

GAO

Report to Selected Congressional
Subcommittees

August 1986

INTERNATIONAL
TRADE

Strengthening Trade
Law Protection of
Intellectual Property
Rights



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United States
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Washington, D.C. 20548

**National Security and
International Affairs Division**

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August 13, 1986

The Honorable John C. Danforth
Chairman, Subcommittee on
International Trade
Committee on Finance
United States Senate

The Honorable Sam M. Gibbons
Chairman, Subcommittee on Trade
Committee on Ways and Means
House of Representatives

This report recommends ways to strengthen section 337 of the Tariff Act of 1930 as a means to protect intellectual property rights from counterfeit and infringing imports. We earlier testified before your subcommittees on the results of our work. As we proposed in our testimony, we have included recommendations in this report to increase access to section 337 relief, improve the International Trade Commission's administration of section 337, clarify the Commission's authority to issue multiple remedies, and strengthen the Customs Service's enforcement of section 337 exclusion orders

Copies of this report are being sent to the Chairman of the International Trade Commission, Secretary of the Treasury, Office of the U.S Trade Representative, various congressional committees, and other interested parties. Copies will be made available to others upon request.

A handwritten signature in cursive script that reads 'Frank C. Conahan'.

Frank C. Conahan
Director

Executive Summary

Purpose

Over the past 11 years, section 337 of the Tariff Act of 1930, as amended (19 U.S.C. 1337), has been an important tool for protecting intellectual property rights against counterfeit and infringing imports. During the course of our work, a number of bills were introduced, one of which was passed by the House of Representatives, which largely aim to (1) increase access to section 337 relief, (2) improve the International Trade Commission's (ITC) administration of section 337, (3) clarify the ITC's authority to issue multiple remedies, and (4) strengthen the Customs Service's enforcement of section 337 exclusion orders. We focused our work on evaluating these proposals.

Background

Although section 337 relief has been available since passage of the Tariff Act of 1922 (which contained the essential provisions of what was later to become section 337), firms began using it extensively to protect intellectual property rights only when it was amended by the Trade Act of 1974. Section 337 proceedings, which are governed by the Administrative Procedure Act, typically begin with the filing of a complaint with the ITC, which then informs the alleged infringers named in the complaint ("respondents") and assigns the case to an administrative law judge. The judge presides over an adversarial proceeding and submits an initial determination to the Commission—the 6 member panel that oversees operation of the ITC and issues the agency's official determinations. To obtain relief, a complainant must demonstrate that a valid and enforceable intellectual property right has been infringed and also must meet certain "economic" tests

The Commission can adopt, modify, or reject the judge's determination. Should it find in favor of the complainant, the Commission can issue relief unless, after considering its effect on the "public interest," it finds that it should not do so. Relief under section 337 most often takes the form of exclusion orders, which instruct the U.S. Customs Service to stop imports of goods that counterfeit or infringe the intellectual property right covered by the order. The Commission also issues cease and desist orders, which instruct respondents to discontinue certain actions found to violate the intellectual property rights of complainants. The President has the authority to disapprove the Commission's determination for policy reasons within 60 days.

Results in Brief

Section 337 of the Tariff Act of 1930 can more effectively protect U.S. intellectual property rights against counterfeit and infringing imports. Legislative changes are needed to.

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- Increase access to section 337 relief by eliminating or redefining statutory criteria for obtaining relief
 - Direct the ITC to speed relief when complainants need expedited government assistance and when no respondents participate in the proceedings.
 - Clarify the ITC's authority to issue both exclusion orders and cease and desist orders to remedy the same unfair trade practice.
 - Strengthen the Customs Service's ability to enforce section 337 exclusion orders.
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Principal Findings

Economic Tests

Section 337 originally was 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 the firms' meeting certain economic tests normally not associated with the protection of intellectual property rights. These tests require complainants to demonstrate that (1) there is a domestic industry, (2) it is efficiently and economically operated, and (3) the unfair acts of respondents have the effect or tendency to destroy or substantially injure that industry. Because of these tests, some holders of valid and enforceable intellectual property rights that are being infringed by imports are denied access to section 337 relief.

ITC Administration

The ITC's 7-month time frame for providing expedited relief to firms that need immediate assistance undermines the effectiveness of such relief. Many see this time frame as inordinately long, especially in light of the one-year statutory deadline for providing permanent relief. During the course of the proceedings for expedited relief, which involve a separate hearing before an administrative law judge and Commission review of the initial determination, foreign firms can flood the domestic market with counterfeit and infringing goods, causing lost sales and damaging consumer confidence in the complainant's products. Further, this 7-month time frame has discouraged some firms in need of expedited relief from seeking it.

The ITC's time frame for providing relief when no respondents participate—generally a full year—also undermines the effectiveness of section 337 relief. Before providing relief in such “default” proceedings, the

ITC needs to assure itself that relief is warranted. Nevertheless, during the course of these proceedings, respondents can continue to import the alleged infringing goods.

Section 337 authorizes the ITC to issue cease and desist orders “in lieu of” exclusion orders. Until recently, the Commission had interpreted this statutory language as prohibiting it from issuing both orders to address the same unfair practice, thus limiting the effectiveness of section 337 relief. Although the Commission recently reinterpreted this provision and issued both types of relief for the same unfair practice, the statutory support for the revised reading is not free from doubt.

Customs Enforcement

Because exclusion orders do not authorize Customs to seize counterfeit and infringing goods, some knowledgeable officials do not consider them to be effective deterrents to importation of such goods. In a GAO survey of firms that received exclusion orders, about two-thirds of the survey respondents that indicated they had a basis to judge reported that imports of counterfeit and infringing goods covered by these orders continued to enter the country. Although these firms most often saw a substantial decrease in these imports, they reportedly caused significant losses in sales and loss of consumer confidence in the legitimate products.

Recommendations

GAO recommends that Congress amend section 337 of the Tariff Act of 1930 for cases involving protection of intellectual property rights as follows

- Eliminate the requirement that a complainant be efficiently and economically operated, eliminate the domestic industry requirement, and redefine the injury requirement so that ownership of a valid and enforceable U.S. intellectual property right and proof of infringement by imports is sufficient to meet the injury test
- Require the ITC, at the request of the complainant, to make temporary relief effective within 10 days of receipt of an administrative law judge’s affirmative initial determination on temporary relief, while requiring the complainant to post bond, unless it finds that such action would be contrary to the “public interest.” The Commission could then review the initial determination in accordance with its current procedures
- In cases where no respondents participate, require the ITC, at the request of the complainant, to provide interim relief if (1) the facts as set out in

the complaint, supporting documents, and other information available to the Commission demonstrate that a violation of section 337 is likely to have occurred and (2) the provision of interim relief is not deemed contrary to the public interest. Also require the ITC to make its determination on permanent relief no later than 6 months from the date all respondents are officially determined to be in default, not to exceed 12 months from the date the Commission instituted the investigation.

- Clearly authorize the ITC to issue both exclusion orders and cease and desist orders to remedy the same unfair trade practice
- Authorize the ITC to direct the U S Customs Service to seize counterfeit or infringing goods when there is evidence that a firm or firms have on more than one occasion attempted to bring such goods into the country in knowing violation of exclusion orders

Appendix I contains specific legislative language for these recommendations

Agency Comments and Our Evaluation

The Office of the U.S. Trade Representative expressed general agreement with a draft of this report. The Department of the Treasury generally agreed with GAO's conclusions and recommendations on Custom's enforcement of exclusion orders (See apps. III and IV)

The ITC Chairwoman in April 1986 commented on a draft of this report. (See app. V.) Her comments recommended that GAO reconsider its position on amending the section 337 economic tests. They expressed concern that GAO based its conclusions only on the perceptions of complainants and that its recommendation would, among other things, lessen the impact of section 337 in encouraging domestic exploitation of intellectual property rights and raise trade policy concerns. GAO believes that its methodology adequately took into consideration all pertinent views on eliminating the economic tests and that its recommendation could enhance domestic entrepreneurial activity. The comments also characterized GAO's recommendations regarding ITC administration of section 337 proceedings as "a useful foundation for thoughtful discussion" and expressed general agreement with GAO's recommendation regarding Customs enforcement of exclusion orders but suggested that Customs, and not the ITC, should decide when it is appropriate to seize and take custody of goods. GAO continues to believe that Customs should seek ITC authorization to enforce an exclusion order by seizing and taking into custody imported goods, since the statute grants to the ITC the authority to determine the appropriate form of relief.

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Abbreviations

GAO	General Accounting Office
GATT	General Agreement in Tariffs and Trade
ITC	International Trade Commission

Section 337 of the Tariff Act of 1930: An Important Tool for Combating Counterfeit and Infringing Imports

As revised by the Trade Act of 1974, section 337 of the Tariff Act of 1930, as amended (19 U S C 1337), has become an important tool for protecting patents, as well as trademarks and copyrights,¹ against counterfeit and infringing² imports. Since the 1974 amendments, firms have increased their use of this provision, focusing congressional attention on section 337 and resulting in the introduction of legislation to amend the statute

Section 337: What Is It? How Does It Work?

Section 337 gives U.S. firms a means to combat unfair practices in international trade. It declares unlawful all

“Unfair methods of competition and unfair acts in the importation of articles into the United States the effect or tendency of which is to destroy or substantially injure an industry, efficiently and economically operated, in the United States, or to prevent the establishment of such an industry ”

To establish that there has been a violation and obtain relief, which most often takes the form of Customs Service assistance, firms participate in an adversarial proceeding administered by the International Trade Commission (ITC) in which they must demonstrate that they meet certain statutory criteria

A typical proceeding (see fig. 1.1) begins with the filing of a complaint that a firm or firms have engaged in unfair methods or acts of competition.³ Upon receipt of a complaint, the ITC must decide within 30 days whether to formally institute proceedings. Such proceedings must be

¹Patents, which protect functional and design inventions, give inventors the right to exclude others from making, using, or selling their inventions. Trademarks protect words, names, symbols, devices, or a combination thereof, used by a manufacturer or merchant to identify its goods and distinguish them from others. Copyrights protect literary and artistic expressions, they grant to an author, composer, playwright, publisher, or distributor the exclusive right to publish, produce, sell, or distribute a literary, musical, dramatic, or artistic work

²Trademark counterfeiting generally refers to the deliberate, unauthorized duplication of another's trademark or packaging and trademark infringement to the unauthorized use of a trademark that is so similar to another existing trademark that, considering the products involved, consumers are likely to become confused. Copyright infringement generally refers to the unauthorized use or copying of a copyrighted work. Patent infringement generally refers to the unauthorized manufacture, use, or sale in the United States of all devices embodying the patented invention, whether copied from an authorized device or resulting from independent development

³Since 1975, the ITC has self-initiated two cases. In such cases, the positions of the complainants are represented in the proceedings by the ITC investigative attorneys. The ITC, on its own initiative, reinstated Auright Cast Iron Stoves in July 1981 after realizing that the exclusion order issued in the original case did not thoroughly address the import infringement problems of the complainant. The ITC also self-initiated Apparatus for Flow Injection Analysis in June 1983 at the request of the U.S. Department of Agriculture

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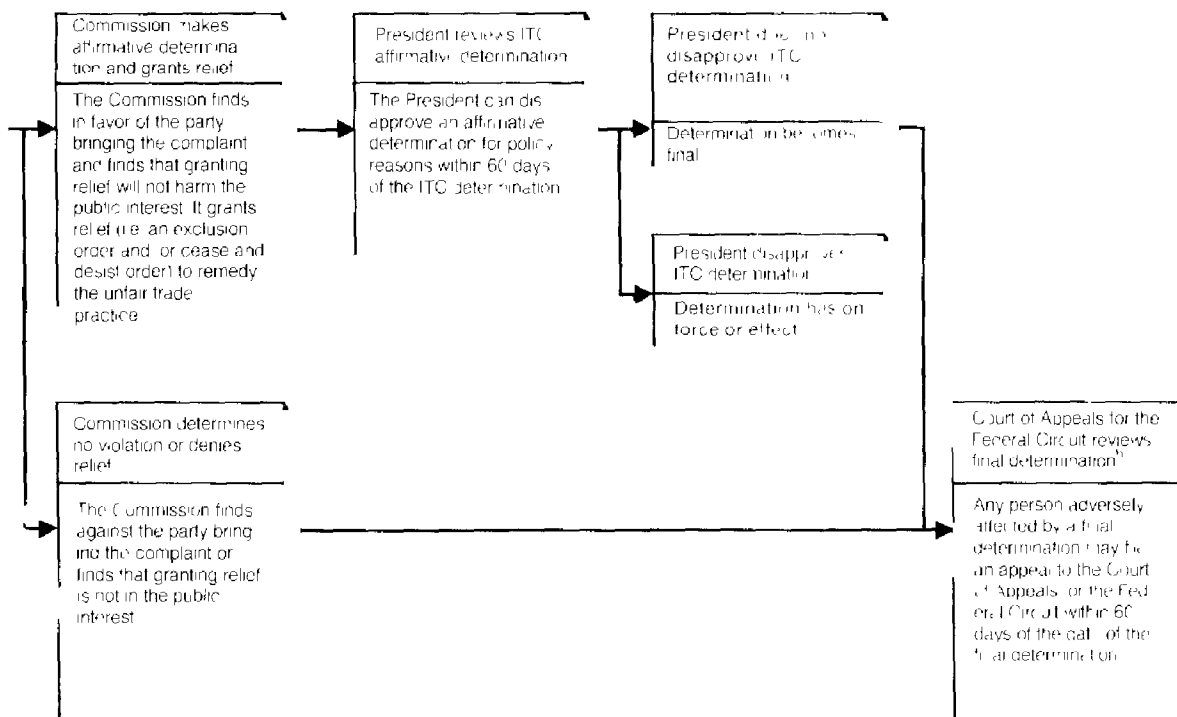
concluded in one year (18 months in “more complicated” cases)⁴ and be conducted in accordance with the Administrative Procedure Act (5 U.S.C. 551 *et seq.*). This Act provides for notification of parties that might be adversely affected by an ITC determination and for a hearing on the record before an ITC administrative law judge. If the ITC proceeds with an investigation, it publishes a notice of the investigation in the Federal Register and notifies by mail alleged infringers named in the petition (“respondents”). The ITC has rejected about one or two of the dozens of complaints it receives each year.

⁴A case can be deemed “more complicated” if it is of an involved nature due to the subject matter, difficulty in obtaining information, or large number of participants.

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Procedure for a one year (as opposed to an 18 month) section 337 proceeding that does not involve a request for temporary relief.

* Parties may seek to appeal Court of Appeals decisions to the Supreme Court. As of April 1985, the Supreme Court had not reviewed a section 337 decision.

Within the first month after the notice is published, the case is assigned to an administrative law judge, who presides over an adversarial proceeding in which attorneys for the complainant and the respondents who choose to participate present their cases. This proceeding is held "on the record" and normally includes discovery (including depositions and interrogatories), cross-examination of witnesses, and filing of briefs. Investigative attorneys from the ITC's Office of Unfair Import Investigations also participate in the proceedings and have all the rights and obligations of the private parties to the proceedings. They are responsible for protecting the public interest, which they do largely by ensuring that the record of the proceeding is complete and by helping to narrow the issues under contention. Unless the case is deemed more complicated,

the judge must submit within 9 months of the notice's publication an initial determination containing findings of fact and conclusions of law to the Commission—the 6 member panel that oversees operation of the ITC and issues the agency's official determinations.

The Commission has about 3 months to review the initial determination (which it can adopt, modify, or reject) and render a final determination. Under ITC rules, the Commission has 45 days to decide whether to review an initial determination. If it decides not to make a review, the initial determination is adopted as the ITC's final determination. If it decides to review the initial determination, the Commission has the remainder of the statutory time period (usually about 45 days) to reach a final disposition of the case. If it finds in favor of the complainant, the Commission can grant relief unless, after considering the "public interest" (i.e., the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers), the Commission finds that it should not do so.⁵

Should it decide to issue relief, the ITC has a number of remedies at its disposal. It most often issues general exclusion orders, which instruct the Customs Service to exclude all shipments of goods that counterfeit or infringe the intellectual property right covered by the order. It can also issue tailored exclusion orders, which are directed at stopping imports of counterfeit and infringing products made by certain overseas firms, or cease and desist orders,⁶ which instruct respondents to discontinue certain actions found to violate the intellectual property rights of the complainants.

At any time before the ITC issues its final determination, parties to a proceeding may decide to resolve the dispute through a settlement or consent order agreement. For instance, in exchange for a royalty payment, the complainant may license the respondent to import the product embodying the intellectual property right. Consent orders provide for

⁵Since 1974, the ITC has denied relief to protect the "public welfare" in two cases: (1) Certain Automatic Crankpin Grinders in December 1979, because the complainant could not meet the domestic demand for a product essential to the automotive industry and (2) Certain Inclined Field Acceleration Tubes in December 1980, because the imported article was a linear particle accelerator intended for use in academic research.

⁶From January 1975 to April 1986, the ITC issued 40 cease and desist orders in 8 separate section 337 investigations.

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ITC enforcement⁷ whereas settlement agreements are enforced through breach of contract actions in state or federal courts. Before terminating a section 337 proceeding based on such an agreement, however, the ITC determines that the proposed agreement is in the public interest.

ITC determinations are not necessarily final. Under ITC regulations, any party to a section 337 proceeding may petition the ITC to reconsider its determination within 14 days after receiving the final determination. Further, the ITC must transmit affirmative determinations to the President, who, "for policy reasons," may disapprove them within 60 days.⁸ If, within the 60-day period, the President does not disapprove the determination or notifies the ITC that he approves it, the determination becomes final for the purpose of judicial appeal.

Any person adversely affected by a final determination (i.e., can show a real, present injury), including those not party to the original ITC proceedings, may file an appeal to the Court of Appeals for the Federal Circuit within 60 days of the date of the final determination. The Court will review the final determination to ensure that it was not arbitrary or capricious, an abuse of discretion, or otherwise not in accordance with the law. The Appeals Court also has authority to review ITC findings on the public interest considerations.

Approximately one-quarter of the petitions for section 337 relief also include separate requests for expedited temporary relief. In such a case, the administrative law judge must hold an additional hearing and issue a separate initial determination on temporary relief within 4 months from the date the case was instituted. The Commission then has 30 days to decide whether it will review some or all of the initial determination and

⁷The ITC does not actually monitor compliance with consent order agreements but assumes that these agreements are working properly unless informed otherwise. The remedies available to the ITC in enforcing consent orders usually include exclusion orders or cease and desist orders. As of April 1985, the ITC has invoked its authority to enforce consent order agreements only once. In July 1983, it partially revoked the consent order issued in Grooved Wooden Handle Kitchen Utensils and Gadgets and issued a temporary exclusion order, which was followed by a cease and desist order in April 1984.

