2 ENFORCEMENT OF INTELLECTUAL PROPERTY RIGHTS IN CHINA’S SPECIAL CUSTOMS SURVEILLANCE ZONES

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ABSTRACT

This article reviews the current regime to enforce intellectual property rights (IPRs) in China’s Special Customs Surveillance Zones. Further, it analyses the challenge ahead as China emerges as a major economic power and provides legal solutions in comparison with experiences of the United States and the European Union.

Keywords: enforcement, intellectual property rights, special customs surveillance zone, anti-counterfeit good, comparison.

I. INTRODUCTION

The first Special Customs Surveillance Zone (SCSZ) was established in June 1990 as the landmark of development of China’s open-door policy. In accordance with Article 34 of China’s Customs Law amended in 2000, the State Council has authority to approve the establishment of SCSZs in Chinese territory. The SCSZ shall be operated under the relevant administrative regulations, such as the Customs Rule on Operation of the Bonded and Logistics Area, which provides that SCSZs shall include a bonded area, an export processing area, a bonded logistics area, a bonded shipyard, and other areas under special customs surveillance by approval of the State Council. In November 2012, the State Council issued a guideline as a national policy to promote the development of SCSZs, directing the integration of six existing SCSZs for the efficient management and improvement of policy-making processes and the multiple functions of these zones. Any newly established SCSZ shall be named ‘comprehensive bonded area’ under this policy.

Since July 2013, the Chinese national Government led by the new Prime Minister, Li Keqiang, has moved to a more liberalized approach to SCSZs by recently establishing the China (Shanghai) Pilot Free Trade Zone (PFTZ). The PFTZ merges the four existing SCSZs in Shanghai, namely the Shanghai Waigaoqiao Bonded Zone, the Waigaoqiao Bonded Logistics Zone, the Yangshan Bonded Port Zone and the Pudong Airport Comprehensive Bonded Zone, to create the single largest SCSZ (total area of 28.78 square kilometres) in China. This merger aims to improve trade facilities and to create more efficient surveillance and an enhanced environment of legal regimes in line with international standards.

In principle, China’s Customs Law provides that the Customs protection of IPRs shall be applied to any inward and outward goods, including bonded goods. The protection of IPRs includes the suspension by Chinese Customs Authorities of the release to exportation or importation of counterfeit trademark, pirated copyright goods and goods infringing patent under the Chinese legal regime, which is in compliance with the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), in particular, Article 51 which requires that customs authorities shall suspend the release of counterfeit trademark or pirated copyright goods, and may provide proceedings against other infringements of IPRs such as patent violations, even though the determination of such infringements is not straightforward. But, in practice, the SCSZs are the grey areas in Customs protection of IPRs. Therefore, it is necessary to review the existing laws and regulations in this regard with a focus on Customs enforcement. China has become the major source of counterfeit goods destined for the United States and the European Union, while emerging as one of the largest exporters of merchandise in the world after China’s accession to the World Trade Organization (WTO). The challenge for China now is to significantly reduce its exportation of counterfeit goods. The improvement of Customs enforcement of IPRs in SCSZs will be an important part of China’s efforts to respond to this challenge.

II. REVIEW OF CHINA’S LEGAL REGIME TO ENFORCE IPRs IN SPECIAL CUSTOMS SURVEILLANCE ZONES


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3 The Customs Rule on Operation of the Bonded and Logistics Area (issued on 28 November 2005, revised on 15 March 2010).
6 China officially became the 143rd Member of the WTO on 11 December 2001.
Article 44 and Article 91 regarding the Customs protection of IPRs, which provide that 'customs shall, in accordance with laws and administrative regulations, protect the intellectual property right relating to inward and outward goods'. Chapter III of China's Customs Law entitled 'Inward and Outward Goods' includes three categories: (1) import goods and export goods; (2) transit, transshipment and through goods; and (3) bonded goods. All these goods are subjected to Customs surveillance. Therefore, in principle, the bonded goods should not be excluded from the Customs enforcement of IPRs.

