



**Submission of the**  
**International AntiCounterfeiting Coalition, Inc.**  
**to the**  
**United States Trade Representative**

**Special 301 Recommendations**

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**February 10, 2006**

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Ms. Sybia Harrison  
Special Assistant to Section 301 Committee  
Office of the United States Trade Representative  
600 17<sup>th</sup> Street, NW  
Washington, D.C. 20508

**Request for Public Comment--Identification of Countries Under Section 182 of the  
Trade Act of 1974 (as amended), 71 Fed. Reg. 10 (January 17, 2006)**

Dear Ms. Harrison:

On behalf of the International AntiCounterfeiting Coalition, Inc. ("IACC"), and its members, I respectfully submit the following report in response to the United States Trade Representative's request for comments identifying countries that deny adequate and effective protection and enforcement of intellectual property (IP) rights. This year the IACC reports on eight (8) countries.

The IACC is the largest multinational organization representing exclusively the interests of companies concerned with product counterfeiting and copyright piracy. Our members consist of approximately 150 corporations, trade associations, and professional firms and represent total revenues of over \$650 billion. The IP owners among our membership represent a broad cross-section of industries, and include many of the world's best known companies in the apparel, automotive, consumer goods, entertainment, pharmaceutical, personal care and other product sectors.

The IACC is committed to working with government and industry partners in the United States and elsewhere to strengthen IP protection by encouraging improvements in the law, allocation of greater political priority and resources, and raising awareness regarding the enormous—and growing—harm caused by IP violations.

We look forward to working with the USTR in its efforts to promote IP protection globally and we are available at any time for clarification of any issues raised in the attached submission.

Respectfully submitted,

Steven D'Onofrio  
Executive Director

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IACC

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## INTRODUCTION

This report has been prepared by the International AntiCounterfeiting Coalition, Inc. (“IACC”) in response to the United States Trade Representative’s (“USTR”) request for written comments, pursuant to Section 182 of the Omnibus Trade and Competitiveness Act of 1988, 19 USC § 2242 (“Special 301”), regarding governments that deny adequate and effective protection and enforcement of intellectual property (“IP”) rights. The IACC has filed Special 301 submissions with the USTR since 1997.

The IACC, based in Washington, D.C., is the largest association representing exclusively the interests of companies concerned with product counterfeiting and copyright piracy. Our members consist of approximately 150 corporations, trade associations, and professional firms and represent total revenues of over \$650 billion annually.

The IACC is actively involved in research, advocacy and educational programs targeting counterfeiting and copyright piracy on a global level.

Working in concert with other government and industry partners, the IACC has been in the leadership of a number of recent initiatives that have aimed to strengthen IP laws and enforcement policies of governments.

Industry and national governments still have much work to do in order to accurately measure the harm caused by counterfeiting. But anecdotal accounts and enforcement statistics generated by both governments and industry clearly confirm that the scale of the problem is enormous, and that it is seriously affecting an ever-widening range of industries. Information from industry and government sources, including Interpol, clearly confirms that the growth of the problem and its complexity are due, in part to the increasing involvement of more sophisticated organized criminal networks operating across national boundaries. It is now widely recognized that free trade zones established in a growing number of countries are increasingly exploited by these networks in order to facilitate the global distribution of fakes.

While there is still an enormous amount to be accomplished, government leaders and policy makers in more and more countries are recognizing the need for greater priority to be given to anti-counterfeiting efforts. This heightened attention is based on a growing recognition of the harm counterfeiting is causing to the public interest, including to consumer health, government tax revenues, market order and fair competition, and economic development. Regrettably, government leaders and other policy makers in certain countries do not yet appear to understand the economic and social costs of tolerating IP crime.

The IACC intends and hopes that the recommendations for legal and policy reform set out in this submission will provide a useful guide for national governments as they consider introducing “best practices” adopted elsewhere, and as they assess whether their laws and enforcement practices meet the minimum standards of protection set out in the Agreement on the Trade-Related Aspects of Intellectual Property (the “TRIPS Agreement”) by the World Trade Organization (“WTO”).

Anti-counterfeiting is a moving target in all countries, including the United States, and there is a constant need to review laws and the sufficiency of government resources allocated to criminal enforcement and training. New technologies, including the Internet, and the increasing sophistication of counterfeiters and pirates require that government and industry work ever more closely in assessing not only the adequacy of laws but their effectiveness in practice.

Articles 41 and 61 of the TRIPS Agreement require WTO members to provide criminal enforcement remedies that are effective and that provide a deterrent to further violations. The TRIPS Agreement also requires that the countries provide adequate enforcement against IP violations through customs. But it is becoming increasingly clear that, in order to provide truly “effective” enforcement, governments need to do more than implement the minimum standards of the TRIPS Agreement. The IACC applauds USTR’s work in concluding Foreign Trade Agreements (“FTAs”) and other international agreements that are having a positive impact in raising the standards of protection and introducing best practices.

Below is a chart indicating the countries analyzed in the IACC’s Special 301 submissions since 1997. In this year’s submission the IACC has chosen to focus on eight countries, among which China, Canada and Russia are of greatest concern.

The IACC will continue to provide USTR and other government agencies with information and views on the situation in other countries through separate submissions, and we would be pleased to respond to questions regarding any particular jurisdiction, upon request.

Finally, the country submissions reflect a number of common problems that warrant particular attention:

- The need for substantially greater political will and resources to combat IP crime;
- The need to ensure greater use of criminal enforcement tools, which create substantially greater deterrence, rather than relying excessively on administrative measures, such as customs seizures, which yield only economic sanctions;
- The need for greater cooperation and coordination among different government enforcement bodies, including police, Customs, and other administrative enforcement bodies;
- The adoption of sentencing and other guidelines that will lead to stronger criminal and administrative sanctions;
- The need to eliminate numerical thresholds for criminalizing IP cases, and to encourage criminal investigations in any case where there is a basis for suspicion of a crime;
- The need for Customs and other enforcement authorities to provide IP owners with earlier access to information needed to pursue investigations and legal actions;
- The need for greater reliance on “creative” enforcement tools, including landlord liability strategies; and
- The need for greater transparency regarding the results of government enforcement work.

## IACC RECOMMENDATIONS

1997 - 2006

	97	98	99	00	01	02	03	04	05	06
Argentina				WL	WL	WL				
Australia			WL							
Belize								WL	PWL	PWL
Bolivia							WL			
Brazil				WL	WL	WL		WL		
Bulgaria						WL		WL		
Canada				WL	OO	WL	WL	PWL	PFC	PFC
Chile		WL		--	WL	WL	WL		WL	
China	PFC		306	306	306	306	306	306	PFC/306	PFC/306
Costa Rica										PWL
Colombia			PWL			WL				
Greece		PWL	PWL							
Hong Kong					OO					
Hungary							WL			
India							WL	PWL	WL	
Indonesia	PWL	PWL			WL	PWL				
Italy				WL	WL	WL				
Japan					WL	WL		WL		
Jordan								WL		
Kazakhstan						WL				
Korea		WL	WL	WL						
Kuwait									WL	
Lebanon								PWL		
Libya								WL		
Malaysia				WL	PWL		PWL	PWL	PWL	PWL
Mauritius								WL		
Mexico		OO	WL	WL	OO	WL	WL	PWL	PWL	PWL
Pakistan								WL		
Panama							WL	WL	WL	
Paraguay					306	306	306	306		
Philippines						PWL	PWL	PWL	PWL	PWL
Poland						PWL	PWL	PWL		
Romania								WL		
Russia				PWL	PWL	PWL	PWL	PWL	PWL	PWL
Saudi Arabia						WL	WL	WL	WL	
Singapore				PWL		WL	WL			
South Africa					WL	WL	WL			
Taiwan	OO	OO	WL	WL	PWL	PWL	PWL	WL	WL	
Thailand				PWL		WL	WL	WL		
Turkey							WL	WL	WL	
Ukraine					WL	PFC		PFC		
UAE						WL	WL	WL	WL	
Venezuela								WL		
Vietnam						WL	WL			

### Abbreviations

PFC: Priority Foreign Country; 306: Section 306 Monitoring; PWL: Priority Watch List; WL: Watch List; OO: Other Observations

## CANADA

### **Recommendation: Priority Foreign Country**

#### **Introduction**

With few exceptions, IACC members report a continuing lack of pro-active effort by Canadian Customs and prosecutors in dealing with counterfeiting. The government's continued "reactive" approach to counterfeiting, inadequate coordination among enforcement bodies, poor cooperation among the authorities and industry in most regions, and gaps in relevant legislation all pose serious obstacles to effective and deterrent enforcement in Canada.

The Canadian government has not taken any significant measures to address the concerns over weak border enforcement identified in the IACC 2005 Special 301 submission. Consequently, the IACC believes Canada should be designated a Priority Foreign Country.

#### **Customs**

Both as a matter of law and policy, Canada continues to embrace a "reactive" approach to the involvement of Canadian Border Services Agencies ("CBSA" or "Customs") in the monitoring and seizure of counterfeit goods at the border.

##### 1. Legislative Gaps

Under relevant legislation in Canada, Customs is only explicitly authorized to take action after the rights holder obtains a Court Order and provides detailed information regarding an anticipated shipment of counterfeit goods. This system is clearly onerous and burdensome to IPR holders, and the lack of clear legislation permitting Customs to engage in *ex officio* monitoring and enforcement is a critical obstacle to effective enforcement in the country.

Canada still lacks a system allowing for the recordal of trademark and copyrights with Customs, and very little training of Customs personnel takes place to assist in the profiling and identification of infringing items.

Where shipments of counterfeit goods have been seized, IACC members have witnessed cases in which the offending items have been released by the CBSA due to a claimed lack of resources. In such cases, the authorities have generally refused to provide rights holders with the information needed to conduct follow-up investigations and to otherwise pursue civil remedies.

Meanwhile, in cases where criminal prosecutions against counterfeiters have been pursued and failed, there are no clear provisions under local law as to whether the illegal goods may be returned to the counterfeiters<sup>1</sup>.

Canada's customs enforcement regime is clearly out of step with practice in the European Union, the United States and other countries—including many developing countries.

Canadian practices fail to recognize the critical importance of border enforcement. This is acknowledged in the Model Legislation currently being developed by the World Customs Organization ("WCO"), an organization to which Canada belongs. Article 9.01 of the WCO's draft Model Legislation states:

Customs' powers to act *ex officio* are a key feature of effective border enforcement regime. **In the vast majority of cases Customs officers are the only ones to know when and which allegedly infringing goods are transported. Therefore unless Customs are empowered and obliged to act on their own to stop suspected shipments at the borders, the border measures will remain ineffective.** TRIPs Agreement Article 58 introduces the possibility to give Customs *ex officio* powers, as such powers are an essential feature of effective border measures it is recommended that WCO Members States include a provision to that effect in the national laws. (*emphasis supplied*)

The lack of priority given to IP protection by Canadian Customs is evidenced by the lack of policy pronouncements on the issue. Indeed, a review of the CBSA's public website<sup>2</sup> fails to mention trademark or copyright enforcement with the list of current "enforcement initiatives".

## 2. Industry Cooperation

IACC members have attempted to stimulate greater cooperation with Canadian Customs through an affiliated coalition of member companies organized under the umbrella of the Canadian Anti-Counterfeiting Network ("CACN").<sup>3</sup> The CACN has organized training seminars throughout Canada over the last year, mainly to assist local law enforcement personnel in product identification. Regrettably, participation by Canadian Customs at these seminars has been disappointing.<sup>4</sup> In addition, while stakeholders have sought to draw attention to counterfeiting issues via seminars, Customs representatives have generally declined the opportunity to participate. Likewise, with rare exceptions, industry requests to conduct training for local Customs authorities at various ports generally have been declined.

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<sup>1</sup> See case study below at page 10, bullet point #1.

<sup>2</sup> See <http://www.cbsa-asfc.gc.ca/general/enforcement/menu-e.html>.

<sup>3</sup> See <http://www.cacn.ca> for further information on the CACN.

<sup>4</sup> For example, at the May 25-27, 2005 Chilliwack, British Columbia Conference held by the Royal Canadian Mounted Police ("RCMP"), of approximately 85 attendees, only six representatives of the CBSA participated. Likewise, at a training event conducted for about 85 attendees in Calgary on June 1 and 2, 2005, only two CBSA representatives participated. At a training event conducted in Halifax for approximately 100 attendees in July 2005, only five CBSA representatives participated.

### 3. Resources and Coordination

There is a clear lack of adequate resources and training dedicated not only by Customs but within the federal RCMP (the federal “Royal Canadian Mounted Police”) and provincial police units responsible for IP enforcement. Police resources in and near key ports of entry to Canada remain particularly understaffed.

In mid-2000, Canadian Customs and the RCMP established a protocol known as the “Joint Force Operation” (“JFO”), intended to intensify cooperation and coordination among Customs and police in handling counterfeiting and piracy cases. In part, the JFO was intended to encourage Customs to work more proactively with the police in handling criminal investigations of IP cases. As indicated below, however, the results have been disappointing, and merely serve to underscore the lack of government priority and resources, as well as a lack of coordination and leadership.

- The city of Vancouver is the closest port to Asia, and the main gateway for counterfeits imported into Canada from China and other production centers in the Orient. Prior to the implementation of the JFO, the IACC understands there were no seizures of any container-load quantity shipments of counterfeit product in Vancouver. Between October 2000 and March 2001, as many as 10 container loads of counterfeits had been seized. However, to our knowledge, due to the lack of resources, Customs was unable to process cases against the importers and seizures then substantially ceased between March 2001 and December 2003.<sup>5</sup>

Officials from the Property Crime Unit of the Vancouver Police Department reported that in some cases, they intervened directly in the handling of cases that should otherwise have been dealt with by Customs. Even then, IACC members and their affiliates reported a pervasive lack of cooperation by local and national prosecutors in British Columbia (i.e., the Attorney General’s Office and Crown Prosecutors), reflected in their decisions not to proceed with prosecutions of IP cases following seizures by local police. Indeed, we are not aware of any cases involving trademark counterfeiting that have been dealt with by the Crown Prosecutor. Although the prosecutors claim they will review each case on its merits, the impression given to industry is that there is no interest in pursuing counterfeiting cases as a matter of current public policy, and only slightly greater interest in dealing with copyright cases.

- In 2001, an importer was known by CBSA and the RCMP to be importing counterfeits of leading brands of sports apparel from Thailand through Vancouver into Montreal. The rights holders proceeded with surveillance through private investigators and provided reports on the case to the RCMP. IACC members involved in the case were provided with no feedback following their reports from the RCMP or CBSA, despite frequent attempts to follow up. To the best of our

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<sup>5</sup> In December 2003, enforcement work by Vancouver authorities reportedly recommenced, due to public attention given to the counterfeiting of well-known “Beyblade” toys.

members' knowledge, the target continues to arrange the production and importation of counterfeits to Canada.

