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**PRODUCT COUNTERFEITING: HOW FAKES ARE
UNDERMINING U.S. JOBS, INNOVATION, AND
CONSUMER SAFETY**

HEARING
BEFORE THE
SUBCOMMITTEE ON
COMMERCE, TRADE, AND CONSUMER PROTECTION
OF THE
COMMITTEE ON ENERGY AND
COMMERCE
HOUSE OF REPRESENTATIVES
ONE HUNDRED NINTH CONGRESS

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PRODUCT COUNTERFEITING: HOW FAKES ARE UNDERMINING U.S. JOBS, INNOVATION, AND CONSUMER SAFETY

WEDNESDAY, JUNE 15, 2005

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE, TRADE,
AND CONSUMER PROTECTION,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:59 p.m., in room 2123 of the Rayburn House Office Building, Hon. Cliff Stearns (chairman) presiding.

Members present: Representatives Stearns, Cubin, Radanovich, Bass, Ferguson, Rogers, Murphy, Blackburn, Barton (ex officio), and Schakowsky.

Staff present: Chris Leahy, policy coordinator; Brian McCullough, professional staff; Will Carty, professional staff; Lisa Miller, deputy communications director; Billy Harvard, clerk; Michael Abraham, clerk; David Nelson, minority investigator; Jessica McNiece, research assistant; and Jonathan Cordone, minority counsel.

Mr. STEARNS. The subcommittee will come to order. Good afternoon, everybody.

Today, counterfeiters have become just another competitor for legitimate U.S. businesses in the high stakes world of global commerce and remain busy in every industry and in every region of the world, developing new ways to exploit and steal the hard work, creativity, and knowledge of others. Unfortunately, in many areas of the world, the traditional practice of branding goods and registering trademarks no longer adequately protects the brand value and know how that is associated with distinctive and innovative products from the thieves and from the criminal organization.

My colleagues, as we hear from the distinguished panel before us today, global counterfeiting is not just limited to fake, high end watches, movie, DVDs, and designer apparel, it is a multi-billion dollar criminal enterprise that has infiltrated virtually every section of the United States economy, targeting our industrial know how in cars, computers, medicine, aircraft parts, and frankly just about everything. What is even more disturbing is that counterfeiting thieves are no longer content with just undercutting the inexpensive labor intensive product with cheaper fakes; they are going after high value products that represent a large part of the current U.S. intellectual capital and know how.

(1)

According to the World Custom Organization in Interpol, product counterfeiting and copyright privacy have increased from \$5.5 billion a year enterprise in 1982 to one that costs almost \$600 billion annually. In the United States, product counterfeiting alone costs United States businesses between \$200 and \$250 billion annually and that is a figure statistic according to the FBI.

Now if these numbers don't alarm you, be aware that counterfeiting is not a victimless crime. In terms of U.S. jobs, those sterile economic statistics translate into layoffs, plant closings at our home here in the United States. U.S. Customs and border protection calculate that the resulting loss in revenue from counterfeiting translates into the loss of more than 750,000 United States jobs. Companies both large and small are faced with sharply reduced revenue and of course lost profits when counterfeiters strike. This, in turn, translates into less capital to invest in expansion, research and development, and innovation. In the auto sector alone, the Federal Trade Commission estimated that by eliminating fakes, the U.S. auto industry could create at least 200,000 more auto related jobs all of the time when many of these jobs are being lost.

My concern today is about how fakes are robbing our U.S. companies of the hard earned intellectual property and ingenuity that they own and need to compete globally. Consumer safety is another area that greatly concerns our committee. Counterfeiters have attempted to sell fake baby formula, pharmaceuticals, phony aircraft parts just quickly to turn a fast buck. Those are frightening revelations that should concern all of us.

The World Health Organization figures that over 10 percent of the world's medicines are simply counterfeit with percentages reaching as high as 60 percent in the developing world. There also have been product recalls including consumer products like shampoo and lifestyle pharmaceuticals, increased technology capability has made counterfeiters even more brazen to push their way into lucrative intellectual property driven industries like healthcare, goods, and of course, pharmaceuticals. Deaths and injuries are inevitable if the current rate of counterfeiting continues.

The auto industry is starting to see more critical safety components like brake pads and windshields being counterfeited. And there are even reports from the FAA that over 2 percent of all aircraft replacement parts are counterfeited each year with some linked to fatal crashes.

My colleagues, this is a massive and pervasive problem that demands a massive and global response. I applaud the administration for action like STOP, the Strategic Targeting Organized Privacy Plan and for aggressively using the USGR Special 301 Report to call our countries out that should be doing better. According to the U.S. Custom Service, over 60 percent of sized counterfeit goods last year originated from China. As we learned last week, the administration is taking China to task for its lack of intellectual property rights enforcement placing it on the USGR Special 301 Priority Watch List.

But before we direct all the blame, we should also understand that counterfeiting is clearly a global phenomena and not just a Chinese one. Counterfeiting hotspots in Eastern Europe, South America, even in the United States are just capable of inflicting se-

rious damage on U.S. economy as any other region. Unfortunately, with today's advances in computer technology, global supply chain management, and the Internet, even the smallest counterfeiting operation based anywhere in the world can be a major problem for our companies.

As I said in last week's hearing on the U.S./China Joint Commission on Commerce and Trade, intellectual property rights are critical to our economy and to the engine of innovation. The fortress around our ingenuity, technological leadership, and creativity is the rule of law. And as we will hear today, it is time to insure that our laws are just as robust as they can be, that they are aggressively enforced, and that all relevant parties be required to live up to our international agreements regarding IPR especially obligations under WTO and the trade related aspects of intellectual property right agreement.

Again, I would like to welcome our distinguished panel of witnesses here today. I would especially like to welcome Dr. David Pearl of Uniweld, Incorporated, a family owned manufacturing company based in Fort Lauderdale, Florida for joining us today. Your story gives a voice to all the U.S. small companies that are also feeling the brunt of this global problem.

I would also like to thank the U.S. General Accounting Office for the samples of counterfeit products they provided to us this afternoon. They are on the table there and we look forward to the testimony from our witnesses. And I would say we will be showing a video, a 5-minute video after the opening statement on counterfeiting so I look forward to that.

With that, the ranking member, Ms. Schakowsky.

[The prepared statement of Hon. Cliff Stearns follows:]

PREPARED STATEMENT OF HON. CLIFFORD STEARNS, CHAIRMAN, SUBCOMMITTEE ON COMMERCE, TRADE, AND CONSUMER PROTECTION

Good afternoon. Today, counterfeiters have become just another competitor for legitimate U.S. businesses in the high-stakes world of global commerce, and remain busy in every industry and in every region of the world developing new ways to exploit and steal the hard work, creativity, and knowledge of others. Unfortunately, in many areas of the world, the traditional practice of branding goods and registering trademarks no longer adequately protects the brand value and know-how associated with distinctive and innovative products from thieves and criminal organizations. As we will hear from the distinguished panel before us today, global counterfeiting is not just limited to fake high-end watches, movie DVDs, and designer apparel, it is a multi-billion dollar criminal enterprise that has infiltrated virtually every sector of the U.S. economy—targeting our industrial know-how in cars, computers, medicines, aircraft parts, or just about anything.

What's even more disturbing is that counterfeiting thieves are no longer content with undercutting inexpensive, labor-intensive products with cheaper fakes; they are going after high-value products that represent a large part of current U.S. intellectual capital and know-how. According to the World Customs Organization and Interpol, product counterfeiting and copyright piracy have increased from a \$5.5 billion dollar a year enterprise in 1982 to a one that costs almost \$600 billion annually. In the U.S., product counterfeiting alone costs U.S. business \$200-\$250 billion annually, according to the FBI.

If the numbers don't alarm you, be aware that counterfeiting is not a victimless crime. In terms of U.S. jobs, those sterile economic statistics translate into layoffs and plant closings at home. U.S. Customs and Border Protection calculate that the resulting loss in revenue from counterfeiting translates into the loss of more than 750,000 U.S. jobs. Companies, both large and small, are faced with sharply reduced revenue and lost profits when counterfeiters strike. This, in turn, translates into less capital to invest in expansion, research and development, and innovation. In the auto sector alone, the Federal Trade Commission estimated that by eliminating

fakes, the U.S. auto industry could create at least 200,000 more auto-related jobs, all at a time when many of these jobs are being lost. Our concern today is about how fakes are robbing our U.S. companies of the hard-earned intellectual property and ingenuity that they own and need to compete globally.

Consumer safety is another area that greatly concerns the Committee. Counterfeiters have attempted to sell fake baby formula, counterfeit pharmaceuticals, and phony aircraft parts to turn a fast buck. Those are frightening revelations that should alarm all of us. The World Health Organization (WHO) figures that over ten percent of the world's medicines are counterfeit, with percentages reaching as high as 60% in the developing world. There also have been product recalls involving consumer products like shampoo and life-style pharmaceuticals. Increased technological capability has made counterfeiters even more brazen to push their way into lucrative, intellectual property-driven industries like healthcare goods and pharmaceuticals. Deaths and injuries are inevitable if the current rate of counterfeiting continues. The auto industry is starting to see more critical safety components like brake pads and windshields being counterfeited, and there are even reports from the Federal Aviation Administration (FAA) that over 2% of all aircraft replacement parts are counterfeited every year, with some linked to fatal crashes.

This is a massive and pervasive problem that demands a massive and global response. I applaud the Administration for action like the STOP! (Strategy Targeting Organized Piracy) Initiative and for aggressively using the USTR Special 301 Report to call out countries that should be doing better. According to the U.S. Customs Service, over 60% of seized counterfeit goods last year originated from China. As we learned last week, the Administration is taking China to task for its lack of Intellectual Property Rights (IPR) enforcement, placing it on the USTR Special 301 Priority Watch List. But before we direct all the blame, we should also understand that counterfeiting is clearly a global phenomenon not just a Chinese one. Counterfeiting hot spots in Eastern Europe, South America, and even in the U.S. are just as capable of inflicting serious damage on U.S. economy as any other region. Unfortunately, with today's advances in computer technology, global supply chain management, and the Internet, even the smallest counterfeiting operation based anywhere in the world can be a major problem for our companies.

As I said at last week's hearing on the U.S.-China Joint Commission on Commerce and Trade (JCCT), Intellectual Property Rights (IPR) are critical to the U.S. economy and its engine of innovation. The fortress around our ingenuity, technological leadership, and creativity is the rule of law. And as we will hear today, it is time to ensure that our laws are as robust as they can be, they are aggressively enforced, and that all relevant parties be required to live up to our international agreements regarding IPR, especially obligations under the WTO and the TRIPs (Trade-Related Aspects of Intellectual Property) agreement.

Again, I would like to welcome our distinguished panel of witnesses here today. I would like to especially welcome Mr. David Pearl of Uniweld Inc., a family-owned manufacturing company based in Fort Lauderdale, Florida for joining us today. Your story gives a voice to all the U.S. small businesses that are also feeling the brunt of this global scourge. I also would like to thank the U.S. General Accounting Office for the samples of counterfeit products they provided us for this hearing. We look forward to the important testimony from all of our witnesses. Thank you.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman. I appreciate you calling today's hearing.

Counterfeiting poses a threat not only to our present and future economic wellbeing, but also to the health and safety of all Americans. Many Americans think of counterfeits as limited to poor copies of luxury products that are sold on city street corners. However, we know that the problem is much bigger than a fake Kate Spade bag and has serious consequences that we must explore. I am pleased that we will be discussing counterfeit auto parts and prescription drugs. Our witnesses' testimony, which I look forward to hearing, should add urgency to the task of dealing with foreign pirates that steal intellectual property and undermine the healthy of the economy.

While stealing our movies is wrong, selling defective medicines, auto brake parts, or helicopter rotor components to Americans or people anywhere in the world is a heinous crime, yet such crimes

occur every day. The question we must ask is what is this administration doing about it. Where is the commitment to defend this country from those that would profit from counterfeit goods regardless of the human consequences? The Food and Drug Administration is charged along with customs to protect us from counterfeit drugs.

I support re-importation and I believe that we could do it safely while the administration continues to block comprehensive re-importation legislation ostensibly to guarantee safety. It is not doing its job with drugs that are coming into the country already. The oversight committee has discovered that the real policy of this administration seems to be to allow virtually any knockoff pharmaceutical into the United States unimpeded. The FDA has tested counterfeits, found them to be subpotent and yet still allowed them to proceed into the commerce of the United States.

When confronted with hard facts regarding this problem by a committee, the administration chose to solve the problem by directing that no more packages containing prescription drugs shipped to individuals be opened at the international mail facility in Miami. I guess they figure that if they don't see it, they cannot be blamed. Even when we try to stop counterfeits, we are facing an uphill battle. Customs has been overwhelmed by years with too many containers and too few inspectors. And that was before 9/11. Now with those scarce resources shifted to the detection of possible chemical, biological, or nuclear weapons, we are increasingly vulnerable to the threats posed by fake auto and aircraft parts and other counterfeit products with the potential to do serious harm.

The Internet has made shopping for substandard goods very easy. Visa and MasterCard have made their entry into the commerce of the United States simple and virtually without consequence. What can we do about it? Should the transporters and financiers of these often dangerous products take some responsibility for their involvement in illegal commerce?

The entry and sale of counterfeit goods in the United States is already a crime. Nonetheless, it may be that the laws do need to be tightened. We know that more resources must be devoted to this fight; however, the problem with counterfeit goods appears to be more likely a case of tragically misplaced priorities by the executive branch. That this administration chooses not to devote the necessary enforcement resources is what has enabled the swelling wave of privacy—piracy, excuse me, piracy.

Last week, we had a hearing on trade with China. The Department of Commerce witness sent here with little or no preparation or ability to answer many of our questions on most subjects did tell us that despite paper promises, counterfeiting in China continues unabated. Why hasn't the administration taken concrete action to stop this?

Mr. Chairman, I would like to see the officials from HHS, Homeland Security, and the Commerce Department that are responsible for the lax enforcement of existing laws and the appeasement trade policy come before us to tell us why they are failing to protect our workers, companies, and the public as a whole from counterfeit products. I hope that we will be able to hear from them as we continue our work on trade.

Mr. Chairman, I thank you for today's hearing. I believe this committee should get to the root cause of the rip offs that are rapidly displacing jobs and threatening the safety of all Americans. And I believe that the administration must be called to account.

Mr. STEARNS. I thank the gentlelady.

Mr. ROGERS?

Mr. ROGERS. Thank you, Mr. Chairman.

I want to thank the panelists for being here today and I hope this does not become a partisan argument about what policies do and do not work. Every product that we see up on that table cost an American a job. It costs financial reinvestment in that particular business or growth.

This is a serious problem that really has exploded over the last few years exponentially. And together, I think we can come up with a very good common sense solution to target these folks who are costing American jobs. And the climate has changed.

It used to be in America we did not have to worry about folks who were doing knockoffs and other things because we were going to be more innovative and more competitive. Well the world has caught up and we have to do a couple of things. We need to stand up for the world and every country that participates in commerce saying hey, look, you need to live by the rule of law. We need to abide by the sanctity of contracts, and we need to protect intellectual property rights. If we do those things, we will have commerce for generations that benefit not only every American, but certainly our trading partners as well.

So again, I appreciate your being here. I don't believe that there is a single person at fault in this process. I commend the chairman for having this hearing and setting us on a course to take some pretty tough and aggressive action in protecting these American jobs and your products and your ability to protect your intellectual property.

So Mr. Chairman, I thank you again, and I yield back the remainder of my time.

Mr. STEARNS. I thank the gentleman.

The gentlelady from Tennessee, Ms. Blackburn.

Ms. BLACKBURN. Thank you, Mr. Chairman. And I want to thank you for holding this hearing today and for your attention to the importance of intellectual property. I will tell you among my constituents in Tennessee, you are building a pretty good fan base but we are not ready to let Florida Gators take on UT. We are going to reserve that one.

Mr. STEARNS. Okay.

Ms. BLACKBURN. But they do appreciate the attention that the subcommittee is putting to protecting those whose production of their product and practicing their trade depends on being able to apply a value to their intellectual property.

And Mr. Chairman, this weekend, I held a listening session in Nashville on intellectual property theft and on our trade with China. And in the room we had songwriters, we had record labels, we had recording engineers, we had film producers, music publishers, book publishers, and artists. And they all came together and shared their thoughts on how this theft and how counterfeiting impacts them and their ability to earn a living practicing their

craft. And it is important for us to point out that this does not just impact big business. In my district and in my state, it impacts small business and independent contractors.

