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STATEMENT OF

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ASSOCIATE DIRECTOR, NATIONAL SECURITY
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BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE
SENATE COMMITTEE ON FINANCE

ON

STRENGTHENING INTELLECTUAL PROPERTY RIGHTS PROTECTION
UNDER SECTION 337 OF THE TARIFF ACT OF 1930



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our recent work on ways to strengthen protection of intellectual property rights under section 337 of the Tariff Act of 1930. Experience since passage of the 1974 Trade Act, which strengthened section 337, shows that this provision has become an important means to stop imports of goods that counterfeit and infringe U.S. intellectual property rights. Our work, which we began in January 1985, shows that section 337 protection of intellectual property rights can be made more effective, and we are proposing ways to

- increase access to section 337 relief by eliminating or redefining certain statutory tests that must be met to obtain relief,
- improve administration of section 337 proceedings either when complainants need immediate assistance or when no respondents participate,
- clarify the International Trade Commission's authority to issue both exclusion orders and cease and desist orders to address the same unfair trade practice, and
- strengthen the Customs Service's ability to enforce exclusion orders.

These proposals are included in a draft report which we anticipate issuing this summer.

NEED FOR INCREASED ACCESS TO SECTION 337

Although section 337 relief has been available since the Tariff Act of 1922 (which contained the essential provisions of what was later to become section 337), firms began using it extensively only when it was amended by the Trade Act of 1974. The 1974 Trade Act transformed section 337 into what one prominent attorney has called "the best forum wherein to challenge widespread infringement of U.S. intellectual property rights." As of April 1985, approximately 95 percent of the section 337 cases initiated since passage of the 1974 Trade Act have involved protection of intellectual property rights, primarily patents.

Section 337 was originally intended as a trade statute to protect U.S. firms and workers against all types of unfair foreign trade practices. Therefore, the provision of relief is contingent on complainants' meeting certain economic tests normally not required to protect intellectual property rights. These tests require complainants to demonstrate that they (1) constitute a domestic industry, (2) are efficiently and economically operated, and (3) are substantially injured by the unfair trade practice.

The International Trade Commission has interpreted these tests broadly. The Commission has:

--Never denied relief on the grounds that the complainant

was not efficiently and economically operated.

--Interpreted domestic industry broadly; for example, the Commission has issued relief in instances where the domestic component of the industry did not involve manufacturing operations, but distribution, research and development, or sales and servicing.

--Been willing to accept small showings of injury as sufficient to meet the statute's injury requirement.

Still, because of these economic tests, some holders of U.S. intellectual property rights who seek relief from counterfeit or infringing imports are denied access to section 337 relief. Since the 1974 Trade Act amendments, 11 complainants have been unable to meet all the economic criteria and 6 of them were denied relief solely for this reason. However, these 11 cases may be only part of the story. Our survey results indicate that firms have terminated their proceedings or accepted settlement agreements which they judged not in their best interests because they could not meet all of the statute's economic tests. In addition, other firms may be discouraged from even initiating proceedings because of these tests. However, their number is not known. The cost of section 337 litigation, which, according to our survey generally ranged between \$100,000 and \$1 million, with a few costing as much as \$2.5 million, adds to this reluctance. The legal costs attributable to satisfying the economic tests can

reportedly equal more than 50 percent of the total litigation expenses.

There is substantial support for eliminating the requirement that the complainant demonstrate that it is efficiently and economically operated. However, objections have been raised to amending the domestic industry and injury tests. We discuss below what we consider to be the four most important objections and why we do not agree with them.

1. Should either or both tests be amended, the Commission may no longer be the proper forum for adjudicating section 337 disputes.

We see no compelling reason for moving adjudication of section 337 cases out of the International Trade Commission should the economic tests be amended. The Commission is generally viewed as doing a good job of administering section 337 proceedings. As a non-partisan, fact-finding body with a built-in appeal level, the Commission would continue to be an appropriate forum for adjudicating section 337 disputes. It has decades of experience in addressing unfair trade practices, which would continue to be the basis for section 337 complaints. The Commission has also developed expertise in adjudicating disputes involving intellectual property rights through over a decade of

experience with section 337 litigation. Further, the Commission's experience places it in a strong position to make "judgement calls" in cases where overriding public welfare considerations require denying relief to complainants that otherwise warrant relief.

2. Amending the economic tests would make federal district court intellectual property litigation and section 337 proceedings virtually identical and duplicative.