It is interesting to note that China's Customs Law expressly provides that:

> Where it is necessary to declare to the Customs the status of intellectual property right, the consignee for import goods and the consignor for export goods as well as their agents shall, in accordance with State regulations, make a truthful declaration to the Customs and produce supporting documents for the lawful use of the right.9

This means that even though China's Customs is responsible for the protection of IPRs related to inward and outward goods, including bonded goods, the procedure of Customs enforcement of IPRs such as right holders' declaration of their IPRs for Customs to take necessary action does not address bonded goods. Bonded goods are seemingly excluded from Customs enforcement of IPRs. Based on this exclusion, Article 2 of the Regulation of Customs Protection of Intellectual Property Rights provides that this Regulation shall be only applied to IPRs 'related to import or export goods'. These legal texts make it clear that the enforcement of IPRs by China's Customs is limited to imported and exported goods.

The situation is complicated by the principle of China's Customs Law on the one hand, and the procedures provided by this Law itself, as well as the Customs Regulation Protection of IPRs on the other hand. The situation is even more complicated if we examine Customs statistics that actually treat bonded goods as imported and exported goods, because under China's Regulation on Customs Statistics and Customs' interpretation on 'import and export goods' recorded in Customs statistics, the scope of Customs records of statistics extends to the bonded goods. These bonded goods, with the approval of the Customs, enter into Chinese territory without going through the formalities to pay duties and are reshipped out of the territory after being stored, processed or assembled in Chinese territory. It has also allowed SCSZs, such as the bonded logistics area and the bonded area to 'store import and export goods or other goods without going through Customs formalities', according to the Customs Rule on Operation of the Bonded and Logistics Area and the Customs Temporary Rule on Bonded Seaport Area.11 In a sense, the bonded goods to be reshipped out of the territory are treated as import and export goods for the purpose of Customs statistics.

In contrast with Article 2 of the Regulation of Customs Protection of Intellectual Property Rights mentioned above, which is limited in its application to IPRs related to import and export goods, the Implementing Rule of this Regulation requests IPR holders to provide the necessary information about 'inward and outward Customs', which includes the Customs in SCSZs, application of Customs recordation of IPRs, or detention of suspected infringing goods.12 In practice, the cases infringing IPRs in SCSZs are included in the annual report of Customs' enforcement of IPRs.13 However, no such cases have been disclosed.

One could draw the preliminary conclusion that confusion remains in the texts of China's Customs Law and China's Regulations and Implementing Rules regarding Customs protection of IPRs in SCSZs. It seems that China's Customs does enforce IPRs in SCSZs, but no cases are available for the public yet. Overall, we might conclude that the current legal regime is not effective for China's Customs to take the necessary actions for IPR enforcement in SCSZs.

III. CHALLENGES AHEAD FOR CHINA TO IMPROVE IPR ENFORCEMENT IN SPECIAL CUSTOMS SURVEILLANCE ZONES

Apparently, China has no further obligation to improve IPR enforcement in SCSZs under TRIPS. For the Members of the World Trade Organization (WTO), TRIPS provides the procedures suspending release of import goods suspected of infringing IPRs upon either approving the right holders' application of detention by customs authorities or initiating such

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9 Article 44.2 of the Customs Law of the People's Republic of China.
10 Regulations of the People's Republic of China on Customs Statistics (entered into force on 1 March 2006).
11 Customs Rule on Operation of the Bonded and Logistics Area (amended on 29 August 2007).
procedure by ex officio actions.\textsuperscript{14} It is optional for WTO Members to provide customs measures for the protection of IPRs related to export goods, but no obligation is imposed to protect IPRs related to goods in transit.\textsuperscript{15} China’s current legal regime has fully implemented its TRIPS obligation in this regard if the bonded goods are excluded from the category of import and export goods. However, the bonded goods are actually treated as import and export goods in SCSZs. Thus, China must improve its Customs enforcement of IPRs in SCSZs.

