

GAO

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INTELLECTUAL
PROPERTY

Initial Observations on the
STOP Initiative and U.S.
Border Efforts to Reduce
Piracy

Statement of Loren Yager, Director
International Affairs and Trade



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Highlights

Highlights of [GAO-06-1004T](#), testimony before the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, Committee on Homeland Security and Government Affairs, United States Senate

Why GAO Did This Study

U.S. goods are subject to substantial counterfeiting and piracy, creating health and safety hazards for consumers, damaging victimized companies, and threatening the U.S. economy. In 2004, the Bush administration launched the Strategy for Targeting Organized Piracy (STOP) – a multi-agency effort to better protect intellectual property (IP) by combating piracy and counterfeiting. This testimony, based on a prior GAO report as well as observations from on-going work, describes (1) the range and effectiveness of multi-agency efforts on IP protection preceding STOP, (2) initial observations on the organization and efforts of STOP, and (3) initial observations on the efforts of U.S. agencies to prevent counterfeit and pirated goods from entering the United States, which relate to one of STOP's goals.

What GAO Recommends

GAO is not recommending executive action.

INTELLECTUAL PROPERTY

Initial Observations on the STOP Initiative and U.S. Border Efforts to Reduce Piracy

What GAO Found

STOP is the most recent in a number of efforts to coordinate interagency activity targeted at intellectual property (IP) protection. Some of these efforts have been effective and others less so. For example, the Special 301 process – the U.S. Trade Representative's process for identifying foreign countries that lack adequate IP protection – has been seen as effective because it compiles input from multiple agencies and serves to identify IP issues of concern in particular countries. Other interagency efforts, such as those by the National Intellectual Property Law Enforcement Coordination Council (NIPLECC), are viewed as being less effective because they have produced little beyond a summary of agencies' actions in the IP arena.

While STOP has energized IP protection and enforcement efforts domestically and abroad, our initial work indicates that its long-term role is uncertain. STOP has been successful in fostering coordination, such as by reaching out to foreign governments and private sector groups. Private sector views on STOP were generally positive; however, some stated that it emphasizes IP protection and enforcement efforts that would have occurred regardless of STOP's existence. STOP's lack of permanent status and accountability mechanisms poses challenges for its long-term impact and congressional oversight.

STOP faces challenges in meeting some of its objectives, such as increasing efforts to seize counterfeit goods at the border – an effort for which the Department of Homeland Security's Customs and Border Protection (CBP) and Immigration and Customs Enforcement are responsible. CBP has certain steps underway, but our initial work indicates that resources for IP enforcement at certain ports have declined as attention has shifted to national security concerns. In addition, prior GAO work found internal control weaknesses in an import mechanism through which a significant portion of imports flow, and which has been used to smuggle counterfeit goods.

Examples of authentic and counterfeit products.



Source: GAO.

Authentic (left) versus counterfeit batteries, counterfeit Nike shoes, and counterfeit toothpaste (left) versus authentic toothpaste.

www.gao.gov/cgi-bin/getrpt?GAO-06-1004T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Loren Yager at (202) 512-4128 or yagerl@gao.gov.

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear again before the subcommittee to discuss our work on U.S. efforts to protect U.S. intellectual property (IP) rights. We appreciate the opportunity to contribute to the record that this Committee has established on IP protection. The United States dominates the creation and export of intellectual property—creations of the mind—and provides broad protection for intellectual property through means such as copyrights, patents, and trademarks. However, because protection of intellectual property in many parts of the world is inadequate, U.S. goods are subject to substantial counterfeiting and piracy. Such goods are widely distributed in global markets, including here in the United States. As you stated in this Subcommittee’s June 2005 hearing on IP protection, the production and distribution of counterfeit and pirated goods create health and safety hazards for consumers, damage companies that are victims of this theft, and pose a threat to the U.S. economy.

Since my last testimony before this committee, the United States has continued to develop and implement its Strategy for Targeting Organized Piracy, or STOP, which outlines priority IP enforcement efforts of six agencies. To understand more fully how this strategy might contribute to better protection of IP, I will address three topics: (1) the range and effectiveness of multi-agency efforts on IP protection that preceded STOP; (2) initial observations on the organization and efforts of STOP; and (3) initial observations on the efforts of U.S. agencies to prevent counterfeit and pirated goods from entering the United States, which relate to one of STOP’s goals.