Mr. Chairman, I look forward to hearing the testimony of our witnesses. I thank our panel for being with us today and I look forward to working with you and the administration as we address the issues that we are going to discuss here today.

Thank you. I yield back.

Mr. STEARNS. Thank you.

Mr. Ferguson, New Jersey.

Mr. FERGUSON. Thank you, Mr. Chairman for holding this hearing on an issue that is really of immense importance to many of the industry sectors in our country and many of them are represented today.

The all out theft of intellectual property and copyrights and the blatant copying of products innovated in our country presents grave threats both to our economy and to the health and safety of our citizens. Whether it is the widespread copying of American movies and songs in places like China, to the counterfeiting of pharmaceuticals practically everywhere throughout the world, stealing these patent processes is a tremendous threat.

The committee has held hearings over the past few years looking into the harm that comes from counterfeiting and patent and copyright infringement. The legal and dangerous fake pharmaceuticals account for hundreds of deaths and many other health complications around the world. These killer drugs find their way to our shores today even with the stringent controls that we have on pharmaceutical imports.

This issue further underscores the threat that is present and that our vigilance—continued vigilance is really necessary. We have to know for certain where our pharmaceuticals actually are coming from and not let this supposed specter of savings from imported drugs from other countries allow us to forget the dangers that are present with drugs coming into our country from other countries.

And I have to respectfully suggest to my friends in this Congress who say they support the re-importation of drugs into our country yet are very concerned about the issue of counterfeits. Wake up and smell the coffee. Let us get a clue, folks. If you like counterfeit drugs, you will love re-importation.

When you—we are going to hear today from some of our witnesses about the poorest borders of the EU. We are going to hear about counterfeit drugs being made in Russia and how they make their way into the EU and eventually of course will make their way into the United States. We have folks who say well importation from Canada is no problem. Well where is Canada getting their drugs? We are seeing huge increases of imports from places all around the world into Canada. Canada cannot possibly supply their drugs needs and ours. So where is Canada getting the drugs?

If you like counterfeit drugs, you will love drug re-importation. And we have to deal with that. We have to wake up and smell the coffee on that because saying that we are going to simply start importing our drugs from other countries and that somehow is going to solve the counterfeit problem. We are having a tough enough

time dealing with the counterfeit problem, even with the tough laws and stringent standards that we have in this country today. We are kidding ourselves if we think we are going to help solve the counterfeit problem. We are going to make it exponentially worse.

Today I also want to make sure I welcome Mr. Jim Christian, who is here from Novartis. I am looking forward to his insights based on the counterfeiting issue. His insights are, of course, based on over 30 years of fighting counterfeiting.

Welcome to all of our panelists today, we look forward to hearing all of your insights.

Thank you, Mr. Chairman, I yield back.

Mr. STEARNS. Thank you, gentleman.

The gentleman from New Hampshire, Mr. Bass.

Mr. BASS. Mr. Chairman, I think this is an interesting hearing and I am eager to hear the witnesses, so I will waive.

Mr. STEARNS. All right. The gentleman waives.

And with that, we welcome—I think we are going to play the video first, so with that, we will shut the lights off so we can see the video.

[Video.]

Mr. STEARNS. Well that was a pretty good introduction here. The chairman of the full committee, Mr. Barton is recognized.

Chairman BARTON. Mr. Chairman, I am not going to be here very long. I appreciate the hearing and I have scanned the testimony. This is a serious issue, and I appreciate you doing it.

[The prepared statement of Hon. Joe Barton follows:]

PREPARED STATEMENT OF HON. JOE BARTON, CHAIRMAN, COMMITTEE ON ENERGY AND COMMERCE

Thank You, Chairman Stearns, for holding this important hearing today. This subcommittee had a hearing last week on U.S.-China trade issues, and particularly intellectual property issues. This hearing on how counterfeiting hurts the American economy and American consumers is a natural extension of that discussion.

Intellectual property (IP) is one of our country's biggest exports. From movies and music to pharmaceuticals and manufactured goods, our innovation, creativity, and entrepreneurship are some of our most important cultural and economic strengths. Given our growing trade deficit—not to mention other concerns such as currency manipulation—it is increasingly important that we protect the economic rights of our inventors, engineers, and designers. In that spirit, I would like to commend the Administration for its interagency "STOP! Initiative," and specifically, the United States Trade Representative for recently placing China on the Special 301 Priority Watch List because of the rampant rate of counterfeiting and piracy in that country. Last year, more than 66% of counterfeit goods seized by U.S. Customs were traced to China. I trust that the administration will continue to keep a vigilant eye on this issue in China and elsewhere.

The growth of the global market for illegal goods has grown exponentially in the last 20 years, estimated now to be more than \$600 billion dollars a year. More than one third of that amount is in fake American goods, which is estimated to cost the U.S. economy over ¾ of a million jobs. We all enjoy cheaper goods, but nobody wants to lose U.S. jobs. We expect our trade partners to enforce international law with regard to copyrights, patents and trademarks in order to prevent these losses. Importantly, the members of the World Trade Organization and signatories to the Trade-Related Aspects of Intellectual Property Agreement ("TRIPs Agreement")—including the U.S., China, and India—agree to abide by minimum standards for IP protection, including requiring enforcement procedures for any IP infringement. These agreements need to be adhered to and enforced.

Regardless of whether counterfeit products come from China, Russia, Ukraine, Brazil, India, or elsewhere, there is significant economic impact to American companies. However, there is sometimes less discussion of an equally important concern regarding the safety of some of these products for consumers. When fake automobile brake pads or counterfeited airline parts are thought to be genuine, they are in-

stalled and presumed safe. When this happens, all of us are at risk. Furthermore, counterfeit pharmaceuticals—which may account for as much as 60% of the market in some countries—frequently do not have the proper ingredients or the proper amounts of those ingredients, rendering them at the very least ineffective, and at worst potentially lethal. Our country has an economic, regulatory, and legal system that ensures a high degree of safety and accountability. When products come into this country that do not abide by the same rules, the entire system is undermined. This must not be allowed to continue as it does.

Simply put, Mr. Chairman, this is a serious concern for our country. Our economy relies heavily on our ability to innovate and improve American products for sale here and around the world. If the economic incentives to “build a better mousetrap” are eroded, it could have devastating effects on our economy. Additionally, the American people expect their government to protect them against unsafe products whatever they may be. We have a responsibility to keep dangerous counterfeits out of the market.

I want to thank the Chairman for putting this panel together to help us understand the extent of these problems and the implications for American industries and consumers. I look forward to their testimony.

I yield back the balance of my time.

Mr. STEARNS. I thank the distinguished chairman. Ms. Cubin is recognized.

Ms. CUBIN. Thank you, Mr. Chairman. I will pass at this time so that I will have more time in questions.

[The prepared statement of Hon. Barbara Cubin follows:]

PREPARED STATEMENT OF HON. BARBARA CUBIN, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF WYOMING

Thank you, Mr. Chairman.

In their wisdom, the founders of our Nation gave Congress the constitutional power to protect the Intellectual Property of “Authors and Inventors” in order to “promote the Progress of Science and the useful Arts.” Among the many political and legal innovations of the Constitution, the addition of this enumerated power to Article I was agreed to unanimously. The spirit of ownership contained in this clause as well as throughout our country’s founding document lives on today as a cornerstone of our economy.

Patents encourage groundbreaking innovation and development by protecting the IP that is even more valuable than material components. Copyrights serve the cause of the arts by rewarding creativity. Trademarks protect consumers from confusion and deceptive marketing practices by allowing them to identify and distinguish unique goods and services.

But we still have much work to be done in protecting IP to keep up with technological innovations and meet the challenges presented by the global marketplace, in which some of our fellow World Trade Organization members and trading partners, like China, fail to comply with their IP protection obligations. The astonishing rates of counterfeiting and piracy in countries like China, to go along with a lack of effective deterrents, casts a long dark shadow on our efforts to promote fair and open global trade. From software and artistic content to auto parts and pharmaceuticals, the lack of IP protection abroad harms U.S. industries and small business owners and in many instances poses a danger to consumer safety.

I look forward to our panel’s insight into the efficacy to date of IP protections in international trade agreements. I hope their expertise will help us identify how to better enforce these obligations abroad, as well as provide guidance as to how we can best protect IP in future trade agreements.

Mr. Chairman, I yield back the balance of my time.

Mr. STEARNS. Okay. All right. With that, we welcome Mr. Scott Emmer, Brand-Protection Manager of the Federal-Mogul Corporation; and Mr. Stephen Arthur, Grocery Manufacturers Association; and Mr. James Christian, Head of Corporate Security at Novartis International; and Mr. David S. Pearl, Executive Vice President, Uniweld Products; and Mr. Steve DelBianco, Vice President, Association of Competitive Technology, Member of U.S. Chamber. And before you start your testimony, I think the ranking member has a request.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman.

I just ask for unanimous consent to submit the testimony of the ranking member, John Dingell into the record.

Mr. STEARNS. By unanimous consent, so ordered.

[The prepared statement of Hon. John Dingell follows:]

PREPARED STATEMENT OF HON. JOHN D. DINGELL, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF MICHIGAN

Mr. Chairman, thank you for calling this hearing today. During my tenure as Chairman, the Subcommittee on Oversight and Investigations held 35 days of hearings on unfair foreign trade practices over some six Congresses. Those hearings detailed many of the same problems we are examining today—counterfeiting, customs fraud, market entry barriers, and other unfair and illegal practices undertaken by foreign pirates aided and abetted by their governments. These scoundrels have continued to steal our jobs, our technology, our very economic future, and endanger the safety and health of American consumers.

Those hearings in the 1980s did see a modicum of change in the approach to this piracy. We passed a stringent law to prevent the entry of counterfeit drugs that unfortunately goes unenforced by this Administration.

We conditioned certain trade preferences upon respect for American patents, copyrights, and trademarks. This was targeted at the emerging economic powers of Southeast Asia. Today, our intellectual property problems in Taiwan, Korea, Singapore, and even Hong Kong are apparently greatly diminished.

In a single Appropriations bill, we managed to add and fund 1,500 new U.S. Customs officials to fight fraudulent entry of contraband goods at our borders. They were used to good effect.

But the last decade or so has seen a growing deterioration in the concern for the well-being of American jobs and health and safety. Free trade agreements have become purposes unto themselves with little or no care for the consequences paid by American workers and their employers in this country.

Yes, we have negotiated intellectual property protection in these agreements as well as in the multinational setting of the WTO. But the paper acquiescence of certain of our trading partners, notably China, has not diminished their appetite for stealing American ideas or American jobs. And we still have those U.S. Customs agents, but they are now trying to prevent the infiltration of weapons of mass destruction rather than policing our borders for commercial contraband.

This Administration has reached new heights of inaction. Last week we held a hearing on China trade and the Commerce Department could not even be bothered to send knowledgeable witnesses. The Director of the Patent Office did testify and confirmed that counterfeiting continues unabated in China despite repeated promises of reform. He told this Committee that if he were the owner of a business that was dependent upon intellectual property protection, he would not open an office in China. Yet he could not tell us if the U.S. could or would file a WTO case against that country that not only protects but actually encourages pirates.

The most recent estimate is that 15 percent of the total manufactured goods produced in China are counterfeit, totaling some 8 percent of that country's GNP. Counterfeiters are not targets of the Chinese Government; they apparently are valued partners.

Yet we stand by hoping that somehow the Chinese will mend their ways as their economic power and our debt to them grows. Meanwhile, our trade agreements with Mexico and other developing countries and the proposed Central American Free Trade Agreement just open back doors for Chinese goods, counterfeit or not, and often produced with stolen American ideas, to enter our commerce virtually unimpeded.

Among the victims of this epidemic of piracy are the workers, manufacturers, and consumers of auto parts. It is estimated that counterfeit auto parts is a \$12 billion business worldwide with \$3 billion of lost sales within the United States, and possibly as many as 200,000 jobs have been lost. But consider the unknown dimensions of this tragedy. There are no National Transportation Safety Board investigations of auto accidents. How many deaths and crippling injuries are caused by defective parts? We do not know but we do know that no one has ever made money selling counterfeits that were superior in quality to the original.

Mr. Chairman, I am pleased that we will have the Commerce Secretary before us soon. I hope we will also have the Food and Drug Administration, the U.S. Trade Representative, and the U.S. Customs and Border Protection before us in the near future, as I have some questions for those Agencies. Our constituents are demand-

ing that their Government protect them from illegal trade practices and we should hold the Administration accountable to them.

Mr. STEARNS. So with that, Mr. Emmer, we will start with you.

STATEMENTS OF SCOTT EMMER, BRAND PROTECTION MANAGER, FEDERAL-MOGUL CORPORATION, ON BEHALF OF THE MOTOR AND EQUIPMENT MANUFACTURERS ASSOCIATION; STEPHEN C. ARTHUR, VICE PRESIDENT, GOVERNMENT AFFAIRS, GROCERY MANUFACTURERS ASSOCIATION; JAMES CHRISTIAN, HEAD OF CORPORATE SECURITY, NOVARTIS INTERNATIONAL AG; DAVID S. PEARL II, EXECUTIVE VICE PRESIDENT, UNIWELD PRODUCTS, INC.; AND STEVE DELBIANCO, VICE PRESIDENT, ASSOCIATION OF COMPETITIVE TECHNOLOGY, MEMBER, U.S. CHAMBER OF COMMERCE, COALITION AGAINST COUNTERFEITING AND PIRACY

Mr. EMMER. Thank you, Mr. Chairman and members of the—

Mr. STEARNS. I would just have you pull the mike a little closer to you. Is that better? I think it is, great.

Mr. EMMER. Thank you, Mr. Chairman and members of the committee for this opportunity to testify today.

My name is Scott Emmer and I am Brand Protection Manager at Federal-Mogul Corporation. We are a global manufacturer of automotive products such as brake, ignition, and chassis products for original equipment manufacturers and the aftermarket which are sold under our well-known brand names to include Champion, MOOG, FERODO, and Wagner. Federal-Mogul is headquartered in Southfield, Michigan and is a global corporation with 55 manufacturing facilities in the United States and a total of 196 facilities worldwide employing 45,000 workers. I appreciate this opportunity to testify today on the problem of product counterfeiting.

First, I just wanted to give a mention of my background which consists of a master's degree in criminal justice, as well as 4 years with the Central Intelligence Agency. Now as Brand Protection Manager for Federal-Mogul, I have a responsibility for all anti-counterfeiting initiatives to include pursuing enforcement against violators of Federal-Mogul's intellectual property both in the U.S. and abroad. Also for raising public awareness within Federal-Mogul and the general public regarding the negative impact caused by counterfeit automotive products, as well as developing a proactive brand protection solution encompassing a product marketing technology for authentication, tracking and tracing.

Federal-Mogul Corporation and its workers are proud to provide high quality products to our customers in the United States and abroad. We are proud to be part of a network of thousands of automotive suppliers in the United States providing the technologies and products that go into making and servicing the safest and most technologically advanced motor vehicles available anywhere in the world. Today our company and our industry are helping to keep drivers safe and enjoying better technologies and products for their motor vehicles year after year. Due to the assault on intellectual property by Chinese counterfeiters, continuing that record of safety and value to American consumers is going to require the diligent attention and involvement of the U.S. Government. We believe in

the integrity of the U.S. market and we aim to do our part to keep it that way. But we need the U.S. Government's help to stop Chinese counterfeiters, as well as counterfeiters from other countries from exporting fake product to America.

Our company and many other automotive suppliers like us are equipped to compete in the global market. Now in China, as well as other markets, we are forced to compete not just against other legitimate manufacturers but against a strong determined criminal element that makes money by stealing our brand names and making off in inferior and defective copies of our products.

Companies work for years building a brand reputation and brand loyalty. Inferior counterfeit products can ruin years of hardworking investment. Destruction of a producer's brand name and good reputation in the market from counterfeit products can be even more serious to a supplier over the long term than the direct loss of sales. Furthermore, legitimate American manufacturers cannot get a foothold in the Chinese market or in other markets where counterfeiters get deep market coverage and often exist out in the open.

As a global corporation, we need to be able to offer products and technologies appropriate to each market. However, introduction of a new product or technology to China to buildup our business in that market creates a huge risk that the product or technology will be copied and counterfeited on a massive scale.

Keeping counterfeit products out of the American market is a first and foremost concern to our company. We believe it will not be enough just to play defense protecting the U.S. market from counterfeiters; we believe the U.S. Government with the support of industry must also go on the offensive and track the counterfeit products back to their source in China. We appreciate all of the efforts the Government has made up to this point, but we believe continued diligence and more action will be required.

