



International Chamber of Commerce
The world business organization

Controlling the Zone:

Balancing facilitation and control to combat illicit trade
in the world's Free Trade Zones



May 2013

An ICC initiative
BASCAP
Business Action to Stop
Counterfeiting and Piracy

About ICC

ICC works to promote a balanced and sustainable system for the protection of intellectual property. It believes that IP protection encourages innovation and the development of knowledge-based industries, stimulates international trade, and creates a favorable climate for foreign direct investment and technology transfer.

About BASCAP

Counterfeiting and piracy have become a global epidemic, leading to a significant drain on businesses and the global economy, jeopardizing investments in creativity and innovation, undermining recognized brands and creating consumer health and safety risks. In response, the ICC launched BASCAP to connect and mobilize businesses across industries, sectors and national borders in the fight against counterfeiting and piracy; to amplify the voice and views of business to governments, public and media; and to increase both awareness and understanding of counterfeiting and piracy activities and the associated economic and social harm.

Visit BASCAP on the web at: www.iccwbo.org/bascap

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Glossary

ACTA	Anti-Counterfeiting Trade Agreement
AEO	Authorized economic operator
AG	Advocate General
ATA Convention	Customs Convention on A.T.A. Carnet for Temporary Admission of Goods
BASCAP	Business Action to Stop Counterfeiting and Piracy
CBW	Customs bonded warehouses
CJEU	Court of Justice of the European Union
EPZ	Export processing zone
FATF	Financial action task force
FEZ	Free economic zones
FP	Free port
FTA	Free trade agreement
FTZ	Free trade zone
IFZ	Industrial free zone
IP	Intellectual property
IPR	Intellectual property right
ITI Convention	Customs convention on international transit of goods
Kyoto Convention	Convention on simplification and harmonization of Customs procedures
OECD	Organization for Economic Cooperation and Development
RKC	Revised Kyoto Convention
SAFE	WCO SAFE Framework of Standards
SEZ	Special economic zone
TFZ	Technological free zone
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
WCO	World Customs Organization
WTO	World Trade Organization

The vulnerability of Free Trade Zones

Free Trade Zones (FTZs) provide significant opportunities for legitimate business and play a critical role in global trade. National governments around the world have found that offering relaxed regulations, limited taxes and reduced oversight in FTZs can drive economic growth and facilitate increased international trade and investment.

However, along with the recent global proliferation of FTZs has come increasing vulnerability to a wide range of abuses by criminal actors who have taken advantage of relaxed oversight, softened Customs controls and the lack of transparency in these zones. The 2010 OECD report on Money Laundering Vulnerabilities of Free Trade Zones, for example, delineates these abuses to include “participation in an organized criminal group and racketeering, illicit trafficking in narcotics, fraud, counterfeiting and piracy of products, and smuggling.”¹

This paper deals with the increasing abuse of free zones by organized crime networks to facilitate the manufacture, distribution and sale of counterfeit goods.

It would be misleading to suggest that all FTZs accommodate or facilitate illegal activity. Most operate as an important and legitimate tool within a country’s economy, facilitating international trade and development. However, the same features of FTZs that provide legitimate business opportunities can be—and are—exploited and misused by organized crime groups to produce, distribute, and sell counterfeit goods. When this criminal activity is allowed to occur or is ignored, the underlying objectives of the free zones to promote trade and economic growth are eventually destroyed.

While the concept of “Customs-free zones” has an important role in global trade, the need is urgent to address this type of abuse. It is hardly reasonable to permit illegal activity because it is of a certain type or because it is conducted within the boundaries of a Free Trade Zone.

A closer look at counterfeiting and piracy

This report looks at the role of FTZs in the context of their unplanned contribution to the global trade in counterfeiting and piracy. The 2008 OECD report on the Economic Impact of Counterfeiting and Piracy, and a later study by Frontier Economics show that this trade is huge and growing. The Frontier Economics study, commissioned by ICC BASCAP, estimates that based on 2008 data, the total global economic value of counterfeit and pirated products is as much as US\$650 billion every year. International trade in counterfeits accounts for US\$360 billion—more than half of this total—and is expected to rise to US\$960 billion by 2015.² The OECD report notes that FTZs have emerged as a facilitator of Intellectual Property Rights abuses and concludes that “the lack of controls has made the free-trade areas attractive locations for parties engaging in trade of counterfeit/pirated products.”³ The report goes on to explain how parties import counterfeit goods into FTZs to “sanitize” shipments, disguise origin, add counterfeit trademarks, manufacture and repackage finished counterfeit goods for export, and use FTZs as “gateways” for smuggling and transshipping fake products. The OECD notes that these parties conduct these illicit activities with little or no risk of IPR-related enforcement.

While FTZs are not the root problem of the global trade in counterfeits, they have become central to the integrated global economy—and their impact continues to grow. Unfortunately, organized crime groups and counterfeiters have also taken an interest in Free Trade Zones. They are exploiting the very ecosystem that governments have put in place to help FTZs contribute to economic development. According to the OECD, “Free-trade zones, with their relative lack of controls [...] have become important channels for counterfeit/pirated products.”⁴

The standards, oversight, and regulations governing FTZs have not kept pace with these developments. As a result, criminal networks are increasingly exploiting FTZs. Reversing this troubling trend requires understanding the following: (1) FTZs are part of the national territory; (2) FTZs are physical locations for goods in a particular status or regime for Customs purposes; and (3) simplified regulation does not mean impunity.

The purpose of this report is to investigate the circumstances that have facilitated the problems and, subsequently, what measures can be taken to address this issue.

- Chapter 1 introduces the concept of FTZs: what they are, how they came to be, their benefits, and the relationship between national Customs and FTZs.
- Chapter 2 examines specific risk points for free zone abuse and how traffickers of illicit goods are exploiting these zones.
- Chapter 3 explores the legal framework for FTZs, including international agreements, national legislation, and judicial enforcement.
- Chapter 4 concludes with a set of policy, legislative, and enforcement recommendations to reverse the alarming trend of FTZ abuse.

This report acknowledges that government policymakers are increasingly recognizing the economic drain caused by counterfeiting and piracy. They understand the vulnerabilities of Free Trade Zones to exacerbating the problem, and they know that they face the daunting task of balancing trade controls with trade facilitation. Since FTZs are geared towards free movement of goods, potential measures to tighten governance could hinder trade. Nevertheless, effective IPR enforcement in FTZs does not mean that policymakers must sacrifice their goal of using FTZs to facilitate legitimate international trade and development. Rather, voluntary establishment of standards and improved practices, along with the implementation of specific FTZ legislative and regulatory measures, can help address the global threat of counterfeit and piracy in Free Trade Zones, without impeding their effectiveness.

This report includes a set of specific policy and legislative recommendations on how to preserve and expand the benefits of FTZs for legitimate traders. At the same time, they serve to protect the public and honest businesses from predatory practices. These recommendations are based on a review of the international and national legal frameworks governing FTZs, including how they are implemented and enforced. The report also includes prior recommendations, several of which are still relevant and merit renewed attention.

While this report focuses on IPRs, a wider dialog needs to address abuse of, and illicit activities within, FTZs. Exploitation of FTZs not only damages legitimate business interests, it also poses a threat to the health and well being of citizens everywhere. Hopefully, this report can act as a springboard for further discussions.

Relationship between Customs and Free Trade Zones

A common misconception exists that free zones are “extraterritorial,” outside of the nation, and are not subject to national Customs or Customs laws. This confusion lends to an environment that enables illicit activities to infiltrate the zones.

The WCO has tried to correct this misconception by emphasizing in the Revised Kyoto Convention (RKC)⁵ that goods are outside the Customs territory only “*insofar as import duties and taxes are concerned.*” The RKC delineates a number of guidelines that address the evolving problem, including explicit Customs jurisdiction over FTZs, rules on origin of goods, and Customs transit and transshipment procedures. Unfortunately, accession to the specific provisions in the RKC for management of FTZs (Specific Annex D, Chapter 2) is optional. Few signatory nations have elected to implement RKC provisions that could substantially address the problem. The national laws must also give full authority to Customs inside the FTZs, and Customs must act in a transparent and professional manner to facilitate legitimate businesses.

This report also looks at the apparent confusion over the difference between tariff and non-tariff controls exercised by Customs. The report shows that stripping Customs of its traditional revenue collection role (tariff controls) leads to a further erosion—real and perceived—of its non-tariff activities (border inspections, seizures, etc.). The report suggests that national governments need to be very careful to ensure that the economic incentives (i.e. tax-free status) offered in zones do not interfere with or eliminate critical non-tariff control functions performed by Customs.

Strengthen national government adherence to international conventions

The report also recognizes that international agreements and conventions have not kept pace with effective enforcement of intellectual property rights in FTZs. While existing conventions cover most of what is needed, they suffer a number of limitations. Most notably, their minimum standards typically allow countries room for “interpretation,” which often leads to minimum action.

WCO’s Revised Kyoto Convention (RKC); the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS); and the proposed Anti-Counterfeiting Trade Agreement (ACTA) all address enforcement of IPR protections and contain Customs-related provisions:

- The RKC adequately covers FTZs for control of goods, such as the right of Customs to enter and inspect goods in the zone for tariff and non-tariff conformance to laws and regulations. A fundamental weakness of the RKC is that its provisions for free zones are in a Specific Annex that is not mandatory for RKC contracting parties or all members of the WCO.
- The TRIPS Agreement provides comprehensive requirements for the protection of intellectual property, including border measures; however, TRIPS does not specifically address FTZs. In addition, some of its stronger provisions are not mandatory for WTO Members.
- ACTA addresses a number of the TRIPS and RKC weaknesses, both by specifically addressing FTZs and by providing clear guidance on optional provisions. ACTA lacks an effective dispute resolution process, however, such as that provided under the WTO. Moreover, ACTA encompasses a limited number of countries, and it has not yet entered into force.

Improved Customs enforcement depends not only on stronger provisions in international agreements, but also upon countries’ adoption of these provisions into stronger laws. Those laws could incorporate flexibility into the TRIPS Agreement to address many issues now. Moreover, courts can apply only the laws as they are enacted. A number of recent court decisions have upheld the authority to regulate activity in FTZs, but judicial authorities cannot, in most countries, overcome limits on the reach of Customs authorities proscribed in national laws.

Empower national Customs authorities

Without precise provisions relating to FTZs and no obligations to add the non-obligatory provisions, as in the case of TRIPS or the RKC’s Specific Annexes, countries enact a wide variety of laws affecting the enforcement and protection of intellectual property rights. For example, some countries empower Customs to control goods and activities in FTZs. Others have, because of a misunderstanding of FTZs as a Customs controlled location, denied Customs jurisdiction over goods in FTZs. These countries operate under the premise that goods in FTZs are not clearing through Customs and are not being imported. This report stresses that strong national IPR legislation should apply to all Customs regimes. A clear Customs mandate should empower Customs with authority over all goods in the territory, including FTZs, which is absolutely key to combating counterfeiters and organized traffickers.

Simply passing laws and issuing regulations, of course, is an incomplete process until such measures are applied in practice. Furthermore, there are instances where, in some countries, the regulations are already in place but are not adequately applied. This report suggests the following absolute key provisions in national legislation and the associated regulatory measures for implementation:

- Review and implement national IPR legislation and include language that makes legislation applicable to all goods in the national territory, in all Customs regimes, including transit, in-transit, and free-zone regimes. Further, state that the discovery of prohibited goods may result in civil and criminal penalties.

- Empower Customs with authority over goods in all territories, including FTZs, SEZs and free ports.
- Clarify that FTZs (or SEZ or free port, etc.) are under the jurisdiction of the national Customs authority; that national Customs has unrestricted rights to enter and observe operations, to audit the books and records of companies in the zone, and to validate goods status and conformance with tariff and nontariff measures under the national Customs mandate.
- Grant Customs *ex-officio* power to detain goods suspected of infringing on IPR, including goods in FTZs, SEZs, free ports, and the like.
- Enable cooperation between national Customs authorities and the special authorities of FTZs or free ports to ensure efficient enforcement of anti-counterfeiting criminal and civil laws to regulate the offenses of trafficking in counterfeit goods.
- Include provisions to simplify the process for notifying trademark holders of infringement and enable them to initiate enforcement action; institute a simple procedure for destroying infringing goods; and prevent suspected IPR infringing goods from changing destination to evade enforcement.

Strike a balance between economic benefits and controls

To achieve what was intended for FTZs, there must be a balance between incentivizing economic growth and maintaining jurisdictional, border and Customs controls that prevent dishonest and harmful practices. Overregulation stifles business development, growth, and profitability; adequate and proper regulation *promotes* it by creating a predictable environment and by discouraging unfair and predatory acts. Today, in the shared Customs-to-Customs community, now known as *global Customs*, authorities have the power and responsibility to both punish bad actors and recognize and reward compliant actors in international trade supply chains.

WCO's SAFE Framework represents such an example. Compliant traders—or Authorized Economic Operators (AEOs)—receive beneficial Customs treatment, including fewer or no inspections on goods imported or exported by or via the AEO, resulting in quicker Customs clearance and lower operator transport costs. FTZs and the companies in the zones can join in receiving these types of benefits only if Customs is fully functional inside the FTZs. When Customs authorities are unable to exercise their due responsibilities in FTZs, bad practices proliferate. This problem is acute where goods are beyond the reach of Customs authorities and other law enforcement bodies while transiting, in-transit, or in free-zone status. As a consequence, violators are free to act without fear of legal sanction.

Summary of recommendations

Drawing on international agreements, lessons learned from both effective and ineffective national legislation, the experience of IP rights holders, and international best practice, this report suggests legislative and regulatory measures to enforce intellectual property right protection in FTZs. Suggested key actions for the WCO, WTO, national governments, and free zone operators include the following:

World Customs Organization (WCO)

1. Robustly promote/re-institute the RKC provisions, including those in Specific Annex D Chapter 2, and more aggressively seek their adoption.
2. Promote WCO IPR Working Group Guidelines.
3. Address FTZs as a separate category of entity for AEOs that engage in best practices to protect from IPR and terrorist attacks on the supply chain.
4. Modify SAFE to include recognition beyond supply chain security of AEO status for tariff and non-tariff measures, such as IPR protection and open provisions for mutual recognition of AEOs with high compliance to tariff and non-tariff measures.
5. Modify the WCO Model for IPR legislation to refer to FTZs.