To address these issues, we have drawn on a number of completed and ongoing GAO studies, including a report on this subject that we published in 2004 and updated in testimony before this committee last year.¹ In addition, we are presenting some initial and preliminary observations based on three ongoing reviews related to IP protection. These include (1) a study that we have initiated for this committee focusing on IP enforcement at the U.S. border, (2) a study for the House Government Reform Committee on interagency efforts to protect IP rights, and (3) additional work on a Customs and Border Protection (CBP) program

¹GAO, *Intellectual Property: U.S. Efforts Have Contributed to Strengthened Laws Overseas, but Challenges Remain*, [GAO-04-912](#) (Washington, D.C.: Sept. 8, 2004). GAO, *Intellectual Property: U.S. Efforts Have Contributed to Strengthened Laws Overseas, but Significant Enforcement Challenges Remain*, [GAO-05-788T](#) (June 14, 2005).

called the “in-bond system” that allows goods to enter U.S. commerce at a port other than the port of arrival. In conducting the GAO studies, we have performed work at multiple U.S. agency headquarters in Washington, at U.S. ports of entry, and in other nations. In addition, we have met with representatives from multiple industry associations to obtain their views on STOP. We obtained technical comments on this testimony from CBP and Immigration and Customs Enforcement (ICE) officials and incorporated their changes where appropriate. All work was conducted in accordance with generally accepted government auditing standards.

Summary

Prior to STOP’s creation in 2004, the U.S. government established a number of mechanisms and structures to coordinate interagency IP protection activity, and they achieved varying levels of success. For example, as we reported in 2004, the Special 301 process² that is annually led by the Office of the U.S. Trade Representative (USTR) was generally cited as being quite effective in collecting input from multiple agencies, identifying IP issues of concern in particular countries, and achieving policy changes in many of those nations. On the other hand, U.S. government efforts to improve IP enforcement under the National Intellectual Property Law Enforcement Coordination Council (NIPLECC), a multi-agency coordinating body, were generally believed to be ineffective, having resulted in little more than the publication of an annual report compiling individual agency submissions. STOP, a presidential initiative, was, in part, a response to the need for further attention to IP enforcement. The initiative is led by the White House under the auspices of the National Security Council and involves collaboration on IP protection and enforcement efforts among six federal agencies.

STOP has energized U.S. efforts to protect and enforce IP and has initiated some new efforts, but its long-term role is uncertain. One area where STOP has increased efforts is outreach to foreign governments. In addition, STOP has focused attention on helping small- and medium-sized enterprises to better protect their IP rights. Private sector views on STOP were generally positive, although some said that STOP was a compilation of new and on-going U.S. agency activities that would have occurred anyway. As a presidential initiative, STOP was not created by statute; has

²The Special 301 process identifies foreign countries that deny adequate and effective protection of IP rights or fair and equitable market access for U.S. persons who rely on IP protection.

no formal structure, funding, or staff; and appears to have no permanence beyond the current administration. STOP's lack of permanence and of accountability mechanisms poses challenges for its long-term impact and congressional oversight.

Certain weaknesses in agencies' IP enforcement efforts at the border illustrate the challenges STOP faces in carrying out some of its objectives. One of STOP's goals is to increase efforts to seize counterfeit goods at the border, an undertaking that rests primarily with CBP and ICE within the Department of Homeland Security. Though STOP doesn't direct these agencies' efforts or resource allocations, and national security remains a top priority, CBP continues to have a trade enforcement role and is taking steps to improve its IP enforcement. However, our initial work for this Committee indicates that significant challenges remain. The overall task of assessing whether particular imports are authentic has become more difficult as trade volume and counterfeit quality increase. While the number of IP seizures has grown, there is generally no similar trend in the estimated value of goods seized. New tools that CBP has developed to better target suspect shipments and deal with problem importers are largely works in progress whose future impact is uncertain. CBP and ICE have undergone dramatic restructuring to manage their new priorities, and our initial evidence indicates that resources dedicated to IP enforcement are shrinking. Finally, a range of internal control weaknesses continue to plague a critical CBP system, called the in-bond system, that allows goods to enter U.S. commerce at a port other than the port of arrival. These weaknesses have been exploited by importers to smuggle counterfeit goods. In our recent work, CBP staff continue to observe that the limited information required from importers on in-bond shipments makes it difficult for CBP to assure that these shipments have reached their proper destinations.

Background

Intellectual property is an important component of the U.S. economy, and the United States is an acknowledged global leader in its creation. However, the legal protection of intellectual property varies greatly around the world, and several countries are havens for the production of counterfeit and pirated goods. The State Department has cited estimates that counterfeit goods represent about 7 percent of annual global trade, but we would note that it is difficult to reliably measure what is

fundamentally a criminal activity.³ Industry groups suggest, however, that counterfeiting and piracy are on the rise and that a broader range of products, from auto parts to razor blades, and from vital medicines to infant formula, are subject to counterfeit production. Counterfeit products raise serious public health and safety concerns, and the annual losses that companies face from IP violations are substantial.