I would like to show you some of the products that Federal-Mogul has found and discuss each one briefly. One of our biggest problems involves counterfeit Champion spark plugs, which are mainly produced in China. I have a couple on display on the front table and on the table—

Mr. STEARNS. If you don't mind, why don't we have the staff just pick them up and then the members could see them. Is that possible?

Mr. EMMER. These counterfeit products or spark plugs rather are exported from China worldwide to include the Middle East, Africa, and North America. Those are the two spark plugs. If they are passed around—Federal-Mogul in this particular case, Federal-Mogul was actually contacted by a counterfeit distributor in Canada who offered to sell us our own Champion spark plugs at a cost far below what we actually—or at a price far below our actual costs. We have since initiated enforcement against this distributor but this example shows a blatant disregard for intellectual property rights to genuine brand owners.

Mr. STEARNS. Are both of these counterfeits?

Mr. EMMER. I believe the one in your left hand is counterfeit. On the package, it should have a tag that says genuine, as well as counterfeit.

Mr. STEARNS. Okay.

Mr. EMMER. The shinier of the two is the counterfeit spark plug.

Mr. STEARNS. I see, I can tell. This one is a counterfeit, okay.

Mr. EMMER. The quality of those are suspect and often fell after 50, 100, upwards of 1,000 miles, also posing severe safety risks to render a vehicle inoperative, as well as potentially projecting out of the engine like a bullet would, so there are some clear safety issues involved with these. You will note from looking at those the similarities in it and it is often extremely different to tell the two apart.

The second example I have, and there is simply some digital pictures on the table as well, but these are the infringing MOOG chassis products which are found or are being sold rampantly in the Middle East, as well as on the East Coast of the United States. Those parts are actually chassis and suspension products that aid the vehicles steering and suspension and when they fell, a vehicle can easily get involved in an accident. Those particular parts that we found are—post a very significant safety threat to the general public since those parts are found on taxi cabs, commercial vans, as well as school buses, so our kids are also at risk.

Federal-Mogul and other automotive suppliers have taken steps to protect our intellectual property. For example, we have pursued joint enforcement action against counterfeiters to seize products. In addition, we worked with U.S. Customs to seize infringing products and we also worked with foreign Customs to include China to seize counterfeit products intended for export. We are also taking steps to include product marketing technologies for easier packaging authentication.

Unfortunately, the profit motive for criminals dealing in counterfeit goods is huge and they are working every day to thwart our efforts.

The House of Representatives recently passed by unanimous consent H.R. 32, the Stop Counterfeiting in Manufactured Goods Act. Federal-Mogul and the automotive supplier industry strongly supported that legislation and were heartened by your action. Our industry is presently seeking similar action in the Senate.

Measuring the impact of this criminal activity is very difficult and beyond the ability of any one company or industry. We would, therefore, urge you to support efforts by the OECD to study global counterfeiting.

Federal-Mogul appreciates your attention to this important industry problem and urges you to combat product counterfeiting with diligent enforcement and constructive but firm discussion with the Chinese Government for the good of our company, our industry, our customers, and the general public.

I appreciate this opportunity to testify today and I will be happy to answer any questions that you may have.

[The prepared statement of Scott Emmer follows:]

PREPARED STATEMENT OF SCOTT EMMER, FEDERAL-MOGUL CORPORATION

Thank you Mr. Chairman and members of the committee for this opportunity to testify today. My name is Scott Emmer. I am the Brand Protection Manager for Federal-Mogul Corporation. We are a global manufacturer of automotive products, such as brake, ignition and chassis products for Original Equipment Manufacturers and the Aftermarket, which are sold under our well-known brand names to include Champion, MOOG, Wagner and FERODO. Federal-Mogul, headquartered in South-

field, MI is a global corporation with 55 manufacturing facilities in the United States and a total of 196 facilities worldwide, employing 45,000 workers. I appreciate this opportunity to testify today on the problem of product counterfeiting.

As brand protection manager for Federal-Mogul, I have responsibility for all anti-counterfeiting initiatives including: pursuing enforcement against violators of Federal-Mogul's intellectual property both in the US and abroad; raising public awareness within Federal-Mogul and the general public regarding the negative impact caused by counterfeit automotive products; and developing a proactive brand protection solution encompassing product marking technologies for authentication, tracking and tracing.

Federal-Mogul Corporation and its workers are proud to provide high quality products to our customers in the United States and abroad. We are proud to be part of a network of thousands of automotive suppliers in the United States providing the technologies and products that go into making and servicing the safest and most technologically advanced motor vehicles available anywhere in the world. Today, our company and our industry are helping to keep drivers safe and enjoying better technologies and products for their motor vehicles year after year. Due to the assault on intellectual property by Chinese counterfeiters, continuing that record of safety and value to American consumers is going to require the diligent attention and involvement of the U.S. Government. We believe in the integrity of the U.S. market and we aim to do our part to keep it that way. But we need the US Government's help to stop Chinese counterfeiters, as well as counterfeiters from other countries, from exporting fake product to America.

Our company, and many other automotive suppliers like us are equipped to compete in the global market. Now, in China, as well as other markets, we are forced to compete not just against other legitimate manufacturers, but also against a strong, determined criminal element that makes money by stealing our brand name and making often inferior and defective copies of our products.

Companies work for years building a brand reputation and brand loyalty. Inferior counterfeit products can ruin years of hard work and investment. Destruction of a producer's brand name and good reputation in the market from counterfeit products can be even more serious to a supplier over the long term than the direct loss of sales. Furthermore, legitimate American manufacturers cannot get a foothold in the Chinese market, or in other markets, where counterfeiters get deep market coverage and exist out in the open.

As a global corporation, we need to be able to offer products and technologies appropriate to each market. However, introduction of a new product or technology to China, to build our business in that market, creates a huge risk that the product or technology will be copied and counterfeited on a massive scale.

Keeping counterfeit products out of the American market is of first and foremost concern to our company. We believe it will not be enough just to play defense, protecting the U.S. market from counterfeiters. We believe the U.S. government, with the support of industry must also go on the offensive, and track the counterfeit products back to their source in China. We appreciate all the efforts the government has made up to this point, but we believe continued diligence and more action will be required.

I would like to show you some of the counterfeit products Federal-Mogul has found and discuss each one briefly. One of our biggest problems involves counterfeit Champion spark plugs, which are mainly produced in China. These plugs are then exported worldwide to include the Middle East, Africa and North America. Federal-Mogul was actually contacted by a counterfeit distributor in Canada who offered to sell Champion spark plugs at a price below our actual costs. We've since initiated criminal enforcement against this distributor, but this example shows the blatant disregard for intellectual property rights of genuine brand owners.

I've brought a couple of sample counterfeit products for your review. First, please find two genuine and two counterfeit Champion spark plugs that were imported into Latin America from China. Please note that the counterfeit packaging and plugs are nearly identical to the genuine product. Second, please find pictures of genuine and infringing MOOG Chassis Products found not only in the Middle East, but also on the East Coast of the United States. These infringing MOOG parts pose a significant safety threat to the general public, especially in this case since these counterfeit parts are used to repair taxicabs, commercial vans and school buses.

Federal-Mogul and other automotive suppliers have taken steps to protect our intellectual property. For example, we pursue joint enforcement action against counterfeiters to seize products. In addition, we work with US Customs to seize infringing products and we work with foreign Customs including China to seize counterfeit products intended for export. Further, we are taking steps to incorporate product-marking technologies into our packaging for easier authentication.

But the profit motive for criminals dealing in counterfeit goods is huge and they are working everyday to thwart our efforts.

The House of Representatives recently passed by unanimous consent HR 32, "The Stop Counterfeiting in Manufactured Goods Act." Federal-Mogul and the automotive supplier industry strongly supported that legislation and were heartened by your action. Our industry is presently seeking similar action in the Senate.

Measuring the impact of this criminal activity is very difficult, and beyond the ability of any one company or industry. We would, therefore, urge you to support efforts by the OECD to study global counterfeiting.

Federal-Mogul appreciates your attention to this important industry problem and urges you to combat product counterfeiting with diligent enforcement and constructive, but firm discussion with the Chinese government for the good of our company, our industry, our customers and the general public.

Thank you for this opportunity to testify. I will be glad to answer your questions.

Mr. STEARNS. Thank you.

Mr. Arthur?

STATEMENT OF STEPHEN C. ARTHUR

Mr. ARTHUR. Thank you.

I am Steve Arthur. I am Vice President of Government Affairs for GMA, the Grocery Manufacturers Association. And I am pleased here to be today to talk about this issue of great concern to our member companies and we very much appreciate the chairman's interest and the interest of the committee in this issue.

Just a little background. GMA is the world's largest association of food, beverage, and consumer product companies. With U.S. sales of more than \$500 billion, GMA members employ more than 2.5 million employees in all 50 States.

Unfortunately, they are also victims of many counterfeiting operations that have the potential to do serious harm to their reputations and to their bottom lines. I have submitted formal comments for the record so what I wanted to do is simply highlight the main issues surrounding the counterfeiting issues that I raised in that testimony.

We see three key problems associated with counterfeiting. The first is the increasing scope and danger of counterfeiting. And I think the video and a number of the opening statements highlighted those some of the legal barriers to punishing offenders here in the United States and the lack of adequate enforcement abroad.

As the chairman mentioned, more than \$200 billion of counterfeiting activity—or \$200 billion of economic activity costs through counterfeiting each year and I think it was also mentioned by another of the members that 750,000 jobs are believed to have been lost because of counterfeiting.

Just recently, just to give you an example of some of the members from our member companies just in the last 3 months things that have been found: milk drinks, wine, and rum, soy sauce, detergents, insecticides, perfumes, and cosmetics and that is just in the last few months. And there is—it is costing our member companies millions of dollars every year.

And our member companies who make those products, they have rigorous quality control procedures in place to ensure that their products are safe for proper human use and consumption. And I can almost guarantee that the counterfeit products don't live up to those same quality standards as I think Mr. Fox on the video referenced or also the Better Business Bureau person. And if the

product does not taste good or perform as well as expected, our companies could end up losing that customer for life. And I think Mr. Emmer mentioned in his testimony the types of things that can happen when the brand reputation can suffer as a result of counterfeiting.

And also as you have heard, the counterfeiting criminals are also part of organized retail theft. They can mix counterfeit goods with stolen goods and get them more easily back into the supply chain. And as the—I believe it was the video mentioned, a lot of that money ends up going to fund organized crime and even terrorist groups.

One of the first things that can be done to help improve the fight of counterfeiting worldwide is to improve enforcement at home. And again, Mr. Emmer beat me to the punch by praising the House by passing H.R. 32 to make sure that we close that loophole that allows counterfeit goods to be—and the labels to be brought in separately without fear of any serious punishment. It also allows the stricter remedies to be enforced on those caught counterfeiting. And GMA also strongly supported its passage in the house and will be working to move it through the Senate as well. GMA also supports the administration's inner agency STOP Initiative that was mentioned by the chairman. And we are working with other key associations on one element of the STOP Initiative to develop purchasing guidelines for manufacturers and retailers to insure that the global supply chains are free of illicit goods.

In addition to protecting the supply chain, it is absolutely essential that we do more to stop the production of counterfeit products in the first place. Again, the chairman mentioned there is a big problem worldwide in China especially. And we do urge the United States to continue to work with the Chinese Government to try to create an effective program to stop the trafficking of counterfeit goods both in their country and at the point of export.

One of the things that GMA has long advocated for is more engagement with the OECD to address the counterfeit issue. And we are pleased that with the support recently of the U.S. Government, the organization recently announced that it will conduct a new study to determine the scope of the problem and the damage product counterfeiting does on a global basis. The project will also develop a set of best practices to guide future efforts in the fight against counterfeiting. And we believe this is really going to be very helpful in pushing countries to improve their anti-counterfeiting initiatives as they look to join the OECD. And I would point to the example of China and Russia trying to get in the OECD that with those best practices there, there may be a real opportunity to really push the real anti-counterfeiting initiatives there.

To conclude, this is not a problem that we can solve overnight and it is not a problem that we can solve alone. We need global cooperation between industry and Governments around the world. And with the adoption of H.R. 32, we will be able to more credibly push our trading partners to tighten their end by counterfeiting laws. And with the OECD now engaged in the issue, there will be better information and increased pressure on countries to crack down on counterfeiting.

And I also thank you for your time and welcome your questions.

[The prepared statement of Stephen C. Arthur follows:]

PREPARED STATEMENT OF STEVE ARTHUR, VICE PRESIDENT, GOVERNMENT AFFAIRS,
GROCERY MANUFACTURERS ASSOCIATION

I am Steve Arthur, Vice President of Government Affairs for GMA, the Grocery Manufacturers Association, and I am very pleased to be here today to talk about an issue of intense concern to our member companies and manufacturers across the country.

GMA is the world's largest association of food, beverage and consumer product companies. Led by a board of 42 Chief Executive Officers, GMA applies legal, scientific and political expertise from its more than 120 member companies to vital public policy issues affecting its membership. The association also leads efforts to increase productivity, efficiency and growth in the food, beverage and consumer products industry. With U.S. sales of more than \$500 billion, GMA members employ more than 2.5 million workers in all 50 states.

GMA has been fighting counterfeiting for a long time and is a member of the Coalition Against Counterfeiting and Piracy, an industry group created by a joint initiative between the U.S. Chamber of Commerce and the National Association of Manufacturers to act as the interface between business and the U.S. Government's Strategy Targeting Organized Piracy (STOP!) program.

Today I would like to focus my comments on three problems: the increasing scope and danger of counterfeiting, the legal barriers to punishing offenders here in the United States, and the lack of adequate enforcement abroad.

Counterfeiting is a Devastating Global Problem

Counterfeiting is not a victimless crime. On the contrary, it causes devastating financial and physical harm to United States companies, employees, investors, consumers, patients, and citizens. Many industries are affected, including consumer products, automotive, pharmaceutical, electronics, textiles and others.

When the average American thinks about counterfeit goods, he or she may think of phony Rolex watches, fake high-fashion handbags, or cheap knock-offs of designer T-shirts. The purchasers of these items usually know the products are not originals, so they may readily conclude that buying a fake is no big deal. However, counterfeiting is far more pervasive and dangerous than street vendors selling fake luxury items. In fact, only a minute portion of counterfeit goods are luxury items.

For example, in December, 2003, Australian customs officials stopped 52,000 containers of counterfeit shampoo at port. Last week, officials in India seized a large quantity of bottled water with spurious marks as well as many counterfeit personal care consumer products. Canadian based Gieschen Consultancy, which tracks counterfeit product enforcement incidents, reports that in the first quarter of 2005, there were 279 incidents of intellectual property theft world wide, valued at a loss of \$396 million dollars. Of particular interest to GMA member companies, this total included counterfeit milk drinks, wine, rum and soy sauce, as well as industrial goods and supplies such as insecticides and detergents and counterfeit perfumes and cosmetics.

Our member companies who make food, beverage and consumer products have rigorous quality controls to ensure their products are safe for proper human use and consumption. Counterfeit products are not subject to those same quality standards. As long as the packaging looks similar, it might enter the supply chain without any quality controls at all.

To put the enormity of the problem in financial terms, the U.S. Customs Service estimates that counterfeiting activity costs the U.S. more than \$200 billion annually and has resulted in the loss of 750,000 American jobs. If you compare that to the earlier number I referenced regarding enforcement actions, its clear that only a small percentage of counterfeit products are caught and the counterfeiters prosecuted. Recently, the FTC stated that eradicating counterfeit auto parts could create 200,000 new jobs in the U.S. auto industry alone. The International Chamber of Commerce estimates that counterfeiting drains more than \$350 billion each year from the world's economy—this is 7 to 9 percent of total world trade. And each dollar lost by law-abiding, hard-working Americans and companies winds up lining the pockets of criminals.

Counterfeiting frequently is part of a larger criminal enterprise involving the theft of legitimate goods. Criminals responsible for distributing counterfeit goods are also often the ringleaders of organized retail theft. They have become expert in mixing counterfeit goods with stolen goods to "sanitize" the stolen property and move them back into the supply chain. These criminals feed on those buyers or distributors who are willing to turn a blind eye in return for a good deal. In other cases, the buyer

is truly unaware that the goods he or she is purchasing are stolen or counterfeit. In addition, the same networks used to distribute counterfeit products also ease the transport of illegal drugs into U.S. markets.