We do not agree. The relative disadvantages of using federal district court to protect intellectual property rights, particularly patents, from infringing imports makes section 337 an important alternative for redress. Of particular importance, while the Commission concludes the large majority of section 337 cases within one year, district court patent litigation proceedings often take as long as 3 to 5 years to conclude. Furthermore, the section 337 exclusion order is a more effective vehicle for addressing the importation of infringing goods from multiple sources. A section 337 exclusion order is "in rem," that is, directed toward the counterfeit or infringing products. Thus, a firm need obtain only one exclusion order to stop all such imports, regardless of source, including goods produced and/or imported by persons that did not participate in the original proceedings. In contrast, relief available

in federal district court is "in personam," that is, directed against individuals. Consequently, to obtain relief equal to an exclusion order in district court, patent holders must often initiate numerous proceedings, often in different areas of the country, to stop several domestic distributors from marketing the infringing goods.

3. Eliminating the domestic industry criterion, in addition to opening section 337 to U.S. firms presently unable to meet this test, would allow foreign concerns to use section 337 against other foreign and U.S. firms.

We do not view this as a problem. Representatives of the legal community with whom we spoke believe that foreign firms that register intellectual property rights in the United States deserve full government protection. In fact, federal district courts have been adjudicating patent suits initiated by foreign firms for decades. Such an application of section 337 would be consistent with this precedent. In a sense, the domestic industry requirement of section 337 is a disguised "working requirement"--a non-tariff trade barrier used by a number of developing countries. This practice requires that a firm "work" (i.e., use in manufacturing) domestically a patent or other intellectual property right in order to use domestic mechanisms to protect that right. The U.S. government has spoken out in

multilateral forums against the use of such trade barriers because they stifle innovation by allowing infringers to use the research and development work of the original inventor without receiving authorization or paying compensation.

4. Amending the injury test may bring new challenges to the consistency of section 337 with the General Agreement on Tariffs and Trade (GATT) rules on measures members can take to protect intellectual property rights.

We do not share this concern and we understand that the Office of the U.S. Trade Representative has also reviewed this matter and found that eliminating the domestic industry and injury tests would not give rise to GATT violations. We believe that such action would be consistent with the protection historically afforded to registered trademarks and to copyrights by the Customs Service, which protects these types of intellectual property rights from counterfeit and infringing imports without requiring owners to meet an injury requirement. In addition, the panel decision in the only GATT dispute settlement case involving section 337 indicated that the section 337 case under consideration would have been consistent with GATT requirements even without the injury test. Although the panel went on to state that it could envision a situation in which use of section 337 to protect intellectual property rights may

constitute a violation of GATT, the situation outlined by the panel is just as likely to occur at present as it would if the injury test were amended.

We are proposing that section 337 be amended for cases involving intellectual property rights by (1) eliminating the requirements that complainants constitute a domestic industry and be efficiently and economically operated and (2) redefining the injury test so that ownership of a valid U.S. intellectual property right and proof of infringement by imports is sufficient to meet this criterion.

NEED TO IMPROVE ADMINISTRATION
OF SECTION 337 PROCEEDINGS

Experience since passage of the Trade Act of 1974 demonstrates that section 337 protection of intellectual property rights could be more effective if the International Trade Commission could (1) expedite the provision of relief to firms when they either need expedited relief or when no respondents participate and (2) issue both exclusion orders and cease and desist orders to remedy the same unfair act.

The Commission presently takes as much as 7 months or longer to provide expedited relief, usually in the form of a temporary exclusion order. Commission regulations give the administrative law judges 4 months to hold a hearing and make an initial determination and give the Commission one month to decide whether

it will review the initial determination and, if so, 2 months to conduct the review and make a final determination.

Many see this timeframe as inordinately long, especially in light of the one-year deadline for providing permanent relief. During this period, respondents can flood the domestic market with counterfeit or infringing goods, thus undermining the effectiveness of the temporary relief. Each of the firms receiving temporary relief that responded to a GAO survey reported that infringing goods entered the country during the course of the temporary relief proceedings and that it was injured by these imports. One firm reported that it lost from \$500,000 to \$1 million in sales during the course of these proceedings and that the infringing imports hurt consumer confidence in its product to a very great extent. This firm's comments bear noting: "[Our] pricing was totally destroyed. Our credibility was severely impaired. Customers became confused, many stopped buying altogether."

We believe that this problem can be addressed in a way that would reduce by 3 months the present 7-month timeframe for providing relief without reducing the time the administrative law judges would have to hold a hearing and make a determination. We are proposing that, at the request of the complainant, the Commission make temporary relief effective at the time of an administrative law judge's positive initial determination on

temporary relief. To ensure that complainants do not benefit should the temporary relief determination be overturned, the complainant in such instances should be required to post a bond. This bond might logically equal the estimated injury that the respondent would incur from the time the temporary relief became effective until the final determination.