Eight federal entities, the Federal Bureau of Investigation (FBI), and the U.S. Patent and Trademark Office (USPTO) undertake the primary U.S. government activities to protect and enforce U.S. IP rights overseas. These eight entities are: Departments of Commerce, State, Justice, and Homeland Security; USTR; the Copyright Office; the U.S. Agency for International Development; and the U.S. International Trade Commission. They undertake a wide range of activities that fall under three categories: policy initiatives, training and technical assistance, and law enforcement. U.S. policy initiatives to increase IP protection around the world are primarily led by USTR, in coordination with the Departments of State, Commerce, USPTO, and the Copyright Office, among other agencies. These policy initiatives are wide ranging and include reviewing IP protection abroad, using trade preference programs for developing countries,⁴ and negotiating agreements that address intellectual property. Key activities to develop and promote enhanced IP protection in foreign countries through training or technical assistance are undertaken by the Departments of Commerce, Homeland Security, Justice, and State; the FBI; USPTO; the Copyright Office; and the U.S. Agency for International Development. A smaller number of agencies are involved in enforcing U.S. IP laws. Working in an environment where counterterrorism is the central priority, the FBI and the Departments of Justice and Homeland Security take actions that include engaging in multi-country investigations involving intellectual property violations and seizing goods that violate IP rights at U.S. ports of entry. Finally, the U.S. International Trade Commission has an adjudicative role in enforcement activities involving patents and trademarks.

³The Organisation for Economic Co-operation and Development (OECD) is conducting a study on IP, examining the extent to which counterfeit goods are entering global trade and associated data reliability issues.

⁴U.S. IP rights policy efforts include use of the Generalized System of Preferences (GSP) originally authorized under the Trade Act of 1974. When GSP was re-authorized under the Trade and Tariff Act of 1984, new “country practice” eligibility criteria were added, including a requirement that beneficiary countries provide adequate IP rights protection.

STOP Is One of Several Interagency IP Coordination Mechanisms

STOP is the most recent of several interagency IP coordination mechanisms that address IP policy initiatives, training and technical assistance, and law enforcement. Some of these have been effective, particularly the Special 301 process that identifies inadequate IP protection in other countries and the Intellectual Property Rights (IPR) Training Coordination Group. However, U.S. law enforcement coordination efforts through NIPLECC have had difficulties. STOP was, in part, a response to the need for further attention to IP enforcement.

Coordination Efforts Involving Policy Initiatives and Technical Assistance Have Been Generally Effective

Our September 2004 report found that coordination efforts through the Special 301 process and the IPR Training Coordination Group have generally been considered to be effective by U.S. government and industry officials.⁵ “Special 301,” which refers to certain provisions of the Trade Act of 1974, as amended,⁶ requires USTR to annually identify foreign countries that deny adequate and effective protection of IP rights or fair and equitable market access for U.S. persons who rely on IP protection. USTR identifies these countries with substantial assistance from industry and U.S. agencies and then publishes the results of its reviews in an annual report. Once a list of such countries has been determined, the USTR, in coordination with other agencies, decides which, if any, of these countries should be designated as Priority Foreign Countries, which may result in an investigation and subsequent actions. As our report notes, according to government and industry officials, the Special 301 process has operated effectively in reviewing IP rights issues overseas. These agency officials told us that the process is one of the best tools for interagency coordination in the government, and coordination during the review is frequent and effective.

The IPR Training Coordination Group is a voluntary, working-level group comprised of representatives of U.S. agencies and industry associations involved in training and technical assistance efforts overseas for foreign officials. Meetings are held approximately every 4 to 6 weeks and are well attended by government and private sector representatives. The State Department leads the group, and meetings have included discussions on training “best practices,” responding to country requests for assistance, and improving IPR awareness among embassy staff. According to several agency and private sector participants, the group is a useful mechanism

⁵GAO-04-912.

⁶19 U.S.C. 2242.

that keeps participants informed of the IP activities of other agencies or associations and provides a forum for coordination.

IP Law Enforcement Coordination Efforts Have Faced Challenges

NIPLECC was created by the Congress in 1999 to coordinate domestic and international intellectual property law enforcement among U.S. federal and foreign entities.⁷ NIPLECC members are from five agencies and consist of: (1) Commerce’s Undersecretary for Intellectual Property and Director of the United States Patent and Trademark Office; (2) Commerce’s Undersecretary of International Trade; (3) the Department of Justice’s Assistant Attorney General, Criminal Division; (4) the Department of State’s Undersecretary for Economic and Agricultural Affairs; (5) the Deputy United States Trade Representative; and (6) the Department of Homeland Security’s Commissioner of U.S. Customs and Border Protection. Representatives from the Department of Justice and USPTO are co-chairs of NIPLECC.⁸

Coordination efforts involving IP law enforcement through NIPLECC have not been as successful as other efforts. In our September 2004 report, we stated that NIPLECC had struggled to define its purpose and had little discernible impact, according to interviews with industry officials and officials from its member agencies, and as evidenced by NIPLECC’s own annual reports.⁹ Indeed, officials from more than half of the member agencies offered criticisms of NIPLECC, remarking that it was unfocused, ineffective, and “unwieldy.” We also noted that if the Congress wishes to maintain NIPLECC and take action to increase its effectiveness, it should to consider reviewing the council’s authority, operating structure, membership, and mission.