The danger of counterfeiting goes beyond mere financial harm and theft. Organized crime and terrorist groups use the sale of counterfeit goods to raise money for illegal activities and violence. Paramilitary groups in Northern Ireland have funded terrorist activities through the sale of pirated products. Protection rackets in Italy no longer demand just money from retailers; instead, they want shelf space to sell counterfeit goods. In testimony before the Senate Homeland Security Committee, the Los Angeles Sheriff's Department testified that many arrested for counterfeit product crimes in Los Angeles are Hamas and Hezbollah sympathizers and supporters. Most alarming is that those who aim to terrorize United States citizens look to counterfeiting to help them achieve their deadly goal: Seized Al Qaeda training manuals recommend the sale of fake goods as a financing source for its terrorism.

It is clearly not just the food, beverage and consumer products industry that is targeted. This committee is also hearing about counterfeit pharmaceutical and automotive products. These counterfeits can and have caused serious injury and even death.

Domestic Efforts

The first step in combating counterfeiting worldwide is to improve enforcement at home. We need to close some of the legal loopholes that allow counterfeiters to escape prosecution, and we need laws that give enforcement agencies better tools to fight counterfeiting.

GMA is pleased that the House has taken this first step by approving HR 32, the *Stop Counterfeiting in Manufactured Goods Act*, by Congressman Knollenberg. As this committee knows, this bill will close a loophole in the federal criminal code that allows phony products to be shipped to the United States without brand markings, so they can pass through customs without any apparent violation. Counterfeit labels are then added and the products are sold through a variety of channels. HR 32 will allow authorities to prosecute the people who do the labeling and packaging here. It will also allow for the forfeiture and destruction of any confiscated counterfeit labels or products that would bear those labels.

In addition, the bill gives law enforcement officials the ability to seize and confiscate the equipment and assets—such as machine tools and computers—used to produce counterfeit products, labels, and packaging. Without this ability, law enforcement officers are forced to chase the same counterfeiters over and over again. The counterfeiters can simply continue to use their infrastructure to replace seized inventory and resume their trade. GMA strongly supported the passage of HR 32 and will now work just as vigorously for its passage in the Senate.

GMA also supports the Administration's Strategy Targeting Organized Piracy (STOP!) initiative, which was launched in 2004 and brings together the U.S. Trade Representative, the Departments of Commerce, Justice, and Homeland Security to stop the distribution of counterfeit goods. The effort is broad in scope and brings a new approach, new tools and new pressure to bear through a coordinated effort from the federal government, the private sector and America's international trading partners.

A key element of the STOP! initiative is the development of purchasing guidelines for manufacturers and retailers to ensure that global supply chains are free of illicit goods. As a coordinator for the Coalition Against Counterfeit Products task force, GMA is working with other associations that represent food, beverage and consumer product manufacturers and retailers to accomplish this objective. The task force is developing voluntary guidelines to prevent illicit goods from entering the supply chain and prevent criminals from exploiting alternate sourcing strategies. The final document is expected to be completed by September, 2005. These guidelines will then be available for use by other industries.

Change Domestically Provides Leverage Globally

Passage of HR 32 is essential to our ability to improve anti-counterfeiting efforts abroad. The Office of the U.S. Trade Representative has made clear that it is not prepared to negotiate for mandatory confiscation and destruction abroad when U.S. law does not contain these provisions. Not surprisingly, our trade negotiators are loath to negotiate with other countries an agreement with which the United States could not comply under existing laws. We need to have domestic mandatory seizure and destruction so our trade negotiators have a foundation to press for this minimum necessary enforcement around the world.

In 2004, the Office of the U.S. Trade Representative, in a "Special 301" annual review, reported that more than 66% of counterfeit goods seized by the U.S. Customs Service at ports of entry into this country were traced to China. In addition to combating counterfeiting within its borders, the Chinese government also must stop the export of counterfeit products. The United States should continue to work with the Chinese government to create an effective program to stop the trafficking of counterfeit goods at the point of export.

GMA is encouraged that the U.S. Government is taking the issue of intellectual property theft and counterfeit products seriously. In April 2005, as part of the Administration's Strategy Targeting Organized Piracy (STOP!), the United States traveled to Singapore, Hong Kong, Tokyo and Seoul to explore avenues for increased cooperation, improved coordination, and expanded information exchanges as an initial step in garnering international support to work together to stem the trade in fakes. A series of 17 U.S. proposals were shared with government officials from these countries generating fruitful discussions, interest and commitments to continue working together on this shared concern. And just last week, officials representing seven United States Government agencies traveled to Europe to meet with German, United Kingdom, French and European Commission officials to discuss cooperation to crack down on global piracy and counterfeiting.

In addition to having appropriate prosecutorial powers in the U.S. and other countries, it is important to understand the scope of product counterfeiting globally in terms of damage to rights holders and countries that harbor counterfeiting. GMA has long advocated engagement with the Organization for the Economic Cooperation (OECD) to address this issue. With the support of the U.S. government, the Organization for Economic Cooperation and Development announced in April 2005 that it will conduct a study to determine the scope of the problem and the damage product counterfeiting does on a global basis. The project will also analyze existing public and private anti-counterfeiting efforts to develop a set of best practices to guide future efforts in the fight against counterfeiting.

The project will include a three-phase study on the adverse impacts of counterfeiting and piracy; a series of four regional workshops, envisioned to take place in Russia, Brazil, India and China in 2006; and two Global Forums, focusing on various aspects of the problem, one planned for 2006 and the second in 2007.

OECD is scheduled to co-host a two-day meeting with the World Intellectual Property Organization in October, 2005 in Geneva to develop metrics and examine statistical issues, and also plans to circulate an outline for the Phase one study to governments, asking them to circulate more widely for feedback. A final report is expected in May, 2006.

Now, around the globe, brand owners, industry coalitions, and governments are joining the fight against counterfeiting. This is not a problem we can solve overnight, and it is not a problem we can solve alone. We need global cooperation. To get it, however, we first need to close the loopholes in current federal criminal laws to criminalize trafficking in fake labels and packaging for all goods. We also need to provide our law enforcement agencies with authority to seize the machinery of counterfeiting. And we need to devote the resources to study this problem comprehensively, so that we can arm ourselves with more information about this problem in ways that will allow us more effectively to fight it.

Mr. STEARNS. Thank you.
Mr. Christian?

STATEMENT OF JAMES CHRISTIAN

Mr. CHRISTIAN. Mr. Chairman and members of the committee, my name is James Christian and I am Vice President and Head of Global Security for Novartis International. Novartis is a world leader in pharmaceuticals and consumer health. The Novartis Group invested over \$4 billion in research and development in 2004.

Prior to joining Novartis, I spent 20 years with the United States Secret Service, the last five as a Special Agent in Charge. While in Government service, one of my duties was to suppress the international counterfeiting of U.S. currency. At Novartis for the last 16 years, one of my responsibilities has been to oversee the companies worldwide anti-counterfeiting operations.

In the past several years, Novartis has participated with law enforcement and health authorities in over 200 counterfeiting investigations in 33 countries involving hundreds of drug products. I have witnessed firsthand the great ingenuity and resourcefulness that unlawful enterprises utilize to manufacture and distribute ineffective and often unsafe counterfeit products. I have also witnessed the hardship and misery counterfeit medicines bring to patients and their families. There can be no doubt that drug counterfeiters present a severe and growing threat to the health and safety of U.S. citizens.

Counterfeit drugs are fake medicines, produced and packaged to look like the genuine article. They include products including correct ingredients although they may be adulterated on in the wrong dosage strength, incorrect ingredients, no active ingredient, and usually have phony packaging and labeling. Counterfeit drugs may be made in garages, basements, warehouses, often under horrific conditions.

Counterfeiters are able to produce labels that are basically indistinguishable from the authentic materials. They can also make stamp tablets with company logos and put them in special packaging such as blister packs.

We have scores of examples of counterfeit, expired, and adulterated medicines. In one case, our anti-counterfeiting efforts interjected millions of yellow tablets of a popular pain reliever that were virtually indistinguishable from a genuine product including the company logo. These tablets were made of boric acid, floor wax, and lead-based yellow paint. You now see mixture that was used to make the tablets. The yellow based paint was used for road markings. Sacks of these raw materials were stacked throughout the counterfeiter's ramshackle warehouse in Bogota, Columbia.

Production of counterfeit medicines is pervasive outside the United States and is growing in an alarming rate. Before I review some international examples of counterfeiting, let us take a look at the difference between a Novartis manufacturing plant and a counterfeit manufacturing lab. There you see a sterile facility typical of an ethical pharmaceutical company. There you see a lab blister pack with some of the chemicals used in the counterfeiting in the background. And there we have their counterfeit shipping and distribution area.

Russia is a drug counterfeiter's paradise. Politically connected organized crime elements in that country face little resistance from the Government and the laws and penalties for counterfeiting pharmaceuticals are weak or non-existent. With its recent expansion, the European Union's border in the east is no longer the well-controlled German border, but instead is a more porous Polish border. Russian counterfeit drugs which cross into Poland have virtually unobstructed access to the markets in the rest of EU. These counterfeit drugs could easily find their way to pharmacy shelves in the U.S. Indeed, some counterfeit Russian pharmaceuticals have already been discovered in this country.

Counterfeiting is also a burgeoning problem in China where seizures have secured large quantities of fake drugs. What is unique about counterfeiting in China is that many of the counterfeiting operations are publicly traded and often health, regulatory, and law

enforcement officials are shareholders. More recently, Novartis has become aware of a Hangzhou-based website called Alibaba where major players in an underground counterfeiting network surface to buy and sell counterfeit products including prescription drugs.

In Latin America, the counterfeit problem is staggering. Last November, four children died from counterfeit drugs in the Dominican Republic. In Venezuela, six children died from counterfeit drugs, including counterfeit anesthesia, in 2004. Six months ago in Argentina, Veronica Diaz suffered acute liver failure and died after being injected with a counterfeit iron supplement while hospitalized. A review of the hospital records disclosed that two other women had died after being injected with the same product.

Two months ago, police in Lima, Peru seized four tons of adulterated and counterfeit pharmaceuticals, including ampoules for injection which contained feces and dangerous bacteria. In Columbia, the length and breadth of the counterfeiting problem is mind boggling. Novartis alone is responsible for the seizure of a counterfeit lab every month. The problem is often referred to as "El Otro trafico de drogas," or "The other drug trafficking." Many hospital administrators have no faith in their drugs in the hospital pharmacy and efforts to switch suppliers are often met with threats of violence.

Pharmaceutical companies and non-U.S. law enforcement authorities have an extremely difficult time suppressing international counterfeiting operations. Many counterfeit pharmaceuticals are manufactured so cleverly that it is virtually impossible for consumers, Government officials, and law enforcement agencies to identify them as counterfeit without elaborate testing. Detection is made more difficult by the criminal practice of mingling counterfeit, adulterated, expired, stolen, and genuine product. When this occurs, random or sample testing is totally ineffective.

Here you see a transplant drug in the oral which present—which prevents organ rejection after a transplant and as you can see, these packages look legitimate from the outside. Internally, they contain Chinese beans.

The United States relies on foreign countries to protect American citizens from counterfeit medicines. This reliance is misplaced. Many governments lack the interest, resources, and technological sophistication to address the problem.

While certain covert and overt technologies may improve the distribution system and the supply chain management, no one has yet demonstrated the ability of such technology to protect against counterfeiting. New anti-counterfeiting technologies have numerous shortcomings, including the following. In almost every case, the technology, be it a hologram, tamper proof labels, embossing, thermo-reactive ink, RFID tags, DNA markets enable companies to track cardboard. That is the packaging not the product. It is not unusual to find genuine product in counterfeit packaging and counterfeit product in genuine packaging.

Additionally, in the United States and in the European Union, the two largest pharmaceutical markets in the world repackaging is legal; thus without violation of any law, packaging of all types of expensive state-of-the-art secure devices can end up in the trash,

or worse in the hands of a counterfeiter, while genuine product is legally distributed in packaging with no security features.

RFID technology which was featured in an FDA task report is more of an inventory management tool than an anti-category device.

Well where do we go from here? Now is the time to do a realistic assessment of the problem. In my view, there is no quick fix. There is no solution around the corner. If we place our trust in the hope that a solution will be available soon, we may well neglect to take the incremental steps necessary to make progress against the terrible plague of counterfeit medicines.

I cannot say strongly enough that drug counterfeiters, blackmarketeers, and other organized criminal elements are ready, willing—drug counterfeiting severely imperils public health and safety across the globe and in the United States. Now is the time to strengthen our commitment to keeping our medicines the best and safest in the world.

Thank you.

[The prepared statement of James Christian follows:]

PREPARED STATEMENT OF JAMES CHRISTIAN, VICE PRESIDENT AND HEAD OF GLOBAL CORPORATE SECURITY, NOVARTIS INTERNATIONAL AG

Mr. Chairman and members of the Committee, my name is James Christian and I am Vice President and Head of Global Corporate Security for Novartis International AG ("Novartis"). Prior to joining Novartis, I spent 20 years with the United States Secret Service, the last five as a Special Agent in Charge. While in Government service, one of my duties was to suppress the international counterfeiting of U.S. currency. At Novartis, for the last 16 years, one of my responsibilities is to oversee the company's worldwide anti-counterfeiting operations.

In the past several years, Novartis has participated with law enforcement and health authorities in over 200 counterfeiting investigations in 33 countries and involving hundreds of drug products. I have witnessed firsthand the virtually limitless ingenuity and resourcefulness that unlawful enterprises utilize to manufacture and distribute ineffective and often unsafe counterfeit products. I have also witnessed the hardship and misery counterfeit medicines bring to patients and their families. There can be no doubt that drug counterfeiters present a severe and growing threat to the health and safety of U.S. citizens.

Novartis has a compelling interest in protecting the medicines that it currently markets as well as those now under development. This year alone, Novartis will spend more than \$4.2 billion on drug research and development. More importantly, patients using Novartis products must have every confidence that the drugs are safe and effective.

Counterfeit drugs are "fake" medicines, produced and packaged to look like the genuine article. They include products containing correct ingredients, although they may be adulterated or in the wrong dosage strength; incorrect ingredients; no active ingredient; or an insufficient quantity of active ingredient; and usually have phony packaging and labeling. Counterfeit drugs may be made in garages, basements, or warehouses, often under horrific conditions.

Counterfeiters are able to produce labels that are virtually indistinguishable from the authentic materials. They can also make and stamp tablets with company logos and put them in special packaging such as blister packs.

We have scores of examples of counterfeit, expired, and adulterated medicines. In one case, our anti-counterfeiting efforts interdicted millions of yellow tablets of a popular pain killer that were virtually indistinguishable from the genuine product—including the company logo. These tablets were made of boric acid, floor wax, and lead-based yellow paint used for road markings. Sacks of these "raw materials" were stacked throughout the counterfeiters' ramshackle warehouse in Bogota, Columbia.

Production of counterfeit medicines is pervasive outside the United States and is growing at an alarming rate. We can provide the Committee with detailed information on the extent of counterfeiting activity in Latin and Central America, Asia, Russia, China, and India. First, let's look at a Novartis manufacturing facility, and then a counterfeit manufacturing plant.

Russia is a drug counterfeiter's paradise. Politically connected organized crime elements in that country face little resistance from the government, and the laws and penalties for counterfeiting pharmaceuticals are weak or non-existent. With its recent expansion, the European Union's border in the East is no longer the well-controlled German border but instead is the more porous Polish border. Once counterfeit drugs have crossed into Poland, they have virtually unobstructed access to the markets in France, Germany, Spain, and the rest of the European Union countries. These counterfeit drugs, which have passed through nations in the European Union, could easily find their way to pharmacy shelves in the United States. Indeed, some counterfeit Russian pharmaceuticals have already been discovered in this country.

Europe has also developed an internet sales problem, with hundreds of web sites selling counterfeit medicines, often from China.

Counterfeiting is also a burgeoning problem in China where seizures have secured large quantities of fake drugs. Novartis and other pharmaceutical companies participated in a raid with authorities in Shantou that resulted in the seizure of over 1800 cartons of counterfeit pharmaceutical products from 14 multinational companies. What is unique about counterfeiting in China is that many of the counterfeiting operations are publicly traded, and often have health, regulatory, and law enforcement officials as shareholders. More recently, Novartis has become aware of a Hangzhou-based website called Alibaba (w) where major players in an underground counterfeiting network surface to buy and sell counterfeit products including prescription drugs.

In Latin America, the counterfeiting problem is staggering. Last November, it was determined that four children died from counterfeit drugs at the Jose Maria Cabral y Baez Hospital in the Dominican Republic. In Venezuela, six children are known to have died from counterfeit drugs, including counterfeit anesthesia in 2004. Six months ago, in Argentina, Veronica Diaz, suffered acute liver failure and died after being injected with a counterfeit iron supplement while hospitalized. A review of the hospital records disclosed that two other women had died after being injected with the same product.