- In October 2002, a container of counterfeit Louis Vuitton, Burberry and other brands of luxury goods were identified in transit from China to Toronto, via Vancouver. Louis Vuitton's counsel was contacted by CBSA and RCMP to verify the goods following their detention, after which the shipment was inexplicably released by authorities in Vancouver. The product then arrived in Toronto, after which the RCMP confirmed that, because trademark rights were involved, Customs lacked the authority to seize the goods and likewise the authority to release to the brand owners information regarding the importer or exporter of the products. Following intensive discussions, Toronto authorities agreed that, if local police intervened, they would provide relevant information to the police. Ultimately, the Major Crime Unit of the Toronto police obtained information on the case, which led to the execution of a search warrant and the seizure of CDN\$15 million in counterfeit goods in two warehouses. Regrettably, the Crown Prosecutor initially decided not to prosecute the case, after which the rights holders successfully lobbied for it to be taken up. Thereafter, a local court determined that there was insufficient evidence for the case to proceed. The case then went to appeal, but was likewise rejected by a higher court. Subsequently, the police advised the rights holders that the infringer requested return of the counterfeit goods. The case remains pending, and the IACC is obviously concerned that the return of these goods will set a bad precedent.
- The JFO's progress in Toronto has probably been the best of any region in Canada. Over the last few years, the JFO's efforts have resulted in seizures of large amounts of fake product. IACC members report that success has been primarily dependant on intensive input from IP owners, rather than on proactive attention from enforcement authorities. But of greater concern are reports of recent reductions in the number of RCMP officers dedicated to IP enforcement in Toronto, and the perennial lack of adequate manpower within the Toronto office of the CBSA.
- In the fall of 2004, IACC member Burberry and other apparel companies approached the Montreal RCMP with information concerning a suspected importer and eBay vendor of counterfeits. Information first came to Burberry's attention when Belgian Customs advised that it had intercepted 22 separate small consignments of fake apparel from June to August 2004 with Canada as the ultimate destination. The rights holders were advised that the RCMP was aware of the counterfeiter, but due to their resource and time constraints they would not be able to deal with the matter until February 2005. The information clearly established this importer as a large-scale vendor and accordingly civil action was pursued, resulting in a van-load of counterfeit merchandise being delivered up by the counterfeiter from his residence. The suspected warehouse location was never disclosed and the defendants produced no documents at all during the discovery process. Had this matter been dealt with by police or Customs, it is likely that the full scale of the counterfeit enterprise would have been disclosed, including the

location of warehouses and the identity of foreign suppliers. This is one example among many in which the RCMP and CBSA initially indicated a willingness to assist, but IP owners were required to take less effective steps on their own due to pessimism over the ultimate outcome of government enforcement.

- In Montreal, the JFO between CBSA and the RCMP has adopted the name Project Castille, and focused enforcement efforts on imports entering Canada primarily through Dorval Airport. Unlike enforcement in other parts of Canada, the authorities managing Project Castille prefer to conduct investigations without any input from rights holders whatsoever—even in cases where the rights holders have evidence of repeat offences, including prior civil actions by relevant individuals and companies. Such evidence would of course be useful in satisfying knowledge requirements for certain offenses. This resulted in a failure by the RCMP to seize products that it was not aware were counterfeit. It may also have resulted in other omissions. In addition, the Montreal JFO has normally refused to provide any information to rights holders until prosecutions have been lodged and the information becomes public record. The brand owner is required to have someone attend in court to obtain a copy of whatever documents have been filed.

### **Trademark**

Canada's Trade-marks Act is in urgent need of amendment. As noted above, this legislation needs to provide a clearer foundation for *ex officio* enforcement work by Customs, including through the establishment of an IP recordal system.

The Trade-marks Act must also be revised as soon as possible to explicitly provide for criminal sanctions against counterfeiters. Absent such specific criminal provisions, authorities in Canada can only pursue criminal cases under the Criminal Code, which is more stringent, particularly with respect to proving knowledge and intent. Amending the Trade-marks Act in this manner would provide a stronger basis for the RCMP and federal prosecutors to handle counterfeiting cases. IACC members acting through the CACN have drafted comments and proposed changes to relevant legislation to address these issues.<sup>6</sup>

### **Copyright**

As with counterfeiting, there remain significant obstacles for rights owners to pursue criminal investigations and prosecutions against copyright infringers in Canada. Under current guidelines, the RCMP will generally limit their actions to cases involving larger-scale commercial enterprises. Presently, copyright infringement at the retail level is not considered a priority, thereby leaving an obvious gap in the enforcement net.

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<sup>6</sup> See <http://www.cacn.ca/PDF/CACN%20&%20Trade%20Marks%20Act%20May%202005.pdf>.

## Conclusion

Problems with counterfeiting in Canada need to be much higher on the overall political agenda. The IACC hopes that continued attention to the problem by U.S. government will help stimulate further attention to the issue by government and legislative leaders in the country.

The IACC meanwhile recommends the following steps by the government of Canada:

- Make IP enforcement a political priority and devote significantly greater resources to Customs, police and prosecutors, particularly at key points of entry such as Vancouver, Toronto and Montréal;
- Take other meaningful steps necessary to facilitate the imposition of significantly greater judicial and administrative penalties against counterfeiters and copyright pirates;
- Strengthen existing legislation to deal with counterfeiting in greater detail, including through revision of the Trade-marks Act to provide for criminal penalties and thereby close existing loopholes in the law;
- Revise customs rules and the Trade-marks Act to facilitate *ex officio* seizures by Customs against infringing product intended for the Canadian market as well as transshipments, and the destruction of seized items;
- Issue laws and regulations needed to create a proper recordal system for IP rights by Canadian Customs;
- Amend Canadian Customs and trademark legislation, as needed, to otherwise bring Canadian law up to international standards; and in particular, to eliminate unreasonable obstacles to the confiscation and destruction of infringing goods and early disclosure of information needed by IP owners, to facilitate private investigations and civil actions against importers and overseas suppliers; and
- Strengthen government leadership and coordination among the various law enforcement authorities responsible for anti-counterfeiting and anti-piracy.

## CHINA

### **Recommendation: Priority Watch List; Section 306 Monitoring**

#### **Introduction**

The detailed concerns set out in the IACC's February 11, 2005 Special 301 report and the IACC's September 15, 2004 letter in response to the USTR's July 29, 2004 Request for Public Comment concerning China's compliance with WTO commitments, remain by-and-large the same.<sup>7</sup> China continues to be the single biggest source of counterfeit product worldwide, and the steps taken by the Chinese government and judiciary over the last year to reduce counterfeiting and piracy have not yet achieved significant and necessary reductions in the level of infringements. Indeed, most of our members with serious problems in China believe that exports of counterfeits and pirated products from China seem to be increasing. Meanwhile, infringers are increasingly exploiting the Internet as a platform for promotion and trade.

Over the last year, there has been a noticeable increase in the number of arrests and prosecutions for counterfeiting in China, due mainly to support from the Ministry of Public Security ("MPS"), China's national police force. Government statistics suggest an apparent 50% increase in arrests in 2005 as compared to 2004. It is hoped that this trend will continue, particularly following the establishment on January 1, 2006 of a new IP Crimes Unit within the Economic Crimes Investigation Division ("ECID") of the MPS. This new IP Crimes Unit is staffed with six full-time officers.

However, the vast majority of IACC members report only modest increases in the number of criminal arrests and convictions of trademark counterfeiters, and almost no criminal actions against copyright pirates or exporters of counterfeit goods. In relative terms, the total number of criminal actions in China is still grossly inadequate, and it is likely to remain this way even if the number of arrests and convictions continues to increase by 50% each year.

Administrative penalties--still the mainstay of the current trademark and copyright enforcement system in China--remain grossly inadequate and in most cases create little if any noticeable deterrent to further infringements. Moreover, serious obstacles still remain in the transfer of most administrative cases to the police.

Following the July 2005 JCCT consultations between the Chinese and American governments, the PRC's government undertook to issue new regulations to promote the transfer of administrative cases, including customs cases, to the police for criminal investigation. Three such regulations are reportedly under preparation, but none of them have yet been issued.

Overall, central government authorities and a growing number of local government leaders are increasingly saying the right things about the need for stronger criminal as well

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<sup>7</sup> For copies of these submissions, see <http://www.iacc.org/2005-301.pdf> and <http://www.iacc.org/china0904.pdf>.

as administrative enforcement. But to achieve real progress, the national and local governments will need to allocate significantly greater human and material resources for Chinese police (the “Public Security Bureaux” or “PSBs”), particularly in key hotspots, such as Guangdong Province. Despite positive pronouncements in recent months over the increase in criminal actions against counterfeiters, there has been no indication that the national or local governments have made available greater resources to local PSBs.

In sum, the IACC believes that China is failing to comply with its obligations under Article 61 of the TRIPS Agreement to provide *effective* enforcement that has a *deterrent* impact.

The IACC has taken note of the recent dialogue between the U.S. and Chinese governments following the TRIPS Article 63 request by the U.S., Japan and Switzerland seeking information from the Chinese government on the legal basis for penalties imposed against infringers in certain cases arising from 2001 to 2004. The Chinese government responded to this request in January 2006, indicating confusion over the nature of the request. The Chinese also underscored that their government is not required under WTO rules to provide answers in response to the Article 63 request. The Chinese government’s response may reflect its reluctance to invest the time and resources needed to prepare a detailed response. But the IACC questions whether the Chinese government is simply reticent to open up dialogue with foreign governments over serious structural gaps in Chinese laws and enforcement practices.

The IACC strongly supports the Article 63 request, and it urges the Chinese government, judicial authorities and the Chinese legislature, the National People’s Congress (“NPC”), to begin an urgent review of the sufficiency of the country’s existing laws and policies on administrative, criminal and civil enforcement of trademarks and copyrights.<sup>8</sup>

The IACC fully recognizes and encourages the progress that the Chinese government has made to date in anti-counterfeiting. However, our members question whether key leaders in the government fully understand the degree of harm caused by counterfeiting and piracy to rights holders (both foreign and domestic), to consumers, and to China’s overall development, and whether they appreciate the need for much deeper measures to address these problems.

## **Trademark**

### **1. Range of Harm Caused**

Counterfeiting in China during 2005 continued to cause severe harm to virtually all IACC member companies. Most members report not only serious counterfeiting inside the country, but with exports as well.

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<sup>8</sup> The State Council and NPC have recently indicated plans to study possible changes to the PRC Trademark Law and Copyright Law by 2008, while there are no plans as yet to amend the Criminal Code, which is the law dealing with criminal enforcement of IP rights.

The range of products affected is the same as in prior years, and includes: electronics, pharmaceuticals, household appliances, computer peripherals, auto parts, lighters, optical media, toys, apparel, footwear, luxury accessories (including handbags, watches and eyewear), and cigarettes.

Counterfeits of some of the above products pose significant threats to human health and safety. In fact, counterfeiting of pharmaceuticals, in particular, appears to be growing to the point where many of the more widely used drugs suffer from counterfeiting at rates of 30% or more.

The provinces in China where counterfeiting poses the greatest challenges include the provinces of Guangdong, Zhejiang, Jiangsu, and Fujian. The cities of greatest concern include the following:

- Guangzhou, Shenzhen, Shantou, Chaoyang, and Jieyang (Guangdong Province)
- Yiwu, Cixi, Taizhou and Wenzhou (Zhejiang Province)
- Linyi (Shandong Province)
- Quanzhou and Jinjiang (Fujian Province)
- Shenyang (Liaoning Province)
- Shijiazhuang (Hebei Province)
- Zhengzhou (Henan Province)
- Beijing
- Shanghai

IACC members in many industries have noticed an increasing trend for counterfeiters to operate at night (when enforcement actions are more difficult to organize through most authorities) and through unlicensed or “underground” factories and other business fronts. Furthermore, IACC members report much more extensive use of the Internet for both domestic and international trade in fakes. This includes through well-known B2B portals, such as Alibaba.com, as well as through smaller sites, which are easily identified through simple Google searches. Fashion and apparel brands are clearly some of the victims in this regard, but sites offering fakes of high-tech products, such as computer peripherals and other electronic products, are now proliferating, with most operators seemingly based in or near the city of Shenzhen. Private investigations into these smaller and more sophisticated operators have proved particularly difficult, even though the sites concerned operate in the open and normally purport to offer multiple brands of fakes. But so far, Chinese police do not appear to be proactively interested in pursuing these sorts of cases, ostensibly due to the lack of evidence of their scale.

For various reasons, it has been difficult for the IACC and its member companies to generate extensive survey data to illustrate the scope and scale of counterfeiting problems in China. However, most of our members are able to recite a litany of experiences that clearly illustrate the seriousness of the problem, as well as the difficulties encountered in the course of investigating and pursuing legal remedies against Chinese counterfeiters.

Data collected by the Chinese government in 1999 and 2002 confirms that the scope of counterfeiting for both local and foreign brand owners during those years was consistent with the estimates given by IACC and other multinational brand owners.<sup>9</sup> Annual industry surveys of leading multinationals, including many IACC members, have suggested that the level of counterfeiting has remained the same or deteriorated since 2002, and that the proportion of foreign companies impacted by exports of counterfeits to other countries has dramatically increased in the last three years.

Meanwhile, a survey undertaken in 2005 by the U.S.-China Business Council revealed that IP enforcement is now one of the top business issues for American companies operating in China, while another survey undertaken by the American Chamber of Commerce in Beijing revealed that 80% of companies polled regarded China's enforcement efforts as "ineffective or totally ineffective".<sup>10</sup>

Updated statistics concerning the seizure of China-sourced products in the U.S., Europe and other countries are not yet available, but IACC members believe that the trend revealed in 2004 figures continued through 2005. But as of May 2005, the Department of Homeland Security reported that 70% of all seizures during the first half of the year originated in China, up from 61% during the same period in 2004.<sup>11</sup>

## 2. Government Progress in Anti-Counterfeiting

IACC members have been very much heartened by the successful cooperation during 2005 between Chinese and American enforcement authorities which led to the arrest of Chinese and foreign counterfeiters of pharmaceuticals<sup>12</sup> and copyright pirates.<sup>13</sup> The IACC

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<sup>9</sup> See reports of the Development Research Center ("DRC") of the State Council, available at <http://www.qbpc.org.cn/en/about/references/drcreports>. The 2002 report estimated that the total value of fake products in the Chinese market in 2002 remained roughly the same as in 1999, between US\$20 to 25 billion. Respondents to the survey estimated that, on average, about 8% of their brands circulating in the Chinese market were counterfeit. The DRC estimated tax losses caused by counterfeits in 2002 at US\$3.3 to \$4.2 billion, which were at least 20% higher than losses estimated for 1999.