6. Invigorate work with stakeholders on FTZ model legislation and best practices.
7. Create an umbrella agreement or other international instrument concentrating on Free Trade Zones, to share trade data and best practices with one another, including policing activities and a shared database of FTZs and companies in FTZs that are documented IPR violators. The agreement would promote world-class international security, checking, and screening standards for best practice and peer policing.

World Trade Organization (WTO)

1. Re-institute the TRIPS enforcement working group to undertake regular peer review of TRIPS implementation. The review would encourage improvement of national legal and enforcement measures that reflect the TRIPS intent. This working group should consider new developments, such as Internet expansion, that have broadened the reach of counterfeit goods. The group should also explore the rapid expansion of and abuses in FTZs, which have enabled traffickers in counterfeit goods to exploit loopholes in jurisdictional authority and evade routine enforcement.
2. Clarify the jurisdiction of TRIPS. For example, WTO should clarify that since TRIPS does not exclude FTZs, WTO Members are obligated to apply TRIPS requirements to all FTZs within their territories.

National Governments

1. Empower Customs authorities with jurisdiction over FTZs' day-to-day operations. Clarify that FTZs (or SEZ or free port, etc.) are under the jurisdiction of the national Customs authority; that national Customs has unrestricted rights to enter and observe operations, to audit the books and records of companies in the zone, and to validate goods status and conformance with tariff and nontariff measures under the national Customs mandate.
2. Review and implement national IPR legislation. Follow WCO Guidelines—including Specific Annex D of the RKC—and include language that makes legislation applicable to all goods in the national territory, in all Customs regimes, including transit, in-transit, and free-zone regimes. Further state that the discovery of prohibited goods may result in civil and criminal penalties.
3. Grant Customs *ex-officio* power to detain goods suspected of infringing on IPR, including goods in FTZs, SEZs, free ports, and the like.
4. Particularly for integrated trading countries (i.e., COMESA, ASEAN), develop uniform Customs rules, regulations, and practices for FTZs, drawing on WCO and WTO provisions, including the draft recommendations and guidelines developed in 2006 by the WCO IPR Strategic Group and Global Task Force.
5. Enable cooperation between national Customs authorities and the special authorities of FTZs or free ports to ensure efficient enforcement of anti-counterfeiting criminal and civil laws and to regulate the offenses of trafficking in counterfeit goods.

Free Zone Operators

1. Self-regulate to prevent piracy and counterfeiting (e.g., conduct standard due diligence in accepting businesses into zones).
2. Allow and encourage national Customs authorities to evaluate the zone via physical observation of operations and verification of compliance with tariff and nontariff requirements.
3. Demand that national Customs apply best practices in exercising authority in zones (e.g., use ordinary company records as primary control documents in determining Customs free-zone status and in changing the Customs regimes).
4. If the national government has committed to WCO SAFE Standards and has an AEO program, consult with the Customs authority for AEO recognition. If the country has notified the WCO of its intent to follow SAFE, but the national Customs authority does not yet have an AEO program, lobby the authority to meet this commitment.
5. For ease of goods status validation, consider the interface and exchange of data with the national Customs automated systems. Recommend that FTZ companies do the same.

1. Vulnerabilities to counterfeiting and piracy

Along with the recent global proliferation of Free Trade Zones has come an increasing concern over their vulnerability to a wide range of abuses by criminal elements. In an attempt to simplify and reduce the cost of trade, national governments have softened Customs controls and allowed FTZs to operate with minimal oversight. As a result, illicit actors have taken advantage of relaxed oversight and the lack of transparency in zones. The 2010 OECD report on Money Laundering vulnerabilities of Free Trade Zones, for example, delineates these abuses to include “participation in an organized criminal group and racketeering, illicit trafficking in narcotics, fraud, counterfeiting and piracy of products, and smuggling.”⁶

This paper deals with the increasing use of free zones by organized crime networks to facilitate the manufacture, distribution, and sale of counterfeit goods.

While FTZs are good for business and global trade, unfortunately, they have also become advantageous for organized crime groups and counterfeiters. In recent years, FTZs have provided a mechanism for counterfeiters to move illegal, fake products around the world. Increasingly, counterfeiters use transit or transshipment of goods, through multiple, geographically diverse FTZs for no other purpose than to disguise the illicit nature of the products. Once introduced into an FTZ, counterfeit goods may undergo a series of economic operations, including assembly, manufacturing, processing, warehousing, re-packaging, and re-labelling.⁷ Once completed, the goods can be imported directly to the national territory of the hosting state or re-exported to another FTZ, where the process is repeated.

Since the declared origin of a product serves as a key risk indicator for IP rights violations, this game of “musical chairs” serves to disguise the fake products’ illegal origins and limits the ability of law enforcement agents to apprehend the counterfeits.

This hijacking of FTZs not only impairs the zones’ primary function—to facilitate legitimate trade—but also creates an enormous drain on the global economy. Billions of Euros in legitimate, economic activity are being crowded out, facilitating “underground economies” that deprive governments of revenues and dislocate hundreds of thousands of legitimate jobs. At the same time, such subversive activity is exposing consumers to deficient or even dangerous products.

International trade conventions and agreements governing the enforcement of IP rights have not kept pace with this rapid exploitation of FTZs. For instance, the TRIPS Agreement—the world’s most broadly subscribed international IP protection agreement—does not oblige members to make border measures available with respect to transhipped goods. Even more alarming, by applying unique laws and Customs rules on FTZs, some governments and Customs authorities have questioned whether they even have jurisdiction to exercise control in FTZs.

The absence of international standards on IPR enforcement in FTZs has produced a sense of perceived immunity over goods in FTZs, creating exactly the type of environment that allows counterfeiters and organized crime groups to flourish.

1.1 IPR abuses facilitated in FTZs

Once in an FTZ, goods may undergo various economic operations, including assembly, manufacturing, processing, warehousing, repackaging, relabeling, storage, and then further shipment.⁸ In an unregulated FTZ, counterfeiters can manufacture goods from raw materials or subcomponents, just as they would outside the FTZ. The advantage of the FTZ is that goods can be misrepresented as transhipped from a country of legitimate production. Methods of deception range from straightforward smuggling in containers with false walls and cover loads to “mis-descriptions” of goods. In some countries, such as Egypt, shipping forms do not have to show brand names. Counterfeiters exploit this relaxed shipping policy by listing descriptions that have nothing to do with the actual goods. Some domestic and FTZ-related companies can even be unwitting partners to counterfeiting. A printer, for example, may produce trademark infringing packaging materials under the direction of third parties purporting to be legitimate license holders.

Additional difficulties arise when FTZs share a physical territory with a residence population that consumes goods in the zone and where the FTZ is also a shopping location for visitors. Commercial quantities of pirated or counterfeit goods are brought to the FTZ with little or no Customs supervision. They are further disguised for shipment to countries beyond the zone. In 2008, the UAE was the second largest source of counterfeit goods detained from entering the European Union, accounting for 15% of all seizures made.⁹ This report specifically notes that counterfeiters use FTZs in the UAE—particularly the Jebel Ali free zone in Dubai—to disguise products' primary origin.

Tracking and treatment of shipped goods require coordination between Customs' document management systems and FTZ administration. A lack of IT system coordination may not be a significant problem if Customs has access to FTZ automation systems and company systems in the FTZ, so reusable IT data can be exchanged. Without coordination or access to data by Customs, however, FTZs are easy targets for re-documenting shipments and hiding the origins, contents, and destinations of illicit goods. These covert operations allay the suspicions of Customs in subsequent transit ports and final destinations, turning zones into both laundering and distribution points for counterfeit goods. Opportunities for counterfeiting, IPR violations, and other crimes are greatly reduced when the national Customs authority works inside the FTZ and can periodically observe and review company operations.

Case study: Counterfeit drugs and the exploitation of FTZs

On May 22, 2006, UK Customs seized eight different pharmaceutical products with a total weight of 384kg at Heathrow Airport in London. Analysis confirmed that seven of the eight products were counterfeit. The shipment was in transit from Oyster Corporation, established in the Sharjah FTZ, Dubai, to Personal Touch Pharmacy, established in the FTZ of Freeport, Bahamas. A search warrant by the Royal Bahamas Police Drug Unit resulted in the seizure of several counterfeit drugs and uncovered a fulfilment center for Internet drug orders placed with www.rxnorth.com, an illegal on-line pharmacy based in Canada.

The day after the raid in the Bahamas, suspect pharmaceuticals stored by Oyster Corporation in the Sharjah FTZ were moved to an unrelated facility in the Jebel Ali Free Zone in Dubai, in an attempt to avoid further detection. The investigation would eventually unravel a complex supply chain of fake drugs that ran from China through Hong Kong, the United Arab Emirates, Britain, and the Bahamas, ultimately being sold online to customers as "Canadian" medicines. The case underscores the role played by FTZs in the global trade in counterfeit drugs, and why these distribution chains are so difficult to trace.

1.2 Transit and transshipment

For those who trade in counterfeit goods, transit and transshipment operations present opportunities to mask the illicit origin of goods. Such illicit transport is effectively accomplished when a good's status is unclear and Customs is not supervising that status—as is all too common in many FTZs as well. Goods may enter a national Customs territory under a variety of Customs regimes. That regime status may change—from "temporary storage" to "transit" or "Customs free zone" or "imported for consumption," depending on the activity involving the goods. Transit goods move from a port of entry to a port of departure. Transshipment goods enter a port and then may be unloaded, repacked, consolidated, or switched to another method of transport. Shipment tracking, especially when repackaging occurs, is essential to enforcement of intellectual property rights. Customs on the importing side relies on declared origin as an indicator of risk of IPR violation.¹⁰

FTZs & the Smuggling of Illicit Whites

Recent years have seen a dramatic increase in Custom seizures of illicit whites—cigarettes manufactured for the sole purpose of smuggling and selling them illegally in another market. Several illicit white brands are manufactured in free-trade zones. In Greece, for example, in 2011, over 70% of custom seizures of smuggled cigarettes were illicit white brands; and the majority of these cigarettes were manufactured in duty-free zones. Although these activities may not necessarily be illegal within the FTZs, the absence of proper oversight in these zones has contributed to the global proliferation of illicit whites.

Unsurprisingly, traffickers in counterfeit goods are increasingly using transit or transshipment of goods through multiple ports to disguise fakes and elude shipment tracking and cargo inspection, both of which are necessary to substantiate claims of IPR violation.¹¹ Goods in transit or transshipment are distinct in where and how IPR violations can be facilitated; therefore, the solutions to prevent IPR infringement are different for these Customs regimes as well. A key point is that goods in these two processes have less time in the national Customs territory. The level of manipulation of the goods is also more restrictive.

1.3 Customs bonded warehouses

Customs bonded warehouses¹² are under the supervision of Customs; bonds are posted to guarantee the status of goods stored there, and the goods are not subject to duty payments. Goods at the warehouse may be manipulated, even repackaged, but their identity is largely preserved for the purpose of tariff classification. This process is in contrast to activity in the FTZ, which may involve manufacturing and legitimate changes in tariff classification, value, and country of origin.

Customs bonded warehouses near FTZs are known to counterfeiters as “flip ports.” Brand-owners have reported that warehouses near or in FTZs, SEZs, or free ports are “hotspots” for laundering counterfeit or pirated goods because oversight—by the local government and/or the FTZ operator—is negligible. Warehouses near extraterritorial SEZs with no national Customs intervention are ideal for laundering.

Laundering begins when fakes are unloaded into bonded warehouses or FTZs. The goods are often stored for long periods, partly or fully assembled, and then relabeled but without Customs supervision. They are then loaded into new containers for subsequent shipment to the final country intended for consumption or to another port, warehouse, or FTZ, where the process is repeated. The movement, storage, relabeling and reshipping process serves to disguise illegal origins.

As with transit and transshipment, the solutions to the violations in Customs bonded warehouses are different from FTZs in the accessibility and the manipulation of goods, which should be more restricted in the warehouse than in an FTZ. What this regime shares with FTZs is a longer opportunity for manipulations by violators; goods are sometimes put under the Customs free zone regime for the intended purpose of warehousing or longer term storage.



2. Customs, Free Trade Zones and how they intersect

2.1 The mandate of Customs

National Customs authorities enforce the laws governing the movement of goods across borders and are responsible for a wide range of tariff and non-tariff activities. The traditional tariff role is to collect and protect revenue, derived primarily from the collections of tariffs, taxes and duties on goods moving through borders. Non-tariff responsibilities include, among others, national security, narcotics interception, protection of endangered species, and prevention of national treasure and artifact smuggling. In most countries, laws governing the movement of currency and fiscal instruments are enforced by national Customs.

As the primary border agency, Customs also enforces the laws and regulations of other government agencies, such as health, agriculture, environment, and in some cases, immigration, involved in the movement of goods across national borders. This border-management responsibility facilitates trade and regulatory compliance when multiple agencies are involved. In today's "globalized economy," national Customs agencies increasingly cooperate with each other, both formally and informally. They enforce tariff and nontariff measures and share information on traders to facilitate risk management and prevent illegal goods trafficking.

Customs has become a critical player in fighting the cross-border trade in counterfeit and pirated goods. While other national government agencies may have primary policy and regulatory responsibility for enforcing intellectual property rights, Customs has a clear mandate for dealing with counterfeit and pirated goods that enter or leave the country. The mandate for Customs involvement takes on increasing importance given the association of counterfeiting and piracy with smuggling and other criminal activities.

2.2 The advent of the Free Trade Zones

Governments are increasingly promoting trade by creating Free Trade Zones (FTZs)¹³, free trading jurisdictions within the country where a minimum level of oversight occurs. FTZs attract employers, stimulate the area's economy, and promote economic growth in foreign investment, employment, technology transfer, and industrialization. Governments also use these zones to kick-start export-led, economic development and to pilot for internationally competitive policies ahead of national economic reforms. FTZs have become indispensable tools for global business, enabling the development of entirely new business models such as "right on time" manufacturing.