Two months ago police in Lima, Peru seized four tons of adulterated and counterfeit pharmaceuticals, including ampoules for injection which contained feces and dangerous bacteria. These seizures took place after numerous epileptic and diabetic patients were hospitalized after taking counterfeit medicines.

In Colombia, the length and breadth of the counterfeiting problem is mind boggling. Novartis alone is responsible for the seizure of a counterfeit lab every month. The problem is referred to as "El Otro trafico de drogas", or "The other drug trafficking". Many hospital administrators have no faith in the drugs in the hospital pharmacy, and efforts to switch suppliers are often met with threats of violence.

Pharmaceutical companies and non-U.S. law enforcement authorities have an extremely difficult time suppressing international counterfeiting operations. Many counterfeit pharmaceuticals are manufactured so cleverly that it is virtually impossible for consumers, government officials, and law enforcement agencies to identify them as counterfeit without elaborate testing. Detection is made more difficult by the criminal practice of mingling counterfeit, adulterated, expired, stolen, and genuine product. When this occurs, random or sample testing is totally ineffective. Counterfeiters do not care about the quality and safety of the product. Their goal is to sell a fake drug to an unsuspecting patient.

The United States relies on foreign countries to protect American citizens from counterfeit medicines. This reliance is misplaced. Many governments lack the interest, resources and technological sophistication needed to address the problem.

While certain overt and covert technologies may improve the distribution system and increase a manufacturer's ability to manage the supply chain and to track and trace products, no one has yet demonstrated the ability of such technology to protect against counterfeiting.

New anti-counterfeiting technologies have numerous shortcomings including the following:

- In almost every case, the technology, be it a hologram, tamper proof labels, embossing, thermo-reactive ink, RFID tags, DNA markers, and the like, enable companies to track cardboard, *not product*. It is not unusual to find genuine product in counterfeit packaging and counterfeit product in genuine packaging.
- In the United States and in the European Union, the two largest pharmaceutical markets in the world, repackaging is legal; thus, without violation of any law, packaging, with all types of expensive, state of the art secure devices, can end up in the trash or worse, in the hands of a counterfeiter, while genuine product is legally distributed in packaging with no security features.

- RFID technology which was featured in a FDA task force report is more of an inventory management tool than an anti-counterfeiting device.
 - A counterfeiter or diverter could purchase RFID tags and attempt to mimic manufacturers' RFID codes.
 - Industries which have and are using RFID products have noted that when their products enter the "grey market", their RFID tags are often "zapped" rendering them unreadable.
 - Counterfeiters generally deal, not only with counterfeit product, but with diverted, expired, and stolen product as well. Envision the scenario where a counterfeiter steals product, removes genuine product from the "secure packages", and then puts the counterfeit product in these packages, and then re-inserts the counterfeit product back into the system. The counterfeit product would pass through all the readers successfully. What then happens to the genuine product? The irony is that the genuine product would most likely be repackaged in counterfeit packaging with unreadable tags and entered into the distribution system. If the RFID system works correctly, the genuine product would be kicked out of then system, but later determined to be genuine, undermining any confidence in the system.

Where do we go from here? Now is the time to do a realistic assessment of the problem. In my view there is no quick fix. There is no "solution" on the horizon. If we place our trust in the hope that a "solution" will be available in the near future, we may well neglect to take the incremental steps necessary to make progress against the terrible plague of counterfeit medicines.

I cannot say strongly enough that drug counterfeiters, blackmarketeers, and other organized criminal elements are ready, willing, and able to exploit any perceived weakness in the U.S. pharmaceutical system. Make no mistake, drug counterfeiting severely imperils public health and safety across the globe, including the United States. Now is the time to strengthen our commitment to keeping our medicines the best and safest in the world.

Thank you.

Mr. STEARNS. Thank you.

Mr. Pearl?

STATEMENT OF DAVID S. PEARL II

Mr. PEARL. Mr. Chairman and members of the subcommittee, my name is David Pearl II. I am Executive Vice President of Uniweld, a small family owned manufacturing company located in Fort Lauderdale, Florida. I am pleased to appear before the subcommittee today and to testify on behalf of the National Association of Manufacturers.

Uniweld was founded by my father in 1949. Currently we employ over 260 people who are producing many industrial products including refrigeration testing and charging manifolds. That is testing instruments used by refrigeration technicians to determine the condition of an air conditioning or refrigeration system. The National Association of Manufacturers, the NAM on whose behalf I am testifying today, is the Nation's largest industrial trade association representing small and large manufacturers in every industrial sector in all 50 States.

Exports are important to Uniweld. In 1976, I went to the Middle East to establish Uniweld's products in that marketplace. Our good American reputation made selling this market possible and profitable. Persistence and diligence in selling our testing and charging manifolds resulted in the gradual buildup of our business and we found ourselves a market leader for this product in the Middle East. We have exported to about 80 countries around the world and today the number has dwindled to 30. The net result of counterfeiting has already cost our company a significant number of jobs. Continued worldwide counterfeiting could even put small companies like mine out of business.

Currently, however, Uniweld Products has lost over \$1 million a year in sales in the Middle East due to Chinese counterfeits in the Saudi Arabian market. The cheap imitation manifolds look like ours. The instruction sheets we provide with our product are copied with our name, address, and telephone numbers and the package even carries the American flag that we put on our own box. The product and the packaging are copied to a "T" and I have brought two pairs of samples with me of genuine and fake products and they are right at the table in front me that you can see. And if you did not know what you were looking at, there is no way you could tell.

Mr. STEARNS. Do you have any objection if we just pass them around?

Mr. PEARL. Absolutely, please take a look.

Mr. STEARNS. Okay. Just make sure we know which one is the counterfeit.

Mr. PEARL. Okay. The one in your left hand is the counterfeit, the one in the right hand is original. You can see that they actually just photographed the boxes, they didn't go through the process to make it a true multi-colored separation.

We have registered our trademark in six countries in the Middle East and 17 other countries elsewhere around the world. Not only has this not worked, but the counterfeiting has recently expanded into the United Arab Emirates, the UAE.

We are losing business and the quality of our counterfeit—of the counterfeit product is so poor that our hard earned reputation for producing a quality product is being destroyed in one of the most promising marketplaces in the world.

When the United States negotiates treaties such as the CAFTA, it is critical that strong anti-counterfeiting provisions be built into the treaty. Trademark counterfeiting must be considered a criminal offense.

It is virtually impossible for a small company like mine to address problems like these halfway around the world. The U.S. Government needs to intervene and assist small businesses trying to protect themselves from piracy and counterfeiting.

I want to note that the Commerce Department and the Office of the U.S. Trade Representative have been working with my company and have been providing advice we have been following and we appreciate that. But companies like mine need more. Removing the restrictions and allowing them to do more would save thousands of American jobs.

A fresh look has to be taken at what the U.S. Government can do. Perhaps by initiating public defender programs or by finding ways that diplomatic means could be utilized to a greater degree. The NAM wants to sit down with Government officials and explore possibilities. Embassies should have an IPR advocate who should do more than assisting the small business in getting a local lawyer and going through the foreign countries legal system, but should also have the responsibility for assisting that small business in defending its good name, its market share and its employment base.

We have a choice. We can either stick our heads in the sand and hope that counterfeiters in China or elsewhere go away, or we can be intelligent and use our national resources and influence to stop

the counterfeiting. If American industry is to be preserved and Americans employed, we need your help and we need it now. Here are immediate action steps that as a representative of a small business I believe we should take.

First, customs authorities need to look for phony "Made in the U.S.A." attributions on imported products that do not come from the United States. It is a tip off for which goods are counterfeit. Counterfeiters are getting better and better at mimicking genuine packaging and "Made in the U.S.A." is a key part of the mimicry. Such vigilance needs to be a part of accepted best practices by custom services around the world. U.S. Customs and border protection should urge greater vigilance through the World Customs Organization.

Second, trade agreements being negotiated should pick up on this point as well. It is very pertinent that the Office of the U.S. Trade Representative is negotiating a free trade agreement right now with the UAE and this is where we can make a big impact. If customs officials in the UAE, or elsewhere for that matter, do not have the authority or guidance to seize goods solely on the basis of fraudulent "Made in the U.S.A." printing, then we should ensure that they do as that agreement is negotiated. We need to help them get the tools that they need to do their jobs, too.

Third, the U.S. Government as a whole, the U.S. embassies in particular must find a way to be more helpful to small and midsize companies that encounter flagrant counterfeiting and other IPR violations. We appreciate the establishment of a point of contact for small and mid-size companies in the patent and trademark office, but we also need more on the ground support overseas.

Fourth, the U.S. Government needs to keep the pressure on foreign Governments, especially the Chinese Government to enforce their IRP laws and stop the flagrant counterfeiting of U.S. products by their companies. It would be helpful to have a link for each country on the annual Special 301 List put out by the USTR so that we could better track IPR problems. Getting like minded trading partners like Europe and Japan to cooperate and send the same message to these Governments would also help.

I and other NAM members certainly appreciate the Government's new initiatives, such as the STOP Program, which is a good start to developing a global strategy on counterfeiting. The NAM though wants to sit down with the U.S. Government agencies to move things further and to put more of a focus on doing things that will really help small businesses that are faced with the scourge of counterfeiting.

Every time a counterfeit of an American product is sold somewhere in the world, it costs American prestige, reputation, worsens our balance of trade, and costs American jobs. By reducing worldwide counterfeiting, we can reduce our trade imbalance.

Thank you, Mr. Chairman.

[The prepared statement of David S. Pearl II follows:]

PREPARED STATEMENT OF DAVID S. PEARL II, EXECUTIVE VICE PRESIDENT, UNIWELD, INC., ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. Chairman, Members of the Subcommittee: My name is David Pearl II. I am the Executive Vice President of Uniweld Products, Inc., a small family-owned manufacturing company located in Ft. Lauderdale, Florida. I am pleased to appear before

the subcommittee today, and to be testifying on behalf of the National Association of Manufacturers. Uniweld was founded by my father, David S. Pearl Sr. in 1949. Starting with 20 employees he expanded the business to as many as 375. Currently, we employ over 260 people who are producing many industrial products, including refrigeration testing and charging manifolds, that is, testing instruments used by refrigeration technicians to determine the condition of an air conditioning or refrigeration system.

The National Association of Manufacturers (the NAM), on whose behalf I am testifying today, is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM also represents over 350 vertical industry associations and state manufacturing associations and their members. The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media and the general public about the vital role of manufacturing to America's economic future and living standards.

In 1976, I went to the Middle East to establish Uniweld's products in the market place. Our good American reputation made selling this market possible and profitable. Persistence and diligence in selling our testing and charging manifolds resulted in the gradual build up of our business and we found ourselves a market leader for this product in the Middle East.

Currently, however, Uniweld Products, Inc. has lost over \$1 million a year in testing and charging manifold sales in the Middle East due to the Chinese counterfeits in the Saudi Arabian market. The cheap imitation manifolds look like ours. The instructions sheets we provide with our product are copied with our name, address and telephone numbers, and the packaging even carries the American flag that we put on our own box. The product and the packaging are copied to a "T." I have brought two pairs of samples with me of genuine and fake products.

We have registered our trademark in six countries in the Middle East and 17 other countries elsewhere around the world. Having a product's trademark being registered is supposed to offer some protection from infringement. Not only has this not worked, but the counterfeiting was discovered to have expanded to the United Arab Emirates (UAE) by our sales manager during a trip in November 2004. Two appendices to my statement provide further particulars.

Not only are we losing business, but also the quality of the counterfeit product is so poor that our hard-earned reputation for producing a quality product is being destroyed in one of the most promising market places in the world.

Traders hold the ultimate responsibility as they find the manufacturers to make the product and travel the world to sell without scruples. Traders collect commissions on what is sold and are extremely hard to track down. The actual Chinese manufacturers may not even know anything about our company as they appear to be manufacturing to the traders' specifications.

Something must be done to stop China from counterfeiting trademarked American goods. Customs authorities in all countries must be alert to any goods that fraudulently state "Made in U.S.A." yet have other countries of origin, such as China. When these goods are found the importer should be sanctioned and arrested if possible and the goods confiscated and destroyed. The real manufacturer along with the trader involved should be located and the entire counterfeit ring could then be eliminated. Counterfeiting should be treated as a serious crime everywhere.

It's impossible for a small company like mine address problems like these halfway around the world. The U.S. Government needs to intervene and assist small businesses trying to protect themselves from piracy and counterfeiting. Intellectual property rights (IPR) must be protected. Small businesses do not have the financial resources or the wherewithal to fight global counterfeiting. Our government, through its embassies, can make a real difference in how the governments of other countries view these issues. Embassies should have an IPR advocate who does not just tell the small business to get a local lawyer and go through the foreign countries legal system, but he should have responsibility of assisting that small business in defending its good name, its market share and its employment base. We have a choice. We can stick our heads in the sand and hope that counterfeiters in China or elsewhere go away, or we can intelligently use our national resources to stop the counterfeiting. If American industry is to be preserved and Americans employed, we need your help and we need it now. Here are immediate action steps that as a representative of a small business I believe we should take:

First, customs authorities need to look for phony "Made in the U.S.A." attributions on imported products that do not come from the United States. This is a tip-off for which goods are counterfeit. Counterfeiters are getting better and better at mimicking genuine packaging, and "Made in the U.S.A." is a key part of this mim-

icry. Such vigilance needs to be a part of accepted best practices by customs services around the world. U.S. Customs and Border Protection should urge greater vigilance through the World Customs Organization.

Second, trade agreements being negotiated should pick up on this point as well. It's very pertinent that the Office of the U.S. Trade Representative is negotiating a free trade area agreement with the UAE right now. If customs officials in the UAE—or elsewhere, for that matter—do not have the authority or guidance to seize goods solely on the basis of fraudulent “Made in the U.S.A.” printing, then we should ensure that they do.

Third, the U.S. Government as a whole, and U.S. embassies in particular, must find a way to be more helpful to small and mid-size companies that encounter flagrant counterfeiting and IPR violations. We appreciate the establishment of a point of contact for small and mid-size companies in the Patent and Trademark Office but we also need more on-the-ground support overseas.

Fourth, the U.S. Government needs to keep the pressure on foreign governments, like the Chinese government, to enforce their IPR laws and stop the flagrant counterfeiting of U.S. products by their companies. The annual Special 301 list is one tool. It would be helpful to have a link for each country on the annual Special 301 list put out by USTR so that we could better track IPR problems. Today, you can find links to only three of the almost 40 countries. Getting like-minded trading partners, like Europe and Japan, to cooperate and send the same message to these governments would also help.

You need to understand that small businesses like ours operate on relatively small margins. It is a major financial commitment to develop a market overseas. To lose a market because of counterfeiting is a difficult loss to incur. We don't have the resources to challenge counterfeiters in countries around the world.

The STOP initiative is a good start to developing a global strategy on counterfeiting. But small businesses can't afford to wait long. We needed to see practical progress soon.

We appreciate the Committee's interest in these concerns and ask that Congress provide the resources and support needed for U.S. agencies to carry out the STOP initiative and move ahead further in the areas that I have noted.

This concludes my statement, Mr. Chairman, and I look forward to your questions.

APPENDIX A

UNIWELD PRODUCTS, INC.—CHRONOLOGICAL HISTORY OF COUNTERFEITING

In the late 1990s, Uniweld noticed counterfeit refrigeration testing and charging manifolds (with hoses) showing up in the market place in Saudi Arabia. Our Mid-East Sales Manager scoured the shops and was able to purchase counterfeit Uniweld manifolds. These manifolds were packaged almost exactly like the original. This included Uniweld's name, part number, address, and instruction sheets with Uniweld's name, address and phone number and of course the American flag.

After several years of investigation, we were able to determine that a former customer of Uniweld had taken our product to China for counterfeit duplication. This very same customer owes us several hundred thousand dollars and has been using every trick in the book to delay his final day in court. The judge in the case has said, in open court, that he does not like liars and the defendant will answer for his crimes. We have been in litigation with our current lawyer for more than 2 years. During the previous 2 years we had several other attorneys that were ineffective. The wheels of justice in Saudi Arabia move very, very slowly. The judge has indicated that there are two issues:

1. Payment for the product acknowledged and received
2. Counterfeiting violations, including Trademark Infringement (Uniweld has numerous trademarks registered in Saudi Arabia).

