

UNFAIR FOREIGN TRADE PRACTICES

Stealing American Intellectual Property: imitation is not flattery (extract of a report by the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, US House of Representatives, February 1984).

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Imitation Is Not Flattery

INTRODUCTION AND SUMMARY

Each day, U.S. firms are seeing their valuable patents, copyrights and trademarks stolen, ignored or otherwise misused. This rapidly growing problem seriously threatens the health and safety of consumers, costs untold numbers of Americans jobs, and undermines the ability of American businesses to compete fairly and effectively in both domestic and international markets. The theft of these intellectual property rights takes different forms, but the net injury to American industry is enormous.

Commercial counterfeiting has spread to an amazingly wide range of products including drugs, automobile and aircraft parts, medical devices, chemicals, computers and personal care items. The variety of fake goods is limited only by the imagination of the counterfeiters. Some consumers have been killed or injured because of substandard counterfeits; many others have been plagued with inferior merchandise. Unless effective action is taken against counterfeiters, more injuries--both physical and economic--will surely result.

The direct loss in sales to American companies from counterfeit merchandise runs into the tens of billions of dollars. The automobile parts industry alone estimates that it suffers \$3 billion worth of damage annually.¹ One study by the Commission of the

¹ "Impact of Unfair Trade Practices on Interstate Commerce," Hearings before the Subcommittee on Oversight and Investigations of the Committee on Energy (Footnote continued)

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European Community estimated that trade in pirated goods now accounts for about two percent of the world total--an astounding figure.² Whatever the precise amount, the cost is huge and growing rapidly.

Counterfeiting includes services as well as goods. The American Automobile Association recently informed the Subcommittee that a Taiwanese organization, the Allied Automobile Association, has copied the logo as well as the illustrations in the advertising brochure of the California State Automobile Association. The Taiwanese firm also reportedly claims to be affiliated with the California auto club, an alliance which does not, in fact, exist.³

Although violating U.S. patents, trademarks or copyrights, many counterfeit products manufactured in foreign countries never reach the U.S. market. It is difficult enough for a U.S. company whose product is being imitated to stop sales in the United States. In cases of foreign market sales, however, it is practically impossible for American firms to stop commercial pirates. Such laws as may exist to protect intellectual property rights in developing nations, where most of the activity takes place, are usually inadequate. Moreover, enforcement is unaggressive or non-existent, especially against a local company. The result is that American companies lose billions of dollars of sales in both the foreign and U.S. domestic markets. The U.S. balance of trade, which sustained a deficit of more than \$60 billion in 1983, as well as the balance sheets of the victimized companies, suffers accordingly. Even worse, the counterfeit products are typically substandard and their failure to perform tarnishes the reputation of the American manu-

1(continued)

and Commerce, 98th Congress, 1st Session, (hereinafter cited as Hearings) August 2, 1983, Statement of Linda Hoffman.

² New York Times, October 10, 1983.

³ Letter to the Subcommittee staff from Ms. Cynthia Skiff, Legislative Representative, American Automobile Association, January 3, 1984.

facturer.

Counterfeiters unfairly exploit the capital invested by a company in the research, development and marketing of a product. By stealing some or all of the market for a successful product, the pirates can prevent the company from recouping this investment. For a small company, this can be fatal. Over the long term, even for a large company, the ability to generate the investment capital necessary to develop new products and remain competitive in world markets will be affected. Thus, counterfeiters steal existing and future jobs from American workers.

A country such as the United States that depends on private investment capital for technological progress and economic growth cannot prosper in a world where counterfeiters operate unchecked. Direct and forceful action must be taken to protect American consumers and American corporations from the devastating, unfair and hazardous effects of commercial counterfeiting and related violations of intellectual property rights.