<sup>10</sup> For U.S.-China Business Council survey results see [http://www.uschina.org/public/documents/2005/08/2005\\_membersurvey.pdf](http://www.uschina.org/public/documents/2005/08/2005_membersurvey.pdf).  
[http://www.findarticles.com/p/articles/mi\\_m0WDP/is\\_2005\\_Sept\\_5/ai\\_n15403331#continue](http://www.findarticles.com/p/articles/mi_m0WDP/is_2005_Sept_5/ai_n15403331#continue).  
<sup>11</sup> [http://www.customs.gov/linkhandler/cgov/import/commercial\\_enforcement/ipr/seizure/fy05\\_midyear\\_stats.ctt/fy05\\_ipr\\_midyear.pdf](http://www.customs.gov/linkhandler/cgov/import/commercial_enforcement/ipr/seizure/fy05_midyear_stats.ctt/fy05_ipr_midyear.pdf). Seizures from China and Hong Kong are combined, given that most (if not all) products sourced from Hong Kong are ultimately produced in mainland China. Indeed, many products imported into the U.S. from the Middle East and other countries may well have been produced in China, but there is inadequate evidence available to confirm this.

<sup>12</sup> See Private Investigator News and Information, Dec. 27, 2005, at <http://www.asginvestigations.com/pi-stories/index.php?p=108.htm> (Reporting that in August and September 2005, Chinese and U.S. authorities arrested 12 people and seized \$4.3 million in fake drugs during a joint sting, called "Operation Cross Ocean", a tip from Pfizer and Eli Lilly & Co. led investigators to an operation that made Viagra's active ingredient in central China, packaged fake pills in the port city of Tianjin, and shipped them to Washington state. Counterfeit Cialis and Lipitor also were found. "Viagra opened the window to a counterfeit drug industry that existed and nobody knew about it," said John Theriault, a veteran of the FBI who is Pfizer's vice president of global security.)

<sup>13</sup> See <http://usinfo.state.gov/xarchives/display.html?p=washfile-english&y=2005&m=April&x=20050420184149mbzemog0.9925196&t=xarchives/xarchitem.html> (reporting on

recognizes these cases as true breakthroughs and models for future cooperation between the U.S. and China. However, the scope of cross-border counterfeiting of famous brands both to U.S. markets and worldwide remains enormous and will require a great deal more cooperation and resources than has so far been the case.

IACC members have also been heartened by some of the recent statistics on criminal enforcement of IP provided by various authorities in China despite their lack of completeness and clarity. For example:

- From November 2004 (the commencement of the “Mountain Eagle” enforcement campaign) to the end of 2005, the MPS reported that local police had handled 3,534 IP cases (mainly counterfeiting), successfully concluding 3,149 of them.<sup>14</sup> During 2005 itself, the number of arrest approvals for IP cases increased 51% over the prior year, to 1,799.<sup>15</sup> The cases dealt with reportedly involved infringing product valued over US\$327 million;
- National prosecutors reported prosecutions of 2,787 persons for IP crimes in the first 11 months of 2005, an increase of 17.7% over the prior year<sup>16</sup>; and
- Chinese criminal courts reportedly accepted 3,250 IP cases during the same period, representing a 28% increase over the prior year. By contrast, the total number of criminal IP convictions for the five years spanning 2000 to 2004 was only 2,566.<sup>17</sup>

The above statistics are incomplete and confusing in a number of critical ways, e.g., they are not broken down by the nature of IP rights infringed or the region in which actions were taken. Furthermore, it is unclear whether they incorporate statistics concerning arrests and convictions for Criminal Code violations that do not directly relate to IP, e.g., the crime of selling “fake and shoddy” goods under Articles 140-149 or the crime of “illegal operations” under Article 225. The IACC strongly encourages the Chinese government to carefully review its procedures for gathering and publishing enforcement data so that the public will have a better tool for measuring progress.

But what *is* clear from available data is that the government is failing in its efforts to ensure the prompt transfer of cases initially handled by administrative enforcement authorities to the police. According to a White Paper issued by the State Office of Intellectual Property Protection in April 2005,<sup>18</sup> out of over 113,000 cases handled between 2001 and 2004 by the most active administrative enforcement body in China, the Administrations for Industry and Commerce (“AICs”), only 283 cases involving 300 individuals were transferred to the PSBs for criminal investigation. Officials with the State Administration for Industry and Commerce (“SAIC”), China’s largest and most important administrative enforcement body for trademark

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April 2005 conviction of American Randolph Hobson Guthrie III and Abram Cody Thrush in Shanghai following a joint investigation by ICE and PSB authorities).

<sup>14</sup> See website of the State Office of Intellectual Property Protection posting on January 13, 2006 at <http://ipr.mofcom.gov.cn/aarticle/xxfb/200601/20060101415973.html> (Chinese).

<sup>15</sup> See <http://ipr.mofcom.gov.cn/aarticle/jlyd/200601/20060101399200.html> (Chinese).

<sup>16</sup> See [http://news.xinhuanet.com/english/2006-01/13/content\\_4050320.htm](http://news.xinhuanet.com/english/2006-01/13/content_4050320.htm).

<sup>17</sup> See <http://ipr2.mofcom.gov.cn/aarticle/speechactivity/200506/20050600136729.html> (Chinese).

<sup>18</sup> See <http://www.iacc.org/chinawhite.pdf>.

rights, recently indicated that the number of individuals and cases transferred to the police during 2005 is likely to be less than 120, or less than 0.3% of the total.

These figures clearly illustrate one of the most critical barriers to progress under the current enforcement regime in China. The vast majority of trademark infringement complaints are filed with the AICs, which are in turn required to transfer cases suspected of being criminal violations to the PSBs for further investigation. Based on their direct experience in China, IACC members believe that the rate of transfers would be dramatically higher, but for ambiguities in the law, insufficient police resources and a general lack of political will. The IACC therefore urges the Chinese government to more carefully review all available options for ensuring that cases warranting criminal transfers are handled properly.<sup>19</sup>

Meanwhile, the SAIC reported that, for the first half of 2005<sup>20</sup>, local AICs had conducted extensive inspections and taken action in 18,130 trademark infringement cases, 2,451 of which involved foreign brands. AIC raid actions in this period netted 14.45 million counterfeit trademark labels, 7 million units of infringing products, and resulted in fines of RMB 115 Million (about US\$14 million). Thus, the average fine imposed against infringers in the first half of 2005 was actually just US\$772. Furthermore, the total amount of fines imposed by AICs, only \$14 million is clearly paltry. No enforcement statistics of any kind have yet been published by two of the other key administrative enforcement authorities in China, the Technical Supervision Bureaux (“TSBs”) and Customs.

The IACC recommends that the national government establish a centralized database of pending and resolved cases that would allow closer monitoring and supervision of difficult cases by higher-level authorities, more accurate analysis of trends, identification of repeat offenders and better coordination in cross-jurisdictional cases. It is tentatively suggested that this proposed database be managed mainly by the MPS.

### 3. Laws and Regulations

Over the past year, no significant new laws or regulations were published in China to fill the gaps in enforcement identified in our earlier report.

Trade Fairs - New regulations on the protection of IP at trade fairs were issued in late December and enter into effect on March 1, 2006. However, an initial review of these regulations indicates no significant changes from earlier regulations.<sup>21</sup>

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<sup>19</sup> IACC members report having greater success in achieving transfers of cases to the police, provided they invest a significant degree of time and resources to lobby relevant officials. Regulations issued by the Supreme People’s Procuratorate in March 2004 were expected to lead to reduce the need for such lobbying by facilitating intervention by higher-level prosecutors and police, but these regulations appear to have had limited impact so far. One idea floated by Chinese officials recently to increase the impact of prosecutor supervision is to require that copies of all administrative enforcement decisions issued be copied to the local prosecutors office for review.

<sup>20</sup> See SAIC report at <http://sbj.saic.gov.cn/pub/show.asp?id=74&bm=zfal>.

<sup>21</sup> The new and previous regulations on IP enforcement at trade fairs provide a reasonably efficient means for forcing exhibitors of goods infringing trademarks, copyrights and patents to have them removed from display on the order of either local administrative enforcement authorities or a committee comprised of exhibition managers and enforcement authorities. Exhibitors found to display infringing items on three occasions are to be prohibited from participation in subsequent exhibitions.

SAIC Enforcement Guidelines - Further, SAIC recently indicated that the Chinese Trademark Office has suspended work on new enforcement guidelines. Following the amendment of the PRC Trademark Law and Implementing Regulations thereto in 2002 and 2003, respectively, the proposed enforcement guidelines had previously been expected to help local AICs in calculating fines and determining the conditions under which authorities would be empowered to confiscate and destroy infringing products, raw materials and production equipment used to make counterfeits. The need for such guidelines, explained in detail in the IACC's 2005 Special 301 submission,<sup>22</sup> had been widely acknowledged by many Chinese officials over the last few years, and no satisfactory explanation has yet been provided for the decision to suspend drafting. IACC members believe these regulations are still sorely needed, as fines imposed by local AICs clearly remain too low to create a meaningful deterrent in most cases. Meanwhile, IACC members report continued problems with fake products being returned to counterfeiters after AIC raids. Furthermore, IACC members report unacceptable delays in enforcement by AICs resulting from the imposition of new requirements that Powers of Attorney from foreign companies be notarized and legalized before raid actions can commence in Shenzhen, Guangzhou and a growing number of other cities. These requirements do not apply to local trademark owners, which presents questions of discrimination.

Transfer of Cases – During the July 2005 JCCT consultations, the Chinese government agreed to issue regulations that would facilitate the transfer of customs and other administrative cases to the Chinese police for criminal investigation. The Chinese government subsequently indicated that three drafts relating to such transfers were under preparation—one by the Supreme People's Procuratorate ("SPP"—the national prosecutors office), one being drafted jointly between the MPS and SAIC, and one by the MPS and the General Administration of Customs. Officials had indicated plans to issue these regulations by the end of 2005 or possibly in early 2006. In the absence of these regulations, transfers of customs cases remain rare, and wholly reliant on the goodwill and good relations between local Customs and PSB officials.

The IACC understands that the drafters of the customs transfer rules are particularly concerned over the need to give proper guidance to local authorities in determining the conditions under which exporters who acted as mere middlemen can be determined to have acted with the level of knowledge required for a finding of criminal liability. The IACC recognizes that this is not a simple issue. However there is a considerable amount of information on international practice that can be drawn upon to address the issue.<sup>23</sup>

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<sup>22</sup> The Implementing Regulations to the Trademark Law, issued by the State Council in September 2003, provide for significantly greater maximum fines—up to 300 percent of the illegal business amount—and a discretionary fine of up to RMB 100,000 (US\$12,000) in cases where the scope of an infringement cannot be determined due to the lack of evidence. These regulations also contain provisions permitting the destruction of counterfeit goods and equipment used primarily to make counterfeits. The Trademark Office of the SAIC had been expected to issue rules since 2002 to give guidance to local AICs in the calculation of fines and the conditions under which infringing goods and related production equipment may be destroyed. Without such rules, local AICs are left a high degree of discretion, which experience indicates they are unlikely to exercise in an aggressive manner, absent pressure from higher-level political authorities.

<sup>23</sup> Generally speaking, under international practice, Customs and police authorities will search for circumstantial evidence that proves that an exporter must have had knowledge that the goods being exported were fake. Such

Clarification of Judicial Interpretation - A significant portion of the IACC's 2005 Special 301 report was dedicated to a detailed analysis of the December 19, 2004 judicial interpretation on IP crimes issued jointly by the Supreme People's Procuratorate ("SPP") and the Supreme People's Court ("SPC"). The interpretation reduced the numerical thresholds for criminalization of IP offences including counterfeiting, by between 50% to 70%. However, IACC members believe this reduction has only marginally increased their ability to bring criminal cases, as counterfeiters appear in many cases to be aware of the new thresholds and are taking additional measures to avoid detection.

At the same time, the SPP and SPC have during the course of 2005 failed to supplement the interpretation in order to clarify any of the critical ambiguities described in the IACC's earlier report. Principal among these are the following:

- Calculation of Case Values – The interpretation failed to clarify whether the authorities should use the retail price of legitimate goods when calculating case values. In the absence of clarification, most authorities are using prices declared by infringers or otherwise inventing prices without a clear empirical basis. Fortunately, pricing bureaus, police, prosecutors and courts in some regions have been relying on legitimate product prices, but the lack of a clear rule is leading to significant additional legal costs as well as uncertainty of case values.
- Inclusion of Semi-Finished Products and Raw Materials in Case Values – The judicial interpretation fails to indicate whether semi-finished products and raw materials—including those bearing offending trademarks—may be included in the calculation of case values. Predictably, local enforcement authorities have erred on the side of caution, and excluded them, thereby leaving a major loophole for counterfeiters.
- Repeat Offender Rule – Earlier prosecution guidelines provided a “three-strike” rule, under which repeat offenders would be subject to criminal prosecution after two prior administrative violations. The December 2004 interpretation contains no mention of this rule, thereby leaving IP owners and enforcement authorities without a proper tool for dealing with more egregious small-scale offenders.
- Differing Numerical Standards for Individuals and Enterprises – The interpretation provides for numerical thresholds that are three times higher for corporate infringers as compared to individual infringers. There is little clear justification for the difference in thresholds, and indeed, it could be argued that corporate violators should bear a heavier burden than individual offenders.

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evidence may include the lack of routine documentation, delays or a refusal to respond to government requests for information or documentation, prices that are obviously below market prices, and other suspicious conditions. Authorities may also inquire into whether the exporter took reasonable measures to verify that the use of the IP rights was authorized. Such reasonable measures may include: a search to determine whether authorization documents issued by IP owner or registered user were properly filed, a direct check with the IP owner, and / or trademark searches.

- Catch-All Provision – It had been hoped that the catch-all provision in the interpretation<sup>24</sup> would be used by authorities to deal with common cases in which the evidence available of the scope of infringements is circumstantial, but still highly persuasive, e.g., where production molds bearing infringed brands are well-worn, where extensive documentation is found but without explicitly indicating the brands involved, and where significant quantities of branded and unbranded raw materials are seized, but only a limited quantity of finished product.
- Exports - The interpretation fails to confirm that “exporting” of infringing products constitutes a form of “sale” under the Criminal Code. It also fails to clarify in greater detail the types of evidence that could be used to raise a presumption of knowledge, such as needed to pursue the criminal liability of vendors and accessories, including import-export agents.<sup>25</sup>

Criminal Code Revision – As explained in the IACC’s 2005 Special 301 submission, our members believe that China’s Criminal Code and the entire “thresholds” approach to criminalization of counterfeiting and other IP offences fails to comply not only with the requirements of Article 61 of the TRIPS Agreement, but also with plain common sense.