As of May 5, 2005, the legal case is moving forward. The Saudi Chamber of Commerce, Ministry of Trade (Department of Counterfeiting and Trademark Infringement) and the Saudi National Commercial Bank were involved to establish a solid basis for this case. Our Middle East Sales Manager has contacted officials at the United States Embassy in Riyadh to inform the embassy of the situation. We asked for United States Government assistance at the time; the only response we received at the time was to get a lawyer, which we did. We had hoped, though, that the United States Government could intervene through diplomatic channels to assist us.

APPENDIX B

COUNTERFEITING IN THE UNITED ARAB EMIRATES

In November, 2004, Uniweld participated in The Big Five Show (an annual five-country trade fair) in the United Arab Emirates in Dubai. At this show, our Sales Manager noticed numerous Uniweld counterfeit manifolds. Potential customers and our distributors approached him to let him know that Uniweld products (manifolds) were being sold in shops in large quantities at a cheaper rate (50% cheaper than prices sold to distributors). He proceeded to investigate the claim by visiting the local markets and discovered that what we were told was true. Counterfeit Chinese manufactured manifolds with Uniweld's name, packaging, design, trademarks and even the American flag were being sold in large quantities in Dubai.

There were three major distributors selling counterfeit Uniweld manifolds. Our sales manager immediately contacted Uniweld's Trademark attorneys in Dubai, United Arab Emirates. We presented our lawyer with counterfeit manifolds (with receipts) that were purchased in the three shops. Our lawyer advised us to take action as per local procedures. This we have done. Step one was to send the three offenders a cease and desist letter. As of today, May 5, 2005, two have responded that they did not import the counterfeit manifolds. They claim they are buying them from our authorized Uniweld distributors in Dubai, which they are not. Our attorney has advised us to wait a few weeks before we send agents to determine if they are still carrying and selling counterfeit Uniweld manifolds. One of the offenders has not yet responded to our legal letter. We are waiting a little while longer for his response before we send him an additional letter.

If any of the offenders are found selling counterfeit Uniweld manifolds, a police raid, which includes confiscation of counterfeit goods and closing of the shop, will be instituted immediately without warning.

Our salesman is willing to meet with any U.S. Government official willing and able to help. We hope someone in our government is willing to stand up and put pressure on the U.A.E. Government to stop counterfeiting. We will help all we can.

Mr. STEARNS. Thank you.
Mr. DelBianco?

STATEMENT OF STEVE DELBIANCO

Mr. DELBIANCO. Mr. Chairman and members of the subcommittee, my name is Steve DelBianco. I am Vice President for Public Policy, the Association for Competitive Technology or ACT. I want to thank the committee for holding this important hearing and I am pleased to testify on the impact on counterfeiting on small business.

ACT is an active member of the U.S. Chamber of Commerce Coalition Against Counterfeiting and Piracy. And I am here today as a coalition member.

ACT is an education and advocacy group for the tech industry where we promote a healthy tech environment which includes innovation, competition, and investment. We are a 3,000 IT and eCommerce firms and professionals, many like the small software consulting firm that I started in Virginia in the 1980's and unfortunately sold in the 1990's.

Today's other distinguished witnesses described the devastating effects of counterfeiting on manufacturers of brand name products, but we cannot forget the effect on the retailer who makes a final sale to the customer. Here for instance is a fake X-Box game and we are still a fake of an Apple iPod shuffle. The customer who buys and later learns that these are counterfeits might never come back to that retailer again. If a counterfeit product fails, the retailer often takes the blame. He has got to deal with an angry customer who wants a replacement or a refund. Does he send the fake back to the manufacturer, the wholesaler, the distributor? And all

this assumes that the customer returns the counterfeit to talk to the retailer. Often, they just get angry and the retailer is passed by the next time his former customer goes shopping.

Small retailers depend on customer trust; that is no surprise. But in the growing world of e-commerce, establishing and maintaining that trust is even more of a challenge. It really says something that so many of us will proffer a credit card for an online purchase from a supplier that we simply selected from an online search results list. Yet more consumers do it every day and they are overwhelmingly satisfied with the quality, convenience, and value of e-commerce. Online selling is attractive for large businesses and small but it is also attracting counterfeiters who want to exploit the reach and anonymity of the Internet.

This fight has to be taken beyond the retail level, however. It has got to be taken to the source of counterfeit goods and the primary source as you have heard before was China. Last week in preparation for this hearing, we hired a consultant in Shin-Jen, a market between Hong Kong and China, to scour the Shin-Jen market for what some know is the Holy Grail of a consumer counterfeit item which was a bag of Calloway golf clubs that retail for \$2,500 here in the States. Well, thanks to a crack customs agent in Memphis, Tennessee this morning, that golf bag is still at Federal Express. I assure members of the committee though that when the bag gets here, we will host a long drive contest on the Capitol Mall to see which is the real and which is the fake Calloway.

As Mr. Christian mentioned, Alibaba is a virtual marketplace for the underground counterfeiting network. Alibaba fails miserably to police its marketplace for counterfeit goods and counterfeit sellers. Consequently, sellers in Alibaba openly seek worldwide distributors for their counterfeit goods including prescription drugs, golf clubs, apparel, and software.

And when it comes to software, please take a moment to appreciate the distinction between piracy and counterfeiting. People download pirated copies of software every day from file sharing services like Grokster. And they know without a question that they are stealing that software. Now contrast, if you would, that pure digital piracy with the counterfeit software copies that come on a CD in a package that looks authentic. On street corners and websites, you can buy a CD-ROM with a copy of Microsoft or Symantec, Adobe, and other forms of software and these counterfeits go further. They create huge new security risks. One Eastern European counterfeit software site contains this piece of fine print "You will not be able to register the software with the manufacturer and get their support." Now that means the users of that counterfeit software may not get critical security updates to prevent identity theft, viruses, and it might even open a backdoor to their PC.

Now the next generation of e-commerce will see even more goods that are delivered in an entirely digital form with no packaging whatsoever. Digital delivery of music, software, books, art, and movies relies on a trust that is created and maintained by technology. Sellers need to know that you are a bona fide buyer and you as a buyer need to know that you are getting a legal copy from a legitimate distributor or seller. This future will turn the wisdom

of President Reagan on its ear. He said trust but verify, but I think the future of that becomes verify in order to create trust.

Today e-commerce infrastructure players like VeriSign, eBay, and Microsoft, they have tools to authenticate the legitimate identify behind emails, websites, and products. Looking further ahead, things will come full circle from physical to digital, and back to the physical world again. A technology called stereo lithography allows a digital design to be downloaded to a fabrication shop that could be thousands of miles away where they create an airline part or even a medical implant. You can see there where authentication of the digital file is absolutely essential.

To summarize, we see three critical points for policymakers. One, counterfeiting is a huge drain on the economy and it affects everyone from the manufacturer to the retailer and it destroys the most valuable commodity we have, customer trust.

No. 2, illegitimate exchanges like Alibaba move counterfeit goods from the streets of China to markets worldwide, and our Government must pressure trading partners to shut down this activity.

And third, the next war in counterfeiting will not be wages with physical packages but with digital seals and certificates. Goods delivered electronically will depend on digital certificates and physical goods bought from stores. It may even use authentication to create and maintain their own customer trust.

ACT joins the chorus at this table and our support of H.R. 32 and the administration's STOP Program and we look forward to working with Congress and the administration to encourage aggressive enforcement against counterfeiters and convince our trading partners to do the same.

Thank you, Mr. Chairman. I look forward to your questions.
[The prepared statement of Steve DelBianco follows:]

PREPARED STATEMENT OF STEVE DELBIANCO, VICE PRESIDENT FOR PUBLIC POLICY,
ASSOCIATION FOR COMPETITIVE TECHNOLOGY

Mr. Chairman, Members of the Subcommittee, My name is Steve DelBianco, and I am Vice President for Public Policy for the Association for Competitive Technology (ACT). I would like to thank the Committee for holding this important hearing and I'm pleased to have the opportunity to testify on the impact of counterfeiting on small business.

ACT is an active part of the US Chamber of Commerce—Coalition Against Counterfeiting and Piracy (CACP), and I am here today as a CACP Member.

ACT is an international education and advocacy group for the technology industry. Focusing on the interests of small and mid-size entrepreneurial technology companies, ACT advocates for a "Healthy Tech Environment" that promotes innovation, competition and investment. ACT represents nearly 3000 IT and eCommerce businesses and professionals.

Today's other distinguished witnesses will better describe the devastating economic effects of counterfeiting on the industries that manufacture or create the name brand products we all know and respect. Without question, this half a trillion dollar drain on the global economy is felt by big business. But we cannot forget the effect on the retailer who makes the final sale to the customer, and the small business for whom even 5% in lost sales will turn the lights out for good.

For small retailers, whether online or on main street, counterfeiting can be devastating.

Counterfeits can ruin the most important relationship we have—customers who trust us. The small retailer depends on his wholesale suppliers to provide legitimate products, and is caught unaware when counterfeit goods make it onto his shelves.¹

If a counterfeit product fails, the retailer takes the blame. We have to deal with an angry customer who wants a replacement, or worse, a refund. If it's clearly counterfeit, our in-store managers have to figure how and where to return the product. Do we send it back to the wholesaler? Do we need to contact the manufacturer? Most often, we just absorb the cost and work to regain the customer's trust.

All of this presupposes the customer decides to return the counterfeit. More often than not, the customer gets angry but doesn't bring the item in for replacement. Instead, the local store gets passed by the next time our former customer goes shopping.

Small retailers depend heavily on customer trust and respect, whether they're selling on main street or online, but in the growing world of e-commerce, establishing and maintaining that trust is even more challenging. Frankly, it says a lot about the growing consumer confidence in e-commerce that so many Americans will proffer their credit card for an online purchase from a supplier they've just selected from a list of search results. Yet, more consumers do it everyday, and they're overwhelmingly pleased with the quality, convenience, and value of e-commerce.

Small business is relying more on online distribution

Small manufacturers and specialty retailers are turning to e-commerce for their distribution and sales. According to Gartner Research, 30% of businesses with fewer than 20 employees and a Web presence now generate more than 25% of their sales online.²

E-commerce doesn't just benefit sellers of DVDs, software, iPods, and other technology-related goods. The benefits of e-commerce extend to industries that might not first come to mind. For example, a 2002 study confirmed that small farms value the Web as a business tool for reaching new customers, buying supplies, and streamlining their administrative processing.³

Small software companies can also take advantage of digital delivery, without the need to create and ship costly packaging or hefty paper manuals that go out of date with the next update. For any manufacturer, the ability to send a product to a customer the instant he wants it, with no warehousing or shipping costs, is the Holy Grail.

Online is the future, but online distribution attracts counterfeiters, too.

Online selling is attractive for large and small businesses, but it's also attractive to counterfeiters who want to exploit the instant reach and relative anonymity of the Internet. Counterfeiters have a long history of exploiting and undermining traditional distribution channels, whether by infiltrating the supply chain or circumventing it entirely through flea markets and street vendors. But now they're learning that online selling offers some advantages over selling from physical locations.

In the physical world, a store can't pretend to be something it isn't. Unless you are attempting to pull-off *'The Sting'*, one doesn't construct an artificial storefront to lure people into purchasing counterfeit goods. Online stores, on the other hand, are relatively simple to create and operate. And the Internet lets a website in Singapore be instantly visible to the entire world.

The fight against counterfeit goods has to be taken beyond the retail level. Industry and law enforcement efforts have to focus on the source—producers, wholesalers, and distributors of counterfeit goods. And the primary source is, not surprisingly, China.

The Hangzhou-based *Alibaba* website (www.alibaba.com) is a virtual market where major players in the underground counterfeiting network connect and trade. While some authentic goods are traded on Alibaba, counterfeiters are in evidence all over this website, in both English and Chinese language renditions.

On Alibaba, many sellers are explicitly seeking worldwide distributors for their counterfeit goods, including software, prescription drugs, golf clubs, apparel, and even batteries. Below is an actual Alibaba screen offering large lots of counterfeit

¹Tim Trainer, president of the International AntiCounterfeiting Coalition, in <http://www.pcworld.com/news/article/0,aid,111319,pg,3,00.asp>

²Mika Kramer, research director of the small and mid-size business group at Gartner.

³Ohmart, Jeri L., "Using E-commerce to Add Value to Small Farming Businesses in California," Study on Retail Farmers' Markets and Rural Development, Cornell University & Iowa State University, funded by the Fund for Rural America and the USDA, May 2002.

Duracell batteries, claiming they were produced using “good materials” and promising “value for money”.

Counterfeit exchanges like Alibaba will undoubtedly harm China’s consumers and impair the future of legitimate e-Commerce there. But Alibaba can also drag other economies down with it, by injecting wholesale quantities of counterfeit goods into the worldwide supply chain.

While Alibaba has created a growing marketplace for counterfeit physical goods, there is another side to counterfeiting that is especially destructive to ACT’s small software developers: *digital* distribution sites that claim to be legitimate, but aren’t.

Software piracy and counterfeiting: double jeopardy

It’s important to note that there is a real distinction between *piracy* and *counterfeiting* when it comes to software. We are all aware that strictly-digital pirated copies of software are downloaded every day from file-sharing services like Grokster and eDonkey. When a user grabs a free digital download of Microsoft Word from these file-sharing sites, he knows without question that he’s stealing a pirated copy of the software. There is not the least pretense of legitimacy from the person giving the copy, from the file-sharing service, or in the mind of the person downloading the copy.

Contrast that pure form of digital piracy with counterfeit software copies that come in tangible form, complete with packaging. On street corners and websites worldwide, you can buy CD-ROM copies of leading software from Microsoft, RedHat, Symantec, Norton, Adobe, and Corel.

For example, SoftwareNow draws people to its website through emails claiming “*Prices slashed to the bone on original U.S. PC software!*” SoftwareNow’s slick website shows pictures of packaged software available at a fraction of retail prices. On their site, here’s how SoftwareNow answers the wary consumer wondering how they can sell so low:

How can you sell this software as OEM ? It seems too good to be true—is there a catch?

There is no catch—the software versions that we sell are OEM (Original Equipment Manufacturer) which means you will receive the installation CDs only (they do not come in their original retail packing and do not include the manual). We do guarantee that all programs are the 100% full working retail versions—no demos or academic versions! When you order, you will receive all materials required for a complete installation—or your money back! Why pay hundreds of dollars more when you can get exactly the same but OEM-CD? You don’t have to pay that much for the fancy box and manuals.

Although SoftwareNow claims they’re selling OEM versions of software from manufacturers like Microsoft, you cannot buy so-called OEM software without buying the computer itself from the OEM. But not many consumers are aware of that, so many are taken-in by the ruse.

Counterfeit Software is a security risk

Consumers who are unfortunately duped into buying counterfeit software may never discover that they’re running counterfeit code. After all, digital copies are perfect copies, so the software looks and performs like the real thing. But that only helps lure users into a false sense of security when it comes to getting notifications and updates to respond to new cybersecurity threats.

Returning to the SoftwareNow example, there’s a dangerous disclaimer buried on the website, warning buyers, “*Note, that you will not be able to register the software with the manufacturer and get their support, but we will do our best to support you any way possible.*”

Not many consumers would be as alarmed as they should be by this “disclaimer”. Those who purchase and install the counterfeit software could go for months without knowing they are missing critical notices and software updates to prevent security vulnerabilities. This compromises their own security against viruses, spyware, and identity theft.

Moreover, their unsecured PC can serve as a platform for other bad actors to exploit for spam relays, virus proliferation, and denial of service attacks. Counterfeit software can contain Trojan Horses or open “back doors” that let criminals into a user’s computer.

Taken together, piracy and counterfeiting are costing the software industry \$30 billion each year, and IDC estimates that 1 in every 3 PCs worldwide contains some pirated or counterfeit software. In 2002, seizures of pirated Microsoft products alone

exceeded \$1.7 billion.⁴ And these costs don't include the wider costs to businesses and consumers of vulnerable PC software that's not registered with the manufacturer and not getting timely notices and security updates.

Government and Industry are fighting back

A Justice Department study in October 2004 describes several examples of how industry and the U.S. Government are battling software counterfeiters. In 2003, a Virginia man was sentenced to five years in prison and ordered to pay \$1.7 million in restitution for selling more than \$7 million in counterfeit software over the Internet. In a 2004 prosecution, a Ukrainian man was charged with illegally distributing millions of dollars of unauthorized copies of software from Microsoft, Adobe, Autodesk, Borland, and Macromedia. And in September 2004, DOJ's "Operation Digital Marauder" seized over \$56 million in counterfeit Microsoft software, and charged 11 people with manufacturing counterfeit software and counterfeit packaging.