FTZs have grown dramatically over the last three decades, which attests to their success. In 1975, only 79 FTZs existed worldwide, employing roughly 800,000 people. Today FTZs number an estimated 3,000 in 135 countries, accounting for 68 million direct jobs and over US\$500 billion of direct trade-related value.¹⁴

FTZs are usually located near a country's ports of entry or close to seaports and airports. They typically offer warehousing, storage, and distribution facilities for trade, transshipment, and re-export operations. Everyone—from large manufacturers to small businesses to individuals—utilizes FTZs. Common characteristics include above-average infrastructure (compared to the standards of many host countries) where tenants have access to quality land, office space, utilities, logistics services, business services, and other facilities. Enterprises located within the zones are primarily focused on production for export to foreign markets.

The main idea behind the creation of FTZs is to stimulate a multitude of economic benefits for the host country. These include increased trade and exports, new business formation and employment, generation of foreign exchange earnings, greater access to foreign direct investment, technology transfer, and knowledge spillover. In many instances, the host country establishes FTZs in underdeveloped areas to attract employers, reduce poverty and unemployment, and stimulate the local economy. UNESCAP has ranked the value of the top seven economic benefits:¹⁵

1. attracting investment capital
2. creating employment
3. generating export revenues
4. generating port traffic
5. transferring know-how
6. creating backward linkages through sourcing of raw materials
7. creating backward linkages through subcontracting

In order to generate these benefits for the national economy, governments have liberalized foreign trade terms beyond those currently in force elsewhere in the country. To encourage such trade, governments offer incentives such as exemptions from duty and taxes; duty-free importation of raw materials, machinery, parts and equipment, and simplified administrative procedures. The following are common elements of government incentive packages to FTZ operators:

- Duty Exemption – no duties on or quota charges on re-exports
- Duty Deferral – Customs duties and federal excise tax deferred on imports
- Logistical Benefits – Companies using FTZ procedures may have access to streamlined Customs procedures (e.g., “weekly entry” or “direct delivery”)

Governments also remove obstacles that regular Customs regulations impose. For example, FTZs have been allowed to operate with minimal or no Customs control on entry or exit of goods, or they outsource official management and control to a private sector Zone Operator.

Public and private organizations may be involved in the management and operation of an FTZ, but the functions are usually centralized under a single entity.¹⁶ Administration, however, does not include Customs responsibilities. In the United States, for example, three agencies integrate authority for foreign trade zones: Customs and Border Protection, Homeland Security, and the Foreign Trade Zones Board, which reports to the Department of Commerce and Treasury. In effect, a privately owned and run FTZ is administered as if it were a public utility.

WTO members must ensure that FTZs abide by their WTO commitments, or other WTO Members can file complaints and seek sanctions. Benefits such as subsidized infrastructure, for example, must satisfy obligations under the Agreement on Subsidies and Countervailing Measures. Prevention of counterfeiting and piracy must satisfy the requirements of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

2.3 Relationship between Customs and Free Trade Zones

FTZs have been increasingly reported as havens for production, storage, sale, and transit and transshipment of illicit counterfeit and pirated goods.¹⁷ This abuse is especially prevalent where government oversight is inadequate and where Customs exercises little to no control. How did this situation arise?

Customs laws define “Customs territory” by land borders and Customs waters. These laws determine the status of goods in relation to national laws, whether inside or outside the physical territory, and whether goods are subject to duties, taxes or other fees. For Customs, “free trade zone” pertains primarily to the status of a good (i.e., being exempt from duties and taxes) and only secondarily to the good’s physical location.

Free Trade Zone: A Physical Location and a Goods Status under Customs

Goods with temporary import status, such as a car used by a visitor to a country, may move freely about a country but cannot be sold. Likewise, some goods with free-zone status may, in best practice, leave the zone—under the supervision of Customs and with the issuance of a bond—to be processed offsite and then returned to the zone. This practice is cost effective, for example, when manufacturers need to use expensive equipment that is available only outside the zone. They cannot justify the purchase of the equipment because they rarely use it. Customs, however, must be confident that such goods will not “leak” into the economy.

Since “FTZ” is a designation to facilitate a *specific Customs status* for goods in the national territory—primarily enabling businesses to be *free of most taxes and duties* related to those goods—then goods in these territories are considered outside the Customs territory *only* as far as import duties and taxes are concerned. The goods and activities in FTZs remain inside the territorial borders of the country and remain subject to national, non-tariff regulation and laws.

Specifically, goods and related activities in FTZs cannot be considered “extraterritorial” if they are in conflict with national laws or Customs laws. If activities such as money laundering, racketeering, illicit narcotics trafficking, fraud, counterfeiting and piracy of products, and smuggling are illegal in the country, then they are illegal in the FTZ and subject to enforcement by the corresponding government authorities, including Customs.

At both national and global levels, Customs administrations are responsible for non-tariff border enforcement measures. When national Customs authorities are excluded from zones, they are not able to enforce these key non-tariff measures.

Even when the national government has full authority over the status of free-zone goods, exempting goods from taxes and duties still creates problems. Such exemption strips away the ability of Customs to enforce non-tariff measures by:

1. Limiting the scope of cargo that Customs inspects; in some zones, it could be the entirety of throughput. This undermines Custom’s associated responsibilities for national security, narcotics interception, protection of endangered species, prevention of national treasure and artifact smuggling, and enforcement of intellectual property rights.
2. Limiting Customs’ incentives to perform its standard inspection procedures, such as raising revenues through duties and taxes.

As a result, both situations lead to (1) physical inspections of fewer goods, and (2) exploitation by illegal traffickers who know that if Customs are not inspecting for revenue purposes, they probably are not inspecting for secondary purposes.

The WCO has tried to correct the misunderstanding of non-tariff “extraterritoriality” in the free-zone concept. It emphasizes in the Revised Kyoto Convention (RKC)¹⁸ free zones as “a part of the territory of a Contracting Party.” It also notes that goods are outside the Customs territory only “*insofar as import duties and taxes are concerned.*” Moreover, Standard 4 of Annex D of the RKC specifically states that Customs shall have the right to carry out checks of goods in the free zone, including the right to conduct checks for non-tariff compliance.¹⁹ Other provisions in the RKC (Specific Annex D, Chapter 2) delineate guidelines that address the management of FTZs, including explicit Customs jurisdiction over FTZs, rules on origin of goods, and Customs transit and transshipment procedures.

While wider adoption and stricter enforcement of RKC Specific Annex D, Chapter 2 would go a long way in fixing FTZ problems, WCO has left adoption and implementation optional, and few signatory nations have elected to implement RKC provisions. WCO should more aggressively promote/re-institute the adoption of RKC provisions, including those in Specific Annex D Chapter 2.

Who has control? A case study from Jebel Ali

January 2012

Based on timely, reliable and specific information, 16 containers full of counterfeit products were imported into Jebel Ali Free Zone (JAFZ). After brand owners jointly lodged complaints, the IP Department of Dubai Customs started to detain the containers as they arrived, ultimately intercepting a total of eight. During the period of interception, brand owners' intelligence revealed that criminal syndicates in both UAE and China were aware that their containers were being detained in Dubai for examination. They knew that the syndicate had a high-ranking figure in either JAFZ Authority or Dubai Customs who would sort out this problem.

The source indicated that the Bills of Lading for all the shipments would be changed and the goods moved to "transit" status. When brand owners contacted the Head of IP Department in Dubai Customs, they wanted him to detain the containers pending contact with the importer. They were informed, however, that the Director General's Legal Advisor had already released all eight containers because these goods were designated for re-export to Iraq with no counterfeit products in any of the detained containers.

Allegedly, the containers had been released as "Ship to Ship" outbound to Iraq. Subsequent check of public container tracking websites, however, indicated that the containers did not go "ship to ship" at all but were emptied at JAFZ. Loads were broken up and moved to different containers, making it impossible to identify what left and what remained behind in JAFZ.

Despite complaints to Dubai Customs and repeated requests for information regarding the onward shipment of the suspect goods, officials did not respond to the complainants prior to the release decision. The whole incident left brand owners discouraged and gravely concerned over transparency within Dubai Customs. They questioned the ability of an unknown individual to manipulate and distort any control process in JAFZ.

Jordan: A Tale of Two Customs Agencies and One Special Economic Zone

Jordan's Aqaba Special Economic Zone (ASEZ) was created in 2001 as a duty-free, low-tax, multi-sector trade hub. Advisors recommended an extraterritorial model, with a Customs agency independent of Jordan Customs.

Unfortunately, creating a "second kingdom" for Customs functions isolated the zone from the global Customs community: In 2003, the zone's Customs agency applied for WCO membership and was told that it would not be eligible until the UN recognized ASEZ as a state. Exclusion of Jordan Customs also prevented businesses in ASEZ from becoming Authorized Economic Operators (AEOs), as envisioned by the WCO SAFE Framework.

Serious concerns over zone activities rose in 2005, when terrorists launched multiple Katyusha rockets from ASEZ toward two US Navy ships. Jordanian Security forces later discovered more rockets in a zone warehouse. In 2010, BASCAP members identified the port of Aqaba as a transshipment point for IPR infringement, with counterfeit goods from the UAE and China

entering into ASEZ for onward shipment to Iraq. Recognizing the need for reunification with Jordan Customs, ASEZ Customs officers and functions merged into Jordan Customs in 2011, returning to one nation, one Customs.

In contrast, Jordan Customs monitors Jordan's Qualified Industrial Zones (QIZs). QIZs were established in 1997 to promote stable relations between Jordan and Israel through joint production of products with free access to the US market. Jordan Customs officers work in the QIZs, validating joint Israeli and Jordanian content and may be present during container loading for security purposes. Hundreds of thousands of high-end original clothing items, not counterfeit knockoffs, have been produced in the QIZs, proving that zones can be both more productive and more secure with national Customs inside zones.

Jordan's contrasting experiences with ASEZ and Jordan's QIZs illustrate well the importance for national Customs, as part of the international Customs community, to manage commodities and companies from inside free trade zones, special economic zones, and free ports. Jordan Customs strives for continuous improvement. In the last decade Jordan has distinguished itself by modernizing, supporting legitimate trade, and becoming the second country to enter into a mutual recognition agreement with the U.S. Customs and Border Protection (CBP) under the WCO SAFE Standards.

U.S. Foreign Trade Zones: Trust But Validate

U.S. foreign trade zones are supervised by U.S. Customs and Border Protection (CBP) and remain within the jurisdiction of local, state, or federal governments or agencies. The CBP ensures compliance with tariff and nontariff measures through review of company commercial records and may directly observe zone activities. Currently, over 3,000 companies exist within U.S. FTZs. In 2011, 12% of foreign trade goods entered the United States through FTZs, and 68% of activities now occur in subzones used primarily for manufacturing. (<http://www.fas.org/sgp/crs/misc/R42686.pdf>). Goods with free-zone status may be moved out of a zone for alteration or manufacturing. Even with liberalized procedures, these zones satisfy CBP requirements, thanks to its "trust but validate" approach to company control and regulation. CBP defines U.S. Foreign Trade Zones as a best practice example of the *Customs–Trade Partnership Against Terrorism* (C-TPAT), the U.S. AEO program under the WCO SAFE.

According to Dan Griswold, President of the National Association of Foreign Trade Zones (NAFTZ), the CBP does well in meeting its "dual responsibilities of revenue protection/regulation enforcement and promotion of legitimate trade." Griswold also says that the good relationship between the CBP and zone operators helps prevent "abuse of the FTZ for IPR piracy or counterfeiting."

3. International agreements, national legislation, and judicial Enforcement

International trade agreements have been slow to address the need for effective enforcement of intellectual property rights in FTZs. To encourage investment and reduce the regulatory burden on businesses, a number of countries have adopted national laws and policies that effectively permit businesses to use FTZs as a base for counterfeiting and other illegal activities. While these practices are inconsistent with the aims of international conventions, few judicial decisions have addressed the enforcement of intellectual property rights in FTZs.

Moreover, a number of governments have chosen not to enforce international obligations in FTZs, apparently preferring to apply weaker national provisions that promote trade at the expense of reasonable regulation. This dual system—compliance with IPR provisions in international agreements outside FTZs but a hands-off approach within the FTZ and at its borders—creates ambiguity over Customs authorities' jurisdiction to seize counterfeit and pirated goods in FTZs. Counterfeiters and other organized crime groups have actively identified and exploited these enforcement weaknesses.

This chapter outlines the international legal framework governing intellectual property and FTZs. The discussion will provide a basis for recommendations that address enforcement weaknesses and strengthen intellectual property protections consistent with international norms and FTZ goals.

A brief review of selected national laws illustrates the types of problems that exist and identifies ways to prevent a conflict or imbalance between IP protection and policies that favor growth and promote international trade.

In addition, this chapter reviews recent court decisions that uphold the authority to take action against IP infringements. These decisions illustrate the reconciliation of differences between national law and practice and a country's international obligations to protect intellectual property. These findings will lend to Chapter 4 recommendations for legislation, regulations, and practices that provide clear authority for Customs and other enforcement agencies to provide appropriate oversight of FTZs.

3.1 International agreements

Efforts to stem international trade in infringing goods have been part of public international law at least since 1883. Language requiring the seizure of goods illegally bearing a trademark or trade name was included in the first draft of the Paris Convention for the Protection of Industrial Property. In 1886, the Berne Convention for the Protection of Literary and Artistic Works adopted similar copyright provisions. These two international agreements have broad reach and form the basic framework for international protection of intellectual property throughout the world.

At the time of their drafts, for the countries that were members of the Paris Convention but not the World Trade Organization (WTO), and for the countries that were members of the Berne Convention but not the WTO, these agreements offered the primary international basis on which to seize infringing goods. Significantly, neither the Paris Convention nor the Berne Convention offered an effective means to enforce their provisions in the event that a member fails to live up to its obligations. Moreover, neither agreement specifically addressed FTZs.

Given the limitations of these two agreements, efforts to prevent trade in counterfeit goods have shifted to the Customs conventions, particularly the WCO's Revised Kyoto Convention (RKC); the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), an annex to the Agreement Establishing the World Trade Organization; and to other trade agreements, including the proposed Anti-Counterfeiting Trade Agreement (ACTA) specifically directed to trade in counterfeit goods. Although a number of agreements contain provisions relating to trade in infringing goods, only two of these three major trade and Customs agreements specifically address the protection of intellectual property rights in FTZs:

- The RKC adequately covers FTZs for control of goods, such as the right of Customs to enter and inspect goods in the zone for tariff and non-tariff conformance to laws and regulations. It is a fundamental weakness of the RKC, however, that its provisions for free zones are in a Specific Annex that is not mandatory for RKC Contracting parties or all members of the WCO.

