

## Comment

# ***China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights***

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The fundamental premise of Saggi's and Trachtman's analysis of this dispute is that the WTO TRIPs agreement should be viewed as an 'incomplete contract'. Should multilateral treaties be analogized to incomplete contracts? What are implications of doing so for the proper approach to treaty interpretation? We have to begin with the theory of incomplete contracts, which is not really explained in Saggi's and Trachtman's report. As developed by Hart and Moore (1988), the notion of 'incomplete contracts' represents the intuition that, while a large number of possible future states of the world may affect the value and cost of performance of a contract, the transaction costs of the parties bargaining *ex ante* about the legal consequences of all of these possible eventualities are prohibitive. Therefore, taking account of transaction costs, we will expect 'incomplete contracts' to be efficient; these contracts generally will either provide various mechanisms for renegotiation triggered by the occurrence of certain future events or allow for the application by an adjudicator or arbitrator of default or background rules to 'complete' the contractual bargaining in the face of such eventualities. Equally important to contract theory is the problem of moral hazard: a party to a contract may have incentives to engage in behavior *ex post* the bargain that increases the riskiness of the contract to the other party. A classic example is insurance contracts. Effective *ex ante* mechanisms for controlling moral hazard often entail effective means of monitoring the behavior of contracting parties *ex post*. Although the concept of 'incomplete contract' and that of moral hazard have in common that both are concerned with the transaction costs of addressing future events that can affect the cost and value of contractual performance, moral hazard deals specifically with what might be called a form of opportunistic behavior by one of the parties. Unfortunately, these concepts are often (implicitly) blurred in the analysis of Saggi and Trachtman, as I shall go on to explain.

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I agree with those trade economists and lawyer economists who find both these concepts useful for understanding specific features of bargaining in the GATT/WTO and specific features of the covered Agreements. For example, ‘incomplete contract’ is a powerful concept for understanding those provisions of the GATT that provide a structure for renegotiation of a Member’s tariff concessions (GATT Article XXVIII) and of the GATS that address renegotiation of a Member’s specific commitments (GATS Article XXI). Contract theory makes sense of these provisions, which could actually allow for renegotiation upwards of particular trade barriers (with compensation), whereas a constitutionalist view of the WTO as a regime progressively moving towards complete removal of all such barriers could not easily do so. Along similar lines, the notion of moral hazard is powerful in understanding the concept of nonviolation nullification and impairment. This entails that a Member that has acted in such a way as to undermine the expected benefit to another Member of a specific negotiated concession provide compensation to the latter.

But it does not follow that because these ideas of contract theory (which are really an application of broader conceptions of information and transactions costs, useful in bargaining contexts far removed from contractual bargaining between private parties, such as political bargaining) necessarily explain or illuminate *all* kinds of WTO obligations, and, much less, that because these insights are, as a matter of intellectual history, closely connected to the emergence of contract theory in law and economics, the canons of treaty construction should be replaced by canons of contract interpretation. What conceptual tools are appropriate with respect to particular provisions, and how the resulting understanding of ‘object and purpose’ relates to the other relevant canons in Vienna Convention 31 and 32 are separate, if obviously interconnected, questions.

### **Do incomplete contract (and/or moral hazard) properly illuminate the functionality of the provisions of TRIPs at issue in the dispute?**

The specific feature common to some of the provisions in TRIPs in question that cause the authors to have recourse to the incomplete-contract concept is that these provisions are ‘incomplete’ in the sense that they articulate an international legal obligation while not fully specifying what exact domestic measures will satisfy that obligation. I do not believe that the incomplete-contract concept is necessarily the most powerful analytical tool for understanding this kind of structure. There are simply more plausible explanations than the transaction costs of bargaining in light of uncertainty about many possible future states of the world. I begin with a very elementary legal observation: as a matter of background norms of state responsibility, states are generally understood to be able to choose the domestic instrumentalities that will implement a given international legal obligation. This background norm may be associated with Westphalian assumptions of the kind we

see in play in the *Lotus* case<sup>1</sup> and in the *in dubito mitius* canon of interpretation. International law is understood as something less hegemonic and more compatible with Westphalian understandings of sovereignty than for instance would be the law of a world state or world federation. An alternative way of formulating this norm, in terms of democracy and related political values rather than Westphalian sovereignty, has been articulated by Kalypso Nicolaidis and myself as global subsidiarity (Howse and Nicolaidis, 2003).