Instead of further analysing whether China’s current legal regime is consistent with the TRIPS Agreement, China should focus on its challenge ahead as the largest exporter of commodities in the world.\textsuperscript{16} The focus should shift to finding solutions to reduce its exportation of counterfeit trademark and pirated copyright goods that are mostly destined for the United States and European Union. The United States and the European Union are, respectively, the largest and the second largest trade partners with China. It is true that China has made considerable efforts to enforce IPRs related to import and export goods. In fact, almost 100 per cent of goods suspended or detained by Chinese Customs officers were export goods. However, more than 70 per cent of counterfeit trademark and pirated copyright goods detained or destroyed by the US and EU customs authorities in 2009 and 2010 came from China.\textsuperscript{17} China not only distorts normal international trade, but it also damages the reputation of goods made in China.\textsuperscript{18} What are the root causes of this issue? Official statistics show that 52 per cent of Chinese export goods in 2012 were exportations related to Original Equipment Manufacturer (OEM) and outward goods from SCSZs, including bonded goods.\textsuperscript{19} It is very likely that some bonded goods reshipped out of SCSZs after being stored, processed or assembled in SCSZs, are counterfeited and pirated copyright goods. This likelihood becomes more critical nowadays because nearly 100 different SCSZs established in China have more functions such as research and development (R&D), industrial designs, brand-creating activities, manufacture of essential parts of IT products and integrated multiple-bonded processing, and logistics and services. All this is in addition to the original functions of SCSZs: foreign trade, outward processing, free warehouses and exhibition of bonded products.\textsuperscript{20} These developments make IPR issues more complicated for China’s Customs surveillance in SCSZs.

One of the purposes of establishing the China (Shanghai) PFTZ is that the legal environment of norms should be set with reference to international standards so other SCSZs can learn for improvement. What is the international standard of the free trade zone? This standard might be found in the International Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Convention).\textsuperscript{21}

IV. INTERNATIONAL STANDARDS FOR CHINA TO IMPROVE IPR ENFORCEMENT IN SPECIAL CUSTOMS SURVEILLANCE ZONES

The free trade zone (or free zones) is defined by Specific Annex D2 of the Kyoto Convention as ‘a part of the territory of a Contracting Party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs territory’.\textsuperscript{22} Specific Annex D2 also provides a standard (5 of Admission of goods), directing that ‘Admission to a free zone shall be authorized not only for goods imported directly from abroad but also for goods brought from the Customs territory of the Contracting Party concerned’. If it is only referred to as the definition and standard as such, all existing SCSZs in Shanghai would already be compliant with international standards, because the first local regulation—Regulation of Shanghai Waigaoqiao Bonded Area\textsuperscript{23} promulgated in 1996—stipulates that any goods are free to be imported from or exported abroad directly as inward or outward goods without payment of any duties or fees for importation or exportation. Accordingly, any goods brought into the bonded area from non-bonded areas in China, or adversely carried from the bonded area to non-bonded area, shall be treated as export goods or import goods. Hence, there are no differences between the free trade zone defined by

\textsuperscript{14} Articles 51 and 58 of the TRIPS Agreement.
\textsuperscript{15} Footnote 13 of the TRIPS Agreement.
\textsuperscript{16} China has been the largest exporter of commodities since 2009. See WTO International Trade Statistics: <http://www.wto.org/english/news_e/pres10_e/pr598_e.htm> accessed 10 October 2013.
\textsuperscript{18} Owing to so many counterfeit goods originating from China, an application for an EC trademark ‘Not made in China’ was filed (see EC Trademark application No. 004688561), but it was rejected because of ‘public policy’ consideration by the examiner. See Wolf Meier-Ewert, ‘Trademark and Designs’ (June 2013) presented at the WIPO-WTO Colloquium for Teachers of Intellectual Property.
\textsuperscript{20} See State Council Guideline to Promote Development of Special Customs Areas ((2012) No. 58).
\textsuperscript{21} The International Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Convention) entered into force in 1974 and was revised in 1999.
\textsuperscript{22} Specific Annex Guidelines: D2 Free Zones.
\textsuperscript{23} Regulation of Shanghai Waigaoqiao Bonded Area (adopted on 19 December 1996).
Zhang Naigen, *Enforcement of IPRs in China’s Special Customs Surveillance Zones*

the Kyoto Convention and the existing SCSZs in China. What should be done to set the legal environment of norms in the China (Shanghai) PFTZ with reference to international standards?

In accordance with the recommended practice of the Kyoto Convention, ‘admission to a free zone of goods brought from abroad shall not be refused solely on the grounds that the goods are liable to prohibitions or restrictions other than those imposed on grounds of the protection of patents, trademarks and copyrights’, which shall be regarded as the international standard that is an essential part of the legal norms set in the China (Shanghai) PFTZ. In this respect, China’s Customs shall enforce IPRs related to goods into or out of the free trade zones directly from or to foreign countries. As mentioned above, China’s Customs has failed to take effective measures to enforce IPRs with reference to the international standard of the Kyoto Convention. Relevant texts and practices are confusing the legal regime.