- The TRIPS Agreement provides comprehensive requirements for intellectual property protection, including border measures, but TRIPS does not specifically address FTZs. In addition, some of its stronger provisions are not mandatory for WTO Members.
- ACTA addresses a number of the weaknesses of TRIPS and the RKC, both by specifically addressing FTZs and by providing clear guidance on optional provisions. Like the Paris and Berne Conventions, ACTA lacks an effective dispute-resolution process such as that provided under the WTO. Moreover, ACTA embodies a limited number of countries and has not yet entered into force.

Other international agreements and frameworks—such as the WCO SAFE Standards, the WTO Agreement on Subsidies and Countervailing Measures (SCM), and the General Agreement on Tariffs and Trade (GATT)—are indirectly relevant to IPR/FTZ issues. Unfortunately, none of the existing or proposed agreements, either alone or in combination, effectively prevents trade in counterfeit goods from free zones.

3.1.1 WCO conventions and instruments

The WCO has a long history of promoting standardization and recognition of best practices. While best practices are critical for Customs administrations, they also benefit traders by promoting predictability among Customs administrations. Many WCO conventions,²⁰ agreements, and other instruments bear some relevance to FTZs and the protection of intellectual property, but only two are critical: the Revised Kyoto Convention (RKC) and the SAFE Framework of Standards.

3.1.1.1 Revised Kyoto Convention

The Kyoto Convention was signed in May 1973 and covers harmonization of Customs procedures, other than classification and valuation. In June 1999, the WCO adopted the revised convention, which reflects expectations for the future of international trade. A major instrument of trade facilitation, the Revised Kyoto Convention (RKC) covers simplified, predictable, transparent Customs procedures; optimum use of information technology; risk management; partnership with the trade and other stakeholders; and a system of appeals. With over 600 standards, transitional standards, and recommended practices, the RKC is a guidebook to modern Customs.

As of September 2012, the RKC had enlisted 83 contracting parties who are responsible for more than 70% of the value of globally traded goods.²¹ Parties must meet all provisions of the convention's General Annex. Contracting Parties are not, however, bound to accept all of the Specific Annexes. They may choose to accept, within the Specific Annexes, only certain Standards and Transitional Standards or Recommended Practices.

Specific Annex D outlines provisions on FTZs and addresses refusal of entry of pirated or counterfeit goods into an FTZ.²² The guidelines for Recommended Practice 6 in Specific Annex D view FTZs as being in the national Customs territory, and Standard 4 in Chapter 2 considers that Customs should have an unrestricted right to enter and observe operations in free zones.²³ The RKC gives contracting parties the authority to enact procedural legislation following a Customs offense.

While the RKC is a convention-level agreement, it does not cover dispute resolution methodology. Second, the WCO reports that of the nations that have acceded to the RKC, only seven have acceded without reservation; another five have acceded but with reservation to Specific Annex D, Chapter 2 that covers free zones. Countries that have not acceded to specific Annex D, Chapter 2 can still use the provisions as guidelines for addressing the management of the Customs free zone and the FTZs, and then at a later date, they can accede to this section of the RKC.

Thus, while the RKC contains excellent models for free zones, its impact is limited by the few signatories that have acceded to Specific Annex D without reservations. And even in those cases, the effectiveness of the provisions will critically depend upon their adoption into stronger laws in each country due to the fact that RKC includes no dispute or punitive actions for non-compliance.

3.1.1.2 SAFE Framework of Standards

First adopted in 2005, the WCO Framework of Standards to Secure and Facilitate global trade (SAFE) was most recently updated in June 2012. The purpose of SAFE is to promote the movement of recognized secure trade, prevent terrorist attacks on trade, and prevent abuse of trade to promote terrorism. SAFE has many supportive model documents, and 166 countries have agreed to implement them. SAFE does not specifically mention FTZs, but through its efforts, two concepts important to FTZs' success or failure have evolved:

- Customs-to-Business cooperation, wherein companies self-regulate to meet standards and gain recognition by national Customs as Authorized Economic Operators (AEOs), a status that has significant implications for exporters, whether in FTZs or not; and
- Customs-to-Customs cooperation wherein Customs administrations cooperate, for example, by extending mutual recognition to each other's AEOs. In 2011, the WCO reported that 15 such mutual recognition agreements are in place, with another 10 in the negotiation process of finalization.

Significantly, the 2012 SAFE Standards updates recognize the relationship between terrorism/supply chain security and IPR protection. They refer to criteria to be used by frontline Customs officers in determining which shipments present a high risk of IPR violations.²⁴

The AEO concept is one of SAFE's main building blocks. Operators accredited by Customs with AEO status receive specific benefits, including fewer or no inspections on goods imported or exported by or via the AEO. The benefits are twofold: faster border clearance means lower transport costs for the operator, while for Customs can target limited capacity on cargo of unknown and potentially unsafe operators. For exporters AEO status also means that the national Customs administration, through the Customs to Customs cooperation and AEO mutual recognition, has increased authority and responsibilities to assist national exports in receiving facilitated benefits at further points in the movement of the goods in the supply chain.

The exclusion for companies operating in FTZs under SAFE recognition can seriously affect export growth. For an FTZ company not to be recognized among good companies that are rapidly becoming a point of near global recognition will have significant impact on their ability to effectively enter the global market.

SAFE, too, has weaknesses as an agreement for IPR protection in FTZs. SAFE does not specifically mention FTZs and is currently focused on supply chain security. Some AEO programs, such as the EUs, have developed a two-part program: one for security issues and the other for tariff and non-tariff compliance. The current SAFE mandate, however, targets only supply chain security for mutual recognition, not best practices, to prevent IPR infractions. It is time for both expansion of the WCO SAFE to include tariff and non-tariff measures and specific FTZ recognition as legitimate actors in the supply chain.

The WCO SAFE may be the most effective international instrument for honest businesses and Customs administrations to correct the misapplication of FTZs. For example, Customs administrations would not recognize as an AEO a company in an FTZ where Customs is not permitted to enter the zone to validate AEO requirements. In addition, national Customs should consider the risks of mutual recognition for a potential partner country, where FTZs and the free-zone regime are not properly controlled by Customs.

3.1.2 TRIPS and other WTO obligations

The need for a multilateral framework to prevent international trade in counterfeit goods is recognized in the opening lines of the TRIPS Agreement and is underscored by provisions that address international trade in pirated and counterfeit goods. TRIPS entered into force for developed-country WTO Members beginning on January 1, 1996. The provisions apply to all WTO Members and are enforceable among governments through the WTO dispute settlement mechanism.

The TRIPS Agreement incorporates major portions of the Paris Convention and Berne Convention and adds specific requirements for civil complaints, criminal prosecution, and requests for provisional measures. TRIPS also suggests procedures for the suspension of Customs clearance, a prohibition on re-export of counterfeit goods, and cooperation among Customs authorities, among other measures. Specifically, TRIPS:

- Requires WTO Members to provide procedures to permit the suspension of Customs procedures for counterfeit and pirated goods. (TRIPS Article 51)
- Requires WTO Members to allow Customs authorities to give the right holder and importer an opportunity for detention and inspection of any goods. (TRIPS Article 57)
- Requires WTO Members to give Customs authorities the power to order the destruction or disposal of infringing goods. (TRIPS Article 58)
- Prohibits WTO Members from allowing “the re-exportation of the infringing goods in an unaltered state or subject[ing] them to a different Customs procedure, other than in exceptional circumstances.” (TRIPS Article 59)
- Requires WTO Members to provide “criminal procedures and penalties to be applied at least in cases of willful trademark counterfeiting or copyright piracy on a commercial scale.” (TRIPS Article 61)
- Requires WTO Members “to cooperate with each other with a view to eliminating international trade in goods infringing intellectual property rights” and to “promote the exchange of information and cooperation between Customs authorities with regard to trade in counterfeit trademark goods and pirated copyright goods.” (TRIPS Article 69)
- WTO Members must also give their judges injunctive authority to prevent the entry of infringing goods into the channels of commerce, immediately after Customs clearance of such goods. (TRIPS Article 44)

In addition to these minimum requirements, TRIPS makes it optional to apply suspension procedures to goods other than trademark counterfeit and copyright pirated goods and to goods destined for export (TRIPS Article 51). TRIPS recognizes the possibility that WTO Members may require their Customs authorities to act upon their own initiative to suspend the release of goods where those authorities have *prima facie* evidence that an intellectual property right is being infringed (TRIPS Article 58). Where there has been a positive determination of infringement on the merits of a case, WTO Members may permit their Customs authorities to inform the right holder of the names and addresses of the consignor, the importer and the consignee and of the quantity of the goods in question. (TRIPS Article 57). Finally, WTO Members may choose not to apply these provisions to small quantities of goods of a non-commercial nature in travellers’ personal luggage or sent in small consignments (TRIPS Article 60).

3.1.2.1 TRIPS and FTZs

The TRIPS Agreement makes no special provisions for FTZs. Because of the special Customs treatment of FTZs, some countries have misinterpreted the Customs free zone regime as outside the Customs jurisdiction for nontariff matters. The result is that free zones in those countries are evading TRIPS requirements, and countries are subsequently failing to exercise appropriate oversight.

A better interpretation is that since TRIPS does not exclude its application in FTZs, WTO Members are obligated to apply TRIPS requirements to FTZs within their territories. This interpretation is consistent with the treatment of FTZs in other WTO agreements that do address FTZs, such as the WTO Agreement on Subsidies and Countervailing Measures (SCM).²⁵ Under the SCM, FTZs are not considered “extraterritorial” but are bound by the obligations of the WTO Member. The issue of direct regulation of FTZs and specifically for counterfeit trademark and pirated copyright goods is, of course, not addressed in the SCM, but the application of the SCM to FTZs creates an important precedent for the proposition that TRIPS protections must apply within FTZs and that failure to apply TRIPS protections within an FTZ may then be subject to dispute settlement under the WTO.²⁶

Although TRIPS does not specifically address FTZs, it contains a number of provisions that, if applied, would enable WTO members to take action against infringing goods, even in free zones. In particular, a WTO member should be required to impose criminal penalties on willful, commercial-scale counterfeiting and piracy to the same degree as it penalizes other criminal acts. Moreover, since infringing goods are exported rather than consumed in the FTZ, the authority provided under TRIPS Article 44 enables a government to seize goods immediately after they move from the FTZ. It is a critical point, however, that nations must actually move to enforce these provisions.

Even using these procedures, countries and Customs territories that adopt only TRIPS-minimum requirements will likely find that their laws do not adequately equip them to deal with counterfeit goods that are being exported from FTZs. Some of the optional TRIPS measures would do much to empower Customs authorities to stop the flow of counterfeit goods into, through, and from FTZs.

Ex officio authority is particularly important since right holders are unlikely to be aware of counterfeit operations until goods have passed beyond Customs control—but Customs authorities are often in a position to observe improprieties and take action. The ability to apply Customs procedures to exported or transhipped goods and to infringing goods sent in small consignments would provide Customs with useful additional authority to inspect and suspend shipments of counterfeit goods.

Customs administrations in numerous countries have shown that by granting authority that exceeds the minimum TRIPS requirement, governments can provide effective, efficient IPR protection and enforcement, both at and within their borders and in FTZs.²⁷

3.1.3 Anti-Counterfeiting Trade Agreement

ACTA is a pluri-lateral trade agreement that addresses commercial-scale counterfeiting and piracy. It is a complementary agreement that incorporates and clarifies TRIPS border measures, adopting a single, mandatory position on some optional TRIPS provisions, and outlining additional safeguards not addressed by TRIPS, such as protection of written information provided under ACTA (Article 4.2) and enforcement in the digital environment and electronic rights management (Article 27). With regard to preventing the proliferation of counterfeit goods, ACTA's most important contributions relate to its specific inclusion of FTZs and the adoption of a stronger position on TRIPS-optional provisions such as the possibility of *ex officio* authority for Customs authorities.

The agreement was signed in October 2011 by Australia, Canada, Japan, Morocco, New Zealand, Singapore, South Korea, and the United States, followed in 2012 by Mexico, the European Union, and the 22 countries that are its member states. One signatory (Japan) has ratified (formally approved) the Agreement, which would come into force after it is ratified by six countries. Based on statements by interested countries, ACTA will likely come into force in the near future. The Agreement is unlikely to encompass all the world's FTZs, however, as it will apply only in countries that have ratified it. In particular, neither China nor India—two major world trade players, as well as hotspot counterfeit and piracy regions, as defined by the US government Special 301 report—have shown support for the agreement.

3.1.3.1 ACTA, counterfeit goods, and FTZs

ACTA makes several important contributions to address trade in counterfeit goods in FTZs. Unlike TRIPS, ACTA specifically includes FTZs within its scope by defining “territory” as including “the Customs territory and all free zones of a party” in its Agreement.²⁸ Further, ACTA explicitly addresses border measures as they apply to transit and transshipment. It retains the TRIPS approach of allowing—but not requiring—Customs officials to undertake procedures with respect to suspect goods (Article 16.2). The agreement permits parties to adopt such measures voluntarily.

Several ACTA provisions could serve as models for countries that wish to move beyond the TRIPS baseline and prevent the proliferation of counterfeit goods. Key provisions are presented below (and are also reflected in Chapter 4 recommendations):

- Defining “Customs territory” to include FTZs for purposes of IPR enforcement, even where the FTZs are considered as being outside the Customs territory for purposes of import duties and taxes. This is an important distinction that would retain the important benefits of a reduced regulatory environment in FTZs but would supply necessary regulation to prevent the exploitation of FTZs for criminal enterprises. (Article 5)
- Limiting use of the TRIPS “*de minimis*” exception to small quantities of goods of a non-commercial nature contained in travellers’ personal luggage, but requiring the application of Customs procedures to goods of a commercial nature even when sent in small consignments. This provision is important, since one strategy exploited by counterfeiters has been to evade Customs by shipping goods in small consignments. (Article 14)
- Adopting procedures authorizing Customs authorities to act upon their own initiative to suspend the release of suspect goods. Granting *ex officio* authority to a country’s Customs authorities would greatly increase a country’s ability to prevent the proliferation of counterfeit goods. (Article 16)
- Where criminal penalties apply, ensuring that aiding and abetting infringement is also considered a criminal offense. Such legislation enables authorities to regulate the manufacture or assembly of counterfeit goods in multiple locations where, for example, criminals are shipping incomplete or finished goods to FTZs and applying counterfeit labels (Article 23.4).