The next generation of e-commerce and of counterfeiting

The next generation of e-commerce will see more goods delivered in entirely digital form—with no packaging at all. Digital delivery of music, software, books, art, and movies will all depend on trust relationships that are created and maintained by technology.

Digital content will be streamed via broadband, but the creators will need a way to know that you are a bona fide buyer, and buyers will need to assure they are acquiring a legal copy from a legitimate vendor. This future world will turn President Regan's adage "*trust, but verify.*" on its ear—the future of digital goods will "*verify, to create trust.*"

We all know what the breakthrough success of Apple's iTunes service has done to legitimize digital music downloads. But what you might not realize is that iTunes relies on digital seals and certificates, the electronic means of authenticating that you are who you say you are.

To make this possible, e-commerce infrastructure leaders like VeriSign, eBay, and Microsoft are developing certification technologies and programs to authenticate the legitimate identity behind emails, websites, and the products themselves. Automated authentications occur quickly and without human intervention, so shoppers are notified only when there's a question about certifications claimed on a store website. If a consumer has to telephone the manufacturer or check lists of authorized dealers, he loses some of the convenience that makes e-commerce attractive in the first place.

Digital seals and certificate services are used by e-commerce sites to prove identity and show they're using secure communications. VeriSign's Secured Seal, for instance, shows that a website has been approved by VeriSign to protect credit card and other confidential information with SSL encryption. Similar technologies help to assure a customer that his bank website really is *his* bank.

New technology behind RFID (Radio Frequency Identification) tags and the Electronic Product Codes network will help stop fakes from penetrating supply chains. Drug shipments, for instance, can be automatically scanned and authenticated as they travel from manufacturer to pharmacy. The pedigree and location of drug shipments will be accessible to all parties, preventing copies from being introduced into the supply chain.

However, these certification technologies could themselves be subject to elaborate counterfeit schemes. Criminal email phishing schemes are luring users to a website that has the marks and logos of legitimate security providers, and some present a "certificate" that the user can accept or refuse. Unfortunately, many users don't read the certificate closely, and are duped into believing it's real. This gives small software firms an abiding fear that a criminal could fake the security certificates for a sales page, and sell digital downloads of software to people who really are trying to buy a genuine product.

For the digital future to fulfill its promise, customers will need to trust the person at the other end of the wire. And if you can't shake their hand, you'll need digital certificates and authentication methods to give you the same sense of trust. When—*not if*—criminals begin to forge security keys, hash codes and security certificates, industry will need to work even more closely with law enforcement to investigate and aggressively prosecute counterfeiters.

⁴Statement of Richard C. LaMagna (Microsoft Corporation) before the House Subcommittee on Courts, the Internet, and Intellectual Property, Oversight Hearing on International Copyright Piracy: Links to Organized Crime and Terrorism, (March 13, 2003)

Conclusion

To summarize, we see three critical points for policymakers to consider when confronting the problems posed by counterfeit goods:

1. Counterfeiting is a huge drain on the economy—it affects everyone from manufacturer to final retailer, destroying the most valuable commodity we have: the trust of our customers.
2. Illegitimate exchanges like Alibaba are moving counterfeit goods from the streets to websites. The U.S. Government needs to exert pressure on foreign nations to shut this activity down.
3. The next war in counterfeiting will be waged not with physical boxes but with digital seals and certificates. Goods that can be delivered digitally will depend on digital signatures, physical goods will be bought and sold from stores using authentication to create and maintain trust relationships with customers.

The technology industry is constantly driven by market forces to help its business partners solve problems quickly and cost-effectively. We look forward to working with Congress and the Administration to encourage aggressive enforcement against counterfeiters, and convincing our trading partners to do the same.

CACP MEMBERSHIP LIST AS OF JUNE 14, 2005

ASSOCIATIONS

Advanced Medical Technology Association (ADVAMED); AeA, Advancing the Business of Technology (AeA); Aerospace Industries Association (AIA); Alliance of Automobile Manufacturers (AAM); American Apparel & Footwear Association (AAFA); American Association of Exporters and Importers (AAEI); American Council of Independent Laboratories (ACIL); American Intellectual Property Lawyers Association (AIPLA); American Society of Association Executives (ASAE); Association for Competitive Technology (ACT); Association of Equipment Manufacturers (AEM); Automotive Aftermarket Industry Association (AALA); Center for Health Transformation (CHT); The Cosmetic, Toiletry and Fragrance Association (CTFA); Consumer Electronics Association (CEA); Electronic Industries Alliance (EIA); Entertainment Software Association (ESA); Food Marketing Institute (FMI); Gas Appliance Manufacturers Association (GAMA); Global Business Leaders Alliance Against Counterfeiting (GBLAAC); Grocery Manufacturers of America (GMA); International Anti-counterfeiting Coalition (IACC); International Federation of Phonographic Industries (IFPI); Intellectual Property Owners Association (IPO); International Communications Industries Association (ICIA); International Trademark Association (INTA); Motion Picture Association of America (MPAA); Motor & Equipment Manufacturers Association (MEMA); Motorcycle Industry Council (MIC); National Association of Manufacturers (NAM); National Electrical Manufacturers Association (NEMA); National Marine Manufacturers Association (NMMA); Outdoor Power Equipment Institute (OPEI); Pharmaceutical Research and Manufacturers of America (PhRMA); Recording Industry Association of America (RIAA); Specialty Equipment Market Association (SEMA); Toy Industry Association (TIA); U.S. Chamber of Commerce (USCC); U.S. Council for International Business (USCIB); and Vision Council of America (VCA).

CORPORATIONS

Altria Corporate Services, Inc.; Altria Group, Inc.; American Standard Inc.; Amgen Inc.; AOL Time-Warner; Aspen Systems Corporation; Baker & McKenzie; BellSouth Corporation; British American Tobacco; C&M International, LTD; Dayco Products, LLC; deKieffer & Horgan; DuPont Security & Solution; Eastman Kodak Company; Gallup; Gillette; Intel Corporation; Jones Day; Kent & O'Connor, Incorporated; National Broadcasting Corporation (NBC); News Corporation; Oakley; Pernod Ricard USA; Pfizer; Robert Branand International; Stanwich Group LLC.; The Fairfax Group; Tiffany & Co.; Torys, LLP; Transpro, INC; Underwriters Laboratories, Incorporated; USA For Innovation; Verizon; and Xerox Corporation.

Mr. STEARNS. I thank you.

I will start with the questions here. You know, listening to you, it is a little overwhelming on what to do. And listening to each of you talk about it, Mr. Christian, you had sort of mentioned in your testimony sort of some steps. You indicated there is no quick fix but we must take the incremental steps to stop this problem.

I would like you to—and I think you did in your opening statement but before you do that, I cannot comprehend, could not eBay have a lot of counterfeit products being sold? I mean, I think Mr. DelBianco you said eBay has worked out a system where they authenticate every product that comes on or something?

Mr. DELBIANCO. Mr. Chairman, e-Bay has worked tirelessly for what they call the trust and security system. And it is a system by which immediately upon notification that an item might be counterfeit, they take aggressive measures to shut down that particular sale. And even after an investigation to block that seller from being on the site. I mentioned the Calloway golf clubs. And Calloway in its statements have said that they get cooperation from eBay the very instant they claim that they suspect that a set of clubs could be a counterfeit—

Mr. STEARNS. So it looks like to me—and Mr. Christian, you can tell me if we could educate the public and we could immediately have a data base in place where we could identify these counterfeits and this data base was made publicly known internationally, wouldn't that be a step to stop this?

Mr. CHRISTIAN. Potentially a step, one of many steps. You mentioned education certainly very important. What scares me at times is the fact that certain people, certain organizations seem prepared to declare victory and go home. This problem is not about to be solved. In the U.S., we have got to become more aggressive. This is an area where we are not a leader. We lead the world in so many areas but in this area we are depending upon foreign governments—

Mr. STEARNS. Yes.

Mr. CHRISTIAN. [continuing] and authorities to do what perhaps we should—

Mr. STEARNS. And you say there is no technology, we cannot have technology to prevent this. For example, Mr. Pearl, in yours if you put an RFID, a radio frequency and you tell every supplier that don't sell this unless it has this RFID, is not there—I am asking any one of you, is not there some technological solution here that we could have to help prevent counterfeiting?

Mr. DELBIANCO. I can take a little of that. If they put an RFID on our boxes, for example—

Mr. STEARNS. Like your refrigerator manifold?

Mr. DELBIANCO. Yes, on one of our manifolds—

Mr. STEARNS. Okay.

Mr. DELBIANCO. [continuing] or other products. The problem is that Chinese are very adaptive and they adapt very quickly.

Mr. STEARNS. You mean they will put an RFID in?

Mr. DELBIANCO. Immediately, the front box that you see was our original packaging, the blue and red one and with less than 6 months after we put our new product on the market in the back boxes which are nicer boxes, they had them copied as you can see, fake being to your left and to my right, and the original to my left and yours, your right. And it is very difficult to stop them. They are—

Mr. STEARNS. So no technological advancement will solve this problem in your opinion? None that—

Mr. DELBIANCO. I don't believe technology will solve it. It has to be solved at the source and we have to—

Mr. STEARNS. You could not put a hologram or you could not put something on there and—

Mr. DELBIANCO. Well in—

Mr. STEARNS. When it comes to safety, I would think there must be something, you know.

Mr. DELBIANCO. Technology is a tool in the toolbox but somehow it got known as the solution. One of the things that you mentioned and one of the things the FDA mentioned in their task force report was holograms. Well Novartis and a number of other pharmaceutical companies are considering putting holograms on packaging. In the meantime, the counterfeiters have already done so. So we have counterfeit product out there with holograms and we don't put holograms. And it says in the different languages for your safety on the hologram.

Mr. STEARNS. So they got hubris here, they will put on their package. Mr. Emmer and Mr. Arthur, is the problem with counterfeiting outside the United States in one sector only or are we talking across the board in your opinion?

Mr. EMMER. Yes, sir.

Mr. STEARNS. Yes.

Mr. EMMER. Mr. Chairman, the vast majority of automotive products that we found are manufactured in China and exported worldwide. The key markets that we found are the Middle East.

Mr. STEARNS. So I could go to an automotive shop in Florida and probably find some counterfeit parts.

Mr. EMMER. Probably. We—Federal-Mogul, we are not naive to think that we don't have a huge problem or a big problem in the U.S. We have identified a couple of issues already. The MOOG chassis parts on the East Coast of the U.S., we have identified as being a problem and we are taking steps to address that. And it is my opinion that you could go into any market in any country and find counterfeit products.

Mr. STEARNS. Mr. Arthur?

Mr. ARTHUR. I would say our member companies would see the same that most of the problem is the counterfeit products are being produced overseas and being distributed overseas and being imported into the U.S. both on the food side and the consumer product side.

Mr. STEARNS. What do you mean the food?

Mr. ARTHUR. Well there is counterfeit as I had mentioned soy sauce, I mean salsas.

Mr. STEARNS. Okay.

Mr. ARTHUR. Just a lot of, you know, even specialty products. There are companies that get a premium because they, you know, make a good hot sauce or a good salsa and somebody will make a cheap imitation of the label and sell it and that can really do damage especially to those small regional—

Mr. STEARNS. Well can I go into the local grocery store and find a counterfeit salsa today?

Mr. ARTHUR. I would like to believe not but I think that you probably could.

Mr. STEARNS. So you are saying that we don't even have protection of food safety in the United States in our grocery stores because you could find counterfeit food?

Mr. ARTHUR. I am hesitant to say that you cannot because that is a pretty much of an absolute statement.

Mr. STEARNS. Yes.

Mr. ARTHUR. I think that we have very good food security but I would be hesitant to say that you could not find it if you went looking for it. And most of the—and I think that as we work with the retailers and look at the supply chain, there is a decent system but there are gaps occasionally in the system that—and some of it can be in some of the discount stores or when products are moved over their—

Mr. STEARNS. Well how would I go about when I go into a grocery store to determine whether it is a bad product? I could not tell. I could not tell, right? Isn't it up to the grocery store to actually come up with a list of suppliers that they feel are credible?

Mr. ARTHUR. Yes.

Mr. STEARNS. Shouldn't that be protection?

Mr. ARTHUR. Yes. In the end, I mean, I—

Mr. STEARNS. I mean, they are going to be sued if myself or my family get hurt from buying something in their store.

Mr. ARTHUR. I think it is not just the retail, I think it is the whole supply chain from the manufacturer to the consumer. We need to have a good system in place and that is one of the things that we are working. The one part that I had mentioned briefly in the STOP initiative is developing some guidelines to protect that entire supply chain, and we are hoping to have something developed before the end of the summer that can then be distributed and then be used more broadly beyond the grocery and consumer products industries.

Mr. STEARNS. My time is expired. The ranking member.

Ms. SCHAKOWSKY. Thank you, to all the panelists. Mr. Emmer, I had the pleasure of taking a tour of the Federal-Mogul facility in my district in Skokie, Illinois not too long ago. I wanted to begin with you and then ask the other panelists the same question.

What has the Government done about your company or your company's counterfeiting problems and if you have suggestion of what more could be done. And I know when we get to you, Mr. Christian, you said that we are relying on foreign countries to do some of the things that we ought to do. So I am interested in sort of what has worked, what has been done, and what more could be done in just a couple of sentences during my time. Mr. Emmer?

Mr. EMMER. The—some of the things that we have seen that have worked are—or steps in the right direction are one the proposals from H.R. 32, seeing an increase in criminal penalties, the proposal to seize tooling patches, labels, anything that can be used to affix to a generic product thereby making it counterfeit. We would like to see it go a step further and see an increased funding to not only Department of Homeland Security, Department of Justice, increased resources for further prosecution and further enforcement of these crimes, specifically earmarked for counterfeiting crimes.

I would also like to see increase in cooperation between U.S. Customs and foreign customs agencies since we are able to track these counterfeit goods moving from one port to the next from say the United Arab Emirates to the U.S. and have some sort of interaction in place. I think that would facilitate a lot of—

Ms. SCHAKOWSKY. Would you favor retaliation against Chinese imports in some way? I mean, we have heard testimony from the Commerce Department that it keeps going on.

Mr. EMMER. It does keep going on. I think the Chinese Government, if they truly wanted to take action, they could stamp out a lot of this problem. I think a lot of the companies that we have found as being involved in the counterfeit production are partly owned by the Chinese Government or Chinese corporations. I think stronger measures on U.S. Government could exert some pressure on China for some positive results.

Ms. SCHAKOWSKY. Thank you. Mr. Arthur, do you have suggestions or what has the Government done?

Mr. ARTHUR. Well as I mentioned and a couple of people mentioned, getting H.R. 32 passed and in place will really help on making our trade position more credible, that we are doing what we can here to destroy counterfeit products that are found plus the machinery that is used to make them when it is done in the U.S. And then I think that stronger—working with the international trade community to make sure that those countries are doing what we are doing here to find those that are counterfeiting and crack down on them. And so I would echo a lot of what Mr. Emmer was saying as well.

Ms. SCHAKOWSKY. Okay.

Mr. CHRISTIAN. As I mentioned, we need to take the lead. I think this is an issue in a way similar to what we—what is often heard about terrorism. That we can fight it across the ocean in a far off land or we can fight it on Main Street, U.S.A. And I think the counterfeiting of medicines falls into that category as well.

If you look at the criminal jurisdictions from the criminal code of the United States, most of the agencies, FBI, Secret Service, DEA, Customs operate internationally. The purpose of doing that is to protect American citizens before the crime occurs in the United States. The criminal jurisdiction for counterfeiting falls to the—for the FDA and they have a small group of professional investigators but that is what it is: a small group, they don't operate internationally.

So while DEA will try and keep a product from being planted, they will try and keep it from being harvested, will try and keep it from being shipped, and we will track it down and investigate it when it is in the U.S., the FDA only has the capability of tracking it down once it is in the U.S. So we are not giving it as much attention. We are not leadership.

If you go out around the globe, whether it is Bogota or Bangkok, if the authorities think the U.S. law enforcement agencies are interested in a problem, they will work hard on it. When nobody ever comes to them and talks about counterfeiting, they back off a little bit. So I think we need to lead. We need to get out front on this issue and take a leadership role around the globe before we are reactive to a serious problem here in the U.S.

Ms. SCHAKOWSKY. Thank you.

