRIPS Agreement. While China argues that the US needs to provide factual evidence of harm in the case of the donation option, our claim is based on the *legal structure* that governs Customs' decision-making. The lack of Customs' *authority* to make these donations in accordance with Article 46 principles is evidenced by the Law on Public Donations, which authorizes the sale into commerce of donated goods when certain conditions are present, and also the need for Customs to sign a donation agreement to avoid the sale of these goods.

17. Even with a donation agreement, sale into commerce appears to be possible. China's Contract Law indicates that when a contract contains a provision inconsistent with a Chinese law, the law prevails over that contract provision. China Customs' own regulations would not affect charitable organizations' rights under the Law on Donations to sell donated goods when circumstances change.

18. China's measures require Customs to move to the public auction step if the right holder does not pay for these goods (and donation is not appropriate). This will in fact have an impact on right holders' decisions about buying the infringing goods. If right holders pay for infringing goods, wishing to ensure that they are destroyed to prevent their auction, this payment causes financial harm.

19. Next, because China's mandatory procedures strip Customs of the authority to prevent auction when this option becomes operative in the Customs hierarchy, the auction procedures are inconsistent with the first sentence of Article 46. A public auction obviously is not destruction, and China does not dispute that it leads to release of such goods into the channels of commerce. While China attempts to argue that the trademarked goods it auctions are exempt from Article 46's protection, China's argument misses the point. In Article 46 last sentence, Members have already settled the issue raised by China – there is no requirement for a further showing of harm to the right-holder. Second, we have also shown that China's public auction step is inconsistent with the principle in the last sentence of Article 46, because China releases these goods into the channels of commerce as a matter of course, rather than only in exceptional cases.

20. As the flowchart indicates, the "destruction" step becomes operational only if no earlier options prove feasible. Then and only then, China Customs gains the power to destroy the infringing goods. The highly limited circumstances under which China's legal regime permits destruction do not comport with Article 46.

III. ARTICLE 4 OF CHINA'S COPYRIGHT LAW

21. China has admitted that it denies copyright protection to certain works whose contents Chinese authorities determine are prohibited by law. The text of Article 4.1 itself demonstrates that China's measure is TRIP-inconsistent and it serves as the principal "fact" demonstrating our claim. We have also provided additional evidence, including a discussion of statements by China's Supreme People's Court; an explanation of the legal force of Chinese judicial interpretations and the relationship between Chinese judicial statements and Chinese administrative agency statements; China's own formal statements to the WTO about the operation of the Copyright Law; and analysis by recognized scholars and legal experts.

22. *First*, Article 4.1 of the Copyright Law is inconsistent with Berne Articles 2(1) and 2(6). *Second*, because Article 4 denies copyright protection to certain works, the exclusive rights enumerated in Article 10 of China's Copyright Law, and all the protections of the law, are also denied to such works. As a result, Article 4 of the Copyright Law does not comply with the requirements of Berne Article 5(1). These arguments were points made in the US first submission about Article 4.

23. The scope of the Article 4.1 exclusion is not limited. China's apparatus for censorship suggest that many categories of works are potentially subject to being excluded from protection. The ongoing rampant infringement in China, including of works that have been censored or prohibited in China, suggests that there are serious implications for right holders. And to the extent that China means *foreign* marketplaces, the enforcement burden falls instead on the recipient countries of infringing exports as right holders do not have a crucial tool for preventing export. Moreover, foreign right holders unfamiliar with the Chinese Government's current content preferences cannot be sure whether or when copyright protection will be granted or denied.

24. Article 17 does not authorize a system that denies all enforceable copyright protection an entire category of disfavored works. If the Berne Convention drafters had sought to do so, they could have expressed this by using phrases in Berne Article 2(8) or Berne Article *2bis*(1). Indeed, the power to censor does not mean that a right holder is stripped of its copyright and the ability to enforce against third parties who might produce or sell infringing copies in domestic or foreign markets. Leading copyright scholars agree. Censorship is distinct from a rightholder's right to authorize or prohibit certain uses of their expression of an idea by a third person.