As illustrated above, threshold requirements leave too much room for interpretation and thereby create too many loopholes that are readily exploited by counterfeiters. Absent a very high degree of proactive intervention from the SPP and SPC, the IACC believes that the Criminal Code is unworkable.

It is hard to believe that the NPC *intended* for these loopholes to exist, and the IACC therefore recommends that the State Council and NPC quickly focus on the options for revision of both the trademark and copyright provisions of the Code.

Chinese jurists often explain the thresholds approach to criminalization as a mere extension of the country’s well-established legal traditions. Almost all economic crimes in China are handled in the same way, with liability thresholds clearly set out in judicial interpretations from the SPC, prosecution guidelines of the SPP, or Criminal Code itself. By contrast, in other countries, the level of transactions of a violator may be relevant for determining the type of crime (a misdemeanor, felony or a particular class of the same) and for determining the appropriate sentence.

The IACC has conducted a review of most economic crimes under the Criminal Code and verified the current liability thresholds under each.<sup>26</sup> It is readily apparent that the threshold for most crimes is between RMB5,000 and RMB10,000 (US\$650-1,300), whereas the threshold for IP crimes is 10 or more times higher—RMB50,000 (US\$6,500) for individuals and RMB150,000 (US\$19,500) for corporate offenders.

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<sup>24</sup> The interpretation permits criminalization of trademark counterfeiters and publishers of pirated works under “other circumstances of a serious nature”, without providing guidance as to what would fall within this exception.

<sup>25</sup> Ibid.

<sup>26</sup> See <http://www.iacc.org/3012006ChinaLiabilityStandardsAnalysis.xls>.

Article 61 of the TRIPS Agreement explicitly provides as follows:

“Remedies...shall include imprisonment and/or monetary fines sufficient to provide a deterrent, **consistently with the level of penalties applied for crimes of a corresponding gravity.**” (emphasis supplied)

The IACC believes that counterfeiting is as serious, and in some cases is more serious, than other categories of economic crime, and we therefore believe that China’s decision to impose substantially higher numerical thresholds for counterfeiting and copyright offences lacks a logical and principled foundation. At the same time, we believe it patently violates the requirements of Article 61 of the TRIPS Agreement of the WTO.

Chinese jurists and policy-makers have on occasion attempted to explain the differences in the thresholds between IP and other economic crimes on the grounds that administrative enforcement penalties are comparable to criminal enforcement. The IACC rejects this proposition, and for a number of reasons:

- The TRIPS Agreement does not indicate administrative enforcement can substitute for criminal enforcement. Indeed, it makes it clear that criminal enforcement must be available to address counterfeiting and copyright piracy that takes place on a “commercial scale”, and the current thresholds are far beyond that level.
- Administrative enforcement authorities in China lack the full range of investigative powers that are normally held by police;
- The administrative penalties actually imposed by administrative authorities have proved to be very weak, and AICs have routinely reported difficulties in imposing higher fines, lest the infringer refuse to pay;
- Experience confirms that in almost all cases, the violator has already dealt in a quantity of product that exceeds relevant thresholds, and is engaged in a continuing violation at the time of detection and intervention by the authorities. Law enforcement authorities and IP owners cannot invest unlimited resources to investigate violations. The threat of criminal investigations and criminal penalties against smaller targets is therefore necessary to send an appropriate message of deterrence; and
- Counterfeiting is at least as serious as other types of economic crime, as it carries with it many serious consequences. This is illustrated by the enormous tax losses created by counterfeiting—estimated in 2002 in China to be between RMB 27 and RMB 34 billion (US\$3.2-4 billion).<sup>27</sup> Almost no counterfeiters pay taxes, and most are engaged in violations of multiple laws and regulations for which they are never punished.

Civil Enforcement under Trademark Law – As in other countries, IACC members have not routinely resorted to China’s civil courts to seek compensation and other remedies available. Criminal and administrative sanctions are generally considered more deterrent and cost-effective, particularly since most counterfeiters go to great lengths to shield their

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<sup>27</sup> See DRC report of 2002, note 9 above.

assets. However, trademark owners are increasingly finding it necessary to increase the level of deterrence by seeking compensation and preliminary injunctions.

IACC members welcomed the introduction into the PRC Trademark Law and Copyright Law in 2002 provisions allowing recovery of “statutory damages” up to RMB 500,000 (US\$62,500) as well as litigation costs. In practice, however, Chinese courts have been somewhat conservative in their calculations of compensation, and in most cases, the actual costs of investigations, raids and civil actions substantially exceed court awards. The IACC therefore recommends the SPC to issue a notice or interpretation that will encourage local courts to be more generous in their awards. We also recommend the State Council and NPC increase the maximum amount of statutory damages available incidental to the next round of amendments of both the Trademark Law and the Copyright Law.

IACC members have also observed that courts in many major cities in China are extremely conservative in their awards of preliminary injunctions. In Beijing, for example, we understand that the courts have in the last year only issued one such order. We therefore recommend that the SPC issue further guidance to local courts to educate them on the conditions under which preliminary injunctions may be issued.

Finally, the IACC recommends that the SPC and local courts in China consider reducing bond requirements imposed as a condition to evidence and asset preservation measures targeting counterfeiters and other infringers of IP rights found to be acting in patently bad faith.

#### 4. Landlord Liability Initiatives

The IACC has been encouraged to learn of the recent decision of the Shanghai Municipal Government to close the infamous “Xiangyang Market”, and we welcome the recent statements of the Shanghai Mayor confirming that the market’s closure is necessitated by the rampant sale of counterfeit fashion and apparel products.<sup>28</sup>

No decision has yet been taken to shut down the infamous “Silk Street Market” in Beijing, which has long been perhaps the single biggest symbol of China’s IP enforcement problems. However, there are indications that the Chinese government is prepared to deal more systematically with counterfeiting of luxury and apparel goods by threatening landlords of major retail and wholesale markets in Beijing with sanctions and thereby pressuring them to police IP compliance in their markets. If successful, these efforts could lead to wider enforcement campaigns that will benefit all industries, and not just luxury and apparel companies.

In parallel to the government’s actions, certain IACC members filed civil claims in mid-2005 against the Silk Street Market landlord, Beijing Xiushui Haosen Clothing Co. Ltd. (“Haosen”).<sup>29</sup> The Beijing No. 2 Intermediate Court’s IP Tribunal made positive decisions in December 2005 in five civil actions against Haosen. The court’s decisions, which were

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<sup>28</sup> See WomensWear Daily, February 1, 2006 at <http://www.wwd.com/search/article/104055?query=xiangyang>.

<sup>29</sup> See China Business Review, January 2006, at <http://www.chinabusinessreview.com> (subscription).

widely covered in the Chinese and international press,<sup>30</sup> confirmed the contributory liability of the landlord, i.e., they clarified the responsibility of the landlord to take “timely and effective” measures to stop infringements by vendors in the market upon being notified thereof. The decisions are now under appeal before the Beijing Higher People’s Court.

The Beijing municipal AIC meanwhile issued notices in March 2005 warning landlords as well as vendors of the risk of administrative fines if they continued to infringe rights in 49 luxury brands. Between April and October 2005, the Xicheng and Chaoyang District AICs in Beijing followed through by imposing fines against five landlords, including Haosen. The Beijing AIC is also gradually implementing a program under which it will require vendors to produce evidence that they have obtained authorization from the trademark owners to distribute their brands. The Beijing AIC is also planning to significantly increase fines imposed against vendors and landlords for repeat offences, but the Beijing PSB has to date been resistant to pursuing criminal actions against repeat offenders, unless they are found to have dealt in fakes of the same brand at least three times.

IACC members remain concerned about the fate of the appeals of the Silk Market decisions pending with the Beijing Higher People’s Court, but we are equally concerned about the true level of commitment of the Beijing city government and SAIC to the Beijing AIC’s current enforcement initiative targeting landlords. History has proven that most administrative enforcement initiatives in China have had a temporary impact and been motivated solely by political pressure. In the past, once political pressure has subsided, counterfeiting would normally return to its earlier levels, or sometimes increase.

While the Beijing AIC’s initiatives in relation to luxury brands are of course welcomed, if the current campaign targeting landlords is to be truly meaningful, it will also need to provide equivalent protection for non-luxury items. The stated reason for its focus on luxury products is the difference in price and the need for simplicity in identifying fakes during market inspections. But the authorities should be encouraged to ensure that landlords are equally accountable for counterfeiting not only of fashion and apparel, but goods in entirely different sectors, including auto parts, pharmaceuticals, optical discs, sports equipment, etc.

Deleted:

The IACC is aware of tentative efforts by AICs in Shanghai, Hangzhou and Guangzhou to implement enforcement programs similar to those in Beijing; and in Guangzhou, regulations were recently issued by the municipal government that target landlords to unregistered businesses engaged in illegal activities. The IACC is closely monitoring developments on these fronts.

### **Copyright**

Piracy of optical discs remains a critical problem for IACC members, notwithstanding the apparent increase in government seizures and the closure of illegal

<sup>30</sup> See Businessweek Online, January 10, 2006 at [http://www.businessweek.com/bwdaily/dnflash/jan2006/nf20060110\\_3904\\_db039.htm?campaign\\_id=search](http://www.businessweek.com/bwdaily/dnflash/jan2006/nf20060110_3904_db039.htm?campaign_id=search).

optical disk production facilities.<sup>31</sup> Pirated product manufactured in Chinese plants is increasingly being exported, which suggests that the Chinese government's efforts to clamp down on the source of supply have either relaxed in recent years or that production and distribution is outstripping the ability of enforcement authorities to deal with the problem.

The Chinese government recently claimed to have imposed administrative sanctions against copyright infringers in over 8,000 cases in 2005, with 282 individuals transferred to the police for criminal investigation.<sup>32</sup> The government has also recently reported that in a three-month enforcement initiative at the end of 2005 focusing on copyright infringements on the Internet, 76 websites were shut down, 137 sites were ordered to delete infringing content, and fines of almost US\$100,000 were imposed. Furthermore, eight cases were transferred to Chinese police for criminal investigation.<sup>33</sup>

Notwithstanding the above, the IACC members have received only scant information on criminal enforcement against copyright infringers in the last few years, and our members remain concerned over the lack of transparency in the government's record in both criminal and administrative enforcement in this regard.

Furthermore, in practice, our members report extreme difficulty in convincing local police to commence criminal investigations into any copyright cases. Our members likewise report extreme difficulties in convincing administrative enforcement authorities to cooperate in the transfer of cases to the police.<sup>34</sup>

The impression ultimately created among IACC members is that the Chinese police are decidedly uninterested in criminal enforcement of copyrights—particularly those involving foreign rights holders.

Where criminal enforcement does take place, action is very often based on censorship provisions in the Criminal Code (Article 225) rather than copyright provisions. This is unsatisfactory from a number of perspectives, but particularly with respect to accountability, since the impression given to the market is that the decision to pursue criminal enforcement rests solely with the government, and that complaints by the copyright owner may be ignored.

The IACC emphasizes the need for China to review provisions in its Criminal Code to ensure full compliance with the TRIPS Agreement, and eliminate or further reduce thresholds applicable to copyright crimes. We further call on the Chinese government and

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<sup>31</sup> The Chinese government claimed that in the first nine months of 2005, it had shut down 33 optical disk plants. The statistics otherwise reported concerning optical disk seizures are contradictory, but astounding nonetheless. See [http://news.xinhuanet.com/english/2006-01/13/content\\_4050320.htm](http://news.xinhuanet.com/english/2006-01/13/content_4050320.htm) (citing seizure of 225 million “illegal audio-visual products”) and [http://news.xinhuanet.com/english/2005-11/03/content\\_3722314.htm](http://news.xinhuanet.com/english/2005-11/03/content_3722314.htm) (citing the seizure of 50 million).

<sup>32</sup> See <http://ipr.mofcom.gov.cn/aarticle/xxfb/200601/20060101415973.html> (Chinese).

<sup>33</sup> See Xinhua news reports of February 5, 2006 at [http://news.xinhuanet.com/english/2006-02/05/content\\_4141096.htm](http://news.xinhuanet.com/english/2006-02/05/content_4141096.htm) and February 7, 2006 at [http://news.xinhuanet.com/english/2006-02/07/content\\_4145512.htm](http://news.xinhuanet.com/english/2006-02/07/content_4145512.htm).

<sup>34</sup> In many cases, administrative enforcement authorities will refuse to consider transfers based on the history of resistance by local police to give due priority to copyright cases.

legislature to eliminate other unreasonable obstacles to copyright enforcement contained in the Criminal Code, including the “for profit” requirement for liability in Article 218 and the provision in Article 219 which limits criminal liability for vendors of infringing items to cases where it can be proved the offender has already earned profits over RMB100,000 (US\$12,500).<sup>35</sup>

The IACC also urges the Chinese government, and in particular, the Social Order and new IP Crimes Unit of the MPS,<sup>36</sup> to allocate greater resources and give higher overall priority to criminal enforcement of copyright cases.

The IACC has further taken note of China’s undertakings in the July 2005 JCCT consultations to criminalize end-user piracy, legalize software used by government and State-owned enterprises by the end of 2005, join the WIPO Internet Treaty during 2006, and issue new regulations to implement its obligations under the treaty. With respect to end-user piracy, we understand that the Chinese government has indicated criminalization is already possible under certain conditions, but the IACC recommends that these be spelled out in regulations, a new judicial interpretation or through amendment to the Criminal Code.

### **Customs**

China’s efforts to provide protection for IP rights through customs only began in 1995, and since then national and local Customs offices in many cities have demonstrated a high degree of enthusiasm and concrete success in monitoring shipments and pursuing administrative penalties against counterfeiters.

China revised its regulations on the recordal and enforcement of IP rights in 2004, and various concerns over the changes in these regulations are described in detail in the IACC’s 2005 Special 301 submission. The concerns raised in this earlier submission are equally applicable today, and they include the following:

- The lack of rules to facilitate the transfer of larger-scale cases to the PSB for criminal investigation (see above). This includes referrals not only of trading companies that report goods to Customs but also the factories that are the ultimate suppliers of the goods;
- Requirements (in practice) that seized fakes be donated to charity without the IP owner’s approval or the opportunity for monitoring;
- The lack of deterrent administrative fines (the maximum now being 30% of the value of goods);

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<sup>35</sup> The IACC’s members in the film industry report new and troubling problems arising from the videotaping of films in Chinese cinemas. It is hoped that future revisions to the Criminal Code and other administrative regulations will facilitate the imposition of appropriate penalties for such activity, as is the case in most other countries.