The Commission generally takes about 12 months to conclude section 337 proceedings when no respondents participate, otherwise known as default proceedings. Commission decisions emphasize that a default does not establish per se a complainant's right to relief. The Commission requires that the attorney for the complainant make a good faith effort to produce evidence to establish a prima facie case that a violation has in fact occurred. The Commission (1) wants some factual and legal basis for providing relief, (2) needs such information to ensure that the granting of relief is in the public interest, and (3) needs to assure that its sweeping powers to exclude goods are not being abused.

During the course of these proceedings, however, defaulting respondents can continue to import counterfeit or infringing goods, undermining the effectiveness of the section 337 relief. Virtually all of the firms responding to our survey that had obtained relief in default proceedings reported that their business was injured during the course of these proceedings.

About 57 percent of those that indicated they had a basis to judge reported that they lost from \$100,000 to \$1 million in sales during the course of the proceedings and about 36 percent reported losses of \$1 million to \$5 million, with one firm claiming to have lost over \$5 million in sales. Of these firms, over 87 percent of those that indicated they had a basis to judge reported that the presence of counterfeit and/or infringing goods hurt consumer confidence in their products to at least some extent during the course of the proceedings. About 50 percent of them reported substantial or very great damage. In addition to these losses, they incurred litigation expenses of as much as \$1 million, with one firm reporting litigation expenses of over \$2.5 million. Defaulting respondents, of course, incurred no litigation expenses.

We suggest a method to resolve this problem that would provide immediate relief to complainants in default proceedings while, at the same time, giving the Commission the opportunity to develop a record to support the granting of relief. We are proposing that, in section 337 cases in which no respondents participate, the Commission, upon the request of complainants, presume the facts alleged in the complaint and issue temporary relief if the facts so warrant. The defaulting respondents could continue to import goods, but only under bond and subject to re-exportation or destruction should the temporary order be made permanent. The Commission would then continue with its present

default proceedings, which would be concluded within 6 months from the date all respondents were officially found in default, not to exceed 12 months from the date the case was initiated. If, after these proceedings, the Commission determines that permanent relief is warranted, it would replace the temporary order with the appropriate permanent relief. In this way, the deserving complainant would be protected from injury during the course of the proceedings and the Commission could develop a record to support the issuance of relief.

We also believe that the Commission can more effectively remedy unfair trade practices by issuing both exclusion orders and cease and desist orders to remedy the same violation. There may be some legal question regarding the Commission's authority to issue both types of relief simultaneously. Section 337(f) authorizes the Commission to issue cease and desist orders "in lieu of" exclusion orders. While the Commission originally read this provision as prohibiting it from issuing both types of relief simultaneously, it has since broadened its interpretation, expanding the instances when it can issue both remedies. Because the statutory support for such action may be in question, we are proposing that section 337 clearly authorize the International Trade Commission to issue both exclusion orders and cease and desist orders to remedy the same unfair trade practice.

NEED TO STRENGTHEN ENFORCEMENT
OF SECTION 337 EXCLUSION ORDERS

Firms initiating section 337 proceedings do so with the objective that, should they win, the exclusion orders will effectively stop the counterfeit and/or infringing goods from entering the country. The president of one firm that initiated a section 337 proceeding characterized his expectations of an exclusion order as "a wall around the country." Of course, the high cost of litigating a section 337 case contributes to this expectation.

Although some firms voluntarily stop importing counterfeit or infringing goods covered by exclusion orders, others ignore the orders, placing the enforcement burden on the Customs Service's port inspectors. Because an exclusion order authorizes Customs to exclude, but not seize, counterfeit and infringing goods, some knowledgeable officials do not consider it to be an effective deterrent to importation of such goods. Since Customs cannot seize these goods, foreign infringers who have shipments stopped by Customs are required only to re-export the goods and, thus, lose only shipping charges. Indeed, foreign infringers have been known to "port shop," that is, carry the counterfeit or infringing goods from port to port until they gain entry.

Of the respondents to our survey that indicated they had a basis to judge, nearly two-thirds of the firms that had received exclusion orders reported that counterfeit or infringing goods

covered by their exclusion orders continued to enter the country. About 71 percent of these firms saw substantial decreases in such imports after the exclusion orders were issued. Nonetheless, about 73 percent of those that had a basis to judge reported that the counterfeit and infringing imports hurt their sales to at least some extent. Over 45 percent of them reported that sales were damaged to a moderate or substantial extent. Further, company officials told us that the continued presence of infringing goods in the domestic marketplace, sometimes in a form virtually indistinguishable from the original, caused consumers to lose confidence in the authentic products.