⁸To date, the President has disapproved four section 337 final determinations. The President disapproved the determinations in Certain Headboxes I (April 1981) and Certain Molded-in Sandwich Panel Inserts (April 1982) because he believed that the relief provided was unnecessarily broad. The ITC reinstated these cases and granted relief which met with Presidential approval. The other disapprovals were permanent. The President disapproved the determination in Certain Stainless Steel Pipe and Tube (March 1978) because he did not believe that the ITC had jurisdiction under section 337 over a predatory pricing situation. He disapproved the determination in Certain Alkaline Batteries (November 1984), which was directed at stopping the importation of so-called "grey market" products made by the foreign licensee of the complainant, largely because Customs regulations were inconsistent with the Commission's exclusion order.

60 additional days to issue its final determination. As with permanent relief, if the Commission decides not to review the initial determination, it is adopted as the ITC's final determination. Temporary relief, which can take the form of a temporary exclusion or cease and desist order, remains in effect until the ITC concludes its investigation. Under a temporary exclusion order, by far the most common type of expedited relief, an importer must post a bond with the Customs Service in order to bring goods covered by the order into the country. Should the temporary order be made permanent, the importer would have to re-export or destroy goods brought in under the temporary order or forfeit the bond. Affirmative final determinations on temporary relief are subject to Presidential disapproval, all final determinations on temporary relief can be appealed to the Court of Appeals for the Federal Circuit.

Trade Act of 1974 Amendments Increase Use of Section 337

Although section 337 relief has been available since passage of 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. Prior to the 1974 amendments, section 337 had been rarely used, largely because the U.S. Tariff Commission, as the ITC was then known, had only advisory responsibility and often took 2 or more years to make a recommendation to the President. The President, who alone could initiate remedial action, often exercised great latitude in deciding whether to accept or reject the Tariff Commission's recommendation.

With the Trade Act of 1974, Congress made substantial amendments to section 337 which corrected these and other deficiencies. Among other things,⁹ the new law imposed the 12- to 18-month deadline for concluding proceedings and authorized the ITC to determine whether and what type of relief was warranted, subject to Presidential disapproval. The Trade Act also required the ITC to accept "all equitable defenses," which could include patent misuse and invalidity, whereas, before, patents were presumed valid unless a court had deemed otherwise. These changes transformed section 337 into what one prominent attorney has characterized as "the best forum wherein to challenge widespread infringement of U.S. intellectual property rights."

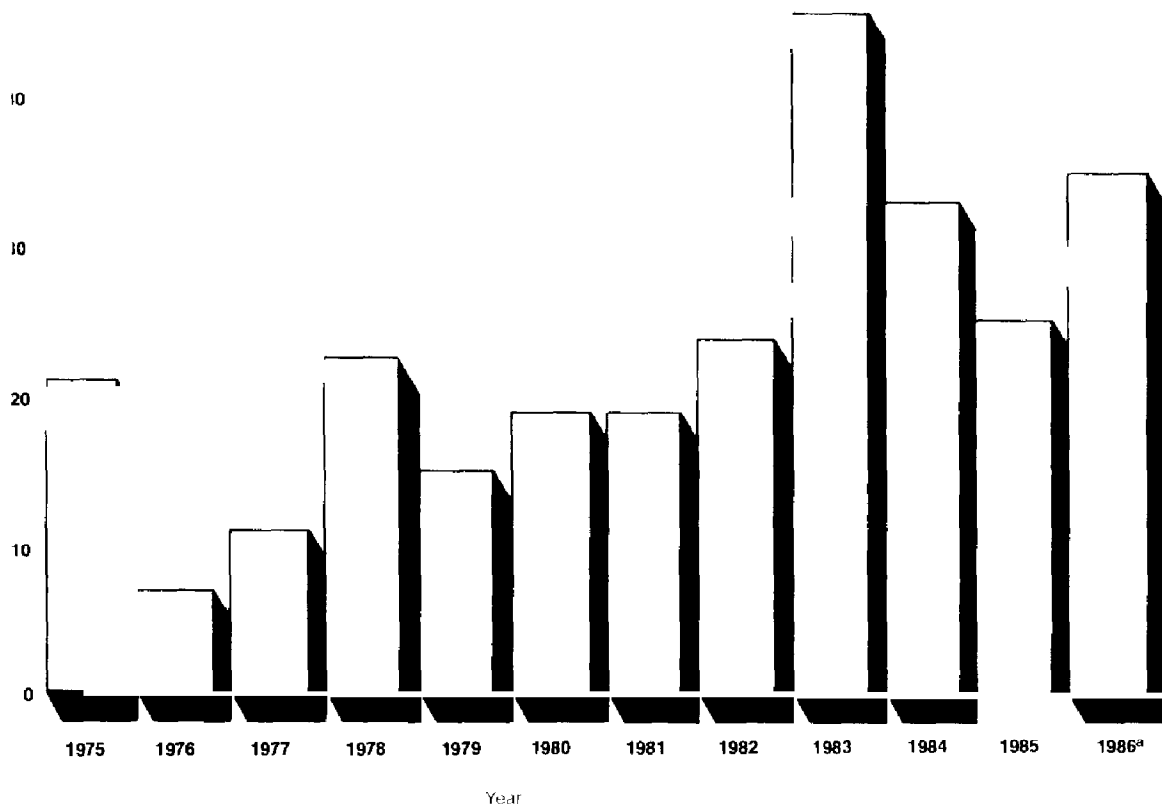
⁹ The Trade Act of 1974 also expanded the types of remedies available to the ITC and made section 337 proceedings subject to certain provisions of the Administrative Procedure Act and judicial review.

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Since passage of the 1974 trade act, U.S. firms have made substantial use of section 337 to protect patents and, to a lesser extent trademarks and copyrights, from counterfeit and infringing imports. (See fig. 1.2.) Between January 1975 and April 1985, approximately 75 percent of the 224 cases instituted by the ITC involved patent infringement, 22 percent involved trademark infringement, and 4 percent involved copyright infringement; 4 percent did not involve violation of intellectual property rights. Complainants in about half of the cases also charged that respondents had committed other types of unfair acts.¹⁰

Figure 1.2: Section 337 Cases Initiated by Calendar Year

0 Number of Cases



Year

*ITC Projection for Fiscal Year 1986

Source: International Trade Commission

¹⁰Other unfair methods of competition and unfair acts alleged in section 337 proceedings include breach of contract, collusive bidding, conspiracy to monopolize, failure to mark country of origin,

Section 337 Is Considered Preferable to District Court Litigation

According to attorneys and officials of companies that have initiated proceedings, the value of section 337 proceedings is particularly apparent when compared with litigation in federal district court—the only other means for protecting patents against foreign infringement. In particular, they cite the relative timeliness of the proceedings and the ability to deal with all foreign infringers in the context of one proceeding

While the ITC concludes the large majority of section 337 cases in 12 months, concluding district court patent litigation proceedings often takes as long as 3 to 5 years. In the absence of a statutory deadline, litigants in district court tend to make fuller presentations of their cases than they would in section 337 proceedings. Further, the courts often face very heavy workloads and must give criminal cases priority over other types of litigation due to the requirements of the Speedy Trial Act

Furthermore, an ITC exclusion order is more effective in addressing the importation of infringing goods. Through an exclusion order, a U.S. firm can deal with infringement by foreign firms that are often beyond the reach of district courts. Exclusion orders are “in rem,” that is, directed at the infringing products as opposed to the manufacturer or distributor of these products, and they are enforced at the border, before the goods enter the stream of domestic commerce. A firm need obtain only one order for Customs to stop imports of all infringing goods, regardless of source, including goods produced and/or imported by persons not party to the original proceeding. In contrast, remedies available through district court—an injunction and/or monetary damages—are “in personam,” that is, directed against individuals. Since U.S. district courts have no jurisdiction over foreign concerns without sufficient presence in the United States, remedies often can be enforced only against domestic parties, usually distributors of the infringing products. Thus, to obtain relief equal to an exclusion order, patent holders must often initiate numerous district court proceedings, often in different areas of the country, to stop several domestic distributors from marketing the infringing goods. One company official likened using the district court system to “stamping out brush fires.” Further, patent holders are understandably reluctant to initiate district court proceedings which may result in injunctions and monetary damages being assessed against distributors who are also major domestic customers

false advertising, designation of origin, and labeling, product disparagement, palming off (i.e., misrepresenting a product as being identical to another product), trade dress misappropriation (i.e., unauthorized use of another product's packaging in such a way as to intentionally cause confusion), and trade secret misappropriation (i.e., unauthorized use of a trade secret)

The advantage of section 337 over district court litigation is illustrated by the following examples. The ITC determination in Furazolidone pointed out that the patent holder in this case had “brought 56 suits against different importers, and the end is not in sight.” The president of Video Commander, Inc., a company that manufactures a video switching system, testified before the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, that, to deal with low-cost Taiwanese imports that infringed his patent, he moved his manufacturing operation to Taiwan rather than initiate legal action against all the companies that market the infringing systems.

Section 337 is preferable to district court litigation for two additional reasons. It is the only means for protecting a process patent against infringing imports. At present, the owner of a U.S. process patent cannot use district court to obtain relief against a foreign firm that uses the patented process to manufacture a product abroad and import that product into the United States.¹¹ In order to use district court, the performance of the patented process must take place in the United States.¹² However, the importation of goods made by a process that infringes a U.S. patent is specifically cited in 19 U.S.C. 1337a as an unfair trade practice in violation of section 337. Several firms have used this provision in section 337 to protect process patents in international trade.

Second, the ITC is seen as being less hostile toward protection of patents than are the district courts. This perception appears to be supported by overall statistics on ITC and district court determinations. In his July 23, 1985 opinion, In Re Convertible Rowing Exerciser Patent Litigation, Chief Judge Murray Schwartz of the U.S. District Court of Delaware cited statistics showing that, “since the passage of the Trade Act of 1974, holders of U.S. patents have prevailed on the issue of patent validity in about 65% of the ITC decisions, as compared to 40 to 45% of the district court decisions.” However, this perception should change in the future. According to knowledgeable officials, the creation in 1982 of the Court of Appeals for the Federal Circuit, which hears appeals of all

¹¹Several bills, including H.R. 1069 and S. 1543 (introduced during the 99th Cong., 1st Sess.), have been introduced to extend protection to process patents infringed in international trade.

¹²In Preventing Importation of Products in Violation Of Property Rights (a paper prepared for an October 1984 American Bar Association conference on “Industrial and Intellectual Property: The Antitrust Interface”), A. Paul Victor writes: “35 U.S.C. 271 (a) provides that ‘[W]hoever without authority makes, uses or sells any patented invention, within the United States during the term of the patent therefor, infringes the patent.’ Since process patents seek to protect the process and not a particular product, in order to present a proper claim of infringement of such patents under 35 U.S.C. 271, ‘it is not only necessary to have the performance of a patented process but that performance must occur within the prescribed territory for which the monopoly was granted.’”

patent cases from both the ITC and federal district courts, should make determinations from these forums more clearly uniform

Congress Is Considering Amendments

The popularity of section 337 has focused congressional attention on the statute. A bill passed by the House of Representatives and several introduced in the Senate contain provisions to amend section 337. While these bills differ in specifics, they for the most part aim to

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

Objectives, Scope, and Methodology

We made this review to assess the effectiveness of section 337 of the Tariff Act of 1930 as a means for U.S. firms to protect their intellectual property rights against counterfeit and infringing imports. We assessed the statute itself as a means for protecting intellectual property. We also reviewed ITC administration of section 337 proceedings and Customs Service enforcement of exclusion orders.

The scope of this review largely reflects the provisions of the recent legislative initiatives that would amend section 337.

- Our assessment of the statute, in chapter 2, focuses on the need for complainants to meet certain economic tests, unrelated to the issues of validity and infringement, to obtain relief
- Our assessment of ITC administration, in chapter 3, focuses largely on its (1) efforts to provide expedited relief to complainants that need immediate assistance, (2) handling of proceedings when no respondents participate, and (3) authority to issue both exclusion and cease and desist orders to remedy the same unfair trade practice
- Our assessment of Customs Service enforcement of exclusion orders, in chapter 4, addresses whether the ITC should be given the authority to direct Customs to seize counterfeit and infringing goods when enforcing these orders

We made a detailed study of the legislative history of section 337; reviewed ITC implementing regulations, case histories, and the judicial precedents created under the statute; reviewed Court of Appeals for the Federal Circuit decisions regarding ITC procedures; and reviewed Customs' implementing regulations. We examined the testimony and, when available, reports of hearings on government efforts to help firms to protect their intellectual property rights held by the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce; Subcommittee on Trade, House Committee on Ways and Means, and Subcommittee on International Trade, Senate Committee on Finance. We also reviewed numerous legal and other academic studies of ITC administration of section 337 procedures.

We interviewed officials involved in administering section 337, including each of the ITC administrative law judges and commissioners, and representatives of ITC's Office of Unfair Import Investigations and Office of General Counsel. We interviewed Customs Service officials at headquarters and at its regional office in Chicago and reviewed procedures there. We also interviewed attorneys who represented both complainants and respondents in ITC proceedings and met with an official of the Administrative Conference of the United States, which is concerned with improvements in the administrative procedures of federal agencies.

We conducted a survey of firms that have initiated section 337 proceedings (See app. III.) Our universe included all firms that had initiated section 337 proceedings to protect intellectual property rights starting January 1, 1975 and had concluded all litigation as of April 25, 1985. About 71 percent of the 163 firms we surveyed¹³ returned completed questionnaires, 11 percent informed us that the information we were seeking was no longer available, and 18 percent did not respond. For the responses cited in this report, the proportion of respondents indicating that they had no basis upon which to provide answers averaged about 16 percent and in no instance exceeded 26 percent. We held in-depth, follow-up interviews with representatives from 11 firms that provided noteworthy responses to verify and amplify the questionnaire responses.

In addition, we assessed whether changes to section 337 envisioned in recent proposed legislation would be inconsistent with U.S. obligations under the General Agreement on Tariffs and Trade (GATT). The GATT is

¹³We excluded from our survey universe eight firms for which we could not find a current address. These firms represented less than 5 percent of the firms meeting our criteria.

the preeminent multilateral trade agreement and contains provisions governing the manner in which contracting parties may treat imports, including those which infringe intellectual property rights. We interviewed officials of the GATT Secretariat, which administers the Agreement, and reviewed the case history of the one formal GATT dispute involving section 337.

Our review was made in accordance with generally accepted government audit standards.

Agency Comments and Our Evaluation

The Office of the U.S. Trade Representative commented that "Those who have prepared the report have done an excellent job" and expressed its hope that it be released soon. It also suggested that we (1) explain what patents, trademarks, and copyrights are in chapter 1 and interpret the summary data contained in later chapters by type of intellectual property right involved and (2) expand our analysis of the implications of the Administrative Procedure Act on ITC procedures in section 337 cases. As suggested, we have included in chapter 1 explanations of patents, trademarks, and copyrights. However, since none of the legislative proposals to amend section 337 differentiate among patents, trademarks, and copyrights, we did not believe that analyzing our data by type of intellectual property right would contribute materially to deliberations on this matter. We also expanded our discussion of the Administrative Procedure Act in chapter 1, reviewed Court of Appeals for the Federal Circuit decisions regarding ITC procedures, and met with an official of the Administrative Conference of the United States regarding our proposals.

ITC Chairwoman's Comments and Our Evaluation

The ITC Chairwoman¹⁴ commented on the methodology used in this report.¹⁵ Her comments expressed the view that our report "suffers enormously from an absence of balance" and that it "was flawed by basing its conclusions on the perceptions of only the proponents of trade remedies." Specifically, they pointed to the fact that only complainants were surveyed and expressed the view that we based our conclusions solely on their views and did not effectively seek out the views of

¹⁴Ms. Stern's term as ITC Chairwoman expired on June 16, 1986. She was replaced by Commissioner Susan Liebler. Where comments of the ITC Chairwoman are cited throughout this report, they refer to the comments provided by Chairwoman Stern.

¹⁵By statute (19 U.S.C. 1331), "No member of the Commission, in making public statements with respect to any policy matter for which the Commission has responsibility, shall represent himself as speaking for the Commission or his views as being the views of the Commission, with respect to such

“respondents ultimately found not in violation of section 337” and of “third parties who have had their legitimate trade disrupted by Customs’ good faith efforts to enforce . . . exclusion orders ”

These comments on our methodology apparently pertain only to our conclusions and recommendations regarding the economic tests (see ch. 2) and, as such, reflect a misunderstanding of the methodology we used. Our findings and conclusions regarding the economic tests were not based solely on the views of complainants, respondents, or any other participant or non-participant in section 337 proceedings. Nor were they based entirely on the results of our survey, which did not elicit the opinions of complainants regarding the appropriateness of the section 337 economic tests. Our survey was designed primarily to obtain information on the level of counterfeit and infringing goods entering the country during the course of section 337 proceedings and after exclusion orders were issued. We based our findings and conclusions on our review of (1) the legislative history of section 337, (2) the case histories and precedents created since passage of the 1974 trade act amendments, (3) information obtained in interviews with representatives from the ITC’s Office of General Counsel and Office of Unfair Import Investigations, the administrative law judges and commissioners, and attorneys that have represented both complainants and respondents in section 337 proceedings, and (4) information obtained in interviews with representatives from the GATT Secretariat knowledgeable about the Agreement’s provisions regarding protection of intellectual property rights.

These comments expressed general agreement with our conclusions and recommendations regarding ITC administration of section 337 proceedings and Customs Service enforcement of exclusion orders. They stated that our proposals regarding temporary exclusion orders and default proceedings (see ch. 3) provide “a useful foundation for thoughtful discussion” and that our proposal to clarify the ITC’s authority to issue both exclusion and cease and desist orders to address the same unfair trade practice (see ch. 3) is “a good idea and one which has a long history of support at the Commission.” They also commented that “Seizure of counterfeit or infringing goods in situations where there are multiple knowing attempts to import such goods is a constructive idea.” (See ch. 4.)

matter except to the extent that the Commission has adopted the policy being expressed.” We understand that the Chairwoman responded to our draft report without seeking the Commission’s approval or a delegation of responsibility.

Need to Increase Access to Section 337

We support initiatives to increase access to section 337 relief for infringement of intellectual property rights by eliminating or redefining the statute's "economic" tests. These tests require complainants to demonstrate that (1) there is a domestic industry, (2) it is efficiently and economically operated, and (3) the unfair acts of respondents have the effect or tendency to destroy or substantially injure that industry. Because of these tests, holders of valid and enforceable intellectual property rights that are being infringed by imports are denied access to section 337 relief. We do not share the concerns of opponents to the proposed amendments, who argue that resulting changes would create administrative and other problems.

Legislative Support for Amending the Economic Tests in Section 337

Reflecting the increasing use of section 337 to protect intellectual property rights against counterfeit and infringing imports, the proposed amendments to section 337 aim to improve the statute's application to protecting these rights, thus furthering legislative changes begun with the Trade Act of 1974. Among other things, these bills would increase access to section 337 relief for firms experiencing violations of their intellectual property rights by eliminating or redefining the statute's economic tests, which appear inappropriate when associated with protection of such rights. Specifically, these bills would (1) eliminate the economic and efficient operation test, (2) eliminate the domestic industry test or broaden the definition of domestic industry to include, among other things, substantial licensing or research and development activity, and (3) redefine the injury test to make demonstration of infringement of a valid and enforceable U.S. intellectual property right sufficient to constitute injury.