<sup>36</sup> To date, responsibility for copyright crimes has been allocated to the Social Order Division of the MPS, whereas trademark and other IP crimes fall under the Economic Crimes Investigation Division. MPS officials have indicated that future complaints by copyright owners may be filed with the IP Crimes Unit, which may either transfer complaints to the Social Order Division or deal with them directly. Given the similarity of subject matter and the need to rationalize resources, the IACC recommends the Chinese government consider granting full responsibility for all IP crimes and related offences—including copyright and product quality offences—to the IP Crimes Unit.

- The lack of regulations to facilitate a general bond system, pursuant to Article 22 of the 2004 customs regulations;
- For cases initiated by Customs but later transferred to Chinese courts, the lack of rules to avoid the need for double-payment of bonds; and
- The need for greater cooperation between Customs and IP owners, particularly in disclosures of information regarding the source and destination of infringing items.

## **Conclusion**

The Chinese government's efforts to date in responding to international as well as domestic concerns over high levels of counterfeiting and piracy deserve recognition and encouragement. However, it is widely accepted that the challenges being faced are deep and complicated, and the measures taken by the government to date have predictably had only a limited impact on the overall level of infringements in the market. The IACC therefore encourages the Chinese government and legislature to conduct a more comprehensive review of the options for legal and administrative reform, focusing particular attention on the following:

- Allocate substantially greater resources to criminal prosecutions of trademark as well as copyright offences;
- Establish specialized IP enforcement units within Chinese police and prosecutors, at least in key hotspots, including Guangzhou, Shenzhen, Yiwu, and other regions;
- Promptly issue promised regulations to promote the transfer of administrative cases to the police—including most particularly customs cases;
- Amend the Criminal Code to ensure compliance with the TRIPS Agreement of the WTO, as well as with the objective needs of the market. Pending amendment of the Code, prompt clarification of numerous ambiguities and loopholes contained in the December 2004 judicial interpretation on IP crimes;
- Introduce greater transparency regarding government enforcement efforts, including regular issuance of more detailed statistics;
- Substantially increase publicity and public education for IP protection and government enforcement work;
- Adopt new measures to allow higher-level criminal and administrative enforcement authorities to promptly address protectionism and other obstacles to effective enforcement, e.g., through the adoption of new database and reporting systems;
- Strengthen administrative enforcement by the AICs and TSBs through the adoption of new enforcement guidelines and procedures;
- Eliminate notarization and legalization requirements for Powers of Attorney submitted with AIC complaints;
- Expand government efforts to press landlords to self-police against counterfeiting in retail and wholesale markets, not only for fashion but for all types of products, and throughout China;

- Request the SPC and NPC to issue new standards for awards of statutory damages and issuance of preliminary injunctions, as well as new rules that will reduce the amount of bonds required for evidence and asset preservation under the Trademark Law and Copyright Law in cases of egregious counterfeiting and piracy; and
- Consider new measures for using administrative means to control counterfeiting, including through greater regulation of the supply of raw materials for drugs and other products, as well as access to industrial-grade electricity, etc.

## **BELIZE**

### **Recommendation:    Priority Watch List**

#### **Trademark / Customs**

IACC members report continuing problems with counterfeiting, particularly in the Corozal Free Trade Zone (“CFTZ”), located on the border between Mexico and Belize. The IACC first reported in its 2004 Special 301 Report the use of the CFTZ as a channel for introducing fakes into Mexico, from which product was later shipped to the United States and elsewhere in the Americas.

Cooperation with Belizean authorities responsible for enforcement has improved since 2004, but the IACC still believes that additional laws and regulations are needed to clarify the responsibility of Customs and police in dealing with counterfeits in the CFTZ, to ensure the authorities have the authority to inspect containers passing through the zone, and otherwise facilitate seizures, prosecutions and product destructions.

To illustrate the current problems in Belize, in July 2005, a shipment of approximately three million counterfeit cigarettes was seized in the CFTZ, based on information supplied by an IACC member. The seizure was only affected following extensive consultations with local police and Customs, neither of which appeared to believe it had jurisdiction over the case.

IACC members also report that Belizean Customs are unwilling to open containers for inspections (random or otherwise) without the presence of the owner of the goods. This policy almost entirely undermines criminal enforcement work, since it ensures that counterfeiters will be given notice of seizure and an opportunity to avoid arrest and otherwise destroy relevant evidence.

Furthermore, an IACC member has reported that a case involving a Customs seizure in Belize that took place in 2004 has not been processed in a timely manner. The fake product seized appears to remain in a Customs warehouse, and no action has apparently been taken to investigate or arrest the persons responsible.

Finally, the IACC recognizes the considerable efforts of the Belize Intellectual Property Office (“BELIPO”) to educate the public, the bar, the judiciary, Customs and other law enforcement authorities on the importance of IPR enforcement, however, IACC members report a lack of responsiveness from officials in the BELIPO in dealing with inquiries from IP owners.

## **Conclusion**

The IACC recommends that Belize be placed on the Priority Watch List, and requests that the USTR encourage the government of Belize to:

- Clarify the authority of police and Customs over seizures, criminal investigations and other enforcement work in the CFTZ and other areas under Customs control;
- Devote more resources and efforts to border enforcement, particularly in the CFTZ;
- Undertake a prompt review and revision of laws and regulations in order to facilitate inspections, seizures, criminal investigations and product destructions; and
- Continue to educate the public, the bar, the judiciary, Customs and other law enforcement authorities on IP protection, and in particular the need to work more cooperatively with industry in effecting seizures of fakes and following up thereon with criminal investigations, prosecutions and the destruction of fakes.

## COSTA RICA

### **Recommendation: Priority Watch List**

#### **Introduction**

IACC members report growing problems with counterfeiting in Costa Rica, including increasing exports from the country to surrounding markets of fake products and labels. The heightened levels of counterfeiting appear in part to be the result of a recent government policy decision against the use of criminal enforcement against counterfeiters, as well a continuing lack of resources and training for police, prosecutors and Customs officials. All of this suggests the government does not recognize the seriousness of counterfeiting or copyright piracy, including the threats they pose to the public interest.

The IACC therefore recommends Costa Rica be placed on the Priority Watch List.

#### **Trademark**

Costa Rica's IP enforcement legislation<sup>37</sup> generally conforms to the requirements of the TRIPS Agreement and the CAFTA-DR Trade Agreement<sup>38</sup>. However, the government's current policies in relation to anti-counterfeiting—adopted by the current Attorney General (“Fiscal General”)—clearly indicate a lack of interest in the use of criminal investigations and prosecutions to deal with the problem. As a result, IACC members report an almost total lack of effective recourse from Costa Rica's criminal enforcement system, and we believe this constitutes an obvious violation of Article 61 of the TRIPS Agreement, which requires the Costa Rican government to provide effective and deterrent enforcement and criminal enforcement against violations occurring on a commercial scale.

In early 2004, the head of the General Prosecutor Office (“GPO”) appears to have adopted an unwritten policy of not prosecuting IP crimes unless they have a direct effect on public health or safety. In adopting this policy, the GPO relied on Article 22(a) of the Costa Rican Code of Criminal Procedures, which gives prosecutors the option of foregoing criminal prosecutions based on the “insignificance principle”, i.e., in cases where the facts or their legal effects are deemed to be so insignificant such that prosecutions are not justified. On the basis of this policy, prosecutors are legally permitted to dismiss complaints without investigation. Consequently, since 2004, IACC members have not been able to successfully pursue criminal enforcement in Costa Rica.

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<sup>37</sup> The current IP regime in Costa Rica was approved in 1999 and entered into effect in 2000. See Ley de Procedimiento de Observacion de los Derechos de Propiedad Intelectual 8039 (Observance Procedures for Intellectual Property Law – 8039), published October 27, 2000.

<sup>38</sup> Formally known as the “Central America Dominican Republic Trade Agreement” or “CAFTA-DR”.

Prosecutors have justified the current policy in relation to IP crimes based on various arguments, including the following:

- That the main objective of IP owners is to seek economic compensation, which can be obtained through civil and administrative remedies, thereby rendering criminal prosecution unnecessary and undesirable. *This argument obviously ignores Costa Rica's obligations under Article 61 of TRIPS, and the underlying policy purposes thereof, i.e., the recognition that criminal investigations are very often the only way to effectively uncover the facts and that the economic penalties alone do not normally have a sufficient deterrent impact;*
- Criminal penalties must be proportional to the harm caused, and due to the economic nature of IP crimes, prison sentences are disproportionate. *This argument again fails to recognize the irreplaceable deterrent impact of criminal sanctions, created in part by the stigma of criminal convictions and the heightened risks to violators who engage in recidivism. It also ignores the fact that courts have the power to impose fines and suspended sentences in less serious cases;*
- The victim's economic interests are not truly harmed by counterfeiting, since counterfeiters sell to different consumers than do the makers of the legitimate product. *This is not always true, and in any case, it ignores the other harm created by counterfeits to both IP owners and the public interest;*
- The Costa Rican criminal system has limited economic and human resources, and the Prosecutor's Office must only prosecute serious crimes that affect the public at large. *Clearly, counterfeiting poses serious challenges to the public interest, including through tax losses, unfair competition with smaller companies, fuelling of the "underground economy", etc; and*
- That IP owners have the economic resources to conduct private prosecutions ("querella"), and public funds should not be used to prosecute claims on their behalf. *As seen in other countries, government involvement in the investigation phase is essential, since IP owners lack the means to obtain the required evidence in more complicated cases and where infringers take extraordinary means to avoid detection.*

The Costa Rican government's decision to regard IP offenses as "insignificant" is now having direct impacts on the markets of IACC members, and as a consequence harming the environment for foreign investment in the country. Counterfeits are said by IACC members to be directly harming sales of legitimate products, and at least one clothing manufacturer has already moved production facilities out of the country as a result of these problems.<sup>39</sup>

Prior to 2004, IACC members had cooperated closely with prosecutors and police in dealing with criminal cases against counterfeiters. In many cases, our members found that the judiciary lacked sufficient training to reach appropriate decisions. In other cases, our members detected a clear bias in favor of Costa Rican nationals—evidenced in some cases through the disclosure of planned raid actions and investigations to the infringers.

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<sup>39</sup> Another apparel company that has been the victim of widespread counterfeiting is considering terminating its long-standing sponsorship of a major tourist event in Costa Rica due in part to the government's failure to adequately enforce IP rights.

The IACC has been particularly discouraged by the Attorney General's decision to disband what had before 2004 been an effective partner in police investigations into IP crimes, the *Direccion de Investigaciones Especiales del Ministerio de Seguridad Publica* (aka the Directorate of Special Investigations of the Ministry of Public Security).<sup>40</sup> By order of the Attorney General, all investigative work handled by this authority was transferred to the Office of Judicial Investigations ("OIJ"), the performance of which has been less impressive.

The OIJ does not have a specialized IP investigations unit, and IACC members report a continuing lack of cooperation which has in specific cases resulted in the loss of evidence and suspected leaks of information on pending investigation which allowed counterfeiters to relocate their production and storage facilities.

IACC members have had positive experiences with the *Direccion General del Registro Publico* (the "DGRP" or General Directorate of the Public Registry), which is the equivalent of the USPTO, but also has the power to deal with counterfeits through its administrative enforcement powers. The DGRP has carried out at least three successful operations in the past on behalf of IACC members. However, in 2005, IACC members report that the level of cooperation enjoyed has been less satisfactory than in previous years. Moreover, the jurisdictional and investigative powers of the DGRP, and the administrative sanctions they are authorized to impose by law are far more limited than those of the police, prosecutors and courts in criminal actions.

In Costa Rica and worldwide, the IACC believes strongly that administrative enforcement remedies are often a superb supplement to criminal and civil enforcement options. However, they should never be regarded as a substitute to criminal enforcement vis-à-vis government obligations under Article 61 of the TRIPS Agreement.

### **Customs**

IACC members report positive experiences with the *Direccion de Investigaciones de la Policia Fiscal de la Direccion General de Aduanas* (the Office of Investigations of the Fiscal Police of the Directorate of Customs). Customs has proved supportive and willing to work closely with IP owners in monitoring and seizing infringing items passing through their jurisdiction. As with the DGRP, however, Customs is an administrative body with limited jurisdiction and investigative powers. Moreover, IACC members report that Costa Rican Customs suffer from a severe lack of resources needed to perform their duties.

Consequently, Costa Rica is generating the reputation of being a major supplier of branded components (including labels and tags) used by counterfeit producers in other countries in Central America, and indeed a "haven" for such suppliers.

### **Conclusion**

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<sup>40</sup> This entity was previously known as the *Centro de Investigaciones de la Fuerza Publica* ("CIFP") (Investigation Center for the Public Force).

While Costa Rican law seems adequate on its face, IACC members have in practice been unable to obtain satisfactory results in their enforcement work, and we therefore recommend the government adopt the following measures:

- Retraction of the unwritten policy of the Attorney General against criminalization of IP offences and issuance of written policy papers which reaffirm the government's commitment to criminal enforcement and cooperation with IP owners in the war against counterfeiting and copyright piracy;
- Establishment of a special unit within the OIJ to deal with IP enforcement issues;
- Additional IP training for Customs, police, prosecutors and judges;
- Strengthened efforts to combat corruption and leaks of information on pending investigations and planned raid actions by government enforcers on counterfeiters; and
- Increased funding for customs inspection and enforcement work.

## MALAYSIA

### **Recommendation: Priority Watch List**

#### **Introduction**

In early 2005, USTR kept Malaysia on the Special 301 Watch List due primarily to the government's inability to deal effectively with exports of optical discs incorporating software, films and sound recordings. Over the past year Malaysia appears to have expanded its efforts to deal with these and other IP enforcement problems. However, Malaysia is still one of the largest single sources of pirated optical discs exported worldwide, and the government's efforts to target the kingpins behind this trade appear so far to be inadequate. At the same time, while the government is finally focusing more attention on the need to address systematic problems that impede anti-counterfeiting and anti-piracy work, including through increasing enforcement manpower, most of the required reforms remain in the pipeline. Furthermore, there do not yet appear to be initiatives underway to address the near total lack of IP enforcement from Malaysian Customs. The IACC therefore recommends that Malaysia be placed on the Priority Watch List.