We believe steps can be taken to strengthen the ability of Customs' present staff to enforce section 337 exclusion orders. We support initiatives to authorize the Commission to direct Customs to seize goods when enforcing exclusion orders. We suggest that any legislation to this effect provide that the Commission is to use this authority not as an initial remedy but as an extraordinary measure to deal with "predatory" infringers that have tried on more than one occasion to violate existing exclusion orders. Under our proposal, before the Commission could authorize Customs to seize shipments in enforcing an exclusion order, Customs or the complainant would have to present evidence to the Commission that a foreign firm or firms have on more than one occasion attempted to bring counterfeit or

infringing goods into the country in knowing violation of an exclusion order.

We also suggest that Customs intensify its efforts to elicit the support of firms that have obtained exclusion orders in identifying shipments containing counterfeit or infringing goods. Over 25 percent of the survey respondents that received exclusion orders undertook independent investigations and provided the results to Customs. Such information could include the names of companies importing counterfeit or infringing goods or information on particular shipments of such goods. These firms were most often satisfied with Customs' response to the information provided. Customs could elicit such information through an informational brochure or similar document that is provided to firms before they initiate section 337 proceedings. Under current procedures, there is no formal mechanism for firms to obtain such information prior to initiating proceedings. As a result, they may not have realistic expectations of Customs' abilities or appreciate the need to provide assistance.

Mr. Chairman, this concludes my statement. I would be happy to respond to any questions you have at this time.

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SUMMARY OF STATEMENT BY

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Issue #1: Economic tests

Findings: We agree that the use of the economic tests is inappropriate in section 337 litigation involving protection of intellectual property rights.

The Commission has interpreted the economic tests broadly. Still, because of these tests, some firms seeking to protect U.S. intellectual property rights from counterfeit and infringing imports have been denied access to section 337 relief.

Proposal: We are proposing that section 337 be amended for cases involving protection of intellectual property rights by (1) eliminating the efficient and economic operation and domestic industry requirements and (2) redefining the injury test so that ownership of a valid U.S. intellectual property right and proof of infringement by imports is sufficient to meet this criterion.

Issue #2: Temporary exclusion orders

Findings: Many see the Commission's 7-month timeframe for issuing expedited relief as excessive in light of the one-year deadline for providing permanent relief.

Firms that have received such relief reported in response to our survey that sales and consumer confidence in their products were injured during the course of the temporary relief proceedings, undermining the effectiveness of such relief.

Proposal: For cases involving protection of intellectual property rights, we are proposing that, at the request of the complainant, the Commission make temporary relief effective at the time of an administrative law judge's positive initial determination on temporary relief, with the complainant posting bond. Using this procedure, temporary relief can be made effective in 4 months.

Issue #3: Default proceedings

Findings: The Commission generally takes 12 months to conclude section 337 proceedings when no respondents participate (i.e., default proceedings).

Firms that have participated in default proceedings reported in response to our survey that sales and consumer confidence in their products were injured during the course of these proceedings, undermining the effectiveness of section 337 relief.

Proposal: For cases involving protection of intellectual property rights, we are proposing that, in proceedings where no respondents participate, the Commission, upon the request of complainants, presume the facts in the complaint and issue temporary relief if the facts so warrant. The Commission would then continue with its present default proceedings, which would be concluded within 6 months from the date all respondents are officially found in default, not to exceed 12 months from the date the case was initiated. If it determines that permanent relief is warranted, the Commission would replace the temporary order with the appropriate permanent relief.

Issue #4: ITC authority to issue both exclusion orders and cease and desist orders to remedy the same violation

Findings: The Commission can more effectively remedy unfair trade practices if it could issue both exclusion orders and cease and desist orders to remedy the same violation.

There may be some legal question regarding whether section 337 authorizes the Commission to issue both remedies to address the same unfair trade practice.

Proposal: We are proposing that section 337 be amended for cases involving protection of intellectual property rights to clearly authorize the Commission to issue both exclusion orders and cease and desist orders to remedy the same violation.

Issue #5: Customs enforcement of exclusion orders

Findings: Because Customs cannot seize goods when enforcing exclusion orders, infringers can "port shop," that is, bring the infringing goods from port to port until they gain entry.

Of the firms responding to our survey that received exclusion orders, nearly two-thirds of those that had a basis to judge reported that infringing goods continued to enter the country in violation of their exclusion orders. The majority of these firms reported that these goods significantly injured sales. Company officials informed us that these imports also hurt consumer confidence in their products.

Proposal: We are proposing that section 337 be amended for cases involving protection of intellectual property rights to authorize the Commission to instruct the Customs Service to seize goods of predatory infringers who, on more than one occasion, bring counterfeit or infringing goods in to the country in knowing violation of section 337 exclusion orders.

We are also proposing that Customs intensify its efforts to elicit the support of firms that have obtained exclusion orders in identifying shipments containing counterfeit or infringing goods.