But there are also various other conceptual tools that would illuminate a structure of obligation that leaves choices about implementation to the state. One is the notion, common to many regulatory approaches influenced by law and economics, that it is more efficient to specify regulatory requirements in terms of performance or results rather than specific means or modalities. This is based in part on the notion that the most efficient means of achieving a given regulatory result will vary from one regulatory entity to another and also over time. Indeed, this concept even finds explicit expression in one WTO treaty, the TBT (Technical Barriers to Trade) Agreements, which provides that, in general, WTO Members should express their domestic regulatory requirements in terms of performance. A further possible conceptual framework would derive from the recognition that the TRIPs Agreement represents a highly contested and controversial limit on regulatory diversity. The resulting text embodies a balance of competing values and interests. One legal instrumentality for expressing or protecting this balance is to entrench a large measure of deference to the choices of states as to the modalities for implementing TRIPs obligations, which are understood as carefully bargained and bounded constraints on regulatory diversity. This is broadly consistent with the views of many economists that regulatory diversity is efficient in the case of intellectual property protection, and that while policy externalities of the kind identified by Saggi and Trachtman might exist, harmonization may entail considerable costs to domestic welfare, thus suggesting the need to manage complex welfare trade-offs between harmonization and regulatory diversity (see Trebilcock and Howse, 1998: 5). These various possibilities are more or less implicitly or obscurely alluded to by Saggi and Trachtman, but there is a certain lack of conceptual clarity or a *glissage* that occurs by assimilating them to the incomplete-contract concept, just because (it seems) there is *some* kind of incompleteness.

Now I want to turn to the interaction of these various possible analytics, for understanding the objective and purpose, or functionality, of the kind of legal provisions, with the other interpretative elements in Vienna Convention 31. These include the preamble of the treaty and other provisions of it and other relevant rules of international law applicable between the parties.

Article I of TRIPs is fundamental to understanding the nature and scope of the legal obligations it creates. It provides an essential part of the ‘context’ within the meaning of Vienna Convention 31. Article I provides: ‘Members shall give effect

<sup>1</sup> The Case of the S.S. ‘*Lotus*,’ Judgment 9, 1927, PCIJ, Series A, No. 10, p. 19.

to the provisions of this Agreement. Members may, but shall not be obliged to, implement in their law more extensive protection than is required by this Agreement, provided that such protection does not contravene the provisions of this Agreement. Members shall be free to determine the appropriate method of implementing the provisions of this Agreement within their own legal system and practice.’ It seems very clear from this provision that the parties did not intend the dispute-settlement organs to complete the contract in the sense of extending intellectual property protection beyond what is manifestly required on the face of the Agreement, regardless of how any future states of the world might affect value or the cost of the performance of the terms of the ‘contract’. Instead, the notion of Members being free to determine the method of implementation is consistent with the alternative analytic frames discussed above. In sum, what Saggi and Trachtman term ‘incompleteness’ does not represent a *grant* of discretion to the dispute-settlement organs, but *retention* of sovereignty by Members. Of course, as the Appellate Body emphasized in the early *India–Patents* ruling,<sup>2</sup> the required deference to Members’ regulatory choices is not by any means absolute: those choices must ensure the requisite state responsibility for fulfilling the obligation. But in determining this, *the dispute-settlement organs should start from the assumption that there may be many different and permissible domestic legislative, judicial, and regulatory options for doing so*. Above all, and especially where the defending state is a developing one such as China with a very different legal system in general, the dispute-settlement organs must avoid judging the domestic implementation choices against the implicit norm of domestic intellectual property laws in for instance the United States or the European Union.

Contrary to what Saggi and Trachtman suggest, the Panel was not so much implicitly rejecting the ‘argument for *special* deference’ (emphasis added) as indicating in the case of TRIPs that the required deference is to be found in the language and structure of the obligations themselves. Since the protection of regulatory diversity is built into the obligations, as is explained or affirmed by Article I, the Panel would not need to refer to some nontextual canon or principle related to deference such as *in dubio mitius* (as did the AB in the first *Hormones*<sup>3</sup> ruling, applying the Precautionary Principle as an interpretative canon, although not as a rule of customary law or a general principle of international law).

Thus, when faced with a provision of TRIPs requiring that judicial authorities have the legal capacity to order the destruction or disposal outside the channels of commerce of copyright-infringing goods so as to avoid harm to the rights holder, the Panel correctly held that this provision in no way limited the discretion of

<sup>2</sup> Appellate Body Report, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:I, 9.