#### **Trademark**

Counterfeiting of fashion, pharmaceuticals, batteries, computer accessories, tobacco, mobile phone batteries, food, electronics, petroleum products and toys remains problematic. IACC members have observed an increasing tendency (reflecting the global trend) for pharmaceuticals and other fakes to be traded in Malaysia via the Internet.<sup>41</sup> The Malaysian government's 2004 initiative to stem the sale of counterfeit drugs through mandatory placement of hologram labels does not appear to have had its intended impact, as counterfeiters have obtained access to both legitimate and counterfeit labels.

As elsewhere, effective action against producers and vendors of counterfeits in Malaysia will require substantially increased human and material resources. The rise of the Internet as a battlefield for anti-counterfeiting and the increasing sophistication of counterfeiters require a greater investment of time to identify and prosecute the masterminds, and the seizure of fake product and the imposition of modest fines are increasingly insufficient to deter the growth of the problem.

The Ministry of Domestic Trade and Consumer Affairs ("MDTCA"), the main IP enforcement authority in Malaysia, announced in mid-2005 that it had more than doubled its manpower to 1,500 officers, and a further increase to approximately 2,000 was recently

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<sup>41</sup> The increased use of the Internet to promote sales of fake drugs was acknowledged by Malaysia's Department of Pharmaceutical Services of the Ministry of Health. See Conference Report - Healthcom 2005, sponsored by the Asian Institute for Development Communication, at <http://www.aidcom.com/healthcom2005/healthcom%20report.pdf>.

approved. However, the MDTCA has publicly acknowledged that it requires 5,000 officers to accomplish its objectives, and interim proposals of borrowing officials from Malaysian police and other government departments have been met with scepticism due to the historical lack of cooperation between these government bodies.

The MDTCA has kept an open door to industry requests for enforcement sweeps, and has been reported to conduct regular actions against high-profile targets such as the Petaling Street market. However, the failure of the courts to process cases in a more timely fashion continues to send the message to the market that the government is not serious about anti-counterfeiting.

Though, the Malaysian government announced plans last year to establish specialized IP courts by mid-2006 to clear the backlog of about 800 civil and criminal cases which have been pending since 2003, it remains unclear at this stage how many courts will be established and how training of the judges and other judicial staff will be handled. The establishment of specialized courts has proved effective in many countries where it has been introduced, and IACC members have similar hopes for Malaysia as well.

Regrettably, official corruption and infiltration of organized crime remain serious obstacles to progress. Tip-offs of major infringers prior to raids are routine. It was also reported that a MDTCA warehouse containing seized items was destroyed in a fire on December 19, 2005, under suspicious circumstances.<sup>42</sup> The fake products destroyed in the fire were seized in 940 infringement cases and are expected to lead to the dismissal of 101 pending cases due to lack of evidence.

The impression given to many foreign companies is that, notwithstanding its resource limitations, the Malaysian government can address trademark counterfeiting much more effectively if it has the political will to do so. This is evidenced by a recent report concerning a Singaporean vendor of counterfeit computer interface cards, who was arrested and, within three days, sentenced to a fine of RM40,000 (US\$10,500) and, following the failure to pay this fine, imprisoned for six months.

Proposals raised by government and industry experts during 2005 to address counterfeiting as well as copyright piracy have included the imposition of mandatory prison terms against violators, the enactment of new legislation targeting lessors of premises used by infringers, and the adoption of new rules to facilitate private criminal prosecutions. It remains unclear at present though whether these proposals will gain traction in the coming year.

Finally, IACC members continue to lament problems in the following areas:

- Continued long delays in obtaining registration of trademarks from the trademark registry, as well as in obtaining determinations in oppositions and cancellations against pirated marks;
- Lack of cooperation by enforcement authorities and the courts in disclosing information relating to ongoing cases;

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<sup>42</sup> See reports in The Star newspaper (Kuala Lumpur) on December 20 and 21, 2005.

- Inadequate penalties under the Sale of Drugs Act of 1952 and the Poisons Act of 1962 for the production and sale of fake pharmaceuticals;
- Protection for pirates of well-known marks for registrations obtained by them prior to the 2001 amendment of the Malaysian Trademark Law; and
- Difficulties in verifying whether seized counterfeits have been properly destroyed in accordance with the law.

### **Copyright**

Domestic consumption of optical discs in Malaysia is reported to be around 60 million units. However, the production capacity of licensed plants is currently estimated at 2.5 billion units. The capacity of unlicensed plants remains unclear. It will therefore come as no surprise that copyright owners regard Malaysia as one of the single largest sources of pirated optical disc content products worldwide.

One IACC member recently reported the uncovering of a Malaysian syndicate in 2005 which was confirmed to export huge quantities of discs to the Middle East and Latin America. This company also reported sightings of Malaysian-made pirated software last year in markets as diverse as Africa, Europe, the United States, Latin America, New Zealand, Thailand, and the Philippines.

Complaints from foreign governments and industry have not gone totally unnoticed. The Malaysian government conducted investigations into 44 licensed plants in 2005, which reportedly led to the raids against operators of 12 of these.<sup>43</sup> It was also reported in November 2005 that the licences of five optical disc plants had been allowed to expire, while other unspecified actions have been taken against more than 27 other plants.<sup>44</sup>

Whether or not any of these investigations will result in prosecutions and convictions remains to be seen. One IACC member reported that, actions in September and October 2005 led to the seizure of 800,000 software discs, produced by a notorious operator of a licensed plant. No criminal charges have yet been laid against this individual or his company, and there is deep concern as to whether there ever will be.<sup>45</sup>

The production of pirated optical discs is increasingly taking place in smaller and more remote locations in Malaysia, and sometimes on ships anchored offshore. Limited government resources currently make the targeting of such factories more difficult, and emphasize the need for the creation of special teams of well-trained and resourced MDTCA officers to deal with more complicated cases.

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<sup>43</sup> See BBC news report in <http://news.bbc.co.uk/1/hi/world/asia-pacific/4411810.stm>.

<sup>44</sup> New Straits Times November 8, 2005.

<sup>45</sup> During the Second Global Congress on Counterfeiting and Piracy held in November 2005 in Lyon, France, MDTCA Minister Datuk Menteri reported that up to October 2005, Malaysian authorities had seized a total of 32 million optical discs with a street value exceeding \$100 million. It was also claimed that seizure rates had doubled over the prior year. See <http://www.interpol.int/Public/FinancialCrime/IntellectualProperty/Meeting/2ndGlobalCongress20051114/DatukMenteri.pdf>.

IACC members also report continuing difficulties in tracing the source of illegal optical discs due to the use of fraudulent shipping documents.

Notwithstanding the above problems, according to the Business Software Alliance, the rate of piracy in the business software sector has reportedly gone down by 2% in 2005, to 61%.<sup>46</sup> This progress appears to have been achieved in large part due to effective cooperation between government and industry in education, inspections, informant programs and criminal actions against businesses found to be using pirated business software.<sup>47</sup> Though this progress and cooperation in the business software sector is promising, it remains to be seen whether the Malaysian government's tentative steps towards shutting down the export of pirated optical discs business software will take root in the same way, for other products.

## **Customs**

The lack of effective customs enforcement against infringements is perhaps one of the most noteworthy gaps in landscape of Malaysia's IP regime. Sadly, over the course of 2005, the Malaysian government does not appear to have taken any public steps to address this problem, which was explained in detail in the IACC's Special 301 submission from February 2005.

Malaysia's customs enforcement regime has proved almost entirely unusable due to the lack of laws and regulations that would permit *ex officio* customs seizures and for the corresponding lack of effort by Customs to monitor import or export shipments for IP compliance. Malaysian Customs has so far not established a recordal system for IP rights, which would naturally be essential if Customs were to begin proactive monitoring of shipments.

Malaysian Customs is authorized to seize infringing shipments, provided that the IP owner provides full details of the shipment, including the name of the ship and date and time of its presence in Customs territory. Customs also requires that IP owners pay significant bonds to facilitate the seizure of products—a requirement which has routinely deterred many IP owners from taking advantage of enforcement opportunities.

Assuming infringing products are seized by Malaysian Customs, IP owners are then required to commence civil proceedings in local courts to maintain the seizure order and pursue other remedies. If the seizure was initiated under the Copyright Act 1987, infringing products can be forfeited as if they are prohibited goods under the law relating to customs. But otherwise, Malaysian Customs has no powers to impose fines or commence criminal investigations.

In the absence of an effective customs regime, the whole of Malaysia effectively functions as a free trade zone for counterfeits. But the country also operates formal free trade

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<sup>46</sup> BSA representatives in Malaysia reported a drop in software piracy rates between 1994 and 2004 from 82% to 61%. See The Star (Kuala Lumpur), July 30, 2005, confirming the reduction by 2% of the level of software piracy from 2004 to 2005. It was also noted, however, that total losses over the past year had increased marginally, rather than decreased, due to the increasing size of the local software market.

<sup>47</sup> The government's cooperation with BSA members has been organized under enforcement campaigns referred to by the names "Ops Banteras", "Ops Tulen 2005 Korporat" and "Tulen Patrol". As a consequence of these campaigns, it was reported that between October 2003 and April 2005, 782 individuals were arrested for the use of pirated software. (Source: Enforcement Division of the Ministry of Domestic Trade & Consumer Affairs)

zones which IACC members report are increasingly being exploited by counterfeiters of cigarettes and consumer goods for transshipments originating in China and other countries. It remains unclear whether the Malaysian government is fully aware of these problems and whether it has any plans in the pipeline to address them.

### **Conclusion**

Though there has been a level of change in Malaysia, the country will need to be closely monitored during 2006 to verify whether the tentative progress realized in 2005 will continue. The stakes are enormous, given the severe impact of optical disc exports from Malaysia on markets elsewhere.

The IACC also recommends Malaysia be encouraged to take the following measures in 2006 to deal with both trademark counterfeiting and optical disc piracy:

- Significantly strengthen government efforts in criminal investigations and prosecutions against the masterminds behind optical disc plants and distribution syndicates. Also, target the kingpins behind trademark counterfeiting operations for all types of products. Respond convincingly to political and other undue influence that might impede such investigations;
- Review the sufficiency of government efforts to target counterfeiting activities over the Internet;
- Begin drafting new laws and regulations to bring the enforcement capabilities of Malaysian Customs up to international standards, and ensure that infringements are subject to criminalization in appropriate cases;
- Adopt new measures to counter the increasing use of fraudulent documentation by international traders of infringing goods;
- Ensure adequate training of IP enforcement officials, and the creation of adequately resourced teams to deal with more complex and otherwise difficult cases;
- Follow through fully with plans to establish in mid-2006 specialized IP courts to deal with both criminal and civil disputes, and thereby effectively clear the backlog of unresolved cases; and
- Increase transparency, information exchanges, and cooperation between enforcement bodies and IP owners.

## MEXICO

### **Recommendation: Priority Watch List**

#### **Introduction**

Despite an indication of a greater awareness of the importance of IP enforcement on the part of the government, the same obstacles to effective and deterrent enforcement in Mexico persisted in 2005, and counterfeiting remains severe in many sectors. Counterfeiters are now developing more sophisticated importation and distribution networks throughout Mexico, and creating more efficient and damaging competition for legitimate retailers and distributors.

The Mexican government is urged to conduct a wider review of problems in the law, as well as policy and resources allocation, and to develop proposals for addressing the current challenges. Pending the adoption of a more comprehensive action plan, the IACC recommends Mexico be placed on the Priority Watch List in the hope that the Mexican government will focus greater attention on necessary reforms in the coming year.

#### **Trademark**

Counterfeiting of an ever-widening array of consumer products has steadily increased over the last several years in Mexico, including pharmaceuticals, apparel, tobacco, sporting goods, video games and other optical media. This counterfeiting has contributed to the expansion of Mexico's underground economy (aka the "informal economy"), which is currently estimated to occupy nearly 10% of GDP in the country. The Mexican government must therefore begin to factor in counterfeiting and piracy as part of its wider strategies for fighting criminality.

IACC members seeking to enforce their rights against counterfeiters in Mexico have for years noted a range of difficulties caused by the lack of political priority and resources on the part of enforcement authorities, continued corruption, and the increasing involvement of organized crime and more sophisticated operational methods of counterfeiters.

Gaps in legislation likewise continue to undermine the effectiveness of the government's enforcement efforts. Many of these gaps relate to procedural requirements that are reflective of an overly-formalistic legal tradition that is clearly in need of modernization.

The problems faced by IP owners and government enforcers have many dimensions and are complex. Resolving these problems will require more than amendment of laws and regulations. The IACC therefore recommends that the government and/or legislature review the current situation afresh and develop a comprehensive roadmap for reform.

## 1. Legal Reforms

Mexican IP legislation is too formalistic, and imposes a number of requirements on IP owners that effectively serve no purpose other than to delay and otherwise hinder enforcement efforts by rights holders. Among these are the following:

- The requirement of requesting a Technical Opinion from the Instituto Mexicano de Propiedad Industria (“IMPI”) regarding the likelihood of confusion and the determination of infringement;
- The obligation of having to disclose the identities of investigators and other witnesses, thereby hampering the effectiveness of those individuals in subsequent cases;
- The need for detailed Expert Witness Reports to verify the nature of what are obviously counterfeit goods;
- The impossibility of filing joint criminal complaints for multiple IP owners who seek to work collectively;
- The impossibility of seizing obvious counterfeits during raid actions due to the lack of a complaint having already been filed by the affected IP owners; and
- The imposition of excessive bond requirements on IP owners seeking seizures of counterfeit goods by relevant authorities.

There are currently several drafts of legislation before the Mexican Congress that would address the above and other obvious gaps in IP legislation, but the progress of this legislation has been slowed by the current lack of a majority in Congress. The viability of much of this draft legislation is also in doubt due to some of its contents, which have been considered impractical in many respects. Consequently, IACC members recommend a wider and more coordinated review of relevant legal problems and potential solutions by the Congress as well as the government.

## 2. Enforcement

Perhaps the greatest obstacle to enforcement in Mexico is the lack of sufficient resources on the part of the main investigations and enforcement authority in the country, the Procurador General de la Republica (“PGR”). The PGR and local police, who assist in conducting raids, both clearly lack sufficient manpower to respond effectively to complaints from IP owners.

The PGR’s efforts are further hindered by the formalities discussed above, which cause serious delays in the commencement of investigations and significantly impact the efficiency of the PGR’s enforcement efforts.

IACC members commend the IMPI (an administrative body) for leadership and resource support in organizing raid actions, but as in other countries, their inability to coordinate effectively with the police in more serious cases has impeded the effectiveness of the IMPI’s enforcement work.

The IACC believes the intervention of the Mexican President's office in promoting action plans before the Congress would be useful. The IACC also recommends addressing problems with inter-agency coordination by centralizing IP enforcement efforts through the creation of an IP czar, independent of the Attorney General, and the creation of a specialized police force tasked with handling IP crime investigations.