In the fiscal year 2005 Consolidated Appropriations Act, the Congress provided \$2 million for NIPLECC expenses, to remain available through fiscal year 2006.¹⁰ The act also created the position of the Coordinator for International Intellectual Property Enforcement, appointed by the

⁷NIPLECC was mandated under Section 653 of the Treasury and General Government Appropriations Act, 2000 (P.L. 106-58), 15 U.S.C. 1128.

⁸NIPLECC is also required to consult with the Register of Copyrights on law enforcement matters related to copyright and related rights and matters.

⁹[GAO-04-912](#).

¹⁰The Consolidated Appropriations Act, 2005 (P.L. 108-447), Division B Title II.

President, to head NIPLECC.¹¹ The NIPLECC co-chairs are to report to the Coordinator. In July 2005, Commerce Secretary Gutierrez announced the presidential appointment filling the IP Coordinator position. Since then, NIPLECC has added an assistant, a policy analyst, part time legislative and press assistants, and detailees from USPTO and CBP. Since the Consolidation Appropriations Act, NIPLECC has held two formal meetings but has not issued an annual report since 2004.

STOP Was Created to Strengthen IP Enforcement

In October 2004 the President launched STOP, an initiative to target cross-border trade in tangible goods and strengthen U.S. government and industry IP enforcement actions. The initiative is led by the White House under the auspices of the National Security Council and involves collaboration among six federal agencies: the Departments of Commerce, Homeland Security, Justice, and State; USTR; and the Food and Drug Administration.¹² STOP has five general objectives: (1) empower American innovators to better protect their rights at home and abroad, (2) increase efforts to seize counterfeit goods at our borders, (3) pursue criminal enterprises involved in piracy and counterfeiting, (4) work closely and creatively with U.S. industry, and (5) aggressively engage our trading partners to join U.S. efforts.

The IP Coordinator is also serving as the coordinator for STOP. Both agency officials and industry representatives with whom we spoke consistently praised the IP Coordinator, saying that he was effectively addressing their concerns by speaking at seminars, communicating with their members, and heading U.S. delegations overseas.

STOP Has Energized U.S. Efforts, but Its Impact and Long-Term Viability Are Uncertain

STOP has energized U.S. efforts to protect and enforce IP and has initiated some new efforts, however its long-term role is uncertain. One area where STOP has increased efforts is outreach to foreign governments. In addition, STOP has focused attention on helping small- and medium-sized enterprises to better protect their IP rights. Industry representatives generally had positive views on STOP, although some thought that STOP was a compilation of new and on-going U.S. agency activities that would have occurred anyway. STOP's lack of permanent status as a presidential

¹¹This official may not serve in any other position in the federal government.

¹²STOP and NIPLECC share the same member agencies, with the exception of the Food and Drug Administration, which is a member of STOP but not NIPLECC.

initiative and lack of accountability mechanisms could limit its long-term impact.¹³

STOP Has Fostered Coordination and Undertaken Some New Initiatives

Agency officials participating in STOP cited several advantages to the initiative. They said that STOP energized their efforts to protect and enforce IP by giving them the opportunity to share ideas and support common goals. Officials said that STOP had brought increased attention to IP issues within their agencies and the private sector as well as abroad, and attributed that to the fact that STOP came out of the White House, thereby lending it more authority and influence. Another agency official pointed out that IP was now on the President's agenda at major summits such as the G-8 and the recent EU-U.S. summits.¹⁴

STOP has initiated some new efforts, including a coordinated U.S. government outreach to foreign governments that share IP concerns and enforcement capacities similar to the United States. For example, the United States and the European Union (EU) have formed the U.S.-EU Working Group on Intellectual Property Rights, and in June 2006, the United States and European Union announced an EU-U.S. Action Strategy for Enforcement of IP Rights meant to strengthen cooperation in border enforcement and encourage third countries to enforce and combat counterfeiting and piracy.

One particular emphasis of STOP has been to help small- and medium-sized enterprises (SMEs) protect their IP in the United States and abroad through various education and outreach efforts. In 2002, we reported that SMEs faced a broad range of impediments when seeking to patent their inventions abroad, including cost considerations and limited knowledge about foreign patent laws, standards, and procedures.¹⁵ We recommended that the Small Business Administration (SBA) and the USPTO work together to make a range of foreign patent information available to SMEs. Within the last year, an SBA official told us that SBA began working with STOP agencies to distribute information through its networks and recently

¹³GAO will be issuing a report on STOP and NIPLECC in the fall at the request of the Chairman of House Committee on Government Reform.

¹⁴The G-8 is an annual summit whose members include Canada, the European Union, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States.

¹⁵GAO, *International Trade: Federal Action Needed to Help Small Businesses Address Foreign Patent Challenges*, [GAO-02-789](#) (Washington, D.C.: July 17, 2002).

linked SBA's website to the STOP website, making information about U.S., foreign, and international laws and procedures accessible to its clients.