Section 337 contains these economic tests because it was originally intended as a trade statute to protect U.S. workers and firms from all types of unfair foreign trade practices and was not originally intended to be used primarily to protect intellectual property rights. It was enacted in response to unsettled market conditions and the deepening worldwide post-World War I depression to give U.S. firms a means for dealing with all types of unfair acts in international trade. Senator Smoot, a major force behind passage of the statute, described section 316 of the Tariff Act of 1922, the precursor to section 337, as "a dumping law with teeth in it—one which will reach all forms of unfair competition in importation." (Underscoring added.) The use of economic tests for granting relief is common in U.S. trade law for protecting firms and workers against unfair foreign trade practices. As section 337 was originally envisioned, the economic tests ensured that granting relief

was in the best economic interest of the United States by requiring complainants to demonstrate that the unfair trade practice was causing economic injury to a well-managed domestic concern

Congress amended section 337 by the Trade Act of 1974 to improve the statute's application to protecting intellectual property rights. As noted in chapter 1, the 1974 trade act amendments, among other things, imposed a 12- to 18-month deadline for concluding proceedings, authorized the ITC, rather than the President, to determine whether and what types of relief was warranted, subject to Presidential disapproval, required the ITC to accept all equitable defenses, which could include patent misuse and invalidity, and made section 337 proceedings subject to the Administrative Procedure Act and judicial review. But Congress stopped short of amending any of the economic tests. Its focus was on maintaining "public health and welfare and the assurance of competitive conditions," which were not considered to be necessarily synonymous with protecting intellectual property rights. The report of the Senate Committee on Finance emphasized that available remedies were to be weighed against potential harm to the "public interest."¹

Since passage of the 1974 trade act, firms have used section 337 almost exclusively to protect intellectual property rights (See ch 1). In a presentation before a November 1985 Georgetown Law Center conference on intellectual property, a former chief of the ITC's Office of Unfair Import Investigations described section 337 as a

"fast-track litigation of intellectual property rights" in which successful litigants can obtain a general exclusion order, which directs the Customs Service to refuse entry to the infringing products. (Underscoring added)

This trend reflects, in part, the growing importance of intellectual property rights to the international competitiveness of U.S. industry. According to the U.S. Department of Commerce

"U.S. industry and citizens hold more intellectual property than any other country's industry or nationals. In 1983, the United States had a \$4.7 billion favorable balance of payments in licensing and sale of patents, copyrights, and trademarks, compared with an overall negative balance of payments of \$40.8 billion."

¹According to one knowledgeable ITC official, the economic tests help the ITC fulfill this legislative intent. Using these tests, the ITC can weigh the effect of the counterfeit and infringing imports on the public interest and competitive conditions against the potential impact of granting relief.

The Commerce Department went on to state that "Effective protection of intellectual property rights is crucial to the export and sale of products and services by United States industry in foreign markets."

Section 337 Economic Tests Deny Access to Firms Needing Relief

According to knowledgeable officials, the economic tests play no useful role in protecting intellectual property rights. According to certain ITC officials, denying relief to the owners of valid and infringed U.S. intellectual property rights because the owners cannot meet one or more of the economic tests gives to the foreign firms involved "a license to steal" these rights.

Numerous government and private sector officials believe that there is no justification for requiring intellectual property owners to meet economic tests to obtain relief under section 337. Of note, Senator Lautenberg, who has introduced a number of bills to amend section 337, characterized these requirements as "unwarranted hurdles that have blocked relief for a range of American firms."² In testimony before the Subcommittee on Trade, House Committee on Ways and Means, the U.S. Trade Representative stated that the section 337 economic tests "create needless uncertainty for intellectual property rights owners seeking relief."

These tests are not required in other means of obtaining relief against infringement of intellectual property rights. A plaintiff in federal district court need demonstrate only that the right in question is valid and enforceable and has been infringed to obtain relief. Possibly of greater relevance to section 337 proceedings, the U.S. Customs Service has statutory authority to protect registered trademarks and copyrights³ against counterfeit and infringing imports without requiring the owners to meet any economic tests; owners of such rights need not use section 337 but can record them directly with the Customs Service.⁴ This divergence

²Senator Frank Lautenberg, "Modernizing a Weapon Against Counterfeiting," International Anticounterfeiting Coalition Bulletin, September/October 1985, p. 1.

³Trademarks registered with the U.S. Patent and Trademark Office of the Department of Commerce and copyrights registered with the Copyright Office of the Library of Congress or unregistered claims to copyright in works entitled to protection under the Universal Copyright Convention may be recorded with Customs.

⁴Section 337 has been used in rare cases for trademarks that had previously been registered with the federal government, such as in Miniature Plug-in Blade Fuses and in Power Woodworking Tools, Their Parts, Accessories, and Special Purpose Tools.

places owners of intellectual property rights, such as patents,⁵ that cannot be recorded directly with Customs at a comparative disadvantage in obtaining Customs assistance. Amending the section 337 economic tests would not hinder Customs' efforts to enforce exclusion orders.⁶ Once the exclusion order is issued, the economic tests become irrelevant to Customs' enforcement efforts.

In effect, the economic tests in section 337 permit respondents to engage in behavior otherwise proscribed by U.S. law. For instance, patent law gives patent holders (and/or any licensees) 100 percent of the domestic market for products embodying the patents. Denying section 337 relief solely because of inability to meet any of the economic tests allows respondents to violate the patent rights of inventors without permission and without paying compensation. Complainants denied relief because of these tests have no recourse to protect their rights except to initiate lengthy federal district court cases which, as discussed in chapter 1, often do not provide adequate protection against infringing imports. By not fully extending section 337 protection to all valid intellectual property rights infringed by imports, the ITC, according to ITC Chairman Liebler, "reduces the value of these rights and the incentive to invest in developing and producing new products."⁷

Despite Broad Interpretation of Tests, Some Firms Cannot Obtain Needed Assistance

Since passage of the 1974 trade act, the ITC has interpreted the economic tests broadly, thus mitigating their impact. Nevertheless, because of the economic tests, firms have (1) lost section 337 proceedings, (2) terminated proceedings or accepted settlement agreements that they viewed as not in their best interests, and (3) been discouraged from initiating proceedings.

⁵Customs has no statutory authority to operate a recordation system for patents, common law (i.e., unregistered) trademarks, and trade secrets. The Semiconductor Chip Protection Act, which created a *suu generis* type of intellectual property right for mask works (i.e., the pattern on the surface of a semiconductor chip), leaves it up to the Customs Service to decide whether it will require an ITC determination under section 337 before it will protect a mask work.

⁶It is much more difficult to ensure validity and to detect infringement of patents, unregistered trademarks, etc. than for registered trademarks and copyrights. Because the validity of such intellectual property rights may be suspect, Customs needs a judicial or administrative determination that they are valid. Because patents are generally far more complex than trademarks or copyrights and infringement is much more difficult to detect, Customs needs greater evidence that a patent is being infringed. The Department of the Treasury's comments (see app. IV) provide further elaboration on this matter.

⁷Section 337 Newsletter, vol 2, no 5, p 16.

ITC Broadly Interprets the Economic Tests

The ITC has never denied relief to a complainant on the grounds that it was not efficiently and economically operated. According to one prominent attorney, the ITC seems to satisfy itself with a statement that the industry uses "modern manufacturing equipment and processing methods." According to ITC officials, although it developed factors to be taken into consideration in determining whether a firm meets this criterion, the ITC does not seriously consider this requirement. The ITC basically follows the practice of federal district court judges of not second-guessing business decisions that appear to have some rational basis.

The ITC has attempted to interpret the domestic industry test in section 337 to reflect the changing nature of American business. For purposes of section 337, the "industry" can be the company that is bringing the section 337 action, a part of that company, that company and several other American companies or parts thereof, or any combination of these. The issue of what types of activities are needed to satisfy the "domestic industry" test has become increasingly complex as U.S. firms increase their use of foreign sourcing.⁸ Typically, a complainant is selling a product in the United States that is at least partially manufactured abroad. Prior to 1981, the ITC's determinations were interpreted to mean that a substantial domestic manufacturing operation was needed to meet the domestic industry requirement. Since that time, the ITC has broadened the concept of domestic industry, particularly in cases involving trademarks and copyrights, to include, among other things, distribution, research and development, and sales and servicing.

Two landmark cases in this regard are Certain Airtight Cast-Iron Stoves and Certain Cube Puzzles, both of which involved common law (i.e., unregistered) trademarks. Although the complainant in Certain Cast-Iron Stoves, Jotul, Inc., manufactured its stoves in Norway and imported them into the United States, the ITC found that its domestic activities were sufficient to constitute a service industry, noting that in section 337:

"Congress anticipated that the great majority of cases brought under Section 337 would involve manufacturing industries. However, there was some indication that the law was not intended to be limited to the protection of manufacturing industries."

⁸In testimony before the Subcommittee on Trade, House Committee on Ways and Means, in 1983, then ITC Chairman Alfred Eekes reflected the concern of the ITC on this issue by stating that "In the absence of clear guidance from the statute and legislative history, the Commission has been attempting on a case-by-case basis to apply the statute, which was written originally more than 50 years ago, to modern circumstances of trade in which U.S. based firms increasingly source out elements of production to foreign suppliers."

[Text omitted]

“The Senate Finance Committee’s report on the Trade Act of 1974 makes clear that the law’s objective is more than merely the protection of American manufacturers ”

Jotul USA, a wholly owned subsidiary of Jotul, Inc., tested the stoves, made any necessary repairs, and distributed them to local warehouses. In addition, it designed advertising and printed brochures for use by its dealers, prepared a service manual, and instructed its dealers on the safe installation of the stoves. Similarly, the complainant in Certain Cube Puzzles, Ideal, Inc., manufactured its products abroad and imported them into the United States under the trademark “Rubik’s Cube.” However, since it tested and packaged each of the puzzles domestically, the ITC found that Ideal’s domestic operations, which were responsible for half of the puzzle’s value, were sufficient to meet the statute’s domestic industry standard.

The ITC has also found the existence of an industry even where the complainant has not yet established a domestic manufacturing capacity. The statute terms as unlawful “Unfair methods of competition . . . the effect or tendency of which is to prevent the establishment of such an industry . . . in the United States” (Underscoring added.) Consequently, complainants who can demonstrate that they intended to establish a domestic industry are able to obtain relief under section 337. For example, the complainant in Certain Caulking Guns (as of April 1985, the only instance in which a complainant successfully demonstrated prevention of establishment), had been importing its products from a manufacturing plant in Hong Kong. However, it had established a business plan to close that plant and begin domestic production. As proof, it presented to the ITC contractual commitments for obtaining machinery, plant buildings, and staff.

Nevertheless, the ITC continues to closely review the nature and extent of domestic operations in relation to the intellectual property right under consideration and, should they be insufficient, will deny relief. The most notable case in this regard is Certain Miniature Battery-Operated, All-Terrain, Wheeled Vehicles, which, unlike Certain Airtight Cast-Iron Stoves and Certain Cube Puzzles, was based on allegations of patent infringement. In such cases, the Commission traditionally has found a domestic industry only when the patents are “worked” (i.e., used in manufacturing) in the United States. In this case, the ITC determined that the complainant’s operations, which largely involved advertising

and selling activities and adding accessories, were insufficient to constitute a domestic industry and, thus, it denied relief

Lastly, the ITC has been willing to accept small showings of present injury as sufficient to meet the statute's injury requirement. Virtually all government and private sector officials with whom we spoke commented that the injury requirement was extremely low. Of note, the ITC Trial Lawyers Association, in commenting on S.1647 (the "Intellectual Property Rights Enforcement Amendments of 1985"), one of the bills introduced to amend section 337, characterized the injury requirement as "easily satisfied."

The ITC bases this policy on the statutory language in section 337 that the complainant need show only that the unfair trade act would have a "tendency" to substantially injure the domestic industry.⁹ Thus, the injury need not be an accomplished fact. For instance, the findings of injury in Certain Trolley Wheel Assemblies and in Amorphous Metals were based upon the fact that respondents had provided samples of their products to potential customers so that their products could be inspected and ultimately sold in the United States. Similarly, the finding of injury in Reclosable Plastic Bags was not based upon a showing of present injury, at the time of the ITC's determination, imports never represented more than 1.5 percent of domestic annual consumption and the complainant's business was very strong. During 1970-75, the complainant's sales of the domestic product rose from 145.8 million units to 1.1 billion units, production increased from 173.4 million units to 1.1 billion units, and employment increased from 52 workers to 130 workers. Rather, the determination was based upon the existence of sufficient manufacturing capacity overseas to injure the complainant and evidence that respondents intended to market infringing products in the United States.

⁹This policy is supported by the legislative history of section 337 and by decisions of the Court of Appeals for the Federal Circuit. The Committee on Ways and Means report on the Trade Act of 1974 amendments which eventually became the current statute stated that "Where unfair methods and acts have resulted in conceivable losses of sales, a tendency to substantially injure such industry has been established." (Underscoring added.) The Court of Appeals for the Federal Circuit concluded in Bally/Midway that, where the unfair practice is the importation of products that infringe an intellectual property right, "even a relatively small loss of sales may establish the requisite injury." More recently, the Court of Appeals concluded in Textron, Inc. v. U.S. ITC that "in the context of patent, trademark or copyright infringement, the domestic industry must normally establish that the infringer holds, or threatens to hold, a significant share of the domestic market in the covered articles." (Underscoring added.)

**Economic Tests Bar Firms
From Obtaining Section 337
Relief**

Despite this broad interpretation, some holders of U.S. intellectual property rights who seek relief from counterfeit or infringing imports are denied access to section 337 relief due to their inability to meet one or more of these economic tests. Company officials with whom we spoke told us that their firms have been injured, sometimes severely, by their inability to obtain section 337 relief against counterfeit and/or infringing imports. In addition to lost royalties, firms have lost sales and have decreased the number of persons they employ due to these imports.

Since the 1974 trade act amendments, 11 firms have been unable to meet all the economic criteria and 6 of them were denied relief solely for this reason¹⁰ (See fig 2.1). Firms were unable to meet the economic tests for several reasons. They could not meet the injury requirement largely because they could not demonstrate (1) injury or a potential for injury or (2) a causal relation between the infringing imports and lost sales and employment. Firms were unable to meet the domestic industry criterion usually because they maintained a substantial portion of their production and related facilities overseas or because the goods produced in the United States were not covered by the patents in question. One such firm is Schaper Manufacturing Co., the complainant in Certain Miniature Battery-Operated, All Terrain, Wheeled Vehicles. Because it lost its case, Schaper accepted a licensing agreement with the foreign respondent. This agreement required the respondent to pay a royalty to Schaper at a rate that was considerably lower than the toy industry's normal royalty rate. A company official told us that, because of the ITC decision, Schaper has lost millions of dollars in sales to foreign infringers of its patent.

¹⁰In a paper prepared for a Practising Law Institute conference on litigating section 337 cases, an attorney advised that "a respondent who decides to litigate [a section 337 case] should devote major effort to the economic issues" and that "building the economic side of the case should be the first order of business."

Table 2.1: Section 337 Cases in Which Complainants Did Not Meet All Economic Criteria (Jan 1975 to Jan 1986)

Case Number	Complainant	Title of Proceeding	Date of Determination	Final Determination
337-TA-010	American Optical Corp	Ultra-Microtome Freezing Attachments	April 1976	No domestic industry
337-TA-026	Solder Removal Co	Solder Removal Wicks	July 1977	Patent invalid, other unfair acts cause no substantial injury
337-TA-045	Presto Lock Co	Combination Locks	February 1979	No substantial injury
337-TA-049	Samsonite Corp	Attache Cases	March 1979	No substantial injury
337-TA-103	Western Marine Electronics, Inc	Stabilized Hull Units and Components Thereof	June 1982	One patent claim invalid, another not infringed, no domestic industry
337-TA-116	Illinois Tool Works, Inc	Drill Point Screws for Drywall Construction	March 1983	No infringement, no substantial injury
337-TA-122	Schaper Manufacturing Co	Miniature, Battery-Operated, All Terrain, Wheeled Vehicles	October 1982	No domestic industry
337-TA-164	R C Dudek & Co, Inc	Modular Structural Systems	June 1984	Importation stopped, no domestic industry
337-TA-189	Corning Glass Works	Optical Waveguide Fibers	April 1985	No substantial injury
337-TA-198	Texas Instruments, Inc	Portable Electronic Calculators	June 1985	No infringement, no domestic industry
337-TA-201	Warner Bros, Inc	Products With Gremlins Character Depictions	January 1986	No domestic industry

Source: International Trade Commission

These 11 cases may be only part of the story. Firms have terminated proceedings or accepted settlement agreements that they judged not in their best interests because they could not meet all the economic criteria. One such firm is I P Container Corporation, the complainant in Plastic Molding Apparatus. According to a company official, this company accepted a settlement agreement which was not judged to be in its best interest because it did not believe it would meet the domestic industry and/or injury requirement. The company used its allegedly infringed patent in machinery used to manufacture containers, it did not sell the machinery itself. Consequently, since the imported machinery did not directly compete with any product sold by I.P. Container, the ITC staff attorneys advised the company that it would probably be unable to meet either the domestic industry or injury requirement. As a result, this company accepted a settlement agreement with the foreign respondent which required the foreign firm to pay I.P. Container a modest licensing fee plus a small indemnity that did not even cover I.P. Container's attorney fees. The existence in the domestic marketplace of foreign-made machinery has limited the company's ability to license its patented equipment to other producers. A company official told us that, because it did not prevail in its section 337 case, I.P. Container is losing millions

of dollars in licensing fees annually and must face stiffer domestic competition from other domestic firms using the allegedly infringing equipment

Other firms may be discouraged from even initiating section 337 proceedings because of these tests. There is no way to determine precisely the number of firms that have been so affected. Nonetheless, several attorneys who regularly litigate section 337 proceedings and ITC staff attorneys told us that they were aware of numerous firms that decided not to initiate proceedings, apparently because they did not believe they could meet all of the economic tests. One such firm is a sporting goods company that manufactures a patented product that it alleges is being copied by several Taiwanese producers. These firms are exporting the allegedly infringing products to the United States and selling them at a lower price, often in major sporting goods retail outlets. To compete with these imports, the patent holder has attempted to reduce its production costs by moving much of its manufacturing operations from the United States to Taiwan. As a result, the firm is reluctant to initiate a costly section 337 proceeding, fearing that it will not meet the domestic industry requirement.