3.2 Trade agreements

Trade Agreements and specifically Free Trade Agreements (FTAs) are an effective way to facilitate trade by lowering trade barriers between two or more countries. In comparison to multilateral agreements, which often require an international consensus and a certain amount of signatory countries to come in to force, FTAs can be negotiated and enacted bilaterally. This allows for more flexibility, taking into account each partner country’s specifics. FTA negotiations can also be used to create incentives for countries with weaker IP enforcement to enact more efficient IPR laws.

In 2010, the WCO estimated that more than 200 preferential trade agreements were in effect. According to the WTO, “As of 15 January 2012, some 511 notifications of RTAs had been received by the GATT/WTO. Of these, 319 were in force.”²⁹ While the statistics are from two different sources, the WCO and WTO, they both reflect the rapid growth of trade agreements.

In all types of free trade agreements, criteria for shift in country of origin are key. A shift in origin occurs when a new item is created that is legitimately considered a product of the country where that shift occurs. Shifts in origin are important because Customs relies on declared origin of inbound goods as a key risk indicator of IPR violations. Unsurprisingly, traffickers of illegal goods go to great lengths to disguise the origins of illicit goods.

General rules on how origin shift occurs are based on a change in the tariff classification and/or advancement in value. Some trade agreements also specifically reference FTZs and whether or not the production of new products for the purpose of the trade agreement applies to zone products. Given the proliferation of bilateral agreements, the treatment of origin and its relation to Customs free-zone regime status and IPR protections is critical.

In October 2011, the U.S. signed trade agreements with South Korea, Colombia, and Panama. Each agreement dedicates chapters to IPR and requires partners to provide their competent authorities with the *ex-officio* right to impose border measures on in-transit goods.³⁰ The agreement with South Korea specifies that this obligation extends to FTZs. The agreement with Colombia is silent on Customs authority in FTZs.³¹ The agreement with Panama notes that this obligation does not extend to Panama’s FTZs.³² While these are limited examples from over 500 agreements, further study could develop best case examples of provisions for inclusion in trade agreements. The provisions would both protect IPR rights generally and FTZs specifically. For now, national Customs administration should provide technical assistance to companies in FTZs and in the domestic market on the issue of origin, particularly where an agreement requires that Customs certify country of origin.

As more and more countries utilize free trade agreements to define the parameters of their bi-lateral trading relationships, opportunity exists to upgrade rules governing the treatment of counterfeiting and piracy in Free Trade Zones. Specifically, partners should empower Customs authorities with the *ex-officio* right to impose border measures on in-transit goods and extend clear Customs authority into Free Trade Zones.

3.3 National free trade zone legislation

The impact of international agreements and guidelines that combat counterfeiting and piracy depends on the number of parties to those agreements and the extent to which signatories enact legislation, as well as their implementation and enforcement of the IPR provisions.

Signatories are encouraged, but often not mandated or legally bound, to integrate provisions into national legislation. In some cases, the parameters of guidance, such as the level of penalties, are so broad that minimum compliance yields virtually no effective enforcement. Without precise provisions relating to FTZs and no requirements to add the non-obligatory provisions—such as in the case of TRIPS or the RKC’s Specific Annexes—countries enact a wide variety of laws affecting the enforcement and protection of intellectual property rights. For example, while some countries empower Customs to control goods and activities in FTZs, others have denied Customs jurisdiction over goods in FTZs. These countries misunderstand the correct function of FTZs as Customs controlled locations, under the premise that goods in FTZs are not clearing through Customs and are not being imported.

Even when Customs authorities are empowered to enforce intellectual property rights in FTZs, their effectiveness depends on Customs properly applying the Customs free zone regime. It must also oversee or exert its authority over goods within the free zone where there is a change of Customs regime, such as change to in-transit status. Trans-shipped and in-transit goods pose a particularly high counterfeiting and piracy risk. These procedures may be used to disguise the true country of origin of the goods or to enter goods into Customs territories, where border enforcement for trans-shipped or in-transit goods is weak. Inaction by governments against infringing goods due to transit or trans-shipment status is the exact situation counterfeiters exploit through complicated transit and trans-shipment strategies.

The traceability of the origin of goods is particularly important in those zones where, due to a lack of a Customs presence, zone operators or companies themselves can change goods arbitrarily from the Customs free-zone regime to the goods-in-transit regime, the warehouse regime, or to zones where goods are released for free circulation and consumption by residents in the zone.

Today, automated systems for inventory controls in the FTZ can greatly ease the process of regime change tracking, but those systems must be accessible to and interfaced with the national Customs automated systems. It is simply bad practice to permit any other agency than national Customs to control change of the Customs regimes.

The following lists a selection of national and regional laws and regulations governing FTZs to:

1. Illustrate the wide variance in national regulatory measures that address establishment jurisdiction, control and enforcement
2. Explain how national laws fall short of meeting or, worse, undermine international obligations
3. Extract national provisions that could serve as model practices for other nations or for inclusion/promotion by WTO and WCO. These examples are used to form Chapter 4 recommendations.

Hong Kong, SAR. Hong Kong has been declared a free port and a separate Customs territory, where China has assured free movement of goods. Section 12 of the Hong Kong's Trade Description Ordinance (CAP 362) prohibits and criminalizes imports and exports of goods bearing counterfeit trademarks. This section, however, specifically excludes "goods in transit" from its application.

[!] Excluding "goods in transit" allows counterfeiters to evade detection by shipping goods through the FTZ to conceal or alter the shipment's history. The ongoing practice of allowing known counterfeit products that are identified or seized by Customs to be released back into commercial circulation—whether for sale abroad or for re-import into the country—is incongruent with the country's manifold commitment to fight counterfeiting and piracy. This practice sends the message worldwide that some countries are willing to tolerate the illegal business of counterfeiting and piracy.

Malaysia. Although Customs controls are minimal in FTZs, Customs has jurisdiction and authority to examine goods in FTZs and can approach the free zone operator for needed information. Even though FTZs are established by decree and operate under specific zone rules, the Royal Malaysian Customs (RMC) has effectively prevented IPR violations in several cases, as noted in the following section on judicial enforcement. The main problem in Malaysia is the use of special *Zon Bebas* forms in FTZs, rather than Customs forms. The resulting lack of physical and documentary controls by the RMC on movement of goods allows criminals to use free zones for storing, moving, and smuggling contraband.

[!] Even when strong IPR enforcement is allowed within FTZs, counterfeiters can forge documents and otherwise exploit limited document controls to store, move, and smuggle contraband.

Vietnam. FTZs are established by Decree, and each has unique conditions and regulations. Unfortunately, the Decrees lack detailed articles on IPR, for instance, requiring that goods produced in, imported into, or exported from FTZs may not violate IP regulations. According to Decree 154/2005/ND-CP, "Goods brought from overseas into Free Trade Zones or vice versa shall be subject to Customs declaration. Actual inspection shall only apply to goods showing signs of law violation." To complicate matters, Vietnam's National Office of Industrial Property (NOIP) does not recognize the trademarks applied to goods and services circulated in FTZs. This is primarily because NOIP considers the zones to be outside of Vietnam.

[!] Customs has the legal authority to intervene in FTZs, but operationally, it only supervises these goods in general and may only inspect the goods if it has reason to suspect a violation of law. This stipulation has created a weakness in the actual day-to-day Customs control in the zones. This is also a situation where two agencies need to reconcile their conflicting interpretations.

Gulf Cooperation Council. The Common Customs Law of the Arab Gulf Cooperation Council prohibits the transit of illegal goods in the Gulf countries of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE,. Goods that violate IP laws are “prohibited goods” under Article 80 (4) and may not be admitted into the free zones and duty-free shops. Customs authorities, therefore, have the right to inspect suspect shipments in FTZs. Over the past two years, UAE Customs has seized in FTZs four shipments of over 21 million counterfeit Phillip Morris-branded cigarettes (Marlboro, L&M). Destruction of the cigarettes is pending.

[!] To address IPRs abuse in FTZs, Customs must have both enabling legislation and clear jurisdiction over zone activities, including goods in transit. Once intercepted, it is equally important that Customs have in place a clear and simple procedure for destroying infringing goods.

Egypt. Egypt has at least 10 FTZs. Counterfeit goods fall under the Egyptian Commercial Law and Export and Import Regulations and Customs. Customs collects duties, while other agencies enforce border measures. It must inspect goods *in situ* and provide evidence that goods were destined for the Egyptian market. Reportedly, Customs authorities and prosecutors do not take legal action on IPR violations for goods in FTZs or transit zones. This report is supposedly based on an understanding that the Intellectual Property Code (Law 82 of 2002) does not provide jurisdiction over goods in FTZ or in transit. Such situations are regarded beyond the scope of the territorial application of trademark rights. In fact, Law 82 does not address border measures, which are left to other laws and regulations.

[!] Countries need to ensure that FTZs recognize and enforce their IPR laws. By excluding these zones from their scope, either explicitly or through ambiguity arising from conflicting laws, governments provide counterfeiters with a perceived immunity, which, in turn, facilitates illicit trade.

Turkey. Under the provisions of the Trademark Decree, Customs Law, and Customs Regulation in Turkey, Customs authorities are empowered to control and check operations in FTZs. Where evidence is available, they can detain shipments and inform rights holders, who can then obtain an injunction from an intellectual property court.

In 2008-2009, Turkish Customs seized two shipments of 19 million counterfeit ASSOS cigarettes in FTZs; both seizures resulted in preliminary injunctions favorable to the right holder. Later, the Mersin decision, described below, confirmed that FTZs operate in the boundaries of the country. That IP courts in Turkey have granted preliminary injunctions confirms that national trademark protection will be applied in FTZs. Although injunctions have been granted, several cases of this nature are still pending before the courts.³³

[!] This is a good example of where law, Customs and judicial authorities have clearly indicated that they have jurisdiction and authority in FTZs and that IPR abuse will not be tolerated.

European Union. Council Regulation 1383/2003 provides for Customs action against goods suspected of infringing certain intellectual property rights. The legislation covers Customs regimes where goods are not released for free circulation in the EU such as transit, Customs free zone, and Customs warehousing. IPR protection, however, is subject to a recent decision by the Court of Justice of the European Union. This decision limits detention and enforcement against counterfeit goods to situations where there is evidence that the goods are intended for the EU market, unless other grounds exist for the detaining the goods. (See case study below).

[!] The failure to stop counterfeit goods in transit at the EU's borders is a major flaw that must be corrected immediately. The ongoing practice of allowing known counterfeit products that are seized by (EU) Customs to be released back into commercial circulation—whether for sale abroad or intended for re-import into the EU—is simply incongruent with the EU's manifold commitment to fight counterfeiting and piracy. This practice sends the message worldwide that the European Commission and the European Parliament tolerates the illegal business of counterfeiting and piracy.


Kenya. The Kenya Export Processing Zone was developed in 1990. It is located with the Athi River port and is regularly used as a transit point for illicit goods smuggled into neighboring countries. Enforcement has been successful when goods are in the FTZ and proved to be affecting the Kenyan market. Country law, however, does not allow legal action against goods in transit, unless deemed counterfeit.

[!] Excluding “goods in transit” allows counterfeiters to evade detection by shipping goods through the FTZ to conceal or alter the shipment's history. The ongoing practice of allowing known counterfeit products that are identified or seized by Customs to be released back into commercial circulation—whether for sale abroad or for re-import into the county—is incongruent with the country's manifold commitment to fight counterfeiting and piracy. This practice sends the message worldwide that the country tolerates illegal counterfeiting and piracy.

South Africa. Section 2(1)(f) of the Counterfeit Goods Act provides that “counterfeit goods” may not be imported into, through, or exported from or through the country, except for the private and domestic use of the importer or exporter. In *AM Moolla Group Limited & Other vs. The Gap Inc. & Others*, the Supreme Court of Appeal of South Africa held that goods in transit or being transshipped through South Africa do not fall within the ambit of this section.


[!] As with Kenya, the effective enforcement of IPRs and actual deterrence require that Customs has authority to intercept all goods violating IPRs, including those in transit. Excluding “goods in transit” allows counterfeiters to evade detection by shipping goods through the FTZ to conceal or alter the shipment's history.

Chile. Chile has two FTZs: the Iquique Free Trade Zone (ZOFRI) and Zona Austral. ZOFRI handles significantly more container volume. Both are considered models of FTZ management in Latin America. In 2003, Chile passed Law 19.912 giving Customs authority to implement border measures allowing inspection and seizure of illicit items. Customs frequently exercises this right to inspect and seize. Customs officials have the latest technology (x-ray machines), which enables them to search more effectively and completely.


 A clear Customs mandate, together with Investments in new technologies, is key in maximizing Customs' ability to deter, detect and intercept illicit goods.

Panama. With 2,200 companies, the Colon Free Zone is the world's second largest FTZ after Hong Kong. Panamá has laws that protect IP in general. Law 35 of 10 May 1996 and Law 15 of 8 August 1994 allow the effective protection of a trademark owner's IPR. In addition to sanctions under the Penal Code, the laws provide for suspension of permits allowing commerce in a free zone and in certain industries; damages compensation; and diverse measures to avoid future offenses. The Intellectual Property Act gives *ex officio* powers to Customs to inspect and seize goods transiting through the zone and suspected of infringing IPR. The Customs Act provides that goods that enter an FTZ shall comply with sanitary and health regulations.

Sections 384 and 382-B of the Panamanian Penal Code also address crimes against industrial property rights and prohibit acts such as the circulation of products bearing trademarks that have been counterfeited, altered or imitated; and the transit of these types of goods through the country, even when the final destination is not Panama. Customs authorities are empowered (under Executive Decree No. 123/96) to inspect this merchandise and detain even the goods in transit if it suspects them of being counterfeit and of violating sections 384 and 382-B of Penal Code.

 Panama, the world's second largest FTZ, illustrates that strong IPR protection and zone productivity are not mutually exclusive objectives, but rather are complementary and synergistic.