Many industry representatives with whom we spoke viewed STOP positively, maintaining that STOP had increased the visibility of IP issues. For example, one industry representative noted a coordinated outreach to foreign governments that provided a more collaborative alternative to the Section 301 process, whose punitive aspects countries sometimes resented. Another indicated that his association now coordinates training with CBP that is specific to his industry as a result of contacts made through STOP. In addition, most private sector members with whom we spoke agreed that STOP was an effective communication mechanism between businesses and U.S. federal agencies on IP issues, particularly through the Coalition Against Counterfeiting and Piracy (CACP), a cross-industry group created by a joint initiative between the Chamber of Commerce and the National Association of Manufacturers. Private sector officials have stated that CACP meetings are their primary mechanism of interfacing with agency officials representing STOP.

There were some industry representatives who questioned whether STOP had added value beyond highlighting U.S. IP enforcement activities. Some considered STOP to be mainly a compilation of ongoing U.S. IP activities that pre-dated STOP. For example, Operation Fast Link¹⁶ and a case involving counterfeit Viagra tablets manufactured in China, both listed as STOP accomplishments, began before STOP was created. In addition, some industry representatives believed that new activities initiated under STOP would have likely occurred without STOP.

STOP Has Features That May Limit Its Long-Term Impact

As a presidential initiative, STOP was not created by statute; has no formal structure, funding, or staff; and appears to have no permanence beyond the current administration. NIPLECC, on the other hand, is a statutory initiative, receives funds, and is subject to congressional oversight. Recently, the lines between NIPLECC and STOP have blurred, possibly lending STOP some structure and more accountability. For example, as mentioned before, NIPLECC's IP Coordinator is also the focal point for STOP. In addition, NIPLECC recently adopted STOP as the strategy it is required to promulgate under the Consolidated Appropriations Act of

¹⁶Under the Department of Justice's Operation Fast Link, in April 2004, law enforcement authorities executed over 120 total searches over 24 hours in 27 states and in 10 foreign countries. Four separate undercover investigations were simultaneously conducted, striking all facets of the illegal software, game, movie, and music trade online.

2005. This legislation calls for NIPLECC to establish policies, objectives, and priorities concerning international intellectual property protection and intellectual property law enforcement; promulgate a strategy for protecting American intellectual property overseas; and coordinate and oversee implementation of these requirements.

However, the nature of the relationship between STOP and NIPLECC is not clear. Although the IP Coordinator has recently reported in congressional hearings that NIPLECC adopted STOP as its strategy, there have been no formal announcements to the press, industry associations, or agency officials responsible for carrying out STOP activities. In addition, STOP documents do not refer to NIPLECC. Our meetings with agency and industry officials indicated that they are unclear about the relationship between STOP and NIPLECC. The absence of a clearly established relationship makes it difficult to hold NIPLECC accountable for monitoring and assessing the progress of IP enforcement under STOP. We believe that accountability mechanisms are important to oversight of federal agency efforts and can contribute to better performance on issues such as IP protection.

IP Enforcement Efforts at the Border Illustrate Challenges Facing STOP

One of STOP's five goals is to increase federal efforts to seize counterfeit goods at the border, but work we are conducting for this Subcommittee illustrates the kind of challenges that STOP faces in achieving its goals. CBP and ICE are responsible for border enforcement efforts, but their top priority is national security. CBP has taken several steps since fiscal year 2003, when it made IP matters a priority trade issue, to update and improve its border enforcement efforts. While CBP seizures of IP-infringing goods have grown steadily since fiscal year 2002, the total estimated value of seizures during that time generally did not exhibit similar growth. Additionally, some steps that CBP is taking to improve IP enforcement are works in progress whose impact on this STOP objective is uncertain. CBP's ability to effectively enforce IP rights at the border is also challenged by limited resources for such enforcement and by long-standing weaknesses in its ability to track the physical movement of goods entering the United States using the in-bond system.¹⁷

¹⁷Early next year, GAO will provide a detailed report to this Subcommittee on our findings related to IP border enforcement and a separate report to the Congress on our findings related to the in-bond system.

CBP IP Seizures Have Increased in Number but the Estimated Value Has Fluctuated

STOP documents cite increases in IP-related seizures as a positive indicator of its efforts to stop counterfeit goods at the border. The overall task of assessing whether particular imports are authentic has become more difficult as trade volume and counterfeit quality increase. The number of IP-related seizures has grown steadily, with CBP and ICE together making about 5,800 seizures in fiscal year 2002 and just over 8,000 seizures in fiscal year 2005.¹⁸ However, there is no corresponding trend in the estimated value of such seizures.¹⁹ The estimated value of goods seized in fiscal years 2002 and 2003 was \$99 million and \$94 million, respectively. This figure jumped to a peak of about \$139 million in fiscal year 2004, but dropped back to the former level, about \$93 million, in fiscal year 2005.