The cost of section 337 proceedings compounds reluctance to initiate these proceedings, especially for smaller firms. According to our survey, most section 337 proceedings that are litigated to final determination cost between \$100,000 and \$1 million, with a few costing over \$2.5 million. Attorneys knowledgeable about section 337 litigation charge about \$125 to \$150 an hour. Since the litigation is compressed into a one year period, law firms often have to devote more attorneys to section 337 cases than to similar district court cases. Thus, section 337 complainants bear litigation costs that are roughly equivalent to district court costs but in a much shorter period of time. In addition, to adequately represent their clients, attorneys must hire expert witnesses, who charge as much as \$250 an hour. We were told that some expert witnesses command as much as \$4,000 a day.

Economic Tests Create Other Problems

The need to meet the economic tests also creates other problems. It adds substantially to the overall cost of litigating a section 337 proceeding. Some attorneys with whom we met estimated that these costs can equal as much as 50 percent or more of the cost of litigating the proceeding. Litigating the economic criteria also requires the sharing of large amounts of sensitive business information with outside legal counsel representing respondents. Although the administrative law judges can

issue broad protective orders aimed at ensuring that this information is not misused, complainants with whom we met were wary of sharing such information with attorneys representing their competitors, fearing that it may be compromised.

Objections to Amending the Economic Tests

Several officials, most notably from the ITC Trial Lawyers Association, object to amending the economic tests, claiming that such action will, among other things,

- thrust upon the ITC the role of a patent, trademark, and copyright court,
- allow foreign firms to use section 337 to initiate cases against other foreign firms as well as U.S. firms, and
- bring into question the consistency of section 337 with U.S. obligations under GATT

Eliminating the Efficient and Economic Operation Criteria Generally Approved

There is substantial support for eliminating the requirement that the complainant demonstrate that it is efficiently and economically operated. Meeting this test is an unnecessary expense for litigants and the ITC. Former ITC Chairman Alfred Eckes testified in 1983 before the Subcommittee on Trade, House Committee on Ways and Means, that this criterion should be eliminated, stating that:

“Despite more than 50 years of experience with litigation concerning this phrase, the Commission has never found a complainant not to be ‘efficiently and economically operated.’ Nonetheless, there has been considerable expense to parties and the government in almost every case due to the discovery of facts related to the issue, trial presentation, briefing, and consideration by the administrative law judge and the Commission.”

In 1985, the American Bar Association’s Committee on Patent, Trademark, and Copyright Law resolved that this requirement should be eliminated, stating that

“the time and costs to the parties to an ITC proceeding and the time and expense of the Commission staff are being wasted in accumulating and considering evidence related to an issue that has never been found determinative of an outcome of a Section 337 proceeding.”

Private sector officials with whom we met shared these views. Some observers, however, did not believe that this test should be entirely eliminated. Some ITC officials suggested making it part of the public interest considerations. The ITC Trial Lawyers Association suggested

that the test be maintained in the statute but effectively eliminated from a substantive role by creating a presumption of efficient and economic operation if the complainant meets the domestic industry test

Others familiar with section 337 litigation believe that, if the efficient and economic operation criterion was eliminated as a separate requirement, it would only reappear in litigation surrounding the injury requirement. In effect, respondents would argue that the injury incurred by the complainant was self-inflicted by inefficient and uneconomic operation. For instance, in Meat Deboning Machines, the administrative law judge found that the complainant did not meet the injury criterion because the firm lost sales largely due to inefficient operation, as opposed to infringement of its patent

Amending the Remaining Tests Raises Opposition

Eliminating the domestic industry test and redefining the injury test would have a much greater impact on the administration and use of section 337 than would removing the efficient and economic operation test. Some officials believe that, should either or both of these criteria be amended, the ITC, an international trade agency expert in investigating the impact of foreign competition on U.S. industry, may not be the proper forum for adjudicating intellectual property disputes

We see no compelling reason for moving adjudication of section 337 intellectual property cases out of the ITC should the economic tests be amended. The ITC is generally viewed as doing a good job of administering section 337 proceedings. As an independent, non-partisan, fact-finding body with a built-in appeal level, the ITC would continue to be an appropriate forum for adjudicating section 337 disputes. The ITC, particularly its commissioners, administrative law judges, Office of General Counsel, and Office of Unfair Import Investigations, has developed expertise in adjudicating disputes involving intellectual property rights through over a decade of experience with section 337 litigation since the 1974 trade act amendments. In addition, it has decades of experience in addressing unfair trade practices, which would continue to be the basis for section 337 complaints. It would be difficult to move that expertise to another agency, particularly since the individuals involved often have responsibilities other than section 337 as well. Further, the ITC's experience places it in a strong position to make "judgement calls" in cases where overriding public interest considerations require denying relief to complainants that otherwise warrant relief

The other potential forums that have some experience in the intellectual property area do not share all the qualifications of the ITC. The federal district courts are already overburdened and, without substantial additional resources, would experience considerable difficulty meeting the one year statutory deadline. The Patent and Trademark Office may suffer from the appearance of conflict of interest. It would be forced into the position of adjudicating the validity of patents and trademarks that it had issued in the first place. Also, the Patent and Trademark Office is part of the Department of Commerce, foreign concerns may question whether Commerce, which represents American business in government and international deliberations, could fairly adjudicate disputes between U.S. and foreign concerns.

Opponents of amending the economic tests argue that this change would make federal district court intellectual property proceedings and ITC section 337 proceedings virtually identical and duplicative. They add that, the more nearly identical the two proceedings are, the more likely it is that, in situations involving concurrent litigation in both forums, the district court will grant a motion to enjoin the ITC from continuing with its proceedings. We do not agree. As we discussed in chapter 1, 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. Even if the economic tests were amended, there are sufficient differences between district court and section 337 litigation to warrant the existence of two separate forums.¹¹

While it is not possible to foresee district court response to an amended section 337, the differences between district court proceedings and an amended section 337 would appear to be sufficient to give district court judges a basis to deny motions to enjoin the ITC from continuing with a section 337 proceeding.

Another argument is that, in addition to opening section 337 to U.S. firms presently unable to meet this test, eliminating the domestic industry test would allow foreign concerns to use section 337 against other foreign concerns and U.S. firms. Such a change would, at least,

¹¹Chief Judge Murray Schwartz wrote in his decision In Re Convertible Rowing Exerciser Patent Litigation that

"The ITC is confronted with the necessity of making a 'determination' as to the validity, infringement, and where applicable, enforceability of patents. This overlap of issues is where the similarity ends. The two proceedings have different jurisdictional foundations, different final adjudications, different purposes, different proof, different time constraints, different remedies, and different issues on appeal." (Underscoring added.)

increase the ITC's workload. Of possibly greater importance, some officials believe that the ITC would be "wasting its time" adjudicating cases in which U.S. firms and workers do not stand to benefit. Worse yet, they envision a potential situation where a foreign firm uses section 337 to stop a U.S. firm from importing infringing products destined for use in domestic assembly operations, thus possibly decreasing production and employment in the United States.

While we agree that eliminating the domestic injury criterion would most likely increase the ITC's workload, we do not share the concerns regarding use of section 337 by foreign firms. Such a change may entail increased administrative costs for the ITC and potential loss of production and employment associated with allowing foreign firms to use section 337. However, its primary aim is to strengthen the U.S. economy and intellectual property system by increasing access to protection available under section 337. We support the argument that foreign firms deserve protection under section 337. By patenting an invention in the United States, a foreign firm has performed a service for the U.S. public by (1) publicly disclosing information on its invention so that U.S. firms can use the innovation in their own research and development and (2) most likely, making a product embodying that innovation available to U.S. consumers. In exchange, this firm should be given opportunity to protect its statutory monopoly over use of the invention, including use of section 337 to protect it against foreign infringement. 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. Improving protection for all patent holders should also strengthen the ability of the U.S. government to encourage foreign governments to strengthen their own protection of intellectual property rights.

In a sense, the domestic industry criterion of section 337 serves as a disguised "working requirement"—a non-tariff barrier often used by developing countries to generate domestic production and employment. This policy generally requires that a firm must "work" (i.e., use in manufacturing) a patent, or other intellectual property right, domestically 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 inventor without receiving authorization or paying compensation.

Opponents also argue that redefining the injury test may raise the issue of whether section 337 is consistent with GATT rules on measures to protect intellectual property rights. Article XX(d) of the GATT permits member countries to take measures otherwise inconsistent with the Agreement to secure compliance with intellectual property rights laws and regulations as long as the (1) laws and regulations in question are not themselves inconsistent with the Agreement, (2) measures taken to secure compliance are “necessary” for this purpose, and (3) measures are not applied in a manner that would constitute a disguised restriction on international trade or are implemented in a manner that discriminates between or among other members of the Agreement.

While it is not possible to project the outcome of a GATT dispute settlement procedure on a revised section 337, we do not have the same sense of concern. We also understand that the Office of the U.S. Trade Representative has reviewed this matter and found that eliminating the domestic industry and injury tests would not give rise to GATT violations. The first GATT criterion for measures to protect intellectual property rights pertains to the intellectual property laws and regulations themselves and not to the measures used to enforce them. While section 337 is used to remedy violations of U.S. intellectual property laws, it is distinct from these laws. Thus, redefining the injury test would not affect the GATT consistency of U.S. intellectual property laws and regulations.

The GATT panel decision on the one dispute settlement case involving section 337 indicates that redefining the injury test would also not violate the second GATT criterion. In that case, which involved the exclusion order issued in Certain Automotive Spring Assemblies, the GATT panel did not define “necessary” in terms of the quantum of injury; indeed, it characterized the section 337 injury test as “irrelevant.” Instead, the panel defined “necessary” in terms of the inability to effectively address imports of infringing goods through the federal district courts. The panel’s final determination stated that

“it was the view of the Panel that United States civil court action would not have provided a satisfactory and effective means for protecting [the complainant’s] patent rights against importation of the infringing product. For the above reasons, therefore, the Panel found that the exclusion order issued under Section 337 of the United States Tariff Act of 1930 was necessary in the sense of Article XX(d) to secure compliance with United States patent law.”

Specifically, the GATT panel found that the issuance of a section 337 exclusion order was necessary because a district court remedy (see ch 1) could not reach the large number of foreign firms that could potentially

produce the spring assemblies in question. The panel went on to state that it could envision a situation where a section 337 exclusion order might not be necessary but the situation outlined by the panel is just as likely to occur at present as if the economic tests were amended

“The Panel did not, therefore, exclude the strong possibility that there might be cases, for example, involving high-cost products of an advanced technical nature and with a very limited number of potential users in the United States, where a procedure before a United States court might provide the patent holder with an equally satisfactory and effective remedy against infringement of his patent rights. In such cases the use of an exclusion order under Section 337 might not be necessary in terms of Article XX(d) . . .”

The GATT panel decision also indicates that amending the injury test would not violate the third GATT criterion. The GATT panel found that the exclusion order in the Spring Assemblies case was not applied in a manner that would constitute a disguised restriction on legitimate international trade nor did it discriminate between or among other countries. The panel noted that “before an exclusion order could be issued under Section 337, both the validity of a patent and its infringement by a foreign manufacturer had to be clearly established.” It noted that notice of the exclusion order is published in the Federal Register and the order is enforced by the U.S. Customs Service at the border. The panel further noted that, since “the exclusion order was directed against imports of [an article] produced in violation of a valid U.S. patent from all foreign sources” and not just a particular country, it “was not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination . . .” Redefining the injury test would not affect the need to demonstrate that a valid intellectual property right has been infringed or the manner in which exclusion orders are enforced.

Conclusions

Because of the economic tests contained in section 337 of the Tariff Act of 1930, as amended, some U.S. firms with valid and enforceable intellectual property rights are being denied government assistance in stopping imports of counterfeit and infringing goods. Section 337 contains these requirements because it was originally intended as a broad trade statute to protect U.S. industry against unfair foreign competition and not to protect intellectual property. While the ITC has interpreted these tests broadly, U.S. firms that otherwise would warrant government assistance continue to be denied relief. Although we recognize that some officials believe such a change may create problems, we support congressional initiatives to increase access to section 337 by amending the economic tests.

Recommendation

We recommend that Congress amend section 337 of the Tariff Act of 1930 for cases involving intellectual property rights to (1) eliminate the requirement that a complainant be efficiently and economically operated, (2) eliminate the domestic industry requirement, and (3) redefine the injury requirement so that ownership of a valid and enforceable U.S. intellectual property right and proof of infringement by imports is sufficient to meet the injury test. Appendix I contains specific legislative language for this recommendation.

Agency Comments and Our Evaluation

The Department of the Treasury, the Customs Service's parent agency, in its comments on a draft of this chapter, stated that it "implies that Customs has discretion with regard to [requiring firms recording trademarks and copyrights to meet economic tests]." Treasury suggested that we revise the draft to make clear that "for trademarks and copyrights different provisions of law are being enforced." We have revised this report accordingly.

ITC Chairwoman's Comments and Our Evaluation

The ITC Chairwoman commented on our conclusions and recommendations regarding the economic tests. Her comments expressed the view that "Although the efficient and economic operation requirement could usefully be converted to one of the public interest factors—elimination of the domestic industry and injury requirements would be ill-advised."

These comments expressed the view that amending the economic tests would limit the effectiveness of section 337 in encouraging domestic entrepreneurial activity. They stated that "Under the present statute, the Commission must weigh both the public interest served by protecting intellectual property and that served by fostering the entrepreneurial activity which exploits the intellectual property." They added that this latter consideration is as important as protecting intellectual property rights since "Society does not obtain the maximum benefit from protecting intellectual property unless the property is exploited. It is such production-related activity that spawns economic growth."

Compared to the macroeconomic factors affecting entrepreneurial activity in the United States, the impact of section 337 is small. Still, we believe that an amended section 337 could enhance the ability of the U.S. intellectual property protection system to encourage innovation and entrepreneurial activity. It is very unclear how maintaining the economic tests in their present form and, thus, denying effective relief to

some owners of valid intellectual property rights that are being infringed by imports, can be seen as encouraging domestic exploitation of those rights. In contrast, we believe that the section 337 economic tests, by constraining government protection of intellectual property rights against counterfeit and infringing imports, limits the effectiveness of the U.S. intellectual property rights protection system as an incentive for firms to develop, produce, and market new products

These comments also expressed the view that our "recommendation to eliminate the domestic industry and injury requirements also raises serious trade policy concerns." They pointed out that "Intellectual property issues will be on the agenda for the new round of trade negotiations to be held under the auspices of the General Agreement on Tariffs and Trade." The comments stated that amending the economic tests would alter the substance of the statute and thereby remove protection it now has under the Agreement's grandfather clause. Thus, they concluded that "common sense dictates that this should be done in the context of the GATT negotiations so the United States can obtain concessions from its trading partners in return." Whether the United States should unilaterally amend the economic tests or do so in the context of the upcoming trade negotiations was beyond the scope of our review. It can be best addressed by the Office of the U.S. Trade Representative, which has primary responsibility for representing the United States in GATT negotiations. During recent testimony in support of removing all of the section 337 economic tests, the U.S. Trade Representative did not indicate that they should be removed as part of the upcoming round of trade negotiations.

These comments also expressed some concerns that we have already addressed in the chapter section dealing with objections to amending the economic tests. They stated that amending the economic tests as we recommend would "transform the Commission into a forum for the adjudication of intellectual property rights" and cause the Commission to "spend the bulk of its time refereeing disputes among importers jockeying for market share in the United States." They added, "One might argue that a jurisdiction of this nature would be better placed in the federal district courts." Our evaluation of these comments are contained on pp. 32 to 37.

Need to Improve ITC Administration of Section 337 Proceedings

Experience since passage of the 1974 Trade Act amendments demonstrates that section 337 protection of intellectual property rights could be more effective if the ITC could (1) speed the provision of relief to firms that need expedited government assistance and when no respondents participate in the proceedings and (2) issue both exclusion orders and cease and desist orders to remedy the same unfair trade practice. We support initiatives to speed the provision of relief but suggest some changes to proposed amendments to section 337 to give the ITC sufficient time to develop a record and better protect the due process rights of respondents. We also support initiatives to authorize the ITC to issue both exclusion and cease and desist orders to remedy the same unfair act.

ITC Needs to Speed Expedited Relief

During the time it takes the ITC to provide relief to complainants that require immediate assistance, respondents can flood the U.S. market with infringing goods, undermining the intent and effectiveness of the expedited relief. We believe that the time frame for providing such relief can be reduced by almost half while still giving the ITC at least as much time as it now has to determine whether relief is warranted.

Section 337 Authorizes the ITC to Provide Expedited Relief

Complainants seek expedited relief when they believe that continued imports of the counterfeit or infringing product during the course of the proceedings would severely undermine the effectiveness of the permanent relief. Respondents often use the one year time period for final determinations to flood the domestic market with the infringing goods. At an April 1985 Practising Law Institute conference on section 337, an attorney representing respondents recommended that they:

“consider ‘stockpiling’ exports to the United States, i.e., increase the level of imports into the United States on a basis that gets them into the stream of commerce as fast as possible.”

By the time the ITC issues its final determination, the exclusion order, in the words of one trade association official may be “too little, too late;” the respondent may have already caused the complainant substantial economic loss from which it may not be able to recover. Counterfeit and infringing imports can be particularly damaging when the product embodying the intellectual property right has a short market life, as do many high-technology products. Because the ITC cannot require respondents to pay monetary damages to complainants, the latter have no way, other than through lengthy and costly district court proceedings, to

recoup losses that occurred during the course of the section 337 proceeding. Thus, some method for obtaining expedited relief is needed.

Section 337(e) authorizes the ITC to provide relief prior to the issuance of a final determination, unless such relief would not be in the public interest

“If, during the course of an investigation under this section, the Commission determines that there is reason to believe that there is a violation of this section, it may direct that the articles concerned be excluded from entry into the United States, unless, after considering the effect of such exclusion upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers, it finds that such articles should not be excluded from entry ” (Underscoring added)

To obtain such relief, which is at the discretion of the ITC, a complainant must specifically request it in a separate motion accompanying the petition initiating the proceeding and must participate in a separate proceeding before an administrative law judge.

The ITC has interpreted the provision so that the “reason to believe” standard is used as only a threshold, after which complainants must meet a strict four-part balancing test similar to that used in federal district court for issuing temporary injunctive relief. If the ITC were to rely solely on the reason to believe standard, virtually every complainant would seek temporary relief, overburdening the ITC’s administrative capacity and relegating the hearing for permanent relief to a secondary position. In making the initial determination, the administrative law judge balances the following four factors

1. Likelihood that the complainant will prevail on the merits
2. Possibility of immediate and substantial harm¹ to the complainant if temporary relief is not granted.
3. Prospective harm to the respondent if temporary relief is granted.
4. Prospective effect on the public interest if temporary relief is granted

¹In Slide Fastener Stringers, the ITC further defined “substantial harm” as being demonstrated by evidence showing that the domestic industry would be unable to recover fully from an alleged unfair act even if permanent relief were to be granted

As noted in chapter 1, expedited relief virtually always takes the form of a temporary exclusion order.² Such orders are in effect while the ITC conducts its proceedings on the provision of permanent relief. They do not stop the importation of the alleged infringing goods but, in accordance with the statute, require importers to post a bond with the Customs Service in order to bring into the country goods covered by the order. The value of the bond is not to be punitive but is supposed to be set at a level that offsets the competitive advantage enjoyed by the importer. Should the temporary order be made permanent, the importer would have to re-export or destroy goods brought in under the order or forfeit the bond.³

**ITC Time Frame for
Providing Expedited Relief
Undermines Its
Effectiveness**

The ITC presently takes as much as 7 months or longer to provide expedited relief.⁴ ITC regulations allow 4 months for the administrative law judges to hold a hearing and make an initial determination. They allow 30 days for the Commission to determine whether or not to review an initial determination and, if the decision is affirmative, an additional 60 days for the Commission's final determination.