United States of America. U.S. free trade zones defined as *Foreign Trade Zones* are under the supervision of the U.S. Customs and Border Protection (CBP), but the authority to establish zones is under the Foreign Trade Zone Board (FTZ Board) under the Departments of Commerce and Treasury. The CBP is responsible for day-to-day operations in the 279 FTZs; over twice that many sub-zones are located primarily in factories. The law authorizing the FTZs is 19 U.S.C. 81a-81u - Foreign-Trade Zones. In the U.S. FTZs, residency (other than Customs officers) is not permitted in the zone. U.S. legislation and regulations for FTZs are some of the most liberal in the world. Goods under special circumstances are permitted to leave the FTZ and return without losing Customs free-zone status.

 Liberal legislation governing FTZs does not in itself preclude a high level of IPR protection. What is most important is efficient national IPR legislation and that Customs have unrestricted access to—and jurisdiction over—all goods and activities in zones.

Good laws ≠ Good Practice When Corruption Prevails

Uruguay has nine FTZs with excellent legislation for control of contraband and money laundering. It implements regulations that apply to all FTZs. Despite this enforcement, Zona Franca Florida Sur, Zona Franca Libertad, and Zona Franz Rivera FTZs are notorious for illicit trade. While it is difficult to explain this situation, in cases where clear and comprehensive legislation is in place, complaisance and corruption are palpable explanations. In 2008, 40 officials from Uruguay Customs were charged with bribery, counterfeiting, and shipping contraband.

Good laws = Good Practice When Integrity Prevails

Chile is a country with a high degree of confidence in Chilean Customs. The awareness of and action against corruption is higher than most Latin American countries.

Conclusions

The preceding section illustrates that countries enact a wide variety of laws affecting the enforcement and protection of intellectual property rights in FTZs. For example, while some countries empower Customs to control goods and activities in FTZs, others have denied Customs jurisdiction over goods in FTZs. Some countries detain infringing goods, even if they are “in-transit,” while others preclude authority over goods in transit.

The following best practices are derived from the examples above:

- Empower Customs authorities with jurisdiction over FTZs’ day-to-day operations.
- Clarify that the national Customs authority has jurisdiction over FTZs (or SEZ or free port, etc.); that it has unrestricted rights to enter and observe operations, audit the books and records of companies in the zone, and to validate goods status and conformance with tariff and nontariff measures under the national Customs mandate.
- Review and implement national IPR legislation, including language that makes legislation applicable to all goods in the national territory, in all Customs regimes including transit, in-transit, and free-zone regimes. Further state that the discovery of prohibited goods may result in civil and criminal penalties.
- Grant Customs *ex-officio* power to detain goods suspected of infringing IPR, including goods in FTZs, SEZs, free ports, and the like.
- Enable cooperation between national Customs authorities and the special authorities of FTZs or free ports to ensure efficient enforcement of anti-counterfeiting criminal and civil laws to check the offenses of trafficking in counterfeit goods.

3.4 Judicial enforcement

States are increasingly recognizing the economic drain caused by counterfeiting and piracy. The rise of laundering and illicit activity within FTZs runs counter to the underlying objective for creating FTZs and gives rise to longer-term concerns over national security and damage to indigenous intellectual property rights. Thus, instances where governments are empowering Customs agencies to ignore the perceived immunity afforded trans-shipped goods, and examples of States tackling illegal activities occurring in FTZs, are increasing across the world.

Enforcement of intellectual property rights depends not only on the actions of Customs and other enforcement officials, but also on the ability of right holders to secure favourable court rulings. Despite widespread violations associated with FTZs and transshipments of infringing goods, relatively few cases have been reported concerning enforcement of intellectual property rights in FTZs or in transit.

In most cases, courts have upheld governments’ ability to effectively enforce counterfeit activity. The different fact patterns of these cases, the diverse laws and enforcement practices, and the courts’ reasoning behind these decisions all offer useful guidance in formulating recommendations to prevent international trade in counterfeit goods.

This section summarizes cases and analyzes their implications in five jurisdictions addressing enforcement against counterfeit goods in FTZs.

Turkey - The Kardo Case

Case Summary

Cigarettes bearing the “Marlboro” and “Parliament” trademarks were found in a depot of Kardo General Trading Co. (Kardo) in the Mersin Free Trade Zone in Turkey. The trademark owner, Philip Morris Products S.A. (PMPSA), filed suit with the Istanbul Court of Industrial and Intellectual Property Rights, requesting the following: prevention of the trademark infringement; prohibition and prevention of unfair competition; destruction of the counterfeit cigarettes; and disclosure of the court judgment by means of publication. Kardo defended on the grounds that the goods were in transit. In September 2003, the Chamber of the Court denied PMPSA’s claims on the grounds that the counterfeit cigarettes were in transit in the Mersin Free Zone, where Turkish law provisions on trademark infringement do not apply. On March 3, 2004 the 11th Chamber of the Turkish Court of Cassation overruled its previous decision: Storing counterfeit goods for commercial purposes and affixing the trademark without the right holder’s consent constitute both trademark infringement and a criminal act. The court noted that the transit of counterfeit goods constitutes an act of trademark infringement. The court also observed that TRIPS Articles 41, 46, and 50 oblige WTO Members to dispose of counterfeit goods outside channels of commerce in such a way as to preclude any injury to the right holder.

[!] Implications

This case argues for the propositions that Turkey’s free zones remain within the country’s territorial boundaries, that the laws applying to free zones give no immunity with respect to trademark counterfeiting, and that TRIPS provisions are applicable in FTZs. It is also notable for its ruling that the *transit of counterfeit goods* constitutes an act of trademark infringement. The fact that this case resulted not only in an appeal, but also in the highest court overruling its own previous decision, illustrates the court’s difficulty in dealing with unclear relationships between IP laws and the rules governing FTZs. This case also illustrates the need for a more definitive treatment of intellectual property enforcement in laws relating to FTZs and goods in transit.

Malaysia - Philip Morris Products SA vs. Ong Kien Hoe & Ors

Case Summary

In September 2002, Royal Malaysian Customs (RMC) officers detained two 40-foot containers holding 1,350 unmarked bale boxes of cigarettes bearing the trademark of “MARLBORO” in the Westport Free Zone. The cigarettes were subsequently found to be counterfeit cigarettes manufactured without the trademark owner PMPSA’s authority. The transporter requested that RMC return the counterfeit cigarettes on the basis that they were being transshipped. Since they were in a free zone, the cigarettes were not within RMC’s jurisdiction. In 2009, the High Court determined that the Westport Free Zone is not excluded from Customs enforcement. RMC declared the cigarettes forfeit. The defendant filed an appeal, which the Court of Appeals dismissed in a unanimous decision on May 3, 2012.

[!] Implications

This case is significant because it addresses the RMC’s authority over goods in Malaysia’s free zones and over goods in transit. The Court of Appeals holding is particularly important because it removes any uncertainty as to that authority. It is also significant that nearly seven years elapsed between discovery of the counterfeit goods and the High Court’s decision. This time lapse suggests that greater clarity would be helpful to the courts in cases relating to intellectual property protection for goods in FTZs and in transit.

Dubai - Case No. 15873 of 2006 penal

Case Summary

Criminal prosecution was initiated after Pfizer International (PI) discovered imitated products in the stores of Euro Gulf Trading Co. of Jebel Ali Free Zone. As owner of the pharmaceutical product “Lipitor,” registered with the Ministry of Health, and trademarks “Pfizer” and “Lipitor” registered in the UAE, PI submitted a complaint, prompting an inspection by the General Inspection Department and the Investigations and Smuggling Control Section, Dubai Seaports and Customs Authority. At the stores, inspectors found quantities of counterfeit goods, including pharmaceuticals, together with evidence of out-of-date foodstuffs, equipment used to print false production and expiration dates, and tablets of Diazepam, a scheduled drug under the law concerning the control of narcotics and mental effects.

Four defendants were charged with the following offenses: (1) importing psychoactive pharmaceutical products contrary to law; (2) relabeling or repackaging foodstuffs by changing expiration dates and by placing other products in the imported packages; (3) acquiring counterfeit pharmaceutical products; (4) with regard to the second and third counts, intentionally committing acts that would endanger life and health; and (5) with regard to the second count, knowingly acquiring foodstuffs that are not fit for human consumption.

Because the crimes would endanger the lives of people and because it involved the acquisition of medicines bearing imitated trademarks for a single criminal objective, the court ordered prison sentences of one year for all defendants on the unfair competition and trademark counterfeiting charges. It ruled an additional seven years’ imprisonment for the manager on the charge of illegally importing Diazepam. All defendants were ordered to be deported from the UAE and to pay damages to the civil plaintiffs.

[!] Implications

This case illustrates the relationship between counterfeiting and other illegal activities, and the danger posed by counterfeiting and related offenses to the health and safety of unsuspecting consumers. From a legal perspective, the decision is significant because it involves a criminal prosecution for intellectual property offenses in an FTZ; because the investigation involved multiple enforcement agencies; because the Court summarily dismissed a defense that goods were not subject to enforcement because they were in a free zone; and because the Court imposed the maximum criminal penalties allowed, and also awarded civil damages and costs to PI and other affected trademark holders. In all these respects, this case provides a model of the types of enforcement that can, and should, be available for commercial-scale counterfeiting in FTZs.

United Arab Emirates - Ras-Al-Khaimah, Court of First Instance–Criminal Circuit Misdemeanor Case No. 1614/2009

Case Summary

This criminal prosecution alleged that Levant Global FZE, located in Ras-Al-Khaimah Free Zone, copied a trademark registered by Du Pont De Nemours & Co. by manufacturing and selling cooling gas cylinders connected to DuPont.

The case arose when consumer complaints regarding the poor quality of the gas cylinders suggested that the cylinders were counterfeit. Investigation found 74 gas cylinders and an invoice signed by the defendant. A driver who delivered another 120 cylinders stated that he received the products from Levant Global FZE and the owner.

On November 2, 2009, the court found that these facts demonstrated that the defendant had imitated another person’s trademark in a way that misleads the public. The defendant also knowingly sold products bearing the counterfeit mark. Finding trademark infringement, the court ordered a one- year prison term for the defendant, who did not appear.

[!] Implications

This case is significant because the court treated trademark counterfeiting in a free zone as a criminal offense, even in the absence of allegations that the acts pose a threat to the health or safety of the public. It is also interesting that the defendant's strategy of abandoning the illicit goods and not contesting the proceedings was ineffective, as it resulted not only in the forfeiture of the goods, but also in the imposition of a one-year prison term.

European Union

Joined Cases *C-446/09 Koninklijke Philips Electronics NV v Lucheng Meijing Industrial Company Ltd and others* and *C-495/09 Nokia Corporation v Her Majesty's Commissioners of Revenue and Customs*

Case Summary

On December 1, 2011, the Court of Justice of the European Union (CJEU) issued its decision in two joined cases. It specified the conditions under which EU Customs authorities may detain counterfeit goods in transit through the EU from non-EU Member States.

The Philips case originated in 2002 and concerned a shipment from Shanghai that Belgian Customs authorities intercepted. The shipment consisted of electric shavers with designs resembling the Philips brand.

The Nokia case, which arose in 2008, concerned a consignment of counterfeit mobile telephones and accessories from Hong Kong destined for Colombia. The English and Belgian courts asked the CJEU to determine whether goods coming from a non-member state, and which are in transit or stored in a Customs warehouse in the European Union, can be classified as "counterfeit goods" or "pirated goods" for the purposes of EU law where there was no evidence to suggest that the goods were intended to be put on the market in the EU.

The CJEU confirmed that goods in transit could not be classified as 'counterfeit' goods within the meaning of the Customs regulations merely because they had been brought into the EU and without evidence of an intention to put the goods on the market. Such proof may be provided where the goods have been sold to a customer in the EU or offered for sale or advertised to consumers in the EU, or where it is apparent from documents or correspondence that the goods are to be placed on the EU market.

Moreover, the Court confirmed that Customs authorities can, and should, detain infringing goods as soon as they have grounds for suspecting that the goods are likely to be diverted onto the EU market. Such indications can include the following: failure to declare the final destination of the goods; a lack of precise or reliable information as to the identity or address of the goods' consignor; a general lack of cooperation with Customs authorities; and/or documents or correspondence suggesting the likelihood of a diversion of the goods onto the EU market.

The Court also reiterated that even without proof of infringement, it was possible to hold goods under other EU legislation, such as whether the goods in question pose a risk to health and safety.³⁴

[!] Implications

Although the ruling falls short of taking appropriate measures against illicit products in transit to non-EU destinations, it is important because it delineates the reach of national Customs authorities with regard to goods in transit in the European Union, the world's largest single market. The court broadly defined the types of situations that can authorize Customs authorities to take action against goods in transit to include (i) any commercial act directed at EU consumers, such as a sale, offer for sale, or advertising and (ii) acts that have not begun but are about to begin or where a party disguises its commercial intentions. In addition, the court recognized that a legal basis for action may exist under other EU laws where, for example, goods pose a risk to the consumers' health and safety.

The *Nokia/Philips* ruling has been subsequently applied in Germany and Finland. In both cases, Customs authorities successfully detained shipments of counterfeit goods being transhipped through the European Union.

The first case dealt with the seizure of counterfeit cigarettes held in a German FTZ that were clearly destined for the EU market (Czech Republic). In the second, Finnish Customs authorities seized goods transiting from China to Russia via Kotka, in Finland. Although the goods were not evidently destined for an EU member state, the cigarettes were mis-declared as ceramic cups. Customs seized the goods in accordance with the criteria in the *Nokia/Philips* case.

In both cases, the seized cigarettes were eventually destroyed. Thus, by enunciating a relatively broad interpretation of EU regulations, the CJEU's decision in *Nokia/Philips* may, in fact, encourage more detentions of goods by EU Customs authorities.

4. Recommendations for legislative and governance model

4.1 Introduction

Chapters 1-3 of this report have identified the following:

- Criminals are exploiting the FTZs by using them to conceal the true origin of infringing goods, to modify goods to mimic legitimate goods and their packaging, and to produce counterfeit products;
- International agreements on IPR protection and the intersection with FTZs are weak; only the WTO TRIPS provides enforcement capacity;
- National laws can be good where a strong national will exists to protect IPR infringement, or the laws can be weak, creating loopholes or fostering opportunities for abuse in FTZs;
- The ultimate point of enforcement—the courts—can support the protection of IPR rights or interpret national or regional laws to violators' advantage; and
- While the concept of Customs free zones have an important and legitimate role in global trade, their purpose as a home for goods in this particular Customs status has been thwarted by the creation of FTZs that are neither nations nor considered fully part of a nation for Customs purposes. This weakness is being exploited to facilitate a global trade in illicit goods.