<sup>3</sup> Appellate Body Report, *United States – Continued Suspension of Obligations in the EC – Hormones Dispute*, DS320, adopted 14 November 2008.

member-state authorities to provide remedies other than destruction, or to choose those other remedies in any given case. When the Panel was faced with interpreting the provision of TRIPs calling for criminal procedures and penalties in ‘cases of willful trademark counterfeiting or copyright piracy on a commercial scale’, it found that the Chinese authorities had the discretion to establish a minimum quantitative threshold below which no prosecutions would be required. In other words, the expression ‘commercial scale’ was for the domestic authorities to interpret. However, this interpretative discretion was not unbounded; any such threshold would need to take account of the product or market in question. Rejecting the US claim of a violation, the Panel noted the United States had not offered any evidence that the thresholds chosen failed appropriately to take into account the nature of the product or market. Saggi and Trachtman speculate that ‘With the Panel’s decision, it can be argued that commercial scale is a context-specific standard that is to be determined by future WTO Panels on a case-by-case basis.’ While consistent with their ‘complete the contract’ approach, this reading is I believe erroneous. Instead, along the lines of Article I of TRIPs, the Panel is interpreting the relevant provision of the TRIPs Agreement as giving the WTO Member in question discretion to determine the kind of legal threshold that expresses the notion of commercial scale, provided that the Member takes into account, in an appropriate way, the nature of the product and the market. Since the Panel does not have institutional competence to second-guess on its own such determinations, it will give the regulating Member the benefit of the doubt unless the complaining Member provides convincing evidence that the threshold actually chosen does *not* reflect the nature of the product and the market.

### **Censorship, human rights, and TRIPs**

In their discussion of censorship, human rights, and TRIPs, the authors refer to a kind of ‘incompleteness’ that is even more removed from the ‘incomplete contract’ concept than the examples discussed above. They invoke a notion of ‘external’ incompleteness to describe the situation where more than one set of international legal norms or more than one international legal regime governs some particular situation or particular behavior of a state. Before the Panel, China defended its denial of copyright protection to prohibited products on the grounds that the provisions of the Berne Union, as incorporated into TRIPs, gave it broad authority to prohibit copyrighted material on public-order grounds. In order properly to adjudicate the United States’ claim of a failure to extend copyright protection to prohibited works and China’s defense, was it necessary to consider the conformity of China’s censorship laws and practices with its international human rights obligations? The answer is quite simply, no. The Panel rightly held that Article 17 of the Berne Convention merely indicated that states could interfere with the *exercise* of intellectual property rights through ‘control’ or ‘prohibition’

of the ‘circulation, presentation, or exhibition’ of a work on their territory. This is *not* the same thing as being permitted to deny copyright protection as such. Could Article 17 really be used for instance to justify failing to prosecute piracy of domestically prohibited works for purposes of *export*? Having found that Article 17 of the Berne Convention as such did not provide a defense to the denial of copyright protection under TRIPs, the Panel simply did not need to reach the issue of the interaction of Article 17 and international human rights norms in relation to China’s censorship policies. Matters might have been different had the Panel found that Article 17 was an applicable defense. In that case, the Panel might well have had to consider how Article 17, as incorporated into TRIPs, had been affected by the evolution of international human rights law. In this respect, I think it is somewhat misleading for the authors to characterize Article 17 as ‘permissive’ towards censorship. Article 17 merely states that *copyright* is not an inherent protection against certain forms of censorship. It is not clear that control or prohibition of circulation, presentation, or exhibition would allow a state to eviscerate, for instance, the moral rights in the Berne Convention (these are not incorporated into TRIPs) through bowdlerizing or sanitizing the work in question or changing its content in a manner contrary to moral rights. Since Article 17 was drafted prior to the evolution of international human rights law, it could not be plausibly interpreted as a limitation on, or contracting out of, customary norms of human rights. (As far as treaty law is concerned, China has signed but not ratified the International Covenant on Civil and Political Rights.) While I have argued that WTO dispute-settlement organs should *interpret* WTO law in a manner informed by and consistent with international human rights law (Howse and Teitel, 2006), one should be mindful of the Appellate Body’s caution in *Mexico–Soft Drinks*<sup>4</sup> that the dispute-settlement system of the WTO is not designed for the *determination* or *enforcement* of legal norms in other international regimes. In the dispute at issue, the Panel was able adequately to *interpret* the provisions of the WTO law at issue without recourse to international human rights norms, as these norms would not affect the essential issue of whether Article 17 is an applicable defense to the denial of copyright protection as such (rather than *what other kinds of acts* might be rendered permissible by Article 17). Of course, in no case could a Panel authorize activity in contravention of *jus cogens*,<sup>5</sup> but freedom of expression or information is not, in the current state of the law, *jus cogens*.

<sup>4</sup> Appellate Body Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/AB/R, adopted 24 March 2006, DSR 2006:I, 3.

<sup>5</sup> See Case Concerning Oil Platforms (*Islamic Republic of Iran v. United States of America*), merits [2003] ICJ Rep 161.

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