25. *Third*, Article 4.1 makes copyright protection subject to a formality that is inconsistent with Berne Article 5(2), and therefore is also inconsistent with TRIPS Article 9.1. China acknowledges that it maintains pre-publication review with respect to the publication and distribution of certain

kinds of works, including films and audiovisual products, and admits that in certain cases, it does not permit publication until content has been approved. Therefore, where pre-publication review is required and publication is prohibited until the completion of a successful review, Article 4 by its terms makes copyright protection subject to the results of that review – i.e., a formality.

26. The *Zheng Haijin* opinion demonstrates that courts examine the contents of a work before deciding whether or not copyright is protected. Indeed, China's statements demonstrate that when it comes time to enforce a copyright owner's rights in a work, they must prove that it passes content review in order to be awarded copyright protection. This is a clear condition precedent to copyright protection (or formality) that if not followed and satisfied, prevents the exercise and enjoyment of rights. Further, China has acknowledged the close overlap between the content review standards and what is "prohibited by law" for purposes of Article 4.1, rendering a distinction immaterial. Moreover, while China claims the content review measures cited by the United States are not referenced in the text of Article 4.1, there is nothing in Article 4.1 that states that the works for which publication or dissemination is prohibited must be prohibited solely by the Copyright Law.

27. *Fourth*, Article 4.1 is inconsistent with TRIPS Articles 41.1 and 61 first and second sentence because of the exclusion of certain civil and criminal remedies. Article 17 does not serve to justify China's exclusion of these remedies. The enforcement of a censorship prohibition simply cannot replace the enforcement of copyright in the works concerned. Indeed, a right holder's copyright rights include the application of certain remedies, such as civil remedies, which do not form part of the governmental enforcement of censorship.

28. With respect to DSU Article 3.7, China's statements in the context of this dispute have confirmed that this claim is "fruitful," as they have reinforced our concerns that Article 4.1 is inconsistent with China's TRIPS obligations.

ANNEX A-6

EXECUTIVE SUMMARY OF THE CLOSING ORAL STATEMENT OF THE UNITED STATES AT THE SECOND SUBSTANTIVE MEETING

I. INTRODUCTION

1. We noted yesterday that the second panel meeting is an appropriate time to take stock of where we are. It is also an appropriate time to recall the context within which this dispute comes before you.

2. This dispute is about the legal regime that China has put into place for protecting and enforcing IPR. More precisely, it is about three specific aspects of that regime. In short, our claims are these: the negotiators of the TRIPS Agreement set out a structure of rules for WTO Members to follow with respect to the protection and enforcement of intellectual property rights. In each of the three claims that we have advanced in this dispute, we seek to ensure that such rules are in place in China, and that the rules are in accordance with the negotiated disciplines. In our submissions, we have shown that – unfortunately – they are not.

II. CHINA'S CRIMINAL IPR THRESHOLDS FOR CRIMINAL PROCEDURES AND PENALTIES

3. Turning to the first aspect of China's legal regime that we have challenged, we would like to make one general observation at the outset: The fact that the measures at issue are criminal measures does not shield them from examination by this Panel. In that regard, we found surprising China's assertion in paragraph 28 of its Oral Statement yesterday. China asserted that this dispute "marks the first time that a WTO panel has been called upon to adjudicate a matter of domestic criminal law." As a responding party in at least two disputes that involved aspects of our criminal law – *i.e.*, the *US – Gambling* dispute (in which China participated as a third party) and the *US – 1916 Act* dispute – the United States can assure the Panel that this is indeed not the case.

4. Turning to the text of the pertinent TRIPS provision, Article 61, first sentence, we have provided a full explication of how the term "commercial scale" should be interpreted, using the customary rules of interpretation in the *Vienna Convention*, to assist the Panel in developing an analytical framework for interpreting and applying the term "commercial scale" in Article 61 of the TRIPS Agreement.