### **Customs**

As noted in the IACC's 2005 Special 301 submission, Mexican Customs has insufficient authority to deal with imports of counterfeit goods.

The earlier introduction of an "observer system" to facilitate inspections for copyright infringements by Customs has not been effectively expanded to assist trademark owners. The IACC again calls up on the Mexican government to consider other practical short and medium-term options for facilitating the monitoring of counterfeit imports for trademark owners.

Mexican Customs is also encouraged to work more effectively with the police and other authorities in sharing information needed to facilitate investigations of counterfeiting cases.

### **Conclusion**

The growing problems with IP enforcement in Mexico demand new ideas and new strategies for action. The IACC therefore recommends the Mexican government adopt the following measures:

- Encourage the legislature and the government of Mexico to conduct a fresh and coordinated review of anti-counterfeiting legislation and resource allocation in the country;
- Establish a new IP czar and specialized IP enforcement teams within the government to ensure adequacy of resources, reduce the impact of corruption and improve coordination among enforcement bodies;
- Eliminate unnecessary formalities as a condition to PGR seizures of counterfeit and pirated goods; and
- Promote educational campaigns to publicize the damages caused by counterfeiting and piracy.

## THE PHILIPPINES

### **Recommendation: Priority Watch List**

#### **Introduction**

In 2005, the Philippine government, through the Intellectual Property Office, engaged in a high-profile campaign to strengthen IP protection, intended in large part to respond to the designation of the Philippines under the Special 301 Priority Watch List. Notwithstanding progress in certain areas in 2005, including a notable increase in raids of producers and vendors of counterfeit and pirated products<sup>48</sup>, IACC members report few improvements in the key issues of concern expressed in prior years, most notably the detrimental influence of corruption on enforcement work, a continuing lack of government enforcement resources, and unacceptable delays in the judicial system. Consequently, the IACC recommends for the fifth year in a row that the Philippines remain on the Priority Watch List, and that USTR continue out-of-cycle reviews of its progress in the coming year.

#### **Trademark**

Counterfeiting of a wide range of consumer and industrial products remains serious in the Philippines. IACC members report infringements of their rights for goods ranging from pharmaceuticals, food, fashion, footwear, apparel, alcoholic beverages, cosmetics, perfume, computer equipment, auto parts and cigarettes.<sup>49</sup>

The WHO recently estimated that 8% of drugs sold in the Philippines are counterfeit<sup>50</sup>, and Philippine government authorities estimated in 2005 that 7 billion pesos (over US\$133 million) in fakes are sold annually in the country. In February 2005, the Bureau of Food and Drugs and the Department of Health disclosed that the drugs most widely counterfeited include those used to cure hypertension, asthma, and diarrhea, as well as analgesics and vitamins.<sup>51</sup> Sales of fake drugs are now conducted outside pharmacies in unlicensed market stalls and so-called *sari-sari* stores.<sup>52</sup>

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<sup>48</sup> From January to September 2005, the government reported raids by various copyright and trademark enforcement bodies of infringing products valued at over US\$20 million. See Intellectual Property Office News, October 2005 at <http://www.ipophil.gov.ph>

<sup>49</sup> See detailed statistics on IP enforcement by various authorities from January to September 2005 in <http://www.ipophil.gov.ph/ipenforcement/iprReport.asp>. These statistics include some of the victim brands that have benefited from enforcement, including many IACC members.

<sup>50</sup> See Tribune (Manila) December 9, 2005) at <http://www.tribune.net.ph/health/20051209.hea01.html>.

<sup>51</sup> Source: Hicap, Fake medicines can be dangerous to your health, August 2005 at <http://www.manilatimes.net/national/2005/aug/16/yehey/life/20050816lif1.html>.

<sup>52</sup> Counterfeit Medicines: Some Frequently Asked Questions -May 2005, May 2005 at [http://www.wpro.who.int/media\\_centre/fact\\_sheets/fs\\_20050506.htm](http://www.wpro.who.int/media_centre/fact_sheets/fs_20050506.htm)

Counterfeits mainly appear to be imported from China and other sources in Asia, but production of many fakes also takes place inside the Philippines.<sup>53</sup>

IACC members report continuing problems in the use of free trade zones for the transshipment of counterfeit and smuggled products to other markets, particularly in Asia. Products typically exported from the Philippines include optical media, clothing, consumer electronics, automotive products, cosmetics and toys.

IACC members have over the years been pleased with the responsiveness of Philippine police, particularly the IPR Division of the National Bureau of Investigation, in organizing criminal raids against counterfeiters and copyright pirates. Our members were also pleased to note the introduction of a new Supreme Court Circular<sup>54</sup> issued on January 27, 2004 that now allows Executive Judges to issue search warrants against targets located outside their territorial jurisdiction. This reform had been highlighted in the 2005 Special 301 submission of the IACC as a necessary measure to address constant problems in the leak of impending raids against infringers.<sup>55</sup>

However, the significant investment of IP owners and government authorities in arranging raid actions continues to be undermined by the persistent failure of the Philippine courts to process both criminal and civil cases in a more timely manner. It currently takes anywhere from two to even ten years for most cases to reach a conclusion<sup>56</sup>, with infringers routinely extending the duration of cases by exploiting procedural loopholes and raising appeals against minor rulings. As a consequence, an increasing number of criminal cases are being settled at an early stage, and on terms that are too favorable to infringers. In many cases, IP owners question whether prosecutors are subject to undue influence in their consideration of the merits.

In 1998, the Philippines amended its trademark legislation to provide for minimum jail terms in counterfeiting cases. This legislation was expected to create a level of deterrence that might lead to a significant reduction in counterfeiting in the country. Sadly, the intention of the

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<sup>53</sup> To illustrate, over 30 million pesos (US\$500,000) in counterfeit Nestle' MILO beverage powder was seized by the National Bureau of Investigations during a raid action in Manila in November 2005. This was reported to be the biggest raid ever against a food counterfeiter in the country. Government investigations suggested that the counterfeiters had been earning at least 3 million pesos (US\$60,000) each month. See Manila Standard December 3, 2005 at [http://www.manilastandardtoday.com/?page=police03\\_dec03\\_2005](http://www.manilastandardtoday.com/?page=police03_dec03_2005).

<sup>54</sup> Supreme Court A.M. No. 03-8-02-SC dated January 27, 2004 and took effect on February 15, 2004.

<sup>55</sup> IACC members are concerned over provisions in the new Circular that require the head of the enforcement agency seeking the seizure to personally sign all requests for actions outside their territorial jurisdiction. This requirement is resulting in significant delays in enforcement in many cases.

<sup>56</sup> Criminal trials continue to be handled in a piecemeal fashion, through a large number of short hearings, rather than limited pre-trial hearings and a single trial focusing on the major issues. This custom clearly violates the express provisions of the Revised Rules of Criminal Procedure, Rules of Court of the Supreme Court (last amended in 2001), which states: Trial once commenced shall continue day to day as far as practical until terminated... In no case shall the entire trial period exceed one hundred and eighty (180) days from the first day of trial.

legislature has been frustrated, mainly by delays in the processing of cases, but also because most prison terms are in practice suspended.

IACC members have been pleased to observe that the National Prosecution Service has established an informal group of prosecutors tasked with handling IP crimes, and these prosecutors have proved more transparent and responsive than prosecutors attached to local governments.

The establishment of specialized courts could help to resolve the critical problems caused by the backlog of criminal and civil cases and also ensure that judges handling IP disputes have adequate training. Such courts previously existed in the Philippines, but regrettably, the Supreme Court decided in 2003 to dismantle them. The Intellectual Property Office reportedly proposed the reinstatement of specialized courts, but the Supreme Court has rejected this proposal, citing the lack of disputes previously filed with the earlier courts outside major cities and provinces.

Another noteworthy development in 2005 concerned the issuance of local anti-piracy ordinances by district governments. One such ordinance was issued in Quezon City (a major district within Metro Manila), providing for fines and prison terms, as well as the suspension and revocation of business licenses of violators. While these ordinances are only effective locally, they include sanctions that go significantly beyond those set out in the national Intellectual Property Code.

Finally, the national legislature is now reported to be considering a draft law that would facilitate civil action against lessors that provide premises to counterfeiters and those engaged in unfair competition.<sup>57</sup> This legislation on landlord liability would target owners of malls and other legitimate retail outlets where fakes are openly traded. Public hearings were recently concluded on the proposed legislation and deliberations by the legislature are continuing.

## **Copyright**

Copyright piracy in the Philippines remains severe, but the government is clearly trying to work more effectively with industry to address the problem. Furthermore, there are signs that the courts are taking an increasingly strict approach to sentencing of copyright pirates.<sup>58</sup>

In early 2005, the new Optical Media Act took effect, and a new Optical Media Board was created to focus additional manpower on enforcement against producers of pirated optical

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<sup>57</sup> Existing laws in the Philippines already facilitate landlord liability against lessors to copyright pirates.

<sup>58</sup> For example, a district court recently convicted a vendor of pirated Sony Playstation software to five years and a fine of 100,000 pesos (about US\$2,000). See Villafania, Court convicts Greenhills video game pirates, August 16, 2005 at [http://news.inq7.net/infotech/index.php?index=1&story\\_id=47097](http://news.inq7.net/infotech/index.php?index=1&story_id=47097). This case was also notable for the speed at which it was handled--just one year.

discs. The government subsequently reported the closing in 2005 of a number of replication plants in and around Metro Manila.<sup>59</sup>

A new Pilipinas Anti-Piracy Team, comprised of both government and industry representatives, was launched in September 2005 to facilitate anti-piracy work. Participants include the National Bureau of Investigation, the Optical Media Board, the Philippine National Police, and the Intellectual Property Coalition.<sup>60</sup> In October 2005, the Pilipinas Anti-Piracy Team reported the seizure of about 19 million pesos (US\$360,000) in pirated software.<sup>61</sup>

Whether these new initiatives will maintain their traction and lead to meaningful reductions in copyright piracy in the longer term remains to be seen.

## Customs

IACC members regret to note that enforcement by Philippine Customs against both counterfeit and pirated products remains negligible. A specialized team of IP enforcers was established within the Bureau of Customs in 2003, but to date this team has reported only a small number of seizures of fakes--only 23 between January and September 2005.<sup>62</sup> Recordal of rights with Customs is possible in the Philippines, but Customs still lacks the manpower and procedures to permit the inspection of meaningful quantities of shipments. Training is also required to assist Customs in prioritizing and profiling potential exports and imports of infringing items, and the IP enforcement team within the Bureau of Customs needs to be provided access to real-time electronic data on imports and exports.

Legislation is now being considered that would facilitate legal action against transshipments of infringing products through Philippine waters. This legislation, which would amend the Tariff and Customs Code, would make the diversion of fakes more difficult by requiring shipping companies, agents, trans-shippers or the owner of the goods to submit a certificate of discharge issued by Customs or port officials at the port of destination.

## Parallel Importation/Counterfeit Drugs

The Philippine pharmaceutical market is being distorted through the Department of Health Administrative Order No. 85, which permits the Philippine International Trading Corporation (ITC) to import pharmaceuticals from India and, starting this year, from Pakistan as well. Products that enter the country through parallel importation carry health risks normally

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<sup>59</sup> See Intellectual Property Office News, October 2005 at <http://www.ipophil.gov.ph>.

<sup>60</sup> See Computerworld Philippines at <http://www.itnetcentral.com/computerworld/article.asp?id=14972&level=0&info=Computerworld>.

<sup>61</sup> See Villafania, Anti-piracy team nets P19M in illegal software, November 17, 2005 at [http://news.inq7.net/infotech/index.php?index=1&story\\_id=56888](http://news.inq7.net/infotech/index.php?index=1&story_id=56888).

<sup>62</sup> See Customs seizure statistics reported in <http://www.ipophil.gov.ph/ipenforcement/iprReport.asp>.

associated with counterfeits, including quality problems caused by improper handling and packaging that fails to meet informational requirements. The Pharmaceutical Healthcare Association of the Philippines (HAP), an industry group comprised of major pharmaceutical companies, has moved to stop parallel imports of drugs under the DOH program through a pending law suit. The petition is still pending with the trial court.

To exacerbate the problem with counterfeit medicines, it appears that the current trend now is for Department of Justice prosecutors and court judges to issue decisions dismissing complaints on counterfeiting of medicines if the same are parallel imports.

### **Conclusion**

The IACC reiterates its earlier recommendation for the Philippine government to:

- Address systematic problems that have for too long resulted in unacceptable delays in criminal and civil actions in Philippine courts;
- Provide additional resources and training to facilitate border enforcement, including against goods in transit, and especially in free trade zones in the Philippines;
- Continue to strengthen resources for routine police investigations against trademark and copyright pirates;
- Establish specialized IP tribunals to handle civil and criminal cases, at least in major cities;
- Adopt proposed legislation on landlord liability and copyright protection without delay; and
- Implement new policies and procedures aimed at reducing the influence of corruption and protectionism that impede IP enforcement.

## RUSSIA

### **Recommendation: Priority Watch List**

#### **Introduction**

Despite a new indication of commitment by the government and the revision of IP laws in 2005, counterfeiting of consumer, pharmaceutical and tobacco products in the Russian Federation remains critical. Copyright piracy, including for entertainment software of IACC member companies, remains pervasive.

Revisions in Russia's IP laws introduced recently were intended to bring the country into greater compliance with the TRIPS Agreement of the WTO, but these revisions have left a number of important gaps which undermine their effectiveness in practice.

Notwithstanding these problems, there are indications the Russian government is giving IP protection higher priority, as evidenced by the re-establishment in 2004 of the IP Inter-Governmental Commission, chaired by Prime Minister Mikhail Fradkov, which is responsible for leading and coordinating the government's IP policies. This Commission has developed a blueprint for legislative and public awareness initiatives that is clearly having a positive impact—but just as clearly has a long way to go in reducing counterfeiting and piracy, and reducing the harm caused to IP owners and consumers.

#### **Trademark**

Market surveys conducted by the Russian government in 2004 and 2005 suggest that counterfeiting of a wide range of consumer products remains severe.

For example, according to the Ministry of Economic Development and Trade, over 20% of food and beverages sampled in 2004 survey of consumer markets were found to be fake. Furthermore, the Internal Affairs Ministry and the Ministry for Healthcare and Social Development reported in 2005 that fake pharmaceuticals occupy anywhere from 3.5% to 12% of the market, and industry sources believe the level for many drugs is between 20% and 60%.<sup>63</sup> Meanwhile, counterfeiting of cigarettes remains a huge and growing business in Russia, with increasingly high-quality fakes being produced in the country for export to the European Union and elsewhere.<sup>64</sup>

Most IACC members now face counterfeiting problems to varying degrees in Russia. The most affected goods at present are the following: alcohol, food, apparel, cigarettes, pharmaceuticals, cleansers, auto parts and batteries.