II. FINDINGS

The Subcommittee makes the following findings:

- Countries in Asia, Africa and South America produce a vast range and growing volume of counterfeit products that violate patents, copyrights and trademarks held by American companies. In some countries, counterfeiting appears to have become the de facto national industrial development strategy.
- Taiwan, South Korea, Hong Kong, Singapore, Thailand, the Philippines, Indonesia, Brazil, Columbia, Mexico, and Nigeria are major sources of commercial counterfeiting.
- The sale and use of bogus products, which are usually substandard and often dangerous, cost Americans many thousands of jobs and threatens our health, safety and economic well-being.
- The willful violation of American intellectual property rights has cost U.S. companies many billions of dollars of sales in world markets. This contributes to our huge balance of payments deficit and negatively affects the income of many American companies.
- The substandard performance of counterfeit products tarnishes the reputation of the legitimate manufacturer and reduces the appeal and good will of these and other American goods wherever they are sold.
- Counterfeiters unfairly exploit the capital invested by an American company in the research, development and marketing of a product. By stealing some or all of the market for a successful product, the pirates can prevent that company from recouping its investment. For a small company, this can be fatal. Over the long term, even for a large company, the ability to generate the investment capital necessary to develop new products and remain competitive in world markets is impaired.
- U.S. laws protecting intellectual property rights are too weak to deter the increasing flow of counterfeit products into markets here and abroad. For example, there are no generic criminal penalties for trademark or patent infringement.
- Significant changes are needed in criminal and civil

statutes relating to patents, copyrights, trademarks and tradedress. Penalties must be increased and the coverage of the protection under these laws should be expanded and modernized.

- Despite the best efforts of its competent and dedicated personnel, the U.S. Customs Service has neither the people nor the resources to stop the flood of counterfeit products.
- Many counterfeit American products are manufactured in one foreign country and sold in another. It is very difficult for a U.S. company to stop this practice. Such laws as exist to protect intellectual property rights in developing nations, where most of the activity takes place, are usually inadequate. Moreover, enforcement is unaggressive or non-existent, especially against a local company.
- Elements of organized crime are evidently involved in the distribution and sale of counterfeit goods, especially in the apparel and consumer electronic industries. Given the high profit in such activity, the role of organized crime is expected to increase.
- Some progress has been made in bilateral and multi-lateral efforts to increase the protection afforded intellectual property rights and to encourage foreign governments to crack down on counterfeiters. However, existing international agreements, such as the Universal Copyright Convention or the 1883 Paris Convention for the Protection of Industrial Property, are antiquated and ineffective. In sum, there is no meaningful or even consistent system of protection for intellectual property rights in world markets.
- A country such as the United States that depends on private investment capital for technological progress and economic growth cannot prosper in a world where counterfeiters operate unchecked. Direct and forceful action must be taken to protect American consumers and American corporations from the devastating, unfair and hazardous effects of commercial counterfeiting and related violations of intellectual property rights.

III. RECOMMENDATIONS

On the basis of the record developed in five days of public hearings, over a thousand pages of testimony and exhibits, and months of staff investigations, the Subcommittee makes the following recommendations:

1. The Congress should pass the Trademark Counterfeiting Act of 1983, H.R. 2447, which is now pending before the Judiciary Committee. The bill would provide badly needed criminal sanctions as well as increased civil penalties against manufacturers, distributors or retailers that intentionally traffic in products with counterfeit trademarks.

2. The Congress should strongly consider amending Title V of the Trade Act of 1974 to deny duty free treatment of imports under the Generalized Schedule of Preferences (GSP) to beneficiary developing countries that violate United States patents, copyrights or trademarks. In 1982, \$8.2 billion worth of imports enjoyed duty free treatment in the U.S. under the GSP program. While the U.S. derives many benefits from the existence of GSP, including the availability of inexpensive consumer goods, foreign governments must recognize that preferential access to our markets will be contingent upon their willingness to minimize and eventually eradicate the parasitic counterfeiting elements of their domestic manufacturing sectors.