5. We request in particular that the Panel reject China's invitation to substitute the term "significant magnitude of activity" for "commercial scale". It would be misguided to substitute a different form of words for the term that was agreed upon by the TRIPS negotiators. As other WTO panels and the Appellate Body have done for so many other terms in the WTO Agreements, this Panel is called upon to develop a sound analytical framework by which to interpret and apply the "commercial scale" standard, not a substitute form of words.

6. As we have stated in our submissions, although "commercial scale" has a clear meaning, that does not imply that every act of counterfeiting or piracy will be analyzed in an identical fashion. As is often the case with such standards, the individual *circumstances* will make a difference. Indeed, we have provided in our submissions an analytical framework for interpreting and applying the term "commercial scale" that recognizes that what is "commercial scale" in any specific case will vary.

7. In our discussions with the Panel yesterday, we addressed how to determine whether a Member complies with this obligation. In this regard, the United States and third parties have mentioned a variety of factors that could be considered. But, the question arises, can we enumerate which factors are relevant to the interpretation and application by this Panel of the term "commercial scale"?

8. The answer is that all of the factors identified by the United States and third parties are *potentially* relevant. This would include factors such as the market for the infringed goods, the object of the infringement, the magnitude or extent of the infringement, the value of the infringed goods, whether the infringer is seeking financial gain, the means of producing the infringing goods, the means of distributing the infringing goods, the marketing and solicitation of business, the intended use of the infringing goods, the impact of the infringement on the right holder, and the involvement of organized crime.

9. Yet, it is difficult to present an exhaustive list of potentially relevant factors. That is because it is difficult to identify in advance all of the circumstances under which infringers may infringe goods, particularly given the creativity of infringers and advances in technology.

10. At the same time, it is important to point out that a Member's criminal law need not consist of a catalog of all the potential ways of measuring commercial scale. The TRIPS obligation requires a legal regime that criminalizes all wilful counterfeiting and piracy on a commercial scale, but it does not mandate specific forms of legislative drafting. The Panel must consider whether China's law results in a safe harbor that eliminates the possibility of criminal liability for acts that are objectively "on a commercial scale."

11. China's thresholds do not permit a consideration of these factors apart from the numerical thresholds themselves and thus, as the United States has demonstrated, they miss classes of "commercial scale" piracy and counterfeiting. We have carefully described China's thresholds for Articles 213, 214, 215, 217, and 218 in turn, pointing out exactly how they miss "commercial scale" activities. For example, we show how the "illegal business volume" threshold under Article 213 shields actual business activity – clearly an example of "commercial scale". Further, it is difficult to see how making or selling a little less than \$6,900 worth of counterfeit personal care products or small electronics would not be "on a commercial scale."

12. Additionally, while China has rhetorically focused on a single sale of an infringing copy, we should turn our attention back to China's Article 217 copy threshold of 500 copies. The reality is that in China, a producer can make 499 copies, or a retailer can sell 499 copies, and escape prosecution thanks to the safe harbor created by the thresholds for Article 217. Again, an examination of the analytical framework and factors noted by the United States and many Third Parties demonstrates that this conduct is "on a commercial scale."

13. Likewise, "commercial scale" certainly extends to those who are genuinely engaged in commercial activities in order to make a financial return. The United States has provided a number of concrete illustrations of "commercial scale" activities related to trademark counterfeiting and copyright piracy at various stages of the commercial supply chain in China – including manufacturing, wholesaling, and retailing. In this connection, we have shown that the Chinese marketplace is characterized by small manufacturers, middlemen, and distributors, and that retail commerce is conducted through small outlets. (Moreover, China now agrees that it is not just manufacturing that can occur "on a commercial scale.")

14. Indeed, the seizure data provided by the CCA Report in Exhibit US-41 reinforces these points, since they provide a specific snapshot of the "scale" of "commerce" in China for certain counterfeit or pirated products. Each page of the seizure data appended to the report lists businesses

operating "on a commercial scale" and in many cases, raids conducted by China's own authorities netting seizures below the thresholds in effect at the time. Retail outlets – classic examples of commercial scale – can and do operate beneath the thresholds, and thus without the possibility of criminal prosecution and conviction under China's thresholds. (We would also note that the seizure data submitted by Nintendo confirms these points in many respects.)