The administrative law judges believe that they need 4 months to make an informed decision. Intellectual property cases, particularly patent litigation, are often very complex. Since they are making a decision on only part of the record, the judges are concerned about issuing temporary relief that subsequently may be overturned, unfairly damaging the ability of respondents to sell legitimate products in the United States. As a result, the judges may allow a fuller development of positions than is required by the Administrative Procedure Act. The Act requires only that the judges hold a hearing at which the parties have the opportunity to "present their case by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross examination as may be required for a full and true disclosure of the facts," such as when there are disputes regarding issues of fact. According to participants, the

²As of April 1985, the ITC has issued only one temporary cease and desist order, in Coin-Operated Audio-Visual Games.

³The importer does not actually pay the full cost of the bond but purchases a type of insurance policy from a bonding firm for a fraction of the cost of the bond. The bonding company then posts the full cost of the bond. If the temporary exclusion order is made permanent and the importer is unable to either re-export or destroy the goods brought into the country under the bond, the bonding firm forfeits the full cost of the bond. This firm will then attempt to recover this money from the importer.

⁴In addition to this 7-month time frame, attorneys representing complainants take months to prepare the case prior to going to the ITC.

judges often hold full evidentiary hearings in which positions are developed as fully as in proceedings for permanent relief.

Many see this 7-month time frame as inordinately long, especially in light of the one-year deadline for providing permanent relief. Commenting on the provision of temporary relief in Certain Double-Sided Floppy Disk Drives, a recently concluded temporary relief proceeding, one attorney in a paper prepared for an October 1985 meeting of the ITC Trial Lawyers Association noted that

“In the context of a one-year statutory deadline for a final decision on the merits, it seems ludicrous that determination on [temporary relief] would consume fully three-quarters of the Commission’s allotted investigation period ”

In this case, the ITC did not make its determination on the issuance of temporary relief until 11 months after the complainant had filed the complaint and 9 months after the ITC had formally instituted the proceedings

During this time period, respondents can flood the domestic market with the infringing goods, thus undermining the effectiveness of the temporary exclusion order. Each of the firms receiving temporary relief that responded to our survey (all but one of the firms receiving temporary relief during the time frame of our survey) claimed 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 \$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. Specifically, it commented that “[Our] pricing was totally destroyed. Our credibility was severely impaired. Customers became confused, many stopped buying altogether.” Another firm that did not receive temporary relief commented that it terminated the temporary relief proceedings because the respondents had imported enough of the product in question during the proceedings to meet domestic demand for the next 5 years.

Further, this lack of timeliness discourages firms that need expedited government assistance from seeking it. Many such firms forego requesting it, preferring to wait the 5 additional months for a permanent exclusion order. In the first 215 cases initiated since January 1975, only 14 complainants participated in temporary relief proceedings and only 5 of them received expedited relief. Of the firms responding to our survey,

nearly 80 percent of those that did not initiate temporary relief proceedings reported that they needed expedited relief. Of these firms, nearly half of those that believed they could meet the temporary relief criteria cited the time required to obtain temporary relief as the major reason why they did not seek it

Over 90 percent of our survey respondents that received permanent relief but chose to forego expedited relief reported that they were injured by infringing imports during the course of the proceedings. Of these firms that indicated they had a basis to judge, nearly 85 percent reported losing over \$100,000 in sales during the course of their section 337 proceedings, with about 35 percent of them reporting sales losses of over \$1 million. One firm commented that "by the time relief was granted, the imported products had so injured the domestic market that there was no longer any market." In addition, nearly 75 percent of these firms that indicated they had a basis to judge reported that these imports damaged consumer confidence in their products to at least some extent, with 65 percent of them stating that consumer confidence was damaged from a moderate to very great extent

GAO Supports Intent of Legislative Initiatives but Suggests an Alternative Solution

The proposed amendments to section 337 would shorten the time available for making a determination on a request for expedited relief. Most of them require the ITC to make a determination on a request for temporary relief within 90 days from the date the petition is filed with the ITC, while authorizing it to require complainants to post bond. H.R. 4800, which was passed by the House, would give the ITC 90 days from the date of institution to make a determination, while authorizing it to extend the 90-day period for an additional 60 days in cases designated as more complicated

The rationale behind these proposals is that, if the complainant is required to post bond and thus share in the monetary stake in the final determination with the respondents, the administrative law judges would be more willing to issue affirmative initial determinations on temporary relief with less information. This bond, which in the ITC Chairwoman's opinion (see app V), should be payable to respondents if they ultimately prevail, would probably equal the estimated injury that the respondent would incur from the time the temporary relief became effective until the final determination. As a result, the judges would be able to make their determination quicker, decreasing the cost of the litigation. Under the proposed amendments, respondents would continue to

post bond to bring goods covered by a temporary exclusion order into the country.

Knowledgeable officials, including those of the ITC Trial Lawyers Association, have commented that requiring the ITC to make a determination on temporary relief within 90 days from the date it receives the petition would not give it sufficient time for an informed decision, especially in complex patent cases. Assuming that the ITC takes one month to formally institute proceedings and the Commission needs one month to make its final determination, it leaves the administrative law judges one month to hold hearings and make an initial determination. Donald K. Duvall, former chief ITC administrative law judge, remarked before the National Council of Patent Law Associations that “this proposed 90-day time frame for complete adjudication of a temporary relief request is too short and unworkable” and that the time allotted to the judge is “insufficient . . . to make a fair determination in writing, based on the submissions and affidavits of the parties much less conduct a mini-hearing after limited discovery by the parties . . .”

The proposed change may, in practice, substantially reduce the likelihood of receiving temporary relief. According to the ITC Trial Lawyers Association,

“A 60-day time limit [from institution to final determination] would make it extremely difficult for complainants to prevail in patent-based cases. [A] complainant would rarely have sufficient time to meet [the high standards for issuance of temporary relief in patent cases] in 60 or even in 90 days.”

The Association adds that “the short time period would also work a substantial hardship on respondents, as respondents would be unable to prepare a defense to validity and infringement in such a short period of time.” Thus, if required to make their initial determination in 30 days, the judges may be even more reluctant than they are presently to issue an initial determination supporting the provision of temporary relief.

Requiring the ITC to make temporary relief determinations in 90 days would create a situation similar to that of federal district court. A district court judge can issue a preliminary injunction in about 30 days. However, according to patent attorneys with whom we met, such injunctions are virtually impossible to obtain. A district court judge will issue a preliminary injunction only if the patent had been previously litigated in district court and found to be valid. While ITC judges, on rare occasions, have been willing to issue affirmative initial determinations on

temporary relief for patents that have not been previously litigated, as was the case most recently in Certain Double-Sided Floppy Disk Drives and Components Thereof, reducing the time for making an initial determination to 90 days may make such findings nonexistent in the future.

H.R. 4800 addresses this problem in two ways. First, it requires the ITC to make a determination on expedited relief within 90 days from the date of institution of an investigation rather than from the date the complaint is filed. Second, it authorizes the ITC to extend the 90-day deadline for an additional 60 days in cases deemed to be more complicated. The first provision could, in effect, extend the time available to the administrative law judge by 30 days. This is a step in the right direction but even 60 days is probably inadequate to make a determination on most requests for expedited relief. This time frame could be extended in a case deemed more complicated by an additional 60 days, potentially increasing the time available to make the initial determination to 4 months, the current standard. However, the Commission has been reluctant in the past to deem cases as more complicated.

We believe that this problem can be addressed in a way that would reduce by about 3 months the present 7-month time frame for providing relief in all cases involving requests for expedited relief, without reducing the time the administrative law judge presently has under ITC regulations to hold a hearing and make an initial determination. We propose that, at the request of the complainant, the ITC make temporary relief effective within 10 days of the Commission's receipt of a judge's affirmative initial determination on temporary relief unless it finds that such action would be contrary to the public interest. The Commission could then review the initial determination in accordance with its current procedures. To ensure that complainants do not unfairly benefit should the temporary relief determination be overturned, the complainant in such instances should be required to post bond. This proposal, in effect, would create a faster temporary relief procedure whereby a complainant experiencing sufficient injury to be willing to post bond can obtain temporary relief about 4 months from the date of institution. A complainant deserving of temporary relief but unwilling to post bond could still obtain temporary relief through the traditional 7 month procedure. We recognize that this proposal is a departure from normal ITC practice. At present, the Commission has the right to review and accept, reject, or amend the administrative law judge's initial determinations on temporary and permanent relief. We believe, however, that this modification is necessitated by the seriousness of the injury being experienced by firms needing temporary relief.

In addition, the Commission might be able to expedite the issuance of final temporary relief determinations by making its review of the initial determinations automatic. It presently takes about 30 days to decide whether it will review an initial determination and another 60 days to make the review. According to a knowledgeable ITC official, since the Commission virtually always decides to review initial determinations on temporary relief, it could bypass the 30-day procedure without hindering its operations.

ITC Needs to Speed Relief in Default Cases

The ITC needs to speed the provision of relief to complainants in section 337 cases when no respondents participate. Since the 1974 Trade Act amendments, there have been 40 cases in which no respondents participated. The ITC generally takes the full year to complete such "default" proceedings, during which time named respondents can continue to bring infringing goods into the country. We support the intent of legislative initiatives to speed the provision of relief in such cases but suggest modifications.

ITC Requires Evidence to Issue Relief in Default Proceedings

Under present regulations, a respondent can be found in default if, among other things, it fails to (1) file a response to the complaint, (2) appear at a hearing before the administrative law judge on the issue of violation of section 337, or (3) respond to a motion for summary determination. Such a ruling allows the administrative law judge to reach a determination without the participation of defaulting respondents. Before finding respondents in default, the judge will take certain precautions to ensure that they received notice of the section 337 proceeding and chose not to attend.

It is not uncommon for only some respondents (i.e., firms who have been served notice) to participate in the section 337 proceeding. Many may be small firms unable to afford the litigation costs. A relatively large firm sometimes presents the case for all foreign concerns. In such cases, the administrative law judge finds the nonparticipating respondents in default but the ITC takes no remedial action against them until it makes its final determination on the case. Complainants, attorneys, and trade association officials with whom we spoke did not identify lack of remedial action against defaulters in such situations as an issue.

In contrast, the ITC's handling of cases that are totally uncontested was identified as a problem. Since the administrative law judges cannot automatically find in favor of the complainants in such cases, the ITC conducts full proceedings. Staff attorneys from the Office of Unfair Import Investigations represent not only the public interest at these proceedings but also, as best they can, the positions of defaulting respondents.

ITC regulations and decisions emphasize that a default does not establish *per se* a complainant's right to relief. As explained in Certain Electrical Slow Cookers, the only effect a finding of default has at this stage is to authorize the judges to

"create certain procedural disabilities for the defaulting party and to entertain, without opposition, proposed findings and conclusions, based upon substantial, reliable, and probative evidence [i.e., a *prima facie* case], which would support a recommended determination."

The ITC 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. In Certain Food Slicers and Components Thereof, the ITC went on to define "substantial, reliable, and probative" evidence as including, but not limited to (1) physical samples of the infringing good, (2) Customs' invoices establishing importation, or (3) affidavits of former customers establishing lost sales. The complainant's inability to obtain such information does not preclude an affirmative determination. Gaps in the complainant's evidence would be bridged by making adverse inferences where the complainant has made a reasonable effort to obtain such information. The ITC's default rules were codified in ITC Rule 210.25 (19 C.F.R. 210.25) in November 1984.

The ITC requires a *prima facie* case for three reasons. First, it wants some factual and legal basis for issuing relief, especially general exclusion orders, which disrupt international trade and thus are seen as a relatively powerful remedy. The ITC wants to assure itself when issuing exclusion orders that the named respondents and others are not being unfairly harmed. Similarly, the President needs some record for use in deciding whether or not to disapprove an exclusion order for policy reasons. Also, the Court of Appeals needs some record upon which to adjudicate appeals of section 337 decisions, which can be initiated by any party adversely affected by such a decision, including defaulting respondents and those not party to the original proceedings (see ch. 1). Second, the ITC still believes it necessary to review all factors to meet the public interest provisions of the statute.

Last, the ITC needs to assure itself that its sweeping powers to exclude goods are not abused by complainants. Although such abuse has never been found, it is possible, particularly in default cases. A government official gave us the following hypothetical example:

A foreign government export promotion agency convinces a small firm to export a product to the United States. The domestic firm that presently has a preponderance of the market for that product, realizing that the new market entrant is small and most likely unable to afford to litigate a section 337 case, initiates a section 337 proceeding against the foreign firm, knowing full well that it has no basis upon which to build a case. It initiates the proceeding solely to frighten the foreign firm from selling in the United States.

The foreign firm receives a notice in the mail stating that it has been named as a respondent in a section 337 case and recommending that it retain a U.S. attorney to respond to the petition, which must be accomplished in 30 days from the date the case was initiated, and otherwise represent it in the proceedings, which will last one year to 18 months. Once it realizes the cost of litigating a section 337 case, the foreign firm decides that it would be best to leave the U.S. market rather than participate in a costly legal battle—even though it believes it can win.

Default Procedures Undermine Effectiveness of Relief

During the course of these proceedings, however, defaulting respondents can continue to import counterfeit and infringing goods, undermining the effectiveness of the section 337 relief. Our analysis of section 337 default cases concluded through April 1985 shows that the ITC has generally taken a full year to render final determinations. During this period, respondents are free to flood the domestic market with the alleged infringing goods. According to ITC officials, respondents may purposely default to maximize their ability to sell the alleged infringing goods in the United States. Since the respondents do not participate in such proceedings, the ITC often cannot obtain the information on their sales of goods in the United States, which is needed to support issuance of a cease and desist order to stop these firms from selling goods brought into the country.

It is unclear why the ITC takes 12 months to conclude total default cases. Participants in these cases—the administrative law judges, commissioners, and attorneys representing the complainants—tend to direct the blame at each other. Two facts are clear. First, although the ITC regulations do not require the judges to hold full evidentiary hearings, they do not believe that they can meet the Commission's requirements without doing so. Second, since these cases are uncontested, the ITC and the complainant's attorneys tend to de-emphasize them and, as a result, these cases are not completed expeditiously.

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 \$100,000 to \$1 million in sales during the course of the default 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, with about 50 percent of them reporting substantial to 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 \$2.5 million.

**GAO Supports Intent of
Legislative Initiatives but
Suggests an Alternative
Solution**

The proposed amendments to section 337 would address this problem for cases involving both complete and partial default by respondents. They provide for ITC issuance of tailored exclusion orders (i.e., orders directed only to a limited number of respondents who were invited to participate in the proceedings but chose not to attend) in partial and complete default situations without the development of a record, unless the ITC finds that public welfare considerations preclude issuing such relief. In contrast, complainants in complete default cases wanting a general exclusion order would need to establish a *prima facie* case, which requires the development of a record. We support the intent of this legislation insofar as it relates to the issuance of tailored exclusion orders in complete default situations but suggest an alternative method to resolve this problem that would provide immediate relief to complainants in complete default proceedings while, at the same time, giving the ITC the opportunity to develop a record to support granting relief.

We believe that the default procedures should become effective only when all respondents choose not to participate. As stated earlier, we understand that partial defaults are relatively common. It is accepted practice that, before providing relief, the ITC expects complainants in such proceedings to prove their cases against participating respondents. Such practice should not cause unfair hardship to complainants. Firms that need immediate assistance to cope with infringing imports could seek temporary relief, which, if made more timely, would adequately help complainants deal with all infringing imports from defaulting as well as participating respondents. In addition, allowing complainants to request exclusion orders against defaulting parties in cases contested by

some respondents could result in misuse of section 337 to restrain trade. For example, a U.S. and a foreign firm that dominate the domestic market for a product could possibly initiate section 337 proceedings solely to exclude smaller firms that share the remainder of the market but cannot afford a section 337 case. Although the provision instructs the ITC to take into consideration the impact of the exclusion order on competitive conditions in the United States as part of the public interest considerations, we understand that such misuse of section 337 would be extremely difficult to prove.

We also believe that the ITC should always develop a record in complete default situations to support issuance of remedial relief. Proposed amendments, as now written, would authorize the ITC to issue tailored exclusion orders without developing a record to justify them. In total default cases in which the complainants do not request a general exclusion order, the ITC, without the benefit of a record, may be permanently excluding from the U.S. market the products of foreign firms that were not committing violations but could not justify the cost of litigation. The proposed amendments instruct the ITC to take into consideration the impact of the tailored exclusion order on the public interest. However, given the abbreviated nature of the public interest segment of section 337 proceedings, it is very unlikely that the issues of validity and infringement could be addressed as part of this segment.

We propose that, in section 337 cases in which no respondents participate, the ITC, upon the request of a complainant, provide interim relief if the facts set out in the complaint, supporting documents, and other information available to the Commission demonstrate that a violation of section 337 is likely to have occurred. However, the Commission would not provide such interim relief if such action was considered contrary to the public interest. Under our proposal, the interim relief would take the form of (1) a tailored exclusion order directed at defaulting respondents, with a bond provision for respondents similar to that of a temporary exclusion order, and/or (2) an interim cease and desist order. The ITC would then continue with the default proceedings to establish a prima facie case, which we propose would have to be concluded within 6 months from the date all respondents were officially found in default, not to exceed 12 months from the date the ITC began its investigation. If, after these proceedings, the ITC determines that relief is warranted, it would replace the temporary order with the appropriate permanent relief.

Under such a procedure, a deserving complainant would be protected from injury during the course of the proceedings, without unduly burdening defaulting respondents, and the ITC could develop a record to support the issuance of relief. Interim relief in complete default cases is a more expeditious remedy than a temporary relief under section 337(e) and is a justifiable consequence of the failure of any respondents to participate in the proceedings. We believe that a tailored exclusion order with a bonding provision, possibly issued in conjunction with interim cease and desist orders, would be an appropriate remedy in this situation. While such a remedy would afford adequate relief to the complainants during the course of the proceedings, it would not constitute a complete bar to importation of the alleged infringing goods. 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. Yet, the prospect of such an order would serve as an incentive for respondents to participate. Importers not party to the proceeding would not be affected. Should the Commission ultimately find against the complainants, the interim order would have been in effect for no longer than 6 months.