China should learn from the experiences of other nations to improve IPRs in SCSZs while using the international standards or recommended practices of the Kyoto Convention as references. The United States was the first country to establish Foreign Trade Zones (FTZs) in the 1930s. The FTZ Board under the Department of Commerce was responsible for the establishment, maintenance and administration of zones under the FTZ Act. Section 81(c) of the FTZ Act provides that the merchandise brought into the FTZ would be exempted from customs laws. Furthermore, Section 400.1 of the FTZ Regulation provides that under zone procedures, foreign and domestic merchandise may be admitted into zones for operations such as storage, exhibition, assembly, manufacture and processing without being subject to formal customs entry procedures and payment of duties. This is true unless and until the foreign merchandise enters the customs territory for domestic consumption. In the United States, each state has FTZs and there are 558 subzones operated by private companies nationwide. The Customs Regulation does not expressly provide that the procedures of Customs protections of IPRs shall be applied to FTZs, but the FTZ Manual includes Chapter 13 regarding enforcement actions in FTZs.

European nations have a tradition of free port dating back to the 15th century. The modern free zones and free warehouses are established under the Community Customs Code. The Code deems free zones and free warehouses (including attendant premises) located within the specified territory to be outside the Community Customs Territory for purposes of import duties and commercial-policy import measures, provided that goods are not released for free circulation, placed under another customs procedure, or used or consumed under conditions other than those provided for in customs regulations. Under the European Regulation on customs enforcement of IPRs, in the cases where counterfeit goods, pirated goods, and, more generally, goods infringing IPR originate in or come from third countries, their introduction into Community customs territory should be prohibited and a procedure should be set up to enable the customs authorities to enforce this prohibition as effectively as possible. This includes their transhipment, release for free circulation in the Community, placing under a suspensive procedure, and placing in a free zone or free warehouse.

Based on the recommended practice of the Kyoto Convention and the experiences in the United States and the European Union to enforce IPRs in their FTZs or free zones, it can be concluded that these zones shall not be exempted from the customs enforcement of IPRs. Within this international landscape, China must improve IPR enforcement in SCSZs, in particular, the China (Shanghai) PFTZ.

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24 5 Recommendation Practice of D2 Free Zones.
26 15 CFR Part 400 - FTZ Regulations.
V. LEGAL SOLUTIONS FOR CHINA TO IMPROVE IPR ENFORCEMENT IN SPECIAL CUSTOMS SURVEILLANCE ZONES

A. TO AMEND CHINA’S CUSTOMS LAW AND REGULATION OF CUSTOMS PROTECTION OF INTELLECTUAL PROPERTY RIGHTS

In order to eliminate legislative confusion, China’s Customs Law must be amended again. In particular, Article 44 of The Customs Law should be amended as follows:

Customs shall, in accordance with laws and administrative regulations, protect the intellectual property right relating to inward and outward goods. The inward and outward goods in special Custom surveillance zones shall be treated as imported and exported goods for the purpose of Customs protection intellectual property rights (to be added).

This amendment is preferred because the Customs Law has already been, in principle, applied to SCSZs for the enforcement of IPRs, but it is also limited to Customs recordation of IPRs for import and export goods, which are subject to customs formalities to pay duties. The inward and outward goods are not subject to any duties, fees and customs formalities for import and export goods. The suggested amendment will clarify the scope of China’s Customs enforcement of IPRs, which shall not only apply to the normal import and export goods, but also to the inward and outward goods in SCSZs, even though these goods have already been treated as import and export goods for Customs statistics in China.

Accordingly, adding Article 3.3 of the Regulation of Customs Protection of Intellectual Property Rights as follows is also suggested:

The Customs protection for intellectual property rights shall apply to special Custom surveillance zones. The implementing rules shall be promulgated by the Customs Administration.

B. TO PROMULGATE THE RULE ON PROTECTION OF INTELLECTUAL PROPERTY RIGHTS IN SPECIAL CUSTOMS SURVEILLANCE ZONES

Considering the unique character of SCSZs, i.e. as both integrated areas of the customs territory coming under customs surveillance and also areas outside of the customs territory in terms of inward and outward goods’ exemption from any payment formalities for duties of import and export goods, the mechanism to enforce IPRs in SCSZs should be somehow different from the current legal regime. Based on the suggested amendments of the Customs Law and the Regulation of Protection for IPRs, China’s Customs Administration shall promulgate the Rule on Protection of IPRs in SCSZs, which, at least, includes three general principles:

(i) It shall be applied to SCSZs such as the bonded area, the export processing area, the bonded logistics area, the bonded seaport, and other areas under special Customs surveillance by approval of State Council.