3. The Congress should pass legislation to increase the international competitiveness of United States industries by requiring reciprocal market opportunities in trade, including trade in services and investment. Such legislation should include explicit protection for the intellectual property rights of United States companies. In the first session of the 98th Congress, three bills sought to achieve this goal: H.R. 3804, the Interstate and Foreign Commerce Development Act; H.R. 1571, the Reciprocal Trade and Investment Act of 1983; and H.R. 2848, the Service Industries Commerce Development Act of 1983. The Committees on Energy and Commerce, Foreign Affairs, and Ways and Means sought to meld these related approaches into a single, effective legislative proposal. The Subcommittee hopes that this effort can

produce an integrated bill in the current session.

The Subcommittee recognizes that the mere threat of reciprocal sanctions by the United States in the area of intellectual property rights may not deter unfair trade practices. Inadequate enforcement of existing trade laws, including reciprocity provisions, has not prevented dumping nor effectively opened foreign markets for U.S. goods. The Subcommittee has not completed its investigation into the impact of illegal and unfair foreign trade practices on interstate commerce, and thus it reserves its recommendations on the changes necessary to make the reciprocity provisions in our trade laws truly effective. In any case, however, U.S. law should contain the explicit recognition that the failure to protect the trademark, tradename, copyright and patent rights of American firms is cause for reciprocal action against the offending country.

4. The Congress should pass legislation greatly increasing the potential monetary penalty for the interstate transportation of stolen property. The current statute (18 U.S.C. 2314) provides only for a \$10,000 fine. As the Subcommittee has clearly learned in reviewing Hitachi's effort to bribe persons to steal the technical secrets behind IBM's largest new computer, a fine of this magnitude is no deterrent at all. Hitachi paid \$612,000 in bribes and had budgeted up to \$1 million for the effort. Moreover, as part of its settlement with IBM, Hitachi paid \$300 million in compensation. The statute should be amended to increase the maximum criminal penalty to at least a million dollars, and a civil penalty should be added at treble the value of the property and set at the discretion of the judge.

The Subcommittee is aware that H.R. 2151, the Comprehensive Crime Control Act of 1983, is pending before the Judiciary Committee. If passed, Title II of that legislation would raise the maximum fine for all felonies to \$250,000 for individuals and \$500,000 for organizations. But this may not provide the desired deterrent in cases such as that of Hitachi, where the market value of the technology is apparently in the hundreds of millions of dollars. The Subcommittee is also aware of Section 5 of Public Law 97-291, the Victim and Witness Assistance Act, which

became effective on January 1, 1983. This section gives the court the option of ordering restitution to the victim of any Title 18 crime. Had it been enacted earlier, this provision could have been applied to Hitachi. However, the section is optional and appears virtually unused--the American Law Division of the Congressional Research Service could find only one case where section 5 restitution was sought. Moreover, in that case, the district court found the provision to be unconstitutional. The Subcommittee believes that large-scale industrial espionage constitutes an ever-increasing threat to the economic security of the United States as a whole, and that it may be necessary to consider remedies beyond the scope of criminal law.

5. The Congress should pass H.R. 1028, the Semiconductor Chip Protection Act of 1983, now pending before the Judiciary Committee. This legislation would extend copyright law to protect the design of semiconductor chips.

6. The Congress should amend the patent law to provide for criminal penalties for the willful violation of such rights. The existing law in no way deters willful infringement of patent rights, especially by large foreign companies and particularly where the rights are held by small United States companies unable to afford the cost of protracted litigation.

7. The Congress should speed the operation of and greatly reduce the paperwork required by the International Trade Commission in ruling on petitions for exclusion orders under the Tariff Act of 1930. Current procedures are so lengthy and so complicated they effectively deny the relief Congress intended to all but the largest and most affluent companies.

At a minimum, Section 337 should be amended to eliminate the need to separately and specifically prove injury. The determination that a product has been counterfeited should, in itself, establish a presumption that injury has occurred. That section should also require that the U.S. Customs Service seize all goods where entry is attempted in violation of an exclusion order rather than permitting their reexportation.