ITC Authority to Issue Exclusion and Cease and Desist Orders for the Same Violation Should Be Clarified

Until recently, the ITC's position was that section 337(f) prohibited issuance of both exclusion orders and cease and desist orders to remedy the same unfair trade practice. In a recent case, the ITC decided that, under certain circumstances, it could issue both orders to remedy the same unfair practice. Nevertheless, the ITC Chairwoman has supported legislation to eliminate any legal question that the ITC has authority to use both remedies. We believe that section 337(f) should be amended to clarify the ITC's authority to choose the appropriate remedy— exclusion order and/or cease and desist order—to address violations.

Section 337(f) provides that the ITC can issue cease and desist orders “in lieu of” exclusion orders to bar persons from engaging in unfair trade practices. This provision was included in the Trade Act of 1974 to provide the ITC with another remedy, besides exclusion orders, to address violations of section 337. In practice, cease and desist orders are most effective in stopping domestic concerns from pursuing some activity, usually conducted after importation of the counterfeit or infringing goods, that is regarded as a violation of the statute.

The first important ITC decision interpreting section 337(f) occurred in the 1979 Doxycycline case. The ITC determined that doxycycline, a chemical product, was being imported and sold in the United States in

violation of a valid U.S. patent. Although the complainant requested both an exclusion order barring future imports and a cease and desist order to prevent future domestic sales of previously imported doxycycline, the ITC issued only an exclusion order. In the prevailing decision, two ITC commissioners concluded that the ITC could issue a cease and desist order only in lieu of and not in addition to an exclusion order.⁵

The Commission has since broadened its interpretation of section 337(f). In 1980, the ITC issued both exclusion orders and cease and desist orders for separate violations of section 337 in Certain Airtight Cast Iron Stoves. It issued the exclusion order to stop the imports of stoves and 6 cease and desist orders to stop domestic companies from false advertising, passing off their products as those of the complainant, and infringing common law and registered U.S. trademarks in violation of the statute. The Commission indicated that this result was consistent with section 337(f) and the decision in Doxycycline since the orders were aimed at addressing separate and distinct unfair acts.⁶ Recently, in Certain Compound Action Metal Cutting Snips, the ITC issued an exclusion order and a cease and desist order barring sales from inventory to remedy the same unfair trade practice—patent infringement. The Commission concluded that section 337(f) does not prevent such action because the unfair act of patent infringement involves multiple import or sales transactions or multiple injuries.⁷ Thus, section 337(f) apparently would affect only the issuance of both a cease and desist order and an exclusion order to remedy a particular import and sales transaction or injury. Some ITC staff believe that these cases—from Doxycycline to Certain Compound Action Metal Cutting Snips—reflect the Commission's efforts to address unfair trade practices in light of the remedy limitation contained in section 337(f).

In recent testimony before the Subcommittee on Courts, Civil Liberties, and the Administration of Justice, House Committee on the Judiciary, the ITC Chairwoman supported legislation that would “confirm current Commission practice,” stating that “should H.R. 3776 be enacted, it

⁵One commissioner, citing section 337(g)(3) as support, also believed that cease and desist orders could be issued only to bar imports and not domestic sales. Two commissioners argued that the ITC should issue cease and desist orders in addition to the exclusion order because the sale of previously imported doxycycline and its importation into the United States were separate violations of section 337.

⁶See also Certain Molded In Sandwich Panel Inserts and Methods for Their Installation (1982) and Certain Plastic Food Storage Containers (1984).

⁷One commissioner also justified the issuance of both orders because they applied to different goods, i.e., prospective imports and previously imported goods.

would be without legal question that the Commission has authority to order such relief when the Commission determines that both remedies are necessary ” (Underscoring added) In our view, the ITC should have the flexibility to select the appropriate remedy—exclusion orders and/or cease and desist orders—to deal with unfair foreign trade practices We believe this could be best accomplished by amending section 337(f) to make it clear that cease and desist orders may be used together with exclusion orders in dealing with unfair foreign trade practices in imported articles

Conclusions

Changes in legislation are needed to improve ITC’s administration of section 337 proceedings ITC procedures for providing expedited relief and for administering default proceedings undermine the effectiveness of section 337 relief Many complainants have sustained substantial injury during the 7 months it takes the ITC to provide expedited relief. Because of this time frame, many firms that needed expedited assistance chose to forego seeking temporary relief and suffered loss of sales and consumer confidence Similarly, many complainants have sustained substantial injury during the time the ITC takes to conclude default proceedings In addition, the statute should clearly authorize the ITC to issue both exclusion orders and cease and desist orders to remedy the same unfair trade practice

Recommendations

We recommend that Congress amend section 337 of the Tariff Act of 1930 for cases involving protection of intellectual property rights as follows

- Require the International Trade Commission, at the request of the complainant, to make temporary relief effective within 10 days of a judge’s affirmative initial determination on temporary relief, while requiring the complainant to post bond, unless it finds that such action would be contrary to the “public interest.” The Commission may then review the initial determination in accordance with its current procedures
- In cases where no respondents participate, require the ITC, at the request of the complainant, to provide interim relief if (1) the facts as set out in the complaint, supporting documents, and other information available to the Commission demonstrate that a violation of section 337 is likely to have occurred and (2) the provision of interim relief is not deemed contrary to the public interest Also require the ITC to make its determination on permanent relief no later than 6 months from the date all

respondents are officially determined to be in default, not to exceed 12 months from the date the Commission instituted the investigation.

- Clearly authorize the International Trade Commission to issue both exclusion orders and cease and desist orders to remedy the same unfair trade practice

Appendix I contains specific legislative language for these recommendations

ITC Chairwoman's Comments and Our Evaluation

The ITC Chairwoman commented on our conclusions and recommendations regarding ITC administration of section 337 (See app V) Overall, her comments contained no objections to our findings and conclusions regarding ITC administration of section 337 They stated that our recommendations regarding ITC administration of section 337 "could provide a useful foundation for thoughtful discussion" but did not endorse them pending further study of their impact

The comments expressed the view that our recommendation to expedite the provision of temporary relief is "an interesting recommendation [that] would shorten the time required for the Commission to act on requests for temporary relief " They added, however, that "the amendment should provide that complainant's bond, if forfeited, should go to respondents rather than the U S Treasury They explained that "The purpose of having complainant post a bond is presumably to hold respondents harmless if the Commission ultimately determines that there is no violation of the statute This purpose can only be accomplished if complainant's bond, if forfeited, is payable to respondents and not to the U S. Treasury " We have revised the section dealing with expedited relief to reflect this comment

The comments also expressed the view that our proposal to expedite the provision of relief in default proceedings is "an interesting recommendation " ⁸ They added, however, that our recommendation may give rise to "definitional problems " In our draft report, we proposed that the ITC complete section 337 proceedings in which no respondents participate no later than 6 months from the date the investigation was begun The

⁸We did not address a related issue involving the ability of defaulting respondents to appeal adverse ITC determinations to the Court of Appeals for the Federal Circuit The comments noted that "Section 337(c) currently allows defaulting respondents to appeal adverse Commission determinations to the [Court of Appeals], and such appeals have in fact been taken" and suggested that consideration be given to "amending section 337 to prohibit defaulting respondents from appealing to the [Court of Appeals] on issues other than those concerning whether the prescribed default procedures have been properly followed "

comments pointed out that “many investigations will be several months old before it can be determined which respondents are participating” and added, in a situation “where the last respondent ceases to participate one week short of six months after the date of institution of the investigation would the Commission still be required to complete its investigation within six months?” We have amended our recommendation to state that the ITC be required to complete the proceedings no later than 6 months from the date all respondents are officially found in default, not to exceed 12 months from the date of institution of an investigation

The comments expressed the view that our recommendation that the ITC be clearly authorized to issue both exclusion orders and cease and desist orders to address the same unfair trade practice is “a good idea and one which has a long history of support at the Commission.”

Need to Strengthen Customs Enforcement of Section 337 Exclusion Orders

About two-thirds of our survey respondents that received exclusion orders reported that imports of counterfeit and infringing goods covered by these orders continued to enter the country. Although these firms most often saw a substantial decrease in these imports, most reported that these imports continued to flow into the United States in sufficient quantities to cause significant losses in sales. Reportedly, these imports also caused loss of consumer confidence in the legitimate products. We support congressional initiatives to strengthen the Customs Services' ability to enforce exclusion orders by authorizing the ITC to direct Customs to seize goods when enforcing exclusion orders. Because this change would not entirely resolve this problem, we also suggest that Customs intensify its efforts to enlist the support of firms that have obtained exclusion orders in identifying shipments containing counterfeit and infringing goods.

Shipments Entering Country in Violation of Exclusion Orders

The Customs Service plays an indispensable role in government efforts to provide relief under section 337. Federal Circuit Judge Nichols wrote in his opinion in Bally/Midway Manufacturing Co. v. International Trade Commission that the "ITC is here the chief of police, and the officers of the customs are the patrolmen on the beat." While the ITC decides which complainants receive relief and in what form, Customs must ensure that the relief is effective.

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." The cost of litigating a section 337 case—generally between \$100,000 and \$1 million, with a few costing over \$2.5 million—contributes to this expectation. A firm would not spend such a sum of money unless it believed the relief would be effective.

Although some firms voluntarily stop importing counterfeit or infringing goods covered by exclusion orders, others ignore the orders and repeatedly attempt to bring such goods into the country, placing the enforcement burden on Customs' port inspectors. Because an exclusion order authorizes Customs to exclude, but not to seize, counterfeit and infringing goods, some knowledgeable officials do not consider it to be an effective deterrent to importation of such goods. While 19 U.S.C. 1526(a) and 17 U.S.C. 603 authorize Customs to seize and, under certain circumstances, take custody of imports of goods that violate registered

U.S. trademarks and copyrights that have been recorded with the Secretary of the Treasury, Customs does not have statutory authority to take such action with respect to imports that infringe U.S. patents, the type of intellectual property right most often protected by exclusion orders.¹ Foreign infringers who have shipments stopped by Customs because they are in violation of exclusion orders are required only to re-export the goods and, thus, lose only the 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. In testimony before the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, the General Counsel of Apple Computer, Inc., stated that

“United States ITC exclusion orders, which provide for the re-export of the illicit goods rather than for seizure or forfeiture, invite importers to ‘port shop’ for an entry point that is understaffed or ill-equipped to detect and intercept infringing merchandise.”

We also understand that foreign infringers sometimes repack the goods that are returned to the country of origin and attempt to export them to the United States at a later date. Knowledgeable business officials have commented that protection of intellectual property is uneven from port to port.

Some officials believe that Customs is not fully enforcing all exclusion orders. Senator Lautenberg wrote in the September/October 1985 bulletin of the International Anticounterfeiting Coalition that “In reality . . . the Customs Service simply cannot and does not catch all infringing goods.” The ITC has received complaints about Customs enforcement from firms that had obtained exclusion orders. One trade association official characterized the Customs Service as the “weak link” in the section 337 process.

Of the survey respondents that indicated they had a basis to judge², about 35 percent reported that counterfeit or infringing goods had not entered the country since their exclusion orders were issued. Although several firms reported that the foreign firms voluntarily discontinued

¹Customs also has other authorities to deal with fraudulent imports (i.e., 19 U.S.C. 1592 and 18 U.S.C. 545) which may be available to address violations of section 337 exclusion orders.

²For the responses cited in this chapter, the proportion of survey respondents indicating that they had no basis upon which to provide an answer averaged about 20 percent and in no instance exceeded 26 percent.

exporting such goods to the United States, others were pleased with Customs' ability to stop infringing goods from entering the country. One firm commented that "Customs reacted quickly and forcefully." Another reported a "definite reduction of piratical goods from the source 337 covered." Still another stated that "Were it not for the . . . ITC Exclusion Orders it is doubtful that [my company and the whole manufacturing industry it services could have continued to exist in their present form."

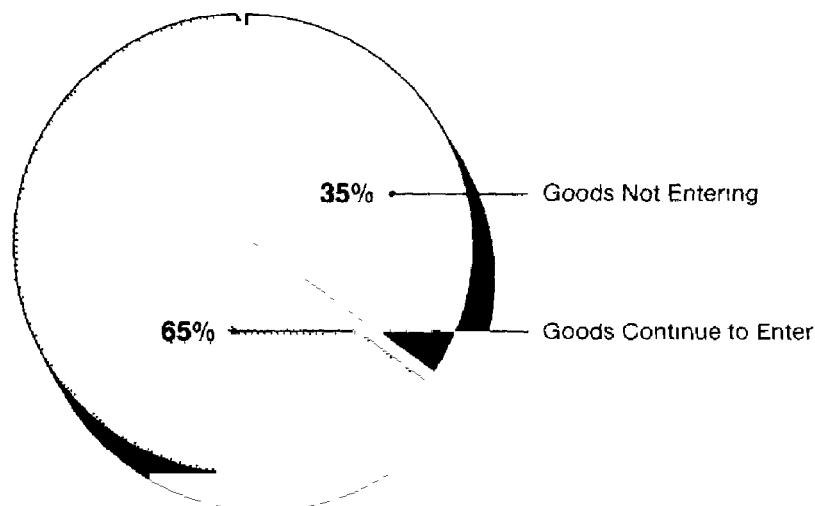
The remaining two-thirds of the firms that indicated they had a basis to judge reported that counterfeit or infringing goods covered by their exclusion orders continued to enter the country, causing some to question the usefulness of section 337 as a trade remedy. About 71 percent of these firms reported substantial decreases in the value of such imports after the exclusion orders were issued, in some cases due to the willingness of importers to abide by the orders. Approximately 29 percent reported little change. One firm commented that "Many shipments have gotten past Customs." Another stated that "We suspect that only 1% of infringing imports are actually being denied entry." (See fig. 4.1.)

Firms indicating the continued importation of counterfeit and infringing goods reported sales losses of as much as \$5 million. Of these firms, about 73 percent reported that the counterfeit and infringing imports damaged their sales to at least some extent, with about 46 percent of them stating that their sales were injured to a moderate or substantial extent. One company official commented that, despite issuance of the exclusion order, infringing imports had cut so deeply into sales that the company has experienced no growth during the past 2 years. Further, company officials told us that the continued presence of illegitimate goods in the domestic marketplace, sometimes in a form virtually indistinguishable from the original, caused consumers to lose confidence in the authentic products.

Figure 4.1: Selected Survey Responses on Customs Enforcement of Exclusion Orders^a

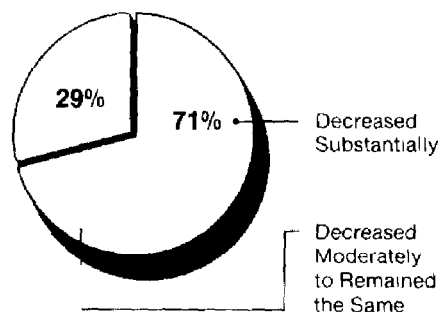
Firms responding to the survey

Imports that violate exclusion orders entering the U S

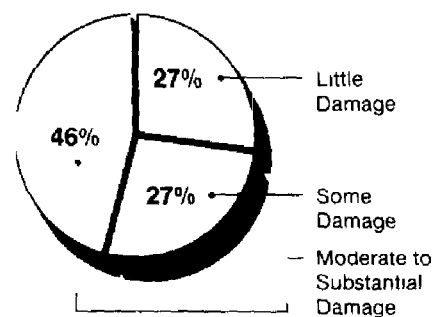


Firms indicating that counterfeit/infringing goods continued to enter the country after issuance of exclusion orders^b

Value of counterfeit/infringing goods



Damage to sales



^a Figures do not include firms indicating they had no basis to judge

^b Figures represent those firms responding that goods continued to enter the country (See shaded area in first pie chart)

Several firms complained that Customs' inability to enforce their exclusion orders undermined the effectiveness of section 337 as a trade remedy. One firm commented that,

“There was no [Customs] enforcement whatsoever [For] the time and money involved for a small firm like ours, the end result was of little benefit because of the lack of enforcement by the Customs Service ”

Another stated that

“[W]e believe that the efforts and money expended to obtain the exclusion ruling from the ITC certainly did not provide the protection we expected ”

Because of the high cost and lack of enforcement, firms commented that they would not use section 337 again to deal with imports of other types of counterfeit or infringing products One stated that.

“There are now many of our products being copied identically Because of the cost of the ITC case and the lack of enforcement by Customs it doesn't seem fruitful to take these other items to the ITC Yet, we are being hurt and sales are suffering and people are being laid off ”

Customs' performance reportedly improves when it is assisted by the owner of the intellectual property right. Over 25 percent of our 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 About 86 percent of the firms that provided information to Customs and expressed an opinion were satisfied with Customs' response to the information provided

Staff Availability Limits Customs Ability to Enforce Exclusion Orders

In our May 1986 report, International Trade U.S. Firms' Views on Customs' Protection of Intellectual Property Rights (GAO/NSIAD-86-96), we reported that the availability of staff was generally seen as the foremost limitation on Customs' ability to enforce section 337 exclusion orders and otherwise protect intellectual property rights We reported that Customs has taken steps to enhance its ability to stop imports of contraband goods (i.e., goods prohibited by law from being imported) but added that these measures are limited

In commenting on our May 1986 report, the Department of the Treasury, the Customs Service's parent agency, stated that protecting intellectual property rights, including enforcement of exclusion orders, is only one of the Customs Services' many responsibilities Customs officials have testified that Customs is responsible for administering and enforcing over 400 provisions of law and regulations for 40 government agencies

These include prohibiting traffic in illegal narcotics, certain foods and drugs, hazardous substances, counterfeit money, and obscenity; controlling exports, including high technology exports to the Soviet bloc; controlling illegal immigration; enforcing auto safety and emission standards; enforcing flammable fabric, quota, marking of country of origin, and animal and plant quarantine restrictions; and protecting endangered species of wildlife. As a result, according to Treasury comments on our May 1986 report, Customs must "manage [its] limited resources . . . to accomplish its total mission."

Comments of respondents to our survey indicated that, despite the efforts of port inspectors, Customs' ability to enforce exclusion orders is limited by the availability of staff. These firms generally expressed high regard for the work of port inspectors and generally noted the competence and helpfulness of port personnel. One firm reported that it was satisfied with Customs because of the staff's "very positive attitude and willingness to work with us." Survey respondents' comments pointed to staffing as a primary limitation on Customs ability to enforce exclusion orders, with one firm stating that it "doubt[s] that [Customs has] adequate staffing to effectively perform required policing."

This finding was reflected in hearings held during June 1983 to September 1984 by the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce.³ Based on these hearings and its own investigation, the Subcommittee concluded that "despite the best efforts of the Customs Service's competent and dedicated personnel, the agency has neither the people nor the other resources to stop the flood of counterfeit products." The Subcommittee found that the Customs Service has sufficient staff to inspect approximately 2 percent of incoming shipments. Further, while the size of Customs' port inspection staff has remained static, Customs' formal entry workload (import transactions exceeding \$250 in value⁴) increased approximately 40 percent from fiscal years 1981 to 1984, and, according to Customs officials, overall incoming shipments increased in fiscal year 1985.