According to CBP officials, the agency's goal is to focus its resources in part on high-value seizures, but a large percentage of annual seizure activity does not result in a significant seizure value. For example, nearly 75 percent of fiscal year 2005 seizures were small-scale shipments made at mail and express consignment facilities (facilities operated by companies that offer express commercial services to move mail and cargo, such as the United Parcel Service) or from individuals traveling by air, vehicle, or on foot. These seizures represented about 14 percent of total estimated seizure value in that year. Conversely, about 14 percent of fiscal year 2005 seizures involved large-scale shipments (i.e., containers) and accounted for about 55 percent of that year's estimated seizure value. The number of seizures made on goods emanating from China has risen from about 49 percent of the estimated domestic value of all IP seizures in fiscal year 2002 to about 69 percent in fiscal year 2005.

While CBP seizes goods across a range of product sectors, in recent years, seizures tend to be concentrated in particular goods, such as apparel, handbags, cigarettes, and consumer electronics. CBP also seeks to increase seizures of goods involving public health and safety risks, and its data shows that the estimated domestic value of seized goods involving certain health and safety risks, specifically pharmaceuticals, electrical articles, and batteries, increased during fiscal years 2002-2005. However,

¹⁸Each seizure action is counted as one seizure, regardless of the amount of goods seized.

¹⁹It is important to note that total estimated seizure value in any given year is a function of the type of goods seized, which varies from year to year. CBP estimates the value of IP-related seizures using "domestic value." CBP defines domestic value of goods as landed cost plus profit (the cost of the merchandise when last purchased, plus all duties, fees, broker's charges, profit, unloading charges, and U.S. freight charges to bring the goods to the importer's premises).

seizures in these and certain other health and safety categories represented less than 10 percent of the total estimated domestic value of seizures in fiscal year 2005, and seizures of other potentially dangerous goods, such as counterfeit auto parts, remain relatively limited. For example, CBP estimated in a letter to an automotive industry trade association that it made 14 seizures in fiscal years 2003-2005 of certain automotive parts.²⁰ A representative from another automotive industry trade association noted that CBP's ability to make seizures in this area depends on its receiving quality information about counterfeiters from companies.

CBP Has Taken Steps to Improve IP Enforcement, but Several Are Still Works in Progress

In various STOP documents, CBP cites steps it has taken to improve IP enforcement, but many of these are works in progress whose impact and effectiveness are undetermined. CBP identified IP matters as a priority trade issue in fiscal year 2003 and developed an agency-wide strategy for IP enforcement. The strategy addresses several components of IP enforcement, such as targeting (identifying high risk shipments), international coordination, communication to employees, and industry outreach. A CBP official who oversees the IP strategy told us that CBP seeks to perform IP enforcement more efficiently, and the strategy notes the importance of conducting IP enforcement while minimizing the burden on front line resources whose priority is national security. Several elements of the strategy were specifically designated as activities to support STOP.

CBP's key STOP-related activity is the creation of a statistical computer model that is designed to identify container shipments that are at higher risk of involving IP rights violations. To develop the model, CBP examined elements of past seizures and container examinations and identified certain factors that were significant characteristics of IP-infringing imports and that could be used to identify future IP rights violations. CBP piloted this model on a nation-wide basis for about one month in February 2005, but the pilot revealed several issues that need to be addressed before the

²⁰In this estimate, CBP counted seizures that were based in whole or in part on infringement of IP rights owned by motor vehicle manufacturers; manufacturers of motor vehicle parts, equipment, tools, and supplies; and manufacturers of automotive chemicals and other products used in the production, repair, and maintenance of all motor vehicles. CBP did not include seizures of IP-infringing products that are not used in production, repair, and maintenance of motor vehicles, such as key chains, toys, and apparel, or counterfeit goods used in the interior of a motor vehicle, such as car organizers, can holders, sunshades, steering wheel covers, and floor mats.

model can be implemented. CBP plans to pilot the model again for up to 3 months this summer at two land border ports and one seaport. CBP will use the results of the second pilot to further evaluate the viability of the model.

Another STOP-related activity for CBP is the use of post-entry audits to assist with IP enforcement.²¹ CBP officials said using such audits for this purpose is a new approach that is designed to assess whether companies have adequate internal controls to prevent them from importing goods that infringe IP rights. Initiated in fiscal year 2005, these audits are a novel approach that is likely to work best with established importers, but they may be less effective for dealing with importers that are engaged in criminal activity and deliberately take steps to evade federal scrutiny. CBP selected 40 known and potential IP-infringing companies to audit in fiscal years 2005-2006, and by July 2006 had completed 17 of these audits.²² In three audits, CBP found that the companies possessed or had already sold infringing goods that were not seized at the border. In two of these cases, CBP imposed penalties on the companies totaling about \$4.6 million.²³ In the third case, the audit closed in September 2005, but the decision on whether to impose penalties is still pending in CBP. A CBP official said that some less significant IP-infringing activity was found in several other audits, but CBP chose not to impose penalties in these cases. CBP also found that internal controls to prevent IP rights violations were lacking or inadequate for most of the 17 companies, and has worked with them to improve these controls.