(ii) It shall make it clear that existing customs procedures for the protection of IPRs related to import and export goods shall be applied to inward and outward goods in SCSZs and, of course, to goods released to non-SCSZs as the normal import goods or brought into SCSZs from non-SCSZs as export goods.

(iii) It shall be flexible enough to meet the unique character of SCSZs. For example, it shall provide the right holders with facilities and expedient procedures entry into SCSZs for checking relevant goods suspected of infringing IPRs. The Customs authorities shall provide necessary assistants for judicial investigations, in particular, collection of evidence. Also, the seized goods of infringement shall be destroyed or disposed of, in order to prevent any possible release to non-SCSZs.

C. TO MAKE REGULATIONS FOR THE CHINA (SHANGHAI) PILOT FREE TRADE ZONE, INCLUDING ENFORCEMENT OF INTELLECTUAL PROPERTY RIGHTS

Institutional innovation is key to establishing the China (Shanghai) PFTZ, which differs from existing SCSZs in its traditional approach in the last two decades to obtain preferential treatment from the Chinese national Government, including seeking exemption from customs duties and fees in SCSZs. The China (Shanghai) PFTZ will have no further exemptions. In terms of exemptions of duties for importation and exportation, the China (Shanghai) PFTZ is no different from existing SCSZs. However, the China (Shanghai) PFTZ will be a test run of different approaches to create a new model of governmental control over foreign trade and investment in SCSZs. It is an attempt to promote trade and investment facilities, to open more services market, and meanwhile, to prevent any possible risks, so as to achieve the goal of test, i.e. the new SCSZ based on a Chinese model in line with international standards of facilities for trade and investment, efficient and expedient surveillance, and legal environment of norms.
The China (Shanghai) PFTZ needs top-level designs of institutional innovation, including new mechanisms to enforce IPRs in accordance with international standards. The Shanghai People’s Congress should pass regulations for the China (Shanghai) PFTZ as soon as possible. However, if it continues with the approach of existing local regulations on SCSZs without any provisions regarding protection of IPRs, it will be hard to establish institutional innovation.32

D. TO IMPROVE CUSTOMS ENFORCEMENT UNDER THE PROPOSED LEGISLATIONS

Although the primary purpose of this article is to review the existing Chinese legal regime of IPR enforcement in SCSZs in the light of current practices and to make proposals for further national or local legislations accordingly, so as to clarify or improve the existing laws and regulations, it may be appropriate to provide a brief explanation of how the proposed legislations are to be implemented, with particular focus on the means of IPR enforcement.

The Chinese Customs Authorities shall provide IPR holders with special procedures to file applications in cases of infringements of IPRs related to any inward and outward goods in SCSZs. The enforcement of IPRs in SCSZs shall be coordinated with other administrative branches, such as China’s State Intellectual Property Office (SIPO) and the local IPR offices, to conduct investigations promptly. It may be necessary to arrest the suspected criminals in the case of counterfeit trademark and pirated copyright goods under China’s Criminal Law. The special courts shall be established in SCSZs with jurisdiction over any civil or criminal infringements of IPRs related to inward and outward goods. In fact, a new special court has recently opened in China’s (Shanghai) PFTZ to handle cases of IPR violations inside the zone. This indicates that my proposals to improve IPR enforcement in SCSZs are not merely conceptual but also practicable.

VI. CONCLUSION

The current Chinese legal regime of Customs protection of IPRs is, in principle, compliant with TRIPS, which is applied to SCSZs. But due to different legal texts and practices, it is hard to apply this regime. Therefore amendments to current rules and changes to implementation schemes are necessary.

Additionally, no cases infringing IPRs suspected by China’s Customs officers in SCSZs are available publicly. As the largest exporter of commodities in the world, China must have an effective mechanism to enforce IPRs in SCSZs, especially in the China (Shanghai) PFTZ, so as to meet the great challenges ahead. Accordingly, some legal solutions are suggested, including amendments to China’s Customs Law, promulgation of protective rules for IPRs in SCSZs, and the proposed Regulation on the China (Shanghai) PFTZ with special Customs protection of IPRs in expectation to practice sooner or later.

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