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8. Executive Branch agencies, such as the Office of the U.S. Trade Representative, the Department of Commerce and the Department of State, should directly and forcefully confront governments of foreign nations in which significant counterfeiting of United States goods occurs. The agencies should use all available forms of moral suasion and economic leverage to convince foreign governments to crack down on commercial counterfeiting. One useful initiative would be for the United States to press hard at the General Agreement on Tariffs and Trade for the adoption of an effective international anti-counterfeiting code, which would give national customs services the authority to seize counterfeit goods and prosecute or assist the legitimate manufacturer in the prosecution of the violator.

9. The U.S. Customs Service should modernize its rules and procedures relating to the importation of certain electronic goods. Existing rules and discretionary rulings should be changed to require the seizure of all computers and related goods, such as video games, which violate copyrights registered with Customs. No reexport of commercial shipments of seized goods should be permitted. Further, the Customs Service should seize and destroy all components of computers and other goods which are clearly intended to be assembled into products which violate such copyrights.

Personal computers and video games are examples of products whose copyrights are imbedded in the operating software incorporated in silicon chips. Apple Computer Company and several American video game manufacturers have been the victims of foreign pirates that have copied their operational programs and sold or attempted to sell their counterfeit products in the U.S. The schemes employed to evade U.S. Customs seizure of counterfeits have become increasingly sophisticated. Customs regulations protecting U.S. copyrights should be updated to address these new problems, especially the issue of what constitutes contributory copyright infringement. Congress should act to clarify the law and mandate these changes should Customs fail to act promptly.

10. Congress should increase the criminal penalty

for willful infringement of copyrights covering computer software. Currently only a misdemeanor, such violations should be made a felony. Infringements of this important segment of the electronics industry are widespread, both in the United States and abroad. Existing penalties are clearly not an adequate deterrent.

11. Customs should be given the authority to enforce U.S. patent rights. The Service already enforces patents in specific cases, such as the result of the patent holder obtaining an order from a U.S. District Court or the International Trade Commission. It is also possible to obtain both a patent and a copyright on components of the same merchandise (as in the case of the Apple II computer). At present, however, until and unless Apple obtains an exclusion order, Customs allows computers or printed circuit boards that infringe on Apple's patents to enter U.S. commerce.

12. The Congress should increase substantially the funds allocated to the enforcement effort by the Customs Service against counterfeit goods and other types of commercial fraud. The number of actual inspections of imported goods has been steadily declining while the volume of entries has been consistently increasing. Despite the best efforts of highly motivated and talented field personnel, the ability of Customs to stem the flow of counterfeit products, many of which are hazardous, is open to serious question. Since Customs collects nearly \$20 for every dollar it spends, the taxpayers could only benefit from a strengthened enforcement program.

The Subcommittee will continue its inquiry and may make more explicit recommendations later. However, at a minimum, the appropriation for the U.S. Customs Service should be increased by \$25 million. This would place its commercial fraud activities on a par with Operation Exodus, the program which controls the export of sophisticated technology susceptible to military applications. Commercial fraud activities, currently termed "Operation Tripwire" by the Customs Service, should include specialized teams of Customs agents, import specialists and, where appropriate, inspectors and other support personnel charged with

detection and investigation of commercial customs fraud. The Customs Service should be required to assign experienced personnel to these teams and should not be permitted to use such assignments as a means of further reducing existing operations, particularly those performed by import specialists.

13. The Congress should seriously consider banning for a specified period of time the right to import goods or services into the U.S. by any foreign person convicted criminally of violating our trade laws. The ban would apply both to a company and its individual officers, who would not be allowed to escape the prohibition simply by forming a new company.

14. The Congress should consider other changes in the patent law. One logical modification would be a seventeen-year ban on the use of the technology by any company or person found guilty of willfully infringing a valid patent. Another problem that needs to be rectified is the current inability of a company to secure patent protection for the fruits of its research in the absence of a tangible product.

15. The Subcommittee and other appropriate bodies of Congress should continue to examine the problems of unfair and illegal foreign trade practices. Scrutiny of the adequacy of enforcement by the Executive Branch should continue and a further search for means to strengthen our laws to deter such practices should proceed as rapidly as possible. Intellectual property theft is only one of the many problems requiring changes in U.S. trade policy and law.