Russia is still negotiating with major trading partners the terms of its proposed accession to the WTO, and recently, a number of changes were introduced to the country's trademark,

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<sup>63</sup> See April 5, 2005 Pravda reports in [http://www.pravda.ru/economics/2005/7/21/63/19760\\_drugs.html](http://www.pravda.ru/economics/2005/7/21/63/19760_drugs.html) (Russian); [http://english.pravda.ru/main/18/89/357/15406\\_medicine.html](http://english.pravda.ru/main/18/89/357/15406_medicine.html) (English).

<sup>64</sup> See Gazeta report October 5, 2005 in <http://en.rian.ru/articles/20051024/41872472.html>.

copyright, customs, and unfair competition legislation to bring it into greater compliance with the TRIPS Agreement. Various departments of the Russian government also appear to be organizing more comprehensive action plans to deal with counterfeiting. As indicated below, there remain a number of serious gaps in Russia's IP laws and enforcement policies that are providing loopholes to trademark pirates and allowing the problem to flourish.

#### 1. Criminal Code

The change in Russian IP legislation of greatest concern to IACC members is the recent amendment of the Criminal Code. Far from aiding law enforcement in its efforts to efficiently deal with counterfeiting, IACC members believe the amendments represent a significant step backward.

Article 180 of the Russian Criminal Code permits criminal sanctions against counterfeiters only where "gross damage" has been inflicted on the trademark owner, and the recent amendments to this provision, which entered into effect on December 9, 2003, now define "gross damage" as harm exceeding 250,000.00 RUR, or about US\$8,700. The revised Code does not explain how "damage" should be calculated. Similar problems were of course faced when the thresholds for criminalization of counterfeiting and copyright cases were amended in December 2004.

It remains unclear at present whether the value of fake product should be calculated by reference to the infringer's prices, the IP owner's retail or wholesale prices, or on some other basis. This question requires further clarification from the Supreme Court of the Russian Federation.

As with China, the IACC believes that the threshold and the "gross damage" requirements in the revised Russian Criminal Code are inconsistent with Article 61 of the TRIPS Agreement<sup>65</sup>. Article 61 requires that WTO member countries provide access to criminal enforcement against trademark counterfeiters found to deal in fakes on a "commercial scale", without requiring a showing of actual damage or sales of fakes over a particular threshold.

The rationale behind Article 61 is based on a simple and largely self-evident premise: generating proof of prior production and sales of counterfeits is inherently difficult, both for government enforcers and IP owners. Furthermore, as practice in China has for years confirmed, the imposition of ambiguous and relatively high thresholds will deter police and prosecutors from commencing investigations that might help to uncover the true scale of counterfeiting in any particular case.

The IACC therefore urges the Russian government and legislature to revise the Criminal Code to eliminate requirements of proving damage or meeting any numerical thresholds.

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<sup>65</sup> Article 61 of the TRIPS Agreement states: "Members shall provide for criminal procedures and penalties to be applied at least in cases of willful trademark counterfeiting or copyright piracy on a commercial scale. Remedies available shall include imprisonment and/or monetary fines sufficient to provide a deterrent, consistently with the level of penalties applied for crimes of a corresponding gravity."

Government resources available for criminal enforcement are understandably limited, and the Russian legislature may well have believed that establishing a threshold would help ensure a more rational allocation of resources. However, in practice, thresholds of this nature have been found to create loopholes for counterfeiters, as well as unnecessary bureaucracy and costs for enforcers and IP owners. Police and prosecutors in countries where counterfeiting is rife will by necessity need to be selective in deciding which cases to investigate and which to leave for administrative or civil enforcement. But mandating such decisions through an inflexible threshold will only invite greater problems.<sup>66</sup>

## 2. Administrative Enforcement<sup>67</sup>

In the absence of better access to criminal enforcement, trademark owners have traditionally relied mainly on administrative enforcement against counterfeiters through the relevant divisions of police or Customs authorities along with the trade inspectorates, which have the authority to initiate administrative cases and transfer such cases to the respective arbitrazh (state commercial) courts or the courts of general jurisdiction. While the deterrence created by administrative enforcement is lower than that from criminal enforcement, administrative procedures have proved simpler. They also often provide a cost-effective alternative to civil litigation, particularly in cases that fall outside the criteria for criminal enforcement.

IACC members have however found a worrying trend of cases where infringers have avoided penalties by claiming they lacked knowledge that they were dealing in counterfeits. This problem arises from ambiguity in Article 2.1 of the Code of Administrative Offences, which provides for a company's liability only where it is determined that the infringer was capable of being in compliance with the Code's provisions, but failed to undertake the necessary measures to do so. The Russian government should be encouraged to address this problem by clarifying the types of evidence that would raise a presumption of failure to comply with Article 2.1. Consideration could, for example, be given to requiring alleged infringers to disclose the legal source of products and provide evidence of such purchases as a condition to avoiding liability.

## 3. Confiscation and Destruction of Counterfeits

Unlike Russia's Copyright Law, which requires the confiscation and destruction of pirated goods and related production equipment, the Trademark Law only permits these sanctions in exceptional cases. In particular, the destruction of fakes is only permitted where the offending trademarks cannot be removed from the infringing goods and their packaging. Destruction of production equipment is currently not permitted in trademark infringement cases under any circumstances.

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<sup>66</sup> For more information on the potential implications of thresholds on enforcement against trademark counterfeiting and copyright piracy, see the China section of this report.

<sup>67</sup> Under Russian law, administrative offences are prescribed in the Russian Federation Code of Administrative Offences. The unauthorized use of a third party's trademark is punishable by administrative fines of up to US\$ 1,500 and the confiscation of counterfeit goods. The proposed penalty is normally set out by trade inspectorates, Customs or the police in a so-called "administrative offence protocol" and thereafter confirmed through judicial review by one of two courts, the "arbitrazh" (state commercial) courts, which have jurisdiction in cases involving corporate entities and registered sole proprietorships, or the general courts, which deal with other individual offenders.

Furthermore, the Trademark Law fails to address how infringing goods are to be disposed of where an administrative or criminal case fails (e.g., due to lack of evidence of intent, failure to meet the relevant threshold, improper influence, etc.). As a consequence, fake goods are routinely returned to infringers. This loophole likewise requires attention from the Russian government and legislature. The IACC accordingly recommends further revision of the Trademark Law to provide for the confiscation and destruction of counterfeit goods and equipment used for their production in all cases, irrespective of the future destiny of corresponding criminal, administrative or civil actions.

#### 4. Piracy at the Registry

IACC members have in recent years reported increasingly troublesome problems with piracy of their trademarks at the trademark register. Pirates routinely copy a famous mark, and by adding a non-distinctive word, achieve registration, notwithstanding the high chances for consumer confusion. Likewise, trademark pirates are all too often able to register similar or even identical marks covering either the same goods or goods that are only slightly different than those of the legitimate trademark owner—even where the goods concerned are closely related and used in the same industry.

The tendency of the trademark registry to interpret laws in a narrow and formalistic way is shared in the courts and other government ministries tasked with enforcing IP rights, and leads to administrative and judicial decisions that in other countries would be considered “easy”. Further pressure on Russian registration authorities to bring their practices in line with international standards is clearly required.

The Russian legislature (the Duma) attempted to address registry piracy through the amendment of the Law on Competition and the Limitation of Monopolistic Activity in Commodity Markets (the “Competition Law”), which entered into effect on October 9, 2002. The revised law explicitly permits the Federal Anti-Monopoly Service (“FAS”) to request invalidation of a trademark registration where the registrant has been deemed to have engaged in unfair competition, and more specifically, where the pirate is found to have obtained the registration with the sole purpose of selling or assigning it to the original owner. Unfortunately, to date, the FAS has adopted a very restrictive approach in enforcement of the revised law, refusing to apply the new law to situations where the pirate has not commenced use of the pirated mark, citing the absence of actual competition in the market between the two brands. The FAS is also unwilling to extend protection under the Competition Law to trademarks that are not identical to the legitimate trademark.

An additional problem that impacts on piracy in Russia is the lack of a publicly accessible official database allowing trademark owners to monitor the progress of pending applications. This, together with the absence of pre-registration opposition procedures under Russian law, precludes trademark owners from identifying and preventing pirated applications. As a consequence, the current system seems to encourage piracy at the registry—including by outright counterfeiters.

The Russian government should be encouraged to review the implementation of both the Competition Law and trademark legislation, generally, to ensure that trademark owners—

whether local, foreign, well-known or not-so-well-known—enjoy more reliable and reasonable protection against bad faith pirates. In the meantime, the lack of protection against trademark pirates puts into question Russia’s compliance with the provisions on well-known trademarks (Art. 6bis) and unfair competition (Art. 10) of the Paris Convention. The Russian government should also take steps to make the Competition Law more detailed in respect of unfair competition issues or to issue a directive on unfair competition practices.

#### 5. Civil Actions Involving Pirated Registrations

Russian law does not authorize the stay of proceedings in state courts pending cancellation of a registration of an infringing trademark by the Chamber for Patent Disputes. The discretion of judges to stay proceedings in such cases should be expressly established in laws or regulations.

#### 6. Preliminary Measures

Russian laws provide for a possibility of preliminary injunctions and the freezing of infringing goods, equipment or other assets of an infringer. Unfortunately, following a significant increase in the use of such measures to deal with commercial disputes, including corporate conflicts and bankruptcy cases, Russian courts have recently become extremely reluctant to resort to these powers in any civil actions—including IP disputes. While preliminary measures are available, in practice IP owners must invest significantly greater time and resources to obtain them, and without a reasonable expectation they will succeed.

Restricting access to preliminary measures severely undermines the value of civil actions in Russia, and the IACC therefore recommends that the Higher Russian Courts establish a non-exclusive list of evidence on the basis of which preliminary measures may be taken, thereby simplifying the process of applying for such measures.

#### 7. Domain Name Piracy

The recent revision to Russia’s Trademark Law includes provisions explicitly prohibiting the unauthorized use on the Internet of a domain name that reproduces a registered trademark or a similar sign, where such use would result in a likelihood of confusion. It had been hoped that these provisions would facilitate enforcement, but this has not turned out to be the case, as Russian courts have been interpreting the law to require that the infringing domain name be in commercial use and that the goods and services offered by the defendant be similar to those of the plaintiff. This contrasts of course with the standards for adjudication under the Uniform Domain Name Dispute Resolution Policy (“UDRP”) adopted by the Internet Corporation for Assigned Names and Numbers (“ICANN”), under which action may be taken where there is a finding of bad faith and where the pirate has not yet commenced commercial use of the domain name.

The policy of the Russian courts would not be of such concern to IACC members if a procedure akin to UDRP dispute resolution were available for top-level domains (“TLDs”) under the .ru suffix. At present, there is still no administrative body for dealing with such disputes,

thereby requiring trademark owners to resort to civil litigation, which is normally costly, time-consuming and unpredictable.

Russia should be encouraged to quickly adopt a domain name dispute resolution system akin to ICANN's UDRP. Doing so would benefit both foreign and local trademark owners.

#### 8. Company Names Infringing Trademark Rights

The IACC is encouraged by plans by the FAS to amend Russia's Trademark Law to provide penalties in cases where a registered company name contains a name that is similar or identical to a registered trademark and thereby constitutes unfair competition or a violation of other IP rights. At present, there are no procedures for avoiding conflicts with registered trademarks in the course of registering company names, and in general, the owners of company names are currently permitted to use their names in advertising materials. Accordingly, the IACC encourages the Russian government to accelerate its drafting and adoption of a Federal Law on Company Names.

#### Copyright

Piracy of IACC member software and movies in Russia is estimated to range between 80% and 90%. Most pirate product appears to be made in Russia, with some product imported from the Ukraine and China. Pirated Russian-made product is also exported to other countries.

Distribution of entertainment software is said to be controlled by several known crime syndicates, some of which place their own logos on pirated products, thereby confusing consumers into thinking the goods are legitimate.

During 2005, the government began taking more coordinated action against CD plants located in Russia, raiding at least 12 plants, half of which were said to be located within military bases.<sup>68</sup>

The level of piracy is also being reduced somewhat incidentally to the opening of legitimate markets for foreign software, particularly in Moscow. However, similar reductions are less apparent or nonexistent outside of Moscow.

In order to make further progress in copyright protection, the Russian government will clearly need to allocate greater resources to criminal enforcement against producers and major distributors of pirated product—particularly the crime syndicates that are controlling a significant portion of the trade. Further efforts will also be needed to license and monitor the huge number of optical disc plants in the country.

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<sup>68</sup> Washington Post, December 14, 2005, at <http://www.washingtonpost.com/wp-dyn/content/article/2005/12/10/AR2005121001218.html>.

## Customs

Notwithstanding recent amendments, the Customs Code of Russia still fails to provide for *ex officio* enforcement against counterfeit and pirated goods that are not recorded with Customs. The IACC recommends that Russia eliminate this loophole in protection without delay.

## Conclusion

The Russian government appears to be taking more seriously the need to improve IP protection to facilitate smooth entry to the WTO, promote foreign investment and provide more favorable conditions for the development of local industry. However, much still remains to be done in order to bring Russia into full compliance with the TRIPS Agreement and ensure reliable access to effective enforcement of IP rights.

In summary, the IACC recommends the following measures be adopted by Russia as soon as possible:

- Improve implementation of existing IP laws through the adoption of more expansive and less formalistic interpretations of IP laws and procedures, and greater investment in the training of law enforcement officials;
- Amend Article 180 of the Criminal Code (and similarly Articles 146 and 147 of the Criminal Code) to eliminate the “gross damage” provision and numerical threshold for criminalization of counterfeiting offences, and pending such amendment, the issuance of guidelines that would encourage police to commence investigations into any case and provide for the calculation of thresholds by reference to the value of product seized (as well as sold) and by reference as well to the retail price of the IP owner’s authentic goods;
- Clarify of the standards for administrative liability for counterfeiting;
- Amend the Trademark Law to require the confiscation and destruction of seized counterfeits and equipment used to produce them in all cases;
- Amend the Russian Customs Code so as to facilitate *ex officio* IP protection for trademarks and copyrights that are not yet recorded with Customs authorities;
- Issue a non-exhaustive list of proof on the basis of which preliminary measures may be applied for in IPR infringement cases; and
- Adopt a new dispute resolution mechanism comparable to the UDRP for domain name disputes in the .ru zone.