FTZs nurture legitimate business and spur trade and development. They also attract organized criminals and counterfeiters who routinely violate IP rights. How can FTZs fulfill their intended purpose and deter abuse of the very features that make the free flow of goods possible?

The answer is effective application of the Customs mandate. Customs can either exercise control (1) at the FTZ gate through intensive physical examination and documentation review, thus negating FTZ advantages; or (2) in the FTZ, through review of commercial records and observation of processing and container loading. Controls inside FTZs need not interfere with legitimate trade. In this regard, improved practices and implementation of FTZ-specific laws and regulations are essential.

This final chapter recognizes and highlights international efforts to curb the exploitation of FTZs. The report then presents policy, legislative, and enforcement recommendations for slowing and reversing the trend of FTZ abuse. These recommendations are derived from a wide range of international conventions, agreements, and standards, including ACTA provisions and WCO Guidelines, as well as lessons learned from national legislations, judicial decisions, and experiences of BASCAP members worldwide.

4.2 What is being done to reverse the alarming trend of FTZ abuse?

The issues of the abuse of FTZs by IPR violators have not gone unnoticed by others. Primary documents, such as WTO TRIPS, the WCO RKC, and SAFE already offer recommendations for correcting FTZ abuses. Other groups have provided their own valid recommendations, including some of the most prominent examples below. While this in no way an exhaustive list, these efforts indicate that governments, Customs, and businesses recognize the growing severity of the problem and are ready to take action.

WCO RKC. Reflecting expectations for the future of international trade, the revised RKC is an international convention with over 600 standards, transitional standards, and recommended practices. Specific Annex D, Chapter 2 offers provisions on FTZs and addresses refusal of entry of pirated or counterfeit goods into an FTZ. Significantly, it confirms that FTZs are within the national Customs territory.

ACTA. Governments have also recognized the need for countries to work together to more effectively tackle large-scale Intellectual Property Rights violations. For those countries that are not part of ACTA and that wish to prevent the proliferation of counterfeit goods, ACTA's provisions can nonetheless serve as models. Significantly,

ACTA improves IPR enforcement in FTZs by accomplishing the following:

- Defining “Customs territory” to include FTZs for purposes of IPR enforcement, even where the FTZs are considered outside the Customs territory for purposes of import duties and taxes.
- Limiting use of the TRIPS “*de minimis*” exception to small quantities of goods of a non-commercial nature contained in travelers’ personal luggage, but requiring the application of Customs procedures to goods of a commercial nature even when sent in small consignments.
- Giving Customs authorities *ex officio* authority to suspend the release of suspect goods.
- Where criminal penalties apply, ensure that aiding and abetting infringement is also considered a criminal offense.

WCO IPR Guidelines. Recognizing that violations of intellectual property rights are a serious and growing threat to the world’s health, safety, and economic interests, the WCO developed in 2007 the WCO SECURE Guidelines. The Guidelines contain valuable provisional standards, procedures, and best practices on IPR enforcement. The guidelines state that Customs administrations should have the legal authority to enforce IPR laws in free zones and detain infringing goods leaving or transiting their national territory.

WCO Guidelines on Controlling Free Zones. In 2004, responding to Customs seizure data, discussions at the First Global Congress on Counterfeiting and examples from business partners of FTZ abuse, the WCO Customs Expert group on Intellectual Property Rights began examining the problem of IPR violations in FTZs.

In 2006, the WCO-IPR Strategic Group, comprised of Customs experts and private sector representatives, drafted “Guidelines on Controlling Free Zones, Goods in Transit/Transshipment and Obligations on service Providers in Relation to Intellectual Property Rights Infringements.”

The guidelines, in current draft form, call on governments to implement legislation that empowers Customs to control goods and free zones, prohibiting the import, storage, manufacture, and export of IP-infringing products in the physical territory where the Customs free-zone regime is in effect. These guidelines should be finalized as soon as possible. The draft includes recommendations and provisions for:

- Legal basis for free zones
- Goods being admitted to a free zone
- Customs control
- Production operation in free zones
- Customs’ jurisdiction
- Customs exercising its rights and obligations

While over 6 years old, many of the guidelines for FTZs are still relevant, perhaps now more than ever. Finalizing the FTZ guidelines is gaining traction as a high priority, so WCO members can compare, modify, and enact legislation that positions zones as facilitators of legitimate trade—not safe havens for illicit goods. This work has been and continues to be done in consultation with private FTZ operators. It is likely to be contentious with state regulatory agencies or other bodies with authority to create and oversee FTZs.

National Customs. NA parties to global Customs, National Customs administrations are continuing to cooperate in managing noncompliance risk while facilitating trade. National authorities are protecting their end of the supply chain from pirated or counterfeit goods and other risks, but some are doing a better job than others.

Piracy safe havens must be identified. Goods coming from them be tagged as high risk for security and noncompliance with tariff and nontariff requirements. At the same time, many Customs administrations are cooperating to identify secure and compliant trade chains—from point of growth, harvest, or manufacture, to further manufacturing, such as in legitimate FTZs, and then ultimately to consumers through AEO programs and mutual recognition of trading partners’ similar programs.

INTA Model Law Guidelines. The International Trademark Association (INTA) model guidelines on standards for the international protection of trademarks contain valuable recommendations on measures to halt the transshipment and transit of counterfeit goods in free trade zones and free ports.

BASCAP Members. BASCAP members are trying to reduce the incidence of counterfeiting and piracy in FTZs by (1) sharing information on FTZs identified as IPR violation hot spots; (2) correlating and sharing information on national legislation relative to FTZs and IPR enforcement; (3) working with the WCO; and (4) supporting the World Free Zone Convention in advocating better protection of IPRs in zones.

Despite this important work, organized illegal traffickers are still exploiting FTZs for the production, storage, sale, and the transit and/or transshipment of counterfeit products. BASCAP recognizes that efforts to end the abuse of FTZs need renewed impetus. It presents the following recommendations and best practices.

4.3 Recommendations

The following section delineates recommendations for legislative and regulatory improvements, along with general policy measures and suggested best practices. The uncontrolled movement of goods into and through FTZs abets growth in the trafficking of counterfeit and pirated goods. Customs authorities with limited legal powers and jurisdiction over FTZs cannot discover or seize infringing goods, and counterfeiters have demonstrated competence in exploiting these legal loopholes and ambiguities.

While law changes can generally accomplish the following recommendations, national governments on an individual basis are encouraged to consider the most practical and expeditious mechanism(s) to effect change. In some cases, royal, presidential, or ministerial decree can accomplish the change process. Simply passing laws and issuing regulations are incomplete processes until those measures are applied in practice. On close review, in some countries, the authorities are already in place but they simply are not proceeding adequately.

The following recommendations suggest key national legislative provisions and associate regulatory measures for implementation:

WCO

1. Robustly promote/re-institute and more aggressively adopt the RKC provisions, including those in Specific Annex D Chapter 2.
2. Promote WCO IPR Working Group Guidelines. Finalize and promote the draft FTZs guidelines developed in 2006 by the WCO IPR Strategic Group and Global Task Force.
3. Recognize FTZs as a trade-related business category, and recommend that members recognize FTZs for AEO status under SAFE. The FTZs have, for the most part, not been adequately covered in WCO's SAFE and are, therefore, not at the national level. As an example, no reference to an FTZ exists in the 2012 edition of the WCO Compendium of Authorized Economic Operator Programmes. The WCO needs to encourage members to recognize zones that are operating well as a legitimate part of the supply chain.
4. Modify SAFE to include recognition of AEO status for tariff and non-tariff measures, such as IPR protection, and extend this recognition to supply chain security. SAFE is presently supply-chain-security focused for the prevention of terrorist acts. The SAFE Framework should be expanded to recognize AEOs for compliance with tariff and non-tariff measures (similar to the EU's dual programs or Jordan's single program with security, tariff, and non-tariff compliance requirements combined).

National Customs should have the mandate to recognize companies using best practices to prevent IPR infringement as one of the non-tariff compliance modules. Then WCO members could include mutual recognition between Customs administrations of AEOs compliant with tariff and non-tariff measures, as well as supply chain security standards. This expansion of SAFE to recognize compliant companies and offer commensurate benefits through the length of their supply chain will provide a more cost-effective use of Customs resources to target high risk (including unknown companies) in their enforcement practice.

5. The WCO should include observation models by Customs officers working inside FTZs. More frequent, routine observations inside an FTZ company are less intrusive than searches or inspections, and they would not interfere with routine work. Those engaged in criminal enterprise in the zone are more likely to strenuously oppose these frequent, non-intrusive observations by Customs; legitimate companies, on the other hand, will welcome this practice as opposed to intensive physical inspections later at the gate or further in the supply chain.
6. Modify the WCO Model Provisions for IPR protection to refer to FTZs, including specific FTZ references, because of the growing trend for abuse and IPR infractions within FTZs.
7. Revitalize prior work on FTZ best practices and model legislation with private and public sector stakeholders. The final model legislation should put FTZs under the authority of Customs for Customs matters. Also, it should assign FTZ licensing and regulation as a shared responsibility with other appropriate government bodies. WCO may be Customs focused, but very good models exist for shared responsibility of FTZ management between other government agencies and private-sector FTZ operators, as in the U.S.
8. Establish a database of FTZs and companies that WCO members—or other sources, such as BASCAP—have identified as violating IPRs in FTZs. Make the database available to WCO members for conducting background checks on companies applying to use FTZ facilities. As with any intelligence database, unconfirmed allegations are restricted in sharing information between WCO members. In documented cases of confirmed violations, however, those cases should be maintained in a publicly accessible database. A public database of known IPR violators and FTZs that are being abused will encourage the private sector to exercise due diligence in avoiding risky business transactions.
9. Create an umbrella agreement—or other international instrument concentrating on Free Trade Zones—to share trade data and best practices with one another. The agreement should also promote world-class security, checking, and screening standards, and create international best practice standards and peer policing.

WTO

1. Re-institute the TRIPS enforcement working group to undertake regular peer review of TRIPS implementation in order to encourage improvements of national legal and enforcement measures that reflect the intent of TRIPS. The working group should consider new developments, such as the expansion of the Internet, which has dramatically broadened the reach of counterfeit goods. It also should consider the rapid expansion of, and abuses in, FTZs, which have enabled traffickers in counterfeit goods to exploit loopholes in jurisdictional authority and evade routine enforcement.
2. Clarify the jurisdiction of TRIPS. Since TRIPS does not exclude FTZs from its application, WTO Members are obligated to apply TRIPS requirements to all FTZs within their territories.

National Governments

Legislative Recommendations

1. Review and implement national IPR legislation to ensure that such legislation is applicable to all goods in the national territory in all Customs regimes, including transit, in-transit, and free-zone regimes.
2. Urge countries that have not acceded to the RKC, Specific Annex D, Chapter 2 on free zones to take this step. As an alternative and to take immediate steps to correct problems, consider the RKC provisions for free zones as guidelines.
3. Restructure legal frameworks governing FTZs.
 - a. Clarify that FTZs (or SEZ or free port, etc.) are under the jurisdiction of national Customs;
 - b. Enable national Customs with unrestricted rights to enter and observe day-to-day operations; audit the books and records of companies in the zone; and validate goods status and conformance with tariff and nontariff measures under the national Customs mandate;

- c. Ensure that any goods prohibited for public morality, order security, hygiene, or health; for veterinary or phytosanitary health; or the protection of patents, trademarks and copyrights are also prohibited in the FTZ; reiterate that the discovery of such goods may result in civil and criminal penalties.
4. Give Customs the following responsibilities:
 - a. *Ex-officio* authority to detain goods suspected of infringing IP rights regardless of regime status, including goods in FTZs, SEZs, free ports and the like; use the most expeditious and/or practical detention means. As an example, *ex-officio* authority may be by Royal, Presidential, or Ministerial decree.
 - b. Encourage simplified processes for notifying trademark holders of infringement and enable Customs to initiate enforcement action.
 - c. Establish a clear and simple procedure for destroying infringing goods.
5. Clarify that Customs determines the regime status of goods (e.g., Customs free zone, transshipment, transit) entering the national or regional or “zone.” Customs authority shall be independent of any other FTZ licensing agency. Customs must have the ability to determine goods status for the Customs regime. Goods cannot be considered for free circulation and consumption in the zone and the Customs free-zone regime status at the same time, nor should goods be considered in any other dual regime status. The Customs must be held accountable for full IPR protection in all matters, for all goods under all regimes (goods status for Customs purposes) to prevent IPR manipulation or other infractions.
6. Prohibit transit, in-transit, warehousing, and admission to FTZs of goods that violate trademark rights, regardless of country of origin, intermediate origin, or destination.

Policy Recommendations

1. Consider fast-track implementation of automated Customs systems, with proper inventory controls and audit systems in special economic zones, as recommended in the World Bank’s report.³⁵ As a more cost-effective and less disruptive alternative, Customs should have read-only access to the automated systems and records of companies in the zones. Customs would, of course, read such records under the company guidance. Customs would provide officers assigned to the zone who are technically competent in using and understanding the companies’ automated systems.

Rather than build competing new systems, businesses’ commercial data should, to the greatest extent possible, be used for direct transfer of data relative to the goods in the zone status into national Customs automated systems. Reusable data is well recognized in border automation that uses the single window concept. The concept of “Customs forms” in an electronic environment, therefore, is simply a collection of reusable data elements.³⁶

2. Apply WCO SAFE Standards provisions regarding cooperation and private-sector shared responsibilities, particularly for the inclusion of AEO status for FTZs and companies operational within FTZs. National Customs should apply all provisions of the Customs-to-Customs Pillar of the SAFE Standards equally to FTZs as other locations in the national territory. In negotiating a mutual recognition agreement, national Customs is urged to inquire and validate the ability of the potential partner Customs to satisfy concern over zones as applicable secure trade partners. In applying SAFE, national Customs must notify other Customs administrations of those locations in the national territory where they are unable to meet their SAFE obligations.
3. Particularly for integrated trading countries (i.e., COMESA and ASEAN), develop uniform Customs rules, regulations, and practices for FTZs. Refer to WCO and WTO provisions, including recommendations and guidelines developed in 2006 by the WCO IPR Strategic Group and Global Task Force. Permit the national Customs administration to be an active participant and investor in these WCO collaborative efforts.