15. Finally, China introduces a number of arguments that invite the Panel to focus on peripheral matters, such as the size, scope, or impact of the breach, rather than on whether there is a breach in the first place. (The same is true for our other two claims as well.) However, this approach does not provide a viable defense. Again, we only seek to have in place in China the rules required by the TRIPS Agreement.

III. CHINA'S BORDER MEASURES FOR DISPOSAL OF CONFISCATED GOODS

16. We turn next to the second aspect of China's legal regime that we have challenged: China's customs measures. We have explained that, as the text of China's Customs Implementing Measures states, certain facts trigger certain mandatory outcomes. And we have further explained that a number of those outcomes are inconsistent with the TRIPS Agreement.

17. In paragraph 66 of its oral statement yesterday, China suggested an analogy between a finding of guilt in a criminal case and Chinese Customs authorities' purported "discretion" to make findings as to the existence or non-existence of the factual predicates triggering the mandatory disposal or destruction options under the China Customs Implementing Measures.

18. China's analogy actually illustrates the contrary point: Customs has no "discretion" to do other than what the facts and the text of its measures require, just as a Chinese court presumably has no "discretion" in determining the fact of guilt or innocence in a criminal case. By law, they are bound to pursue the step dictated by the facts.

19. If other laws constrain Chinese Customs officials' actions as well, they may shift what option is or is not operative under given facts, but they do not change the mandatory nature of the Chinese disposal/destruction hierarchy. Non-Customs laws, referred to nowhere in the Customs measures, cannot contradict the specific, mandatory directives of the regime outlined in the Customs measures. We respectfully request that the Panel reject any suggestion to the contrary.

IV. ARTICLE 4 OF CHINA'S COPYRIGHT LAW

20. We turn finally to the third aspect of China's legal regime for IPR protection and enforcement that we have challenged: the first sentence of Article 4 of the Copyright Law. Here, too, China's rules fail to meet the disciplines that have been negotiated. In this case, the failure arises out of China's outright denial of copyright protection to an entire class of works, contrary to the provisions of the Berne Convention (and thus contrary to the provisions of the TRIPS Agreement).

21. The text of Article 4.1 is clear, unambiguous, and undisputed. It denies copyright protection to any work that cannot lawfully be published or disseminated in China – not just the illegal content in a work. We note in passing that from time to time, China has appeared to suggest that Article 4.1 applies only to illegal "content" – but nothing in Article 4.1, or anywhere else, supports those suggestions. Indeed, the text of Article 4.1 – and for that matter the text of Article 2.2 – uses the word "works," not "content".

22. China's defense largely rests on creating an artificial distinction between copyright and copyright protection. But, as we have emphasized, the Berne Convention and the TRIPS Agreement

do not countenance a distinction between "copyright" and "copyright protection" – rights holders are entitled to have their copyrights *protected*.

23. In addition, the evidence presented by both parties makes clear that, in some cases at least (including the situation considered by the Supreme People's Court in the *Zheng Haijin* matter), works are either subject to mandatory pre-publication review or must be reviewed by the relevant content review authority or the courts before a decision is made on whether or not copyright in that work is protected. Furthermore, China has acknowledged the close overlap between the standards for content review and the standard for what is "prohibited by law" for purposes of Article 4.1. Thus, in such circumstances, copyright protection in China is subject to the formality of content review (and to the uncertainty of the Chinese Government's current content preferences).

24. Finally, China argues that Article 17 of the Berne Convention authorizes the first sentence of Article 4. However, as we have emphasized in our rebuttal and during this meeting, censorship and copyright cannot be equated. In this dispute, we are challenging the *copyright consequences* of the choices that China has made. Article 17 does not permit China to eliminate copyright protection, and thus Article 17 does not shelter the first sentence of Article 4 of China's Copyright Law.