A third STOP activity for CBP is the development of a system that allows companies to electronically record their IP rights through CBP's website. While trademark and copyright protection is obtained from USPTO and the Copyright Office, respectively, these rights must be separately

²¹CBP's Regulatory Audit Division in the Office of Strategic Trade performs various types of audits on importing companies. "Quick Response Audits" are designed to address single-issue trade compliance or enforcement concerns. The IP enforcement audits are a type of Quick Response Audit that examines importer controls to prevent IP infringement. They are referred to as post-entry audits because they examine controls over goods that have already entered the country.

²²The same computer model being developed to detect high-risk shipments was used to help select some companies for the post-entry audits in fiscal year 2005.

²³CBP imposed penalties under 19 U.S.C. 1595a(b), which allows it to assess penalties equal to the domestic value of any articles introduced or attempted to be introduced into the United States contrary to law.

recorded with CBP, for a fee.²⁴ Recording with CBP provides CBP officials with information about the scope, ownership, and representation of protected IP rights being recorded. Although CBP officials have said recordation is important because it helps CBP effect legally defensible border enforcement, some companies fail to record their rights with CBP, either because they are unaware of the recordation requirement or because they choose not to. The electronic recordation system, implemented in December 2005, is designed to streamline the process; reduce processing times; and, ideally, increase the number of recordations.²⁵ A link to the recordation system has been established on USPTO's website, and a link from the Copyright Office is planned. CBP expects that most paper-based applications will eventually be eliminated.²⁶ While these are important steps, we have not yet evaluated the impact of the new recordation system. Several industry representatives have cited other concerns about recordation generally, such as long recordation processing times and the effective lack of border protection caused by the inability to record copyrights with CBP before such rights are issued by the Copyright Office. For example, one private sector representative said that during the 6 to 9 months it takes to process a copyright, pirated master CDs may be allowed to enter the United States because the rights holder has not yet been able to record the title with CBP.²⁷

Initial Evidence Indicates That Resources for IP Enforcement Are Shrinking

CBP and ICE priorities and resource allocations changed dramatically after September 2001, and our initial work indicates that some headquarters and field resources for IP enforcement have declined since then. As you indicated in your statement at the June 2005 IP hearing, the ultimate success of STOP, and of IP enforcement generally, depends on whether agencies are able to recruit, train, and retain the necessary workforce to meet their objectives. You also noted that prior hearings

²⁴The recordation fee is \$190 per trademark or copyright application, or, if a trademark application covers more than one class of protected goods, the fee is \$190 per class of goods to be recorded.

²⁵Pendency times for paper-based recordation applications could be months long, according to a CBP official.

²⁶CBP would still offer paper-based recordation to accommodate companies that lack Internet access.

²⁷A CBP official said that an exemption to allow companies to record certain copyrights with CBP based on the copyright application, rather than the issued copyright, awaits approval in CBP.

before this Subcommittee revealed that human capital issues were hindering federal enforcement of trade laws. At several border locations we visited, we found that resources for trade and IP enforcement are thinly spread, certain IP enforcement positions had been reduced or eliminated, and one location faced challenges in filling vacant CBP Officer positions.

At CBP port operations, employees in two job categories are responsible for IP enforcement — CBP Officers and Import Specialists. CBP Officers are responsible for targeting incoming shipments for security and trade purposes and conducting physical examinations of suspect goods. Import Specialists are responsible for assessing the actual value and composition of goods for duty and quota purposes and for making initial determinations of whether goods are believed to be in violation of U.S. IP rights laws. While CBP Officers are typically assigned to a single port of entry, Import Specialists assigned to a large port may be responsible for covering other smaller ports that report to the larger port. ICE field office agents investigate IP infringement cases.

We have not yet gathered comprehensive data on the number of CBP Officers, Import Specialists, and ICE agents devoted to IP enforcement, but we found reduced resources, thinly spread, at several border locations that we have visited.

- At the Port of Los Angeles/Long Beach, the largest U.S. seaport by volume, two trade enforcement teams have been disbanded and their CBP Officers shifted to national security details. Port officials said that since the late 1990s, the number of CBP Officers performing trade-related examinations has dropped by about 43 percent, and the number of Import Specialists on an IP-devoted enforcement team has dropped by half.
- The Port of San Francisco services multiple port facilities, including two major seaports, two major airports, and seven smaller port locations. CBP Officers at the San Francisco air cargo facility said that 4 out of 13 CBP Officers are assigned to inspect cargo for trade violations. These 4 officers share coverage of a 7-day work week, such that about 2 CBP Officers perform trade inspections on any day. In 2001, there were about 12 CPB Officers assigned to trade inspections. San Francisco's Director of Field Operations told us that filling 33 vacancies within his approximately 450 CBP Officer positions is a high priority. Currently, there are 3 Import Specialists, down from 6 in 2003, that focus primarily on IP enforcement and service the seaports, airports, and smaller ports within the Port of San Francisco's area.