Customs has tried to enhance its ability to stop counterfeit and infringing imports. Its primary effort in this area is "Operation Tripwire," a special initiative to detect commercial fraud, including

³These hearings were summarized in a Feb. 1984 Committee Print, entitled Stealing American Intellectual Property: Imitation Is Not Flattery (Print 98-V), and in an Apr. 1985 Committee Print, entitled Criminal Components of America's Trade Problem (Print 99-II).

⁴Customs increased its threshold value for formal entries to \$1,000 in fiscal year 1985.

imports of counterfeit and infringing goods. As part of this effort, the Commercial Fraud Investigation Center at Customs headquarters coordinates the activities of commercial fraud teams, located at the regional and district levels, which assess incoming intelligence on shipments containing contraband goods and also assist port inspectors in determining whether questionable goods are indeed contraband.

Possibly of greater importance, Customs is developing a computerized selective cargo inspection system, which is aimed at better focusing the efforts of port inspectors by identifying import shipments most likely to contain mislabeled, counterfeit, infringing, or otherwise contraband products. At present, this system is installed at 45 ports which account for about 50 percent of the volume of total imports. Customs plans to increase the volume of imports processed through this system to about 80 to 90 percent by 1987. Using this system, port inspectors enter information, such as the product type, importer, and country of origin, into a computer terminal linked to a centralized data base. The computer then indicates the type of inspection the shipments should receive. However, according to a knowledgeable Customs official, this system targets about 20 percent of incoming shipments for physical inspection. Since Customs has the manpower to inspect only about 2 percent of shipments, port inspectors must use their discretion in acting on the recommendations. Because of this situation, they often perform only cursory or no inspections of shipments that have been identified as warranting physical inspection.

Further, although the U.S. tariff schedules used by this system to categorize goods are highly detailed, Customs inspectors experience difficulty detecting counterfeit and infringing goods that are classified in "basket categories" (i.e., categories that include many items under a common heading). One firm that received an exclusion order covering its staple guns reported that

"The counterfeit copies are shipped in under a general classification "Hand Tools" and Customs says there is no way they can check everything in a shipment to see if infringing staple guns are part of it."

Firms also reported that importers have attempted to disguise or conceal infringing imports to escape Customs' scrutiny.

Customs Enforcement of Exclusion Orders Can Be Strengthened

We believe that a number of steps can be taken to strengthen the ability of Customs' present staff to enforce section 337 exclusion orders. We support congressional initiatives to authorize the ITC to direct Customs to seize goods when enforcing exclusion orders. The proposed amendments to section 337, for the most part, would give Customs seizure authority under exclusion orders, most of which cover patents, that it now has for registered trademarks and copyrights recorded with the Secretary of the Treasury. We suggest, however, that the legislation should clearly delineate the situations in which this authority can be used. Also, realizing that this change will not entirely solve the problem, we also suggest that Customs intensify its efforts to enlist the support of firms that have obtained exclusion orders in identifying shipments that contain counterfeit or infringing products.

A number of the bills to amend section 337 would authorize the ITC to direct the Customs Service to seize goods and take them into custody when enforcing exclusion orders. We believe that such authority would strengthen the deterrent effect of exclusion orders. Should such a provision become law, infringers would not only face the prospect of losing shipping costs but also the possibility that Customs would seize and dispose of their entire shipments. Over 90 percent of our survey respondents who expressed an opinion believed that allowing Customs to seize and take custody of counterfeit or infringing goods would improve its ability to enforce exclusion orders.

We suggest that the legislation provide for the ITC 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 circumvent exclusion orders. Our objective is not that the ITC use seizure authority as an initial remedy but keep it in reserve as an extraordinary enforcement remedy to deal with "predatory" foreign infringers who have refused to abide by ITC determinations. Under our proposal, before the ITC could issue a seizure order, Customs or the complainant would have to present documented evidence to the ITC that the foreign firm or firms have on more than one occasion attempted to bring goods into the country in knowing violation of an exclusion order.

This procedure is needed to be consistent with U.S. national treatment obligations under GATT, which require that the member states' trade practices and procedures treat foreign nationals no less favorably than domestic concerns. Use of seizure as an initial remedy under section 337 may not be consistent with U.S. national treatment obligations since seizure is not available as an initial remedy in federal district court.

patent infringement cases. However, use of this authority as an extraordinary remedy is consistent with federal district court contempt proceedings, which can be invoked to deal with defendants who do not comply with judgments. District court judges have a number of remedial actions at their disposal, including seizure of infringing goods, to deal with defendants that refuse to abide by court ordered injunctions.

We also suggest that Customs intensify its efforts to elicit the support of intellectual property owners in identifying shipments containing counterfeit or infringing goods. As discussed in our May 1986 report, despite having the authority to seize goods that counterfeit or infringe registered trademarks and copyrights that have been recorded with it, Customs also has experienced significant problems protecting these intellectual property rights and relies on intellectual property owners for assistance. Customs could elicit such assistance through an informational brochure or similar document that is provided to firms obtaining Customs assistance. Under current procedures, there is no formal mechanism for firms to obtain such information from Customs prior to initiating section 337 proceedings. As a result, they may not have realistic expectations of Customs' abilities or appreciate the need to provide assistance.

Conclusions

Respondents to our survey reported that the U.S. Customs Service is not fully enforcing all exclusion orders, undermining the effectiveness of section 337 relief as a means to protect firms against counterfeit and infringing imports. Since they do not face the potential seizure of their goods, foreign firms are not always deterred from attempting to bring infringing goods into the country in violation of exclusion orders, placing the enforcement burden on the Customs' port inspectors. As was most recently demonstrated in congressional hearings, Customs' ability to protect intellectual property rights, including enforcement of exclusion orders, is limited foremost by staff availability.

Recommendations

We recommend that Congress amend section 337 of the Tariff Act of 1930 for cases involving the protection of intellectual property rights to authorize the International Trade Commission to direct the U.S. Customs Service to seize counterfeit or infringing goods when there is evidence that a firm or firms have on more than one occasion attempted to bring such goods into the country in knowing violation of exclusion orders. Appendix I contains specific legislative language for this recommendation.

We also recommend that the Secretary of the Treasury instruct the Commissioner of Customs to intensify the efforts of the U S Customs Service to enlist the support of firms that have obtained exclusion orders in identifying shipments containing counterfeit or infringing products, possibly by providing an informational brochure or similar document to firms initiating section 337 proceedings.

Agency Comments and Our Evaluation

The Department of the Treasury did not take issue with our overall findings and conclusions. Treasury pointed out that enforcing section 337 exclusion orders “creates unique Customs enforcement problems” and elaborated on these problems. It specifically concurred “with the finding that the most successful efforts in this area involved the support of the domestic industry and that the participation of the complainant in this effort should be encouraged ” (See app. IV)

Treasury commented that it is “in general agreement that the proposal to give Customs seizure authority for certain violations of exclusion orders will improve enforcement ” Treasury added, however, that “to the extent that these proposals might be considered to affect grey market importations,⁵ we believe that it is premature for us to take any position pending the recommendations of the Administration task force now studying grey market issues ” We were not aware that our proposal might affect grey market importations and did not intend such a result As in the past (see footnote 8, ch 1), the President would maintain authority to disapprove exclusion orders that cover grey market imports and, as a result, are deemed inconsistent with Customs regulations

Treasury also commented on a statement appearing in our draft report that Customs intended to install its computerized selective cargo inspection system at ports with 200 or more entries per day Treasury pointed out that, in fact, Customs intends to install this system at all ports, regardless of import volume We have revised our report accordingly

⁵Grey market goods are foreign-made goods bearing authentic U S -registered trademarks that are diverted from their intended foreign markets and imported and sold in the United States by third parties without authorization from the U S trademark owners

ITC Chairwoman's Comments and Our Evaluation

The ITC Chairwoman commented on our conclusions and recommendations regarding Customs enforcement of exclusion orders. (See app. V.) Her comments expressed the view that "Seizure of counterfeit or infringing goods in situations where there are multiple, knowing attempts to import such goods is a constructive idea." They added, however, that "the U S Customs Service, not the Commission, . . . should be authorized to order seizure ." As we stated in our May 1986 report, we believe that the ITC, and not Customs, should exercise control over Customs' use of exclusion orders to seize and take custody of goods. We agree that Customs is in the best position to determine when firms have on more than one occasion attempted to violate exclusion orders. Nevertheless, we believe that Customs should seek ITC authorization to enforce an exclusion order by seizing and taking into custody imported goods. Section 337 authorizes the ITC to grant relief against unfair trade practices and to determine the appropriate form of relief; Customs simply carries out the ITC's instructions. By allowing Customs to determine when seizure is appropriate, the ITC would be relinquishing to Customs part of its responsibility to determine what form of relief is needed to protect U S firms under section 337. It would be ceding control over the use of a harsher remedy that we believe should be used under section 337 only in extraordinary circumstances, i e , when foreign firms on more than one occasion knowingly bring counterfeit or infringing goods into the country in violation of exclusion orders.

Suggested Legislative Language for GAO Recommendations¹

Section 337 of the Tariff Act of 1930 (19 U S C 1337), as amended, is further amended as follows.

(1) Subsection (a) is amended

(a) by striking out “(a) Unfair” and inserting in lieu thereof “(a)(1) Unfair”, and

(b) by adding the following paragraph (2)

“(2) Notwithstanding paragraph (a)(1), the importation of articles into the United States, or their sale by the owner, importer, consignee, or agent of either, which infringes or violates a valid and enforceable United States intellectual property right are declared to be unlawful acts or methods of competition and when found by the Commission to exist shall be dealt with, in addition to any other provisions of law, as provided in this section. The term “intellectual property right” includes a United States patent, a copyright registered under Title 17, United States Code, a trademark registered under the Trademark Act of 1946, trade secrets, maskworks registered under Chapter 9 of Title 17, United States Code and unregistered trademarks.”

(2) Subsection (e) is amended

(a) by striking out “(e) If” and inserting in lieu thereof “(e)(1) If”; and
(b) by adding the following paragraph (2)

“(2) In lieu of relief available under paragraph (1), upon request of a complainant filing under subsection (a)(2) of this section, accompanied by a bond in an amount to be determined by the Commission, the Commission shall direct that such articles be so excluded from entry into the United States within 10 days of receipt of the administrative law judge’s initial determination that there is reason to believe that such person is violating this section, unless after considering the effect of such exclusion on the matters set out in paragraph (1), it finds that such articles shall not be excluded from entry. The Commission shall notify the Secretary of the Treasury of its action under this subsection directing such exclusion from entry, and upon receipt of such notice, the Secretary shall, through the proper officers, refuse such entry. Nothing in this paragraph shall otherwise affect the Commission’s review of the initial determination.”

(3) Subsection (f) is amended

(a) in subsection (f)(1) by striking out “In lieu of” in the first sentence and inserting in lieu thereof “In addition to”,

¹Conforming Amendments to Provisions of Section 337 Not Affected by GAO’s Recommendations Are Not Included

(b) by redesignating subsection (f)(2) as (f)(3), and

(c) by adding the following new subsection (f)(2)

“(2) Notwithstanding paragraph (1), upon request of a complainant filing under subsection (a)(2) of this section, the Commission shall direct that such an order to cease and desist from engaging in the unfair methods or acts involved be issued within 10 days of receipt of the administrative law judge’s initial determination that there is reason to believe that such person is violating this section, unless after considering the effect of such an order on the matters set out in paragraph (1), it finds that such an order should not be issued. Nothing in this paragraph shall otherwise affect the Commission’s review of the initial determination.”

(4) By redesignating subsections (g), (h), (i) and (j) as subsections (i), (j), (k) and (l) respectively, and

(5) by inserting after subsection (f) the following new subsections (g) and (h)

“(g) INTERIM ORDERS - (1) Notwithstanding any other provision of this section, at the request of a complainant filing under subsection (a)(2), the Commission shall direct that the articles concerned in an investigation be excluded from entry into the United States on an interim basis or shall issue and cause to be served on any person an interim cease and desist order from engaging in the unfair methods or acts involved, or both, when the Commission has found all respondents to be in default, if the facts set out in the complaint, supporting documents, and other information available to the Commission, demonstrate that a violation of this section is likely to have occurred, unless, after considering the effect such action may have upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States and United States consumers, it finds that such action shall not be taken. The Commission shall complete its investigation and provide any relief as set out in subsections (d) and (f)(1) within six months from the date the Commission found all respondents to be in default, but in no event, later than twelve months from the date the Commission instituted its investigation.

“(2) The Commission shall notify the Secretary of the Treasury of its action under paragraph (1) directing such exclusion from entry on an interim basis and upon receipt of such notice the Secretary shall, through the proper officers, refuse such entry, except that such articles shall be entitled to entry upon bond determined by the Commission and prescribed by the Secretary.

“(3) The term “default” as used in this subsection refers to the failure of a respondent to take actions, including, but not limited to the following: (1) file a response to the complaint and notice of investigation within the time provided, (2) respond to a motion for summary determination, (3) respond to a motion which materially alters the scope of the investigation, or (4) appear at a hearing before an administrative law judge on the issue of the violation of this section.

Appendix I
Suggested Legislative Language for
GAO Recommendations

“(h) FORFEITURE - In addition to taking action under subsections (d), (e), (f) and (g), in cases filed under subsection (a)(2), the Commission may issue an order providing that an article imported in violation of the provisions of subsection (d) be seized and forfeited to the United States when there is evidence that a firm or firms have on more than one occasion attempted to bring such articles into the country in knowing violation of an exclusion order. The Commission shall notify the Secretary of the Treasury of any order issued under this subsection and, upon receipt of such notice, the Secretary shall enforce such order in accordance with the provisions of this section.”

Survey of Firms That Have Initiated Section 337 Proceedings



U.S. GENERAL ACCOUNTING OFFICE
SURVEY OF FIRMS THAT HAVE INITIATED
SECTION 337 PROCEEDINGS

Please respond to the questions with respect to the following Section 337 proceeding:

INTRODUCTION/INSTRUCTIONS

The U.S. General Accounting Office, an agency of Congress, is studying Government efforts to help U.S. firms protect their intellectual property rights--such as patents, trademarks or copyrights--in international trade. As part of this study, we have developed this questionnaire to help assess: (1) the International Trade Commission's (ITC) procedures for providing relief under Section 337 of the Tariff Act of 1930 and (2) the Customs Service's enforcement of Section 337 exclusion orders. The questionnaire solicits the views of officials of companies, like yours, that have initiated Section 337 proceedings.

The questionnaire should be completed with respect to the Section 337 proceedings outlined on the label attached above. It can be completed in about 20 minutes. Nearly all of the questions can be answered by checking a box or filling in a short blank. A few require a brief narrative. Some of the questions are to be skipped depending upon your answer to a previous question. Therefore, we ask that you pay particular attention to the skip instructions within the questionnaire.

Please complete the questionnaire and return it in the enclosed business reply envelope within 10 days. The return address is:

U.S. General Accounting Office
441 G Street, N.W.
Room 4148
Washington, D.C. 20548

ATTN: Joseph Natalicchio

If you have any questions about our work or the questionnaire itself, don't hesitate to call Mr. Natalicchio at (202) 275-5889. Thank you for your cooperation and assistance.

BACKGROUND

1. Please provide the name, title, and phone number of the person who completes the questionnaire. If more than one person helps, identify the person you suggest we contact for clarification or additional information about your responses to the questionnaire.

Name: _____

Title: _____

Phone number: _____

**Appendix II
Survey of Firms That Have Initiated Section
337 Proceedings**

2. What is your estimate of the total cost to your company of participating in Section 337 proceedings through the time of ITC's final disposition of your request for relief? (INCLUDE BUT DO NOT LIMIT YOUR ESTIMATE TO THE COST OF OUTSIDE COUNSEL.) (CHECK ONE)

- 1. \$100,000 or less
- 2. \$100,001 - 250,000
- 3. \$250,001 - 500,000
- 4. \$500,001 - 1,000,000
- 5. \$1,000,001 - 2,500,000
- 6. More than \$2,500,000
(Specify to nearest million: _____)

ITC ADMINISTRATION OF SECTION 337

This section solicits information on the actions of ITC after you requested relief under Section 337 and the impact of their actions on your firm

ITC provision of expedited relief

3. Did your firm seek expedited relief in the form of a temporary exclusion order from ITC? (RECALL THAT MANY FIRMS DO NOT SEEK EXPEDITED RELIEF, BUT RATHER INITIALLY SEEK PERMANENT RELIEF) (CHECK ONE AND COMPLETE AS APPLICABLE)

1. Yes, date of request

Mo. Yr.

2. No (SKIP TO Q. 9)

4. Did your firm receive a temporary exclusion order from ITC? (CHECK ONE AND COMPLETE AS APPLICABLE)

1. Yes, date of receipt:

/ _____

2. No (SKIP TO Q. 10)

5. Between the dates your firm requested and received the temporary exclusion order, was your firm being injured by the unfair trade practice being adjudicated under Section 337? (CHECK ONE)

1. Yes

2. No (SKIP TO Q. 20)

6. What is your estimate of the value of your firm's lost sales between the dates of your request and receipt of the temporary exclusion order? (CHECK ONE)

1. \$100,000 or less

2. \$100,001 - 500,000

3. \$500,001 - 1,000,000

4. \$1,000,001 - 5,000,000

5. More than \$5,000,000
(Specify to nearest million: _____)

6. No basis to estimate

7. To what extent, if any, did counterfeit or infringing imports hurt the product's reputation with consumers between the dates of your request and receipt of the temporary exclusion order? (CHECK ONE)

1. Little or no extent

2. Some extent

3. Moderate extent

4. Substantial extent

5. Very great extent

6. No basis to judge

Appendix II
Survey of Firms That Have Initiated Section
337 Proceedings

8. Describe how, in your view, the product's reputation with consumers was hurt by counterfeit or infringing imports between the dates of your request and receipt of the temporary exclusion order.

SKIP TO Q. 20

9. Which of the following were major reasons your firm did not seek expedited relief in the form of a temporary exclusion order from ITC? (CHECK ALL THAT APPLY)

1. Expedited relief was not necessary
2. Took too long to obtain
3. Cost too much to obtain
4. Requirements for obtaining a temporary order were too stringent
5. Other, please specify:

ITC provision of permanent relief

10. Did your firm receive a permanent exclusion order and/or a cease-and-desist order from ITC? (CHECK ONE)

1. Yes
2. No (SKIP TO Q. 16)

11. What was the date of the final disposition by ITC?

____/____/____
Mo. Yr.

12. Between the dates your firm requested relief and received permanent relief was your firm being injured by the unfair trade practice being adjudicated under Section 337? (CHECK ONE)

1. Yes
2. No (SKIP TO Q. 20)

13. What is your estimate of the value of your firm's lost sales between the dates of your request and receipt of the permanent relief? (CHECK ONE)

1. \$100,000 or less
2. \$100,001 - 500,000
3. \$500,001 - 1,000,000
4. \$1,000,001 - 5,000,000
5. More than \$5,000,000 (Specify to nearest million _____)
6. No basis to estimate

14. To what extent, if at all, did counterfeit or infringing imports hurt the product's reputation with consumers between the dates of your request and receipt of the permanent relief? (CHECK ONE)

1. Little or no extent
2. Some extent
3. Moderate extent
4. Substantial extent
5. Very great extent
6. No basis to judge

Appendix II
Survey of Firms That Have Initiated Section
337 Proceedings

15. Describe how, in your view, the product's reputation with consumers was hurt by counterfeit or infringing imports between the dates of your request and receipt of the permanent relief.