4. Review best practices for FTZ licensing and regulation in other nations where no or very few IPR violations are associated with FTZs. Use these models for FTZ creation, licensing, regulation, and management. Likewise, countries with no or very few IPR violations should welcome other Customs administrations to observe and learn from their successful IPR and FTZ programs.
5. Enable cooperation between national Customs authorities and FTZ or free-port special authorities. Such cooperation will ensure enforcement of anti-counterfeiting criminal and civil laws to check offenses of trafficking in counterfeit goods. In situations where agencies are disputing an FTZ's jurisdiction, highest-level government may need to intervene. Consider requesting a neutral, outside party to assist in this agency-to-agency arbitration.
6. Provide training to Customs officials and include policy and procedures for observing businesses in FTZs and other factors in the specialization of the Customs free-zone regime. Customs must deploy highly skilled specialists to FTZs to accommodate special circumstances.
7. In negotiating trade agreements with another country or trading block, IPR protection must be given due priority. Furthermore, trade agreements should contain provisions to prevent the abuse of FTZs as safe havens for criminal enterprise.
8. Urge WTO members to use the WTO dispute resolution process in countries where IPR infringement is a continuing problem. Those nations that have not met TRIPS obligations—and where FTZs have become pirate havens—should be held accountable for facilitating counterfeit and piratical products.
9. Intellectual property right protection is a specific area of legal practice. So, too, is Customs law. In the case of the intersection of Customs law and IPR, few legal professionals understand the technical issues. For this reason, prosecutors and judges need training in these two areas. Perhaps a local organization with specific interest in IPR protection could work with national Customs to develop national legal guidelines.

Free Zone Operators and Zone Users

1. Government agencies and private-sector companies responsible for FTZs should consider the provisions of this policy paper for their business modeling. FTZs that, for whatever reason, have excluded national Customs should reconsider the ramifications of that decision.
2. Self-regulate to prevent piracy and counterfeiting (e.g., conduct standard due diligence in accepting businesses into FTZs). Develop documentation on how to exercise due diligence in business practices. For a zone operator, include specific steps to understand FTZ companies' history and reputation. Companies making a decision to locate within a particular FTZ should consider the FTZ's past performance.
3. Open doors to national Customs authorities to observe physical operations and verify compliance with tariff and nontariff requirements. Without this Customs capability, a zone is automatically vulnerable to risk.
4. Train national Customs officers who are assigned to a zone. Customs officers rarely have expertise in industrial practice. For example, garment manufacturers' cut and waste percentages may be unknown, but it is important for Customs to know how these processes impact final product count or a valuation shift for origin. With this type of information, Customs can be more confident that the manufacturer does not present a threat for revenue leakage. Train Customs in business record-keeping systems so they can validate inventories accordingly.
5. National Customs should apply best practices in exercising authority in zones (e.g. use ordinary company records as the primary source for determining Customs free-zone status and changing the Customs regimes). National Customs has a responsibility to service the legitimate needs of FTZ operators as a legitimate customer. In some instances, it may be necessary to have country of origin certified by national Customs to meet the requirements of a trade agreement. Trade agreement expertise for origin determination is another important skill set that should be required of Customs officers.

6. If the FTZ country has committed to WCO SAFE Standards and has an AEO program, consult with the Customs authority for AEO recognition. If the FTZ country has notified the WCO of its intent to follow SAFE, but the national Customs authority does not yet have an AEO program, lobby the authority to meet this commitment.
7. Consider data interface and exchange of data with the national Customs' automated systems for ease of goods status validation. This recommendation applies to zone operators and the companies that operate in FTZs.
8. FTZs offer many opportunities for Customs modernization. In many countries, one root cause of corruption may be Customs officers' inadequate salaries. Integrity of both private sector and Customs is key: *no bribes offered, no bribes taken*. To break the corruption cycle, FTZs are encouraged to establish a contract-like relationship with national Customs. Companies need to consider national Customs as a service provider. In exchange for meeting service standards and for Customs providing highly skilled FTZ officers, the FTZ and businesses should consider paying WTO-compliant, cost-based user fees to national Customs for services it renders in the FTZ.

¹ FATF, Money Laundering vulnerabilities of Free Trade Zones (OECD, Paris, 2010). <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf>

² BASCAP, Global Impacts Study (ICC/BASCAP, 2011). <http://www.iccwbo.org/Advocacy-Codes-and-Rules/BASCAP/BASCAP-Research/Economic-impact/Global-Impacts-Study/>

³ OECD, Economic Impact of Counterfeiting and Piracy (Paris, 2008). <http://www.oecd.org/sti/industryandglobalisation/theeconomicimpactofcounterfeitingandpiracy.htm>

⁴ Fayle and Hübner, Counterfeiting and piracy: Fakes, facts and figures (OECD Observer No. 262, July 2007). http://oecdobserver.org/news/fullstory.php/aid/2278/Counterfeiting_and_piracy_.html

⁵ The RKC is formally "The International Convention on the Simplification and Harmonization of Customs Procedures (as amended)."

⁶ FATF, Money Laundering vulnerabilities of Free Trade Zones (OECD, Paris, 2010). <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf>

⁷ OECD, Economic Impact of Counterfeiting and Piracy (Paris, 2008).

⁸ FATF Report (2010), paragraphs 33-34.

⁹ *EU Business*, "China Accounts for 85% of Fake Goods Seized in EU," July 15, 2011. <http://www.eubusiness.com/news-eu/china-counterfeit.bbg>

¹⁰ World Customs Organization 2008 Customs and IPR Annual Report, p. 9. Available at: <http://www.wcoomd.org/files/1.%20Public%20files/PDFandDocuments/Enforcement/IPR%202008%20EN%20web.pdf>

¹¹ In 2008, 21% of counterfeit goods seized were "intended for transit to third countries en route to their final destinations." World Customs Organization 2008 Customs and IPR Annual Report, p. 9. See also WCO Guidelines on Controlling Free Zones in Relation to IPR Infringements, paragraphs 17 and 21 (January 12, 2005). "From our knowledge based on IPR seizures, we know that quite often free zones have been used to hide the true origin of the goods and have also been exploited to produce and/or distribute counterfeit and pirated goods."

¹² Customs warehouses are distinct from free Customs zones but are covered under RKC Specific Annex D. The free-zone regime allows more latitude for manipulation of the goods, and creation of new goods as defined by a tariff classification shift or value change, both of which are important to country-of-origin definition. Dependent on preferential trade agreement requirements, the result may actually make a legitimate country-of-origin change.

¹³ Other common terms for these designated trade-promotion areas are Free Economic Zones (FEZ), Export Processing Zone (EPZ), Free Port (FP), Industrial Free Zone (IFZ), Technological Free Zone (TFZ), and Special Economic Zone (SEZ).

¹⁴ Akinci & Crittle – FIAS/World Bank Report on Special Economic Zones – Performance, Lessons Learned & Implications for Zone Development," April 2008, p. 7 and 23. Available at: [http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/SEZpaperdiscussion/\\$FILE/SEZs+report_April2008.pdf](http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/SEZpaperdiscussion/$FILE/SEZs+report_April2008.pdf). These statistics were derived from a database developed by FIAS in close consultation with the World Economic Processing Zones Association (WEPZA) and the International Labour Organisation (ILO). Date from an ILO document is April 2007.

¹⁵ UNESCAP, Free Trade Zone and Port Hinterland Development (UN, 2005). http://www.unescap.org/ttdw/publications/tfs_pubs/pub_2377/pub_2377_fulltext.pdf

¹⁷ See: Money laundering vulnerabilities of Free Trade Zones – March 2010, FATF/OECD; WCO IPR Report; INTA policy study; http://www.nytimes.com/2007/12/17/world/middleeast/17freezone.html?pagewanted=all&_r=0; <http://www.nytimes.com/2010/11/11/world/middleeast/11iht-m11trade.html?ref=world>; Fayle and Hübner, Counterfeiting and piracy: Fakes, facts and figures (OECD Observer No. 262, July 2007). http://oecdobserver.org/news/fullstory.php/aid/2278/Counterfeiting_and_piracy_.html

¹⁸ The RKC is formally "The International Convention on the Simplification and Harmonization of Customs Procedures (as amended)."

¹⁹ RKC; Specific Annex D; Chapter 2; Standard 4: "The Customs shall have the right to carry out checks at any time of the goods stored in a free zone."

²⁰ E.g., The Customs Convention on the International Transit of Goods (ITI Convention) and The Customs Convention on the A.T.A. Carnet for

the Temporary Admission of Goods (ATA Convention).

²¹ In terms of 2007 trade statistics excluding intra-EU trade, as estimated by the WCO Secretariat based on WTO Trade Profile (WTO 2009a) and International Trade Statistics (WTO 2009b).

²² RKC; Specific Annex D Free Zones; Recommended Practice 6 "Admission to a free zone of goods brought from abroad should not be refused solely on the grounds that the goods are liable to prohibitions or restrictions other than those imposed on grounds of: ... the protection of patents, trade marks and copyrights."

²³ RKC; Specific Annex D Free Zones; Chapter 2; Standard 4: "The Customs shall have the right to carry out checks at any time on the goods stored in a free zone."

²³ WCO SAFE, page 18, Section 7.4. WCO Handbook for Customs Officers on Risk Indicators - Factors for Intellectual Property Infringement. Because of the nature of this information—as it is an intelligence tool the actual criteria is not publicly available.

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²⁵ In addition to the provisions of the Agreement on Subsidies and Countervailing Measures (SCM), a number of other WTO member obligations may apply to SEZ programs under the General Agreement on Tariffs and Trade (GATT): These include Most Favored Nation (MFN) treatment (GATT Article I); national treatment (GATT Article III); the limitation of fees and formalities connected with importation and exportation to the approximate cost of the services rendered (GATT Article VIII(1)); transparency requirements (GATT Article X); the elimination of quantitative restrictions (GATT Article XI); the Agreement on Trade-Related Investment Measures; and the General Agreement on Trade in Services.

²⁶ See *Global Trade and Customs Journal*; Published by: Kluwer Law International; 2007; Free Zones and the World Trade Organization Agreement on Subsidies and Countervailing Measures; Raul A. Torres

²⁷ See, Model Provisions for National Legislation to Implement Fair and Effective Measures consistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights, 2005 http://www.dnCustoms.gov.vn/So_huu_tri_tue/MODEL_PROVISIONS.htm

²⁸ ACTA, Article 5: General Definitions: (m) territory, for the purpose of Selection 3 (Border Measures) of Chapter II (Legal Framework for enforcement of Intellectual Property Rights), means the Customs territory and all free zones¹ of a party; [Footnote 1:] For greater certainty, The Parties acknowledge that free zone means a part of the territory of a Party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs territory.]

²⁹ http://www.wto.org/english/tratop_e/region_e/region_e.htm

³⁰ US-Colombia Agreement (2011), Ch. 16, Article 16.11: para 23; U.S.-South Korea Agreement (2011), Ch. 18, Article 18.10, para 22.; U.S.-Panama Agreement (2011) Ch. 15, Article 15.11

³¹ US-South Korea Agreement (2011), Ch. 18, Article 18.10, para 22.

³² The agreement between the United States and Panama permits Customs officials to act ex-officio against in-transit goods (Ch. 15, Article 15.11); however the agreement does not extend to Panama's FTZs. See Ch. 5, Article 5.11 of the U.S.-Panama trade agreement (2011) (<http://www.ustr.gov/trade-agreements/free-trade-agreements/panama-tpa/final-text>)

³³ E.g. Papastratos Cigarette Manufacturing Company S.A. v. Guangzhou Yuekang Trading Co. Ltd., Belstar Denizcilik ve Tasimacilik A.S., Georgios Chartomatidis Import Export and Philip Morris Products S.A. v. the Lions S.A.

³⁴ The full text of the opinion can be accessed at <http://curia.europa.eu/juris/document/document.jsf?text=&docid=115783&pageIndex=0&dclang=en&mode=req&dir=&occ=first&part=1&cid=2701>.

³⁵ Akinci & Crittle – FIAS/World Bank Report on Special Economic Zones – Performance, Lessons Learned & Implications for Zone Development April 2008 [http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/SEZpaperdiscussion/\\$FILE/SEZs+report_April2008.pdf](http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/SEZpaperdiscussion/$FILE/SEZs+report_April2008.pdf)

³⁶ *Holistic Modernization of the International Trade Transaction Process*; Nathan Associates; Hekala and Damuth; 2009





The International Chamber of Commerce

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

The fundamental mission of ICC is to promote trade and investment across frontiers and help business corporations meet the challenges and opportunities of globalization. Its conviction that trade is a powerful force for peace and prosperity dates from the organization's origins early in the last century. The small group of far-sighted business leaders who founded ICC called themselves "the merchants of peace".

ICC has three main activities: rules-setting, dispute resolution and policy. Because its member companies and associations are themselves engaged in international business, ICC has unrivalled authority in making rules that govern the conduct of business across borders. Although these rules are voluntary, they are observed in countless thousands of transactions every day and have become part of the fabric of international trade.

ICC also provides essential services, foremost among them the ICC International Court of Arbitration, the world's leading arbitral institution. Another service is the World Chambers Federation, ICC's worldwide network of chambers of commerce, fostering interaction and exchange of chamber best practice.

Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on vital technical and sectoral subjects. These include financial services, information technologies, telecommunications, marketing ethics, the environment, transportation, competition law and intellectual property, among others.

ICC enjoys a close working relationship with the United Nations and other intergovernmental organizations, including the World Trade Organization, the G20 and the G8.

ICC was founded in 1919. Today it groups hundreds of thousands of member companies and associations from over 120 countries. National committees work with their members to address the concerns of business in their countries and convey to their governments the business views formulated by ICC.

For information on how to join ICC, visit the ICC website (iccwbo.org) or contact the ICC Membership Department in Paris.



International Chamber of Commerce

The world business organization

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