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- ICE also performs IP enforcement and houses the National IPR Coordination Center (called the IPR Center) – a joint effort between ICE and the FBI intended to serve as a focal point for the collection of intelligence involving, among other things, copyright and trademark infringement. Currently, 9 of the 16 authorized ICE positions are filled and a 10th is slated to be filled. Neither of the 2 CBP authorized positions are filled. Additionally, in January 2006, 7 of 8 FBI positions were empty and the 8th position was filled by rotating FBI staff. In July 2006, an FBI official told us that no FBI staff were working at the IPR center because of limited physical space and pressing FBI casework, but that some staff would return in September 2006.
 - The ICE field office in Los Angeles, one of the largest field offices in the country, had two commercial fraud enforcement teams before the formation of the Department of Homeland Security, but now has one. The number of agents working on commercial fraud enforcement cases, which include IP enforcement, dropped from about 14 to 9 since 2003. However, an official from this office said resource changes have not affected how the team addresses IP enforcement nor caused it to turn away any IP enforcement cases.

In-Bond System Faces Persistent Control Weaknesses and Has Been Used to Circumvent IP Laws

The in-bond system has been identified by CBP and ICE officials as a mechanism that has been used to circumvent import and IP laws and regulations, presenting an enforcement challenge. A significant portion of goods received at U.S. ports do not immediately enter U.S. commerce but are instead shipped “in-bond” for official entry at other U.S. ports or are transported through the United States for export.²⁸ When goods are shipped in-bond, they are subject to national security inspections at the port of arrival, but are exempt from U.S. duties or quotas and formal trade inspections until they reach the final port where they will officially enter

²⁸ CBP regulations provide for three different types of “in-bond” shipments: (1) immediate transportation (IT) in-bond, which allows goods arriving at one U.S. port to move to another U.S. port where they enter U.S. trade; (2) transportation and exportation (T&E) in-bond, which allows goods arriving at a U.S. port to be transported through the United States for export to another country; and (3) immediate exportation (IE) in-bond, which allows goods arriving at a U.S. port to be shipped to a foreign port without transport through the United States. In our 2004 report, GAO found that in-bond entries comprised about 58 percent of total entries in Miami, 60 percent in New York, and 46 percent in Los Angeles. Recent work confirmed that in-bond shipments continue to account for a considerable share of all cargo arriving through these ports.

U.S. commerce.²⁹ For many years, GAO and others have noted weaknesses in the in-bond system used to monitor shipments between ports.³⁰

CBP and ICE officials recognize that the in-bond system has been used by certain importers to bring counterfeit and pirated goods into the United States by avoiding official entry at the port of arrival and then diverting the goods afterwards. Some CBP officials said the in-bond system may contribute to imports of counterfeits by allowing some importers to “port shop” for ports that are less likely to identify IP violations. Indeed, CBP has made sizable IP-related seizures from the in-bond system, including 220 seizures valued at about \$41 million in fiscal year 2004, representing nearly 30 percent of the total estimated domestic value of IP seizures in that year. In fiscal year 2005, there were 126 seizures valued at about \$14 million, representing about 15 percent of estimated domestic value of IP seizures that year.

We have found weaknesses in the past with the in-bond system and are currently conducting follow-up work to determine whether these weaknesses have been corrected. Our audit is still underway, but work to date indicates that some previously identified weaknesses in tracking and monitoring in-bonds remain. For example, in January 2004 GAO reported that CBP collects significantly less information on in-bond shipment than for regular entries and that this lack of information makes tracking in-bond shipments more difficult.³¹ In our recent work, CBP staff continue to observe that the limited information required from importers on in-bond shipments makes it difficult for CBP to ensure that the shipments have reached their proper destinations.

Conclusions

Intellectual property protection is an issue that requires the involvement of many U.S. agencies, and the U.S. government has employed a number of mechanisms to combat different aspects of IP crimes, with varying levels of success. The STOP initiative, the most recent coordinating mechanism,

²⁹The in-bond system allows arriving cargo that is intended for export to other countries to move through the United States without being subject to formal U.S. entry, duties, and quotas.

³⁰GAO, *International Trade: U.S. Customs and Border Protection Faces Challenges in Addressing Illegal Textile Transshipment*, [GAO-04-345](#) (Washington, D.C.: January 23, 2004).

³¹[GAO-04-345](#).

has brought attention and energy to IP efforts within the U.S. government, and participants and industry observers have generally supported the new effort. At the same time, the challenges of IP piracy are enormous, and will require the sustained and coordinated efforts of U.S. agencies, their foreign counterparts, and industry representatives to be successful. Our initial observations on the structure of STOP suggest that it is not well suited to address the problem over the long term, as the presidential initiative does not have permanence or the accountability mechanisms that would facilitate oversight by the Congress. Our ongoing work on IP protection efforts at the U.S. border, one of the five areas identified by STOP, also illustrates the types of challenges that need sustained attention to make progress on the issue. We believe that our more detailed reports to be released in the near future will contribute to continuing Congressional oversight of these issues.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the subcommittee may have at this time.

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