SKIP TO Q. 20

16. Did your firm settle the dispute through a settlement, consent order, and/or licensing agreement? (CHECK ONE)

1. Yes
2. No (SKIP TO Q. 18)

17. What was the major reason your firm chose to settle the Section 337 proceedings before the ITC made its final determination? (CHECK ONE)

1. The agreement(s) resolved the problem to our satisfaction.
2. Although the agreement(s) was not fully satisfactory, we believed it was in our best interest because we needed immediate action.
3. Although the agreement(s) was not fully satisfactory, we believed it was in our best interest because we could not afford to litigate the case through final determination.
4. Other, please specify:

SKIP TO Q. 20

18. Did your firm voluntarily terminate the Section 337 proceedings? (CHECK ONE)

1. Yes
2. No (SKIP TO Q. 20)

19. What was the major reason(s) your firm chose to terminate the Section 337 proceedings before the ITC made its final determination? (CHECK ALL THAT APPLY)

1. We did not believe that we could support the validity of the intellectual property right in question.
2. We did not believe that we could demonstrate that our firm constituted a "domestic industry" for Section 337 purposes.
3. We did not believe that we could demonstrate that our firm was efficiently and economically operated.
4. We did not believe that we could demonstrate sufficient injury to an industry to obtain relief.
5. Other, please specify:

20. Overall, taking into account ITC's handling of your request, the timeliness of their response and other aspects of the ITC proceedings you consider relevant, how satisfied or dissatisfied were/are you with the ability of ITC to respond to your needs under Section 337? (CHECK ONE)

1. Very satisfied
2. Satisfied
3. Neither satisfied nor dissatisfied
4. Dissatisfied
5. Very dissatisfied

**Appendix II
Survey of Firms That Have Initiated Section
337 Proceedings**

21. What is the major reason(s) for your satisfaction or dissatisfaction with ITC's implementation of Section 337?

**CUSTOMS SERVICE ENFORCEMENT OF
EXCLUSION ORDERS**

This section solicits information on the actions of the Customs Service after your firm received a permanent exclusion order from ITC.

22. Did your firm receive a Section 337 permanent exclusion order from ITC? (CHECK ONE)

- 1. Yes
- 2. No (SKIP TO Q. 35)

23. Since your firm received the permanent exclusion order, have counterfeit or infringing goods covered by the order entered the country? (CHECK ONE)

- 1. Yes
- 2. No (SKIP TO Q. 27)
- 3. No basis to judge

24. What is your estimate of the value of lost sales due to counterfeit or infringing imports between the dates you received the permanent exclusion order and June 30, 1985? (CHECK ONE)

- 1. \$100,000 or less
- 2. \$100,001 - 500,000
- 3. \$500,001 - 1,000,000
- 4. \$1,000,001 - 5,000,000
- 5. More than \$5,000,000 (Specify to nearest million: _____)
- 6. No basis to estimate

25. To what degree has the value of counterfeit or infringing imports entering the marketplace increased or decreased since the permanent exclusion order was issued? (FOR THE PRODUCT COVERED BY THIS ORDER, COMPARE A RECENT TIME PERIOD TO A SIMILAR TIME PERIOD JUST BEFORE THE ORDER WAS ISSUED) (CHECK ONE)

- 1. Increased substantially
- 2. Increased moderately
- 3. Remained about the same
- 4. Decreased moderately
- 5. Decreased substantially
- 6. No basis to judge

Appendix II
Survey of Firms That Have Initiated Section
337 Proceedings

26. To what extent have counterfeit or infringing imports covered by the ITC exclusion order hurt your company's sales since the permanent exclusion order was issued? (CHECK ONE)
1. Little or no extent
 2. Some extent
 3. Moderate extent
 4. Substantial extent
 5. Very great extent
 6. No basis to judge
27. Has an inhouse or outside investigative group been used to identify foreign-made counterfeit or infringing goods covered by the exclusion order that were intended for sale in the United States? (CHECK ONE)
1. Yes
 2. No (SKIP TO Q. 32)
28. What is your estimate of the approximate total cost to your firm to maintain this investigative group during your firm's most recently completed fiscal year? (FILL IN THE BLANK OR CHECK THE BLOCK)
- \$ _____ (dollars)
- No basis to estimate
29. Has your firm provided information to Customs based on intelligence developed through your investigative group that has led to Customs interdicting shipments of goods covered by your permanent exclusion order? (CHECK ONE)
1. Yes
 2. No (SKIP TO Q. 31)
30. What is your firm's level of satisfaction with Customs' response to your information that goods covered the permanent exclusion order are entering the country? (CHECK ONE)
1. Very satisfied
 2. Satisfied
 3. Neither satisfied nor dissatisfied
 4. Dissatisfied
 5. Very dissatisfied
31. In enforcing an exclusion order, Customs can exclude counterfeit or infringing goods, but cannot seize and destroy them. In your opinion would giving Customs the authority to seize and destroy counterfeit or infringing goods covered by Section 337 permanent exclusion orders improve their ability to help firms protect intellectual property rights? (CHECK ONE)
1. Definitely no
 2. Probably no
 3. Not sure
 4. Probably yes
 5. Definitely yes
 6. No basis to judge
32. Would you favor giving Customs the authority to seize and destroy counterfeit or infringing goods covered by Section 337 permanent exclusion orders? (CHECK ONE)
1. Definitely no
 2. Probably no
 3. Not sure
 4. Probably yes
 5. Definitely yes

Appendix II
Survey of Firms That Have Initiated Section
337 Proceedings

33. Overall, taking into account Customs' handling of your permanent exclusion order, including their ability to keep counterfeit or infringing goods out of the country, how satisfied or dissatisfied were/are you with the ability of the Customs Service to respond to your needs under the Section 337 permanent exclusion order? (CHECK ONE)

- 1. Very satisfied
- 2. Satisfied
- 3. Neither satisfied nor dissatisfied
- 4. Dissatisfied
- 5. Very dissatisfied

34. What is the major reason(s) for your satisfaction or dissatisfaction with Customs' enforcement of your exclusion order?

ADDITIONAL INFORMATION

35. If you would like to receive a copy of our report on this matter, please check the box below and provide a mailing address.

Yes, send us a copy of your report.

Please provide the name and mailing address of the person to receive the report.

Name _____

Address _____

36. Please use the space below to provide us with any additional comments related to the questionnaire or to provide us with other comments related to ITC's implementation of Section 337 or Customs' enforcement of exclusion orders. Attach additional sheets if necessary. Thank you for your cooperation and assistance.

HRM 7/85

Comments From the Office of the U.S. Trade Representative

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

May 5, 1986

The Honorable Frank C. Conahan
Director
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

Ambassador Yeutter asked that I prepare comments on the draft report, "International Trade: Strengthening Section 337 Protection of Intellectual Property Rights." Those who have prepared the report have done an excellent job. I hope that your report will be released soon.

I have a couple of recommendations for any follow-up work you may do on this issue.

First, you might explain what patents, copyrights, and trademarks are both in the Executive Summary and in the body of the report. The summary data then could be interpreted, identifying the kinds of intellectual property rights involved. The identification of the domestic industry in patent based cases, for example, is considerably more complicated than it is in trademark based cases because of the nature of the property right involved. Data broken down by type of property right will help those who are interested to evaluate the many legislative proposals more carefully.

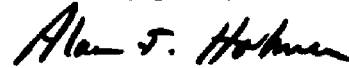
Second, I recommend that more analysis could be done on the implications of the Administrative Procedure Act on Commission procedures in section 337 cases. The analysis should include review of appeals to the Court of Appeals for the Federal Circuit involving the Commission's procedures and appellate decisions involving other agencies' procedures. Procedural due process is important in evaluating proposals for changes in temporary relief and default judgments under section 337.

Appendix III
Comments From the Office of the U.S.
Trade Representative

The Honorable Frank C. Conahan
May 5, 1986
Page Two

Attached are specific comments prepared by my staff that I
enclose for your review.

Sincerely yours,



Alan F. Holmer
General Counsel

AFH:z

[GAO note The technical comments referred to in this letter were not
included, they were addressed as appropriate in the body of the report.]

Comments From the Department of the Treasury



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON

MAY 14 1986

Re: Draft of a Proposed Report
International Trade: Strengthening Section 337
Protection of Intellectual Property Rights (483402)
March 11, 1986

Dear Mr. Anderson:

We have reviewed the subject Draft of a Proposed Report prepared by your staff which, inter alia, recommends legislation which would authorize the International Trade Commission to direct the U.S. Customs Service to seize counterfeit or infringing goods when there is evidence that a firm or firms have on more than one occasion attempted to bring such goods into the country in knowing violation of exclusion orders. The report also recommends that the Secretary of the Treasury instruct the Commissioner of Customs to intensify the efforts of the Service to enlist the support of firms that have obtained exclusion orders in identifying shipments containing counterfeit or infringing products.

The administration of patent infringement exclusion orders of goods in violation of section 337 of the Tariff Act of 1930 creates unique Customs enforcement problems. Ordinarily, since there is nothing in the appearance of imported articles which exposes a patent violation, the mechanism of the imported item must be examined. Customs officers often have to remove protective covers to examine the mechanisms. Once the mechanical parts are exposed, a decision has to be made regarding whether or not the patent has been infringed. Questionable articles must be sent to a Customs laboratory for analysis where a decision can be reached on whether a violation has been made with respect to the patent exclusion order.

Consequently, we are in general agreement that the proposal to give Customs seizure authority for certain violations of exclusion orders will improve enforcement. We concur with the finding that the most successful efforts in this area involved the support of the domestic industry and that the participation of the complainants in the effort should be encouraged. Customs also believes that enhancements to the Cargo Selectivity System in its Automated Commercial System (ACS) will provide further improvements in this Customs enforcement concern.

Appendix IV
Comments From the Department of
the Treasury

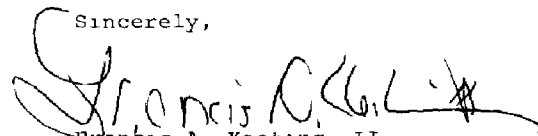
- 2 -

The material on page 33 implies that Customs has discretion with regard to economic tests. It should point out that for trademarks and copyrights different provisions of law are being enforced.

However, to the extent that these proposals might be considered to affect grey market importations, we believe that it is premature for us to take any position pending the recommendations of the Administration task force now studying grey market issues. Until that time, we would oppose any legislation involving grey market issues.

We would like to point out too that the statement on page 90 of the draft concerning Customs plans for a computer system at all ports processing 200 entries or more a day is incorrect. ACS is intended to be implemented at every Customs port, regardless of volume. ACS has already been implemented at many ports with a volume under 200 entries per day

Sincerely,



Francis A. Keating, II
Assistant Secretary
(Enforcement)

Mr. William J. Anderson
Director
General Government Division
General Accounting Office
Washington, D.C. 20548

Comments From the ITC Chairwoman

CHAIRWOMAN



UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON D.C. 20436

April 11, 1986

Frank C. Conahan
Director
National Security and International
Affairs Division
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Conahan:

This letter provides comments on GAO's draft report entitled "International Trade Strengthening Section 337 Protection of Intellectual Property Rights" (Code 483402). On the basic policy issues involved, I strongly urge you to reconsider the severe position you are taking in an area of competing public policy goals.

This study suffers enormously from an absence of balance. It was clear as early as the preliminary interview that your staff had drawn conclusions regarding the effectiveness of the statute even before the study began and was closed to any contrary arguments.

The study is further flawed by basing its conclusions on the perceptions of only the proponents of trade remedies. Neither respondents ultimately found not in violation of section 337, nor third parties who have had their legitimate trade disrupted by Customs' good faith efforts to enforce our exclusion orders, were effectively sought out. It is my understanding that only complainants were surveyed. Particularly when one asks firms that have lost as complainants their views on section 337, it is not difficult to predict what their recommendations will be.

With regard to some of the suggestions for improving current section 337 procedures to reduce time and costs, the study contains some useful suggestions. Although I am not prepared to endorse all of them until we have had further time to study their practical impact, I do not object to them. They could provide a useful foundation for thoughtful discussion. However, even with these proposals there are many minor inaccuracies in the report. It is my hope that you will substantially rethink and rework this report before its release. We would, of course, be willing to offer any appropriate assistance in such an endeavor.

Appendix V
Comments From the ITC Chairwoman

Frank C. Conahan Page 2

Elimination of the domestic industry, injury, and efficient and economic operation requirements

Chapter 2 of the draft report recommends elimination of the current domestic industry, injury, and efficient and economic operation requirements in section 337. Although the efficient and economic operation requirement could usefully be converted to one of the public interest factors that the Commission must consider before it orders relief, elimination of the domestic industry and injury requirements would be ill-advised.

Under the present statute, the Commission must weigh both the public interest served by protecting intellectual property and that served by fostering in the United States the entrepreneurial activity which exploits the intellectual property. Eliminating the domestic industry and injury requirements from section 337 would have the effect of removing the other equally-important policy concern that should be balanced against the policy element of the protection of intellectual property. Society does not obtain the maximum benefit from protecting intellectual property unless the property is exploited through the efforts and capital of the entrepreneur. It is such production related activity that spawns economic growth. Elimination of the domestic industry and injury requirement would transform the Commission into a forum for the adjudication of intellectual property rights. The Commission would spend the bulk of its time refereeing disputes among importers jockeying for market share in the United States, and would no longer concern itself with the effect of the unfair acts alleged on U.S. production facilities and jobs. One might argue that a jurisdiction of this nature would be better placed in the federal district courts.

The draft report's recommendation to eliminate the domestic industry and injury requirements also raises serious trade policy concerns. Intellectual property issues will be on the agenda for the new round of trade negotiations to be held under the auspices of the General Agreement on Tariffs and Trade (GATT). One important protection for section 337 is the "Grandfather Clause" of the GATT Protocol of Provisional Application, i.e., section 337 is almost certain of being interpreted as consistent with GATT by virtue of the Grandfather Clause so long as its present substance is preserved. Elimination of the economic tests would alter the substance of the statute and thereby remove Grandfather Clause protection. If the present industry requirement is to be eliminated, common sense dictates that this should be done in the context of the GATT negotiations so the United States can obtain concessions from its trading partners in return.

Appendix V
Comments From the ITC Chairwoman

Frank C. Conahan Page 3

Temporary relief, default, and issuance of exclusion orders in addition to cease and desist orders

Chapter 3 of the draft report recommends that section 337 be amended to require the Commission-

at the request of the complainant, to (1) make temporary relief effective with an administrative law judge's positive initial determination on temporary relief, while requiring the complainant to post bond, and (2) issue its final determination on temporary relief within 2 months of the initial determination

This is an interesting recommendation, its implementation would shorten the time required for the Commission to act on requests for temporary relief. However, the amendment should provide that complainant's bond, if forfeited, should go to the respondents rather than to the U S Treasury. The purpose of having complainant post a bond is presumably to hold respondents harmless if the Commission ultimately determines that there is no violation of the statute. This purpose can only be accomplished if complainant's bond, if forfeited, is payable to respondents and not to the U S Treasury.

Chapter 3 of the draft report also recommends that section 337 be amended to require the Commission -

when no respondents participate, to presume the facts in the complaint for the purposes of issuing a temporary exclusion order and continue with the current default proceedings, which are to be concluded no later than 6 months from the date of institution

This is also an interesting recommendation, albeit one with some definitional problems. One such problem involves deciding when a respondent is not participating in the investigation. Is non-participation to be equated with default? If so, many investigations will be several months old before it can be determined which respondents are participating. If not, how is non-participation to be defined? A related problem involves the situation where the last respondent ceases to participate one week short of six months after the date of institution of the investigation. Would the Commission still be required to complete its investigation within six months? These questions deserve further consideration.

Appendix V
Comments From the ITC Chairwoman

Frank C. Conahan Page 4

There is one aspect of default that is not addressed in the draft report --the ability of defaulting respondents to appeal adverse Commission determinations to the U S Court of Appeals for the Federal Circuit (CAFC). Section 337(c) currently provides that "[a]ny person adversely affected by a final determination of the Commission may appeal such determination to the United States Court of Appeals for the Federal Circuit." This provision allows defaulting respondents to appeal adverse Commission determinations to the CAFC, and such appeals have in fact been taken. See, e.g., *Unipak (H.K.) Ltd v U.S. ITC*, 645 F.2d 976, 990-991 (Fed. Cir. 1981). Consideration should be given to amending section 337 to prohibit defaulting respondents from appealing to the CAFC on issues other than those concerning whether the prescribed default procedures have been properly followed. There is no reason in law or policy why a respondent that defaults at the Commission should be permitted to appeal the Commission's substantive determination to the CAFC.

Chapter 3 of the draft report notes the need to speed relief in temporary relief and default cases. One way to speed relief in all section 337 investigations is to provide Commission administrative law judges with additional tools with which to control the discovery process. The Commission has published for comment (51 Fed. Reg. 5087, Feb. 11, 1986) a proposed rule which would authorize its administrative law judges to award attorney fees and costs for abuse of discovery.

The final recommendation of Chapter 3 is to amend section 337 to authorize the Commission to issue both exclusion orders and cease and desist orders to remedy the same unfair trade practice. This is a good idea and one which has a long history of support at the Commission.

Enforcement of exclusion orders

Chapter 4 of the draft report recommends, *inter alia*, that section 337 be amended to authorize the Commission "to direct the U.S. Customs Service to seize counterfeit or infringing goods when there is evidence that a firm or firms have on more than one occasion attempted to bring such goods into the country in knowing violations of exclusion orders." Seizure of counterfeit or infringing goods in situations where there are multiple, knowing attempts to import such goods is a constructive idea. However, it is the U.S. Customs Service, not the Commission, which should be authorized to order seizure. The Customs Service is charged with the responsibility of enforcing exclusion orders and is in the best position to determine whether "a firm or firms have on more than one occasion attempted to bring such goods into the country in knowing violation of" a Commission exclusion order. It is the Customs Service, therefore, that should have the authority to order seizure.

Appendix V
Comments From the ITC Chairwoman

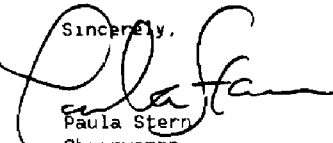
Frank C. Conahan Page 5

Technical comments

What follows is a series of technical comments on the draft report. The comments are arranged in the same order as the statements prompting them occur in the draft report.

[The technical comments referred to in this letter were not included, they were addressed as appropriate in the body of the report.]

Sincerely,



Paula Stern
Chairwoman

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