Mr. PEARL. In my instance, the USTR has been helpful in at least helping me find attorneys in these countries where counterfeiting is taking place. The—I think that for us to be successful in reducing the amount of worldwide counterfeiting, it will be important to get the Governments and the offending countries to cooperate. It has to be done. If we have to twist their arms, we have to twist their arms, but it has to be done. We cannot do it as long as they are getting paid off in their own countries. And if there is no reason for them to try and do the right thing, we have to try and give them one. If we can do that, then they will start stopping the counterfeits before they get into their country. They will destroy them and they will probably try and find out who is bringing them in. We have to make it worth their while because right now it does not make any difference to the person looking at containers, he could care less. But if he comes—if—in our case, a whole container load of product came in from China, the bill of lading said China, the product said Made in the U.S.A.

Now if that does not tell you something and the guy said—I mean if he—I would have gladly given him a bonus to stop that container. It costs me a fortune when that gets into the market and ruins our reputation. And we have to find a way to get the other Governments to cooperate and see—make it in their interest too. It has to be in their best interest and I think it is.

Ms. SCHAKOWSKY. Thank you.

Mr. DELBIANCO. Representative Schakowsky, I believe your question was what concrete steps has the administration taken to combat counterfeits. I will just simply address sort of a top down and a bottom up response to your answer.

From the top down, trade representatives and the administration have been aggressive in negotiating strong intellectual property protect rights in free trade agreements and have been big supporters of pushing through the CAFTA, Central America Free Trade Agreement. That, I believe is the top down approach.

From the bottom up, this Justice Department—and to partly catalog in a study they did last fall, this Justice Department went a long way to document the cases that have been prosecuted. In 2004, a prosecution of a Ukrainian man was charged with illegally distributing millions of dollars of unauthorized copies of software and was extradited to this country. And then the Department of Justice conducted operation digital marauder last fall and it seized almost \$60 million of counterfeit Microsoft software and have charged 11 people with manufacturing counterfeit software and distributing it. And that sort of public hanging or a public execution, I think will focus the mind of some counterfeiters.

Ms. SCHAKOWSKY. Let me ask you a question though. You talk about 11 individuals but if we have companies that are trading on Chinese Stock Exchange that are actually making money from—their business is counterfeiting, then this is kind of out in the open and larger than 11 people. What can we do about that?

Mr. DELBIANCO. From the top down, we have to negotiate heavily with China for intellectual property protection rights that would help to shut down the Alibaba exchange. And from the bottom up, those prosecutions, they are still going to have an effect, Represent-

ative, on the distribution channels here in the States. Because if someone is taking those Alibaba based counterfeits and moving them to a U.S. based market, there are going to be folks in that distribution chain. And I know we cannot arrest them all, but let us not let the perfect be the enemy of the good. I think we can make a difference.

Ms. SCHAKOWSKY. Thank you.

Mr. FERGUSON. [Presiding] Ms. Blackburn for questions.

Ms. BLACKBURN. Thank you so much. And I want to thank each of you for being here and for your comments on this issue.

Mr. Christian, I think it was you that mentioned the tools, that technology was just one tool in the toolbox. I will remind each of you and all of us collectively, I think it was Napoleon who said tools belong to those who know how to use them. And I think that it is high time we start figuring out how to use some of these tools to help protect the creative community in this country and I hope that we all will work collectively and aggressively on this issue.

I have four questions and I am going to address them to each of—to you all collectively and then you may either respond now or respond in writing. I know we are a little close on time. And Mr. DelBianco, you can respond for the association that you work with.

And we talk in Tennessee where I am from and as we look at this whether it is my entertainment industry, whether it is our pharmaceutical development that takes place there, our biopharmaceutical industry, our auto engineers that are working, we talk about the impact of this. In entertainment alone, we know that we have lost half of our songwriters in this country over the past decade. Intellectual property theft is an expensive business, very expensive business.

So what I would like to know from each of you with your companies is this. No. 1, will you please give me an estimate of the economic loss that you incur each year because of piracy and intellectual property theft? What is it costing you in raw dollars. No. 2, for your industry or your company jobs lost, annual jobs lost. What do you estimate that to be? No. 3, would you as a company support WTO action against China for their infringement and lack of respect for intellectual property and counterfeiting. And No. 4, in addition to China, what other countries or regions of the world are producing counterfeit product or infringements on the intellectual property that many in our country own.

And Mr. Emmer, I will start with you. We will work down and if each of you will just briefly respond or either let me know that you are responding in writing.

Mr. EMMER. I will have to submit the response in writing to you certainly on the economic loss, the annual job loss, as well as the confirmation of the support against—action against China. It certainly needs to be considered, as well as the—it just needs to be considered. The other areas that we have seen counterfeit products being produced, I can—I will include that in writing as well but we have seen an increase in the India/Pakistan Region or India/Pakistan specifically and those areas are affecting our company as well.

Ms. BLACKBURN. Thank you.

Mr. ARTHUR. The job loss numbers and the economic loss numbers I have seen as nationwide. I will have to get back to see if we

have those on an industry basis. And I will also have to get back on the—your last two questions.

Ms. BLACKBURN. Thank you.

Mr. CHRISTIAN. I will have to do as well. To us, this is more of a public health issue than an economic issue, although it is an economic problem. It does cost money. It does cost jobs. There are other areas of concern. One of the areas I did not mention today was India but India remains a concern and a problem. Certainly in Latin America, Russia is a disaster as I mentioned. But as far as the specifics, we will have to get back to you because—

Ms. BLACKBURN. Excellent, thank you.

Mr. CHRISTIAN. [continuing] we are in the public health.

Ms. BLACKBURN. Mr. Pearl?

Mr. PEARL. As far as an economic loss from my small company it is at least a million dollars a year. Jobs lost, a few years ago we had 375 employees, we now have 260. As far as the World Trade Organization, I think that China wants to belong and I think we should make them follow the rules. Absolutely force them to take some action. And if we don't, we are all going to suffer. They want what we have and they have a 20 or 30 year plan to get it from us and we are just feeling it now and they are not going to stop. If we don't slam them now and get their respect, we will never have their respect. Something serious has to be done now.

And you asked about other countries other than China. There are many as have already been mentioned. But I believe if you really want to slow down the Chinese counterfeit, you can do it by making the traders responsible. Traders are people who go out and scour the world, find products and customers, have them made in China. They don't care about trademark law anywhere. They have no scruples whatsoever and no morals and they will copy anything that they think they can make a commission on.

Ms. BLACKBURN. Thank you.

Mr. PEARL. And if we can get China to make them responsible, then I believe that we can slow down the Chinese counterfeiting. Not stop it but we can certainly slow it down and make it more difficult. If you—when I go to trade shows around the world, I see the Chinese there. They are not particularly selling but they are certainly getting all the catalogs and talking to people about which one of their products is well thought of so that they know which one to copy. And before you know it, they have copied it and they are in your market and they are producing inferior products.

Ms. BLACKBURN. Thank you. Mr. DelBianco?

Mr. DELBIANCO. Thank you for your question, Representative Blackburn.

With respect to the first question, the economic losses due to the information technology industry to the piracy and counterfeiting is estimated by IDC at \$30 billion a year. And they estimate that one in three computers worldwide contains some form of pirated or counterfeit software.

Representative, I would like to get back to you in writing with the number of jobs and the specific WTO actions we would recommend against China.

And with respect to your fourth question, I believe that Brazil and at least three nations in Eastern Europe, Russia, Poland, and

Romania are a source of counterfeit software that is plaguing software makers in this country and costing American jobs as well and they deserve the same kind of scrutiny we are applying to China here today. Thank you.

Ms. BLACKBURN. Thank you very much.

Thank you, Mr. Chairman.

Mr. FERGUSON. The chair recognizes himself for questions.

A couple of questions for Mr. Christian. You say in your testimony that EU's eastern border has become increasingly poor. I referenced this in my opening statement allowing for Russian counterfeit pharmaceutical cartels to being dangerous counterfeit drugs into the EU pharmaceutical supply reaching France and Germany. Can you talk a little bit more about that? Can you elaborate in what you said in your statement?

Mr. CHRISTIAN. Sure. Historically, Western Europe particularly has enjoyed the same quality, the same safety that the United States has in its medical distribution system. Despite the fact it is a little more porous, a little more dangerous because of the legal parallel trade that goes on among the various northern and southern European countries which is encouraged and, of course, the repackaging that I mentioned.

So Europe is beginning to see some of the problems that we are beginning to see. You know we have had a series of counterfeit cases that have made the news in the United States. Europe is beginning to see that. The border issue, Russia is just exploding with counterfeiting and some cities it is up to 25 or 30 percent of the products in the pharmacies are counterfeit. And these are coming out into the old Eastern European areas. And now with the expansion of the EU, then once you are into Eastern Europe, you are into the major markets.

Additionally in Europe, they are beginning to have the same problem with the Internet sales that we have. There are many hundreds of Internet sales selling counterfeit products from Russia and also from China. So they are going through some of the same pains and learning experiences that we are going through. It is more dangerous for them at this point in time because they are that much closer to a major existing counterfeiter.

Mr. FERGUSON. With the EU's development and formation, it seems then that the safety of the drug supply, you seem to be suggesting is getting less safe rather than more.

Mr. CHRISTIAN. That is correct.

Mr. FERGUSON. Any signal that that is not going to continue to deteriorate?

Mr. CHRISTIAN. No, but I think it is similar to the U.S. It is similar to most of the world that the drug supply in general is getting less safe. There is a new book out that just deals with the issues of the United States called "Dangerous Doses" and that would be eye opening for members of the committee to read because it just devotes itself to the problems in the United States that often go unreported or under reported.

Mr. FERGUSON. What about Canada?

Mr. CHRISTIAN. Canada has a safe drug supply at this point in time. As you may have seen today in the news, the latest survey showed that 2 percent of the Canadian websites are actually in

Canada, and that to me is a precursor of what potentially could happen if we have importation, re-importation, or whatever you want to call it. Back in the 1980's, it was called American goods returned. And this very committee determined that there were major problems with counterfeit, adulterated, expired products coming back into the United States and passed the Prescription Drug and Marketing Act. And the same arguments that we used in the mid-1980's by this committee exist today.

One of the major receipts of the American goods before they returned were the Cayman Islands. Now the Cayman Islands had no problem with counterfeit, or expired, or adulterated products until the criminal organized crime elements decided to use it as a launching point. So they would get millions of doses of products shipped to the Cayman Islands where the population might have been 15,000 people. And after sitting on the dock and being messed with, if you will, replaced, or adulterated, or liquid products being divided in two and water being added, these products came back to the United States. And this committee discovered and uncovered that scandal and the Prescription Drug and Marketing Act took place.

Because Canada does not have a problem today, does not mean if opportunity for criminal elements to take advantage of the situation is created, then they will take advantage of it. If the door is opened, then you are going to see what you see with the Internet sales where 86 percent of all product entering via the Internet is illegal in the United States.

Mr. FERGUSON. The chair recognizes Mr. Bass. No other questions.

Mr. BASS. Thank you very much, Mr. Chairman.

I regret having missed the chairman's questioning and others. I have heard a lot of discussion here about the problem. It is unclear to me as to exactly what the solutions might be. In fact, it looks like a dam that is sort of being broken here and as we get more technologically advanced, the problems don't get easier to solve but harder.

I also think that we need to differentiate between the—especially in the pharmaceutical field between the issue of re-importation which is an economic issue and counterfeiting which is quite different. Counterfeiting can occur anywhere in the world, abroad or here or anywhere else. Manufacturing is another story all together because the reason why you get knock off products is because they are a lot cheaper to manufacture. And as we well know, there are legitimate businesses in the country that are subbing out manufacturing abroad but it has their name on it so therefore it is okay.

Is there a nexus between the issue of counterfeiting and the whole trade debate that we are having today? Is that—is there any—do trade agreements help reduce the issue of counterfeiting? Maybe, Mr. Pearl, you could answer. You are representing NAM. Is NAM in favor or opposed to CAFTA. Do you know?

Mr. PEARL. They are in favor of it. And I—

Mr. BASS. That is what your little button is?

Mr. PEARL. Absolutely. And the reason that I am in favor of it also personally is that it will strengthen our IPR issues. We can force them. When you are negotiating with someone, you have an

opportunity and I don't want our country to lose the opportunities with every trade agreement. We need to drive home IPR issues, counterfeiting issues, and other issues that are very important to us.—went to the United Arab Emirates and that to me personally is very important because we just in November found them counterfeiting our parts there. And we—temporarily we may have it stopped but it is something constant diligence is required.

Mr. BASS. And Mr. Pearl, the reason your parts are counterfeited is because I am going to assume labor is cheaper elsewhere. Is that right?

Mr. PEARL. Correct.

Mr. BASS. Yes.

Mr. PEARL. Chinese labor is virtually free.

Mr. BASS. But you are not worried about counterfeiting within the United States of your—

Mr. PEARL. We have not seen our products counterfeited in the United States yet and I am hoping I never do.

Mr. BASS. All right.

Mr. PEARL. But in the Middle East definitely.

Mr. BASS. Did anybody mention any specific legislative ideas for dealing with this counterfeiting issue?

Mr. DELBIANCO. Representative Bass?

Mr. BASS. Yes, sir, Mr. DelBianco.

Mr. DELBIANCO. Thank you. We, I think as a chorus, all of us supported H.R. 32.

Mr. BASS. Okay.

Mr. DELBIANCO. And need to move that through on the Senate's side.

Mr. BASS. But we have done that in the House, didn't we, H.R. 32?

Mr. DELBIANCO. Yes.

Mr. BASS. So we have already passed that. Anything else?

Mr. DELBIANCO. The digital seals and certificates that I spoke of in my testimony—

Mr. BASS. Okay.

Mr. DELBIANCO. [continuing] it is possible that those would not be considered the same kind of labels that are named in H.R. 32. So it is entirely possible we may need more targeted legislation to identify that trafficking in digital seals and certificates is every bit as bad as trafficking and physical labels and certificates.

Mr. BASS. Mr. Christian, again, I do not want to talk about re-importation so this is not the reason for this question. Is there counterfeit-proof packaging technology available? Please do not get into re-importation. Is it possible for pharmaceutical companies to create, just like we have currency, counterfeiting of currency which obviously we try to stay out of. Is it possible to do it in your area?

Mr. CHRISTIAN. Well if we just use the currency example, sir, since 1986, the U.S. Currency has been changed, I think seven times because it was being counterfeited. And in that particular instance, you have to realize that the security features are on the product. And so what we have is we are putting security features when we talk about technology, we are talking about putting them on the packaging. And at the end of the day, we are tracking the cardboard, we are not tracking the product and we constantly find

counterfeit product in genuine packaging and genuine product in counterfeit packaging.

The changes are being made. Legal repackaging as I mentioned is—exists in the U.S. and the EU, the two biggest markets. So a pharmaceutical company can put a great deal of money into these new secure devices and packaging and they can end up on the floor of the repackager as he puts it in his new plain packages with no security features and if they just end up in the trash that is a good thing. They sometimes end up in the hands of the counterfeiter.

Mr. BASS. Is there as big—is there a significant issue of counterfeit pharmaceuticals in American drug stores and if so, what measures could be taken to reduce that problem?

Mr. CHRISTIAN. Well, I think it can be said that we have the safest distribution system in the world but it is very far from perfect. And different States most recently and most effectively Florida discovered a number of serious problems in the distribution system and made a number of arrests and has convictions and passed legislation tightening things up in Florida and eliminating—in many States, you can become a pharmaceutical distributor by filling out a one or two page application and sending on a check for \$100. And now you are a distributor. And in Florida, they discovered these people carrying temperature sensitive medicines around in the trunk of a car in 90 degree heat.

Mr. BASS. How do pharmacists tell a counterfeit drug from a non-counterfeit drug on—this is an American pharmacist on the shelf? Can American pharmacists tell the difference between a counterfeit and a non-counterfeit or genuine pharmaceutical that arrives at their door from—

Mr. CHRISTIAN. No, because what we are seeing and if you recall the very well publicized cholesterol lowering case by one of the major U.S. manufacturers about 1½ years ago, they mixed in the counterfeit product with the genuine product. So right down to the small container of 100 tablets you—one day you might take a genuine product and the next day you might take a counterfeit product. So we are not seeing what we did 7 or 8 years ago where the counterfeiters just had counterfeit product. Today they have expired, they have adulterated, they have stolen product and additionally, they have some genuine and some counterfeit and they are mixing it together. And this greatly complicates the reinforcement efforts.

Mr. BASS. Okay. Thank you very much, Mr. Chairman.

Mr. FERGUSON. Seeing no other members who are prepared to ask questions, I want to thank all of our panelists for your testimony today. You made persuasive and an articulate case for some of the challenges that we face and our hopes in addressing those so thank you very much for being here today. We will adjourn.

[Whereupon, at 4:34 p.m., the subcommittee was adjourned.]



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