

Testimony of

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June 17, 2008

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Gates Corporation

Senate Judiciary Committee

Protecting Consumers by Protecting Intellectual Property

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Chairman Leahy, Ranking Member Specter, other distinguished Members of the Judiciary Committee, thank you so much for this opportunity to testify on "Protecting Consumers by Protecting Intellectual Property." I am Jeffrey Thurnau, Patent Counsel for Gates Corporation. Gates shares the bipartisan view of this Committee that much more needs to be done in the Congress and the country to combat counterfeiting. We appreciate your leadership on the range of global intellectual property protection challenges facing our country and support your effort to pass legislation this year on this important topic.

Headquartered in Denver, Colorado, Gates has 5,000 employees at 25 facilities across America. We are one of the world's largest manufacturers of industrial and automotive products, systems and components.<sup>1</sup> We are proud to work with the Motor & Equipment Manufacturers' Association (MEMA)<sup>2</sup>, our voice in Washington, DC on motor vehicle parts issues. MEMA's Brand Protection Council leads industry efforts on brand protection and intellectual property issues.

We at Gates are pleased to be part of an innovative American auto parts industry. Motor vehicle parts suppliers are the nation's largest manufacturing sector, directly employing 783,100 U.S. workers and contributing to 4.5 million private industry jobs across the nation. Suppliers manufacture the parts and develop the technology used in the domestic production of more than 11 million new cars and trucks annually, as well as the aftermarket products necessary to repair and maintain over 247 million vehicles on the road today. Strong intellectual property protections are critical to the success of Gates Corporation and our entire industry.

Today I am going to focus my comments on the safety implications of counterfeit automotive parts for the American people. I will begin with an overview of the global counterfeit challenges facing the auto parts industry, give you an idea of the particular counterfeit issues faced by Gates Corporation and then offer some ideas, legislative and

otherwise, that would help combat the intellectual property piracy that face our company and our industry.

Protection of Gates intellectual property is critical to the success of our high end business model. Our aim is to continually develop the most innovative technology in our market sectors, patent the products that our technology creates, then lead the market in those sectors. This approach allows us to create high-wage, high-skill jobs in America. For example, at Gates, we are developing a range of energy efficiency solutions that reduce the cost of operating motor vehicles, reduce the impact on our environment, and reduce dependency on foreign oil. However, every time our technology and the integrity of our brand and technology is violated by intellectual property pirates our business model and industry leadership are further compromised. Clearly, strong intellectual property protection benefits Gates Corporation, our communities, our customers, and ultimately the American people.

The enshrining of patent protection in our Constitution more than 200 years ago signaled that intellectual property protection would be a critical component of American innovation going forward. Over time, the value of strong IP protection was recognized by our allies around the world. The expectation that innovation and hard work will be rewarded and protected has provided the incentive for companies such as Gates to invest in developing new products and technologies, thus fueling the global economic engine. Intellectual property owners of high-end products such as those Gates manufacturers must have the ability to protect their developments from piracy in all markets, not just in those of developed nations. The design and enforcement of comprehensive intellectual property laws must be a top priority to spur the creation of new technology and to protect that investment throughout a product's viable life. Clearly, protecting IP is a key factor in any nation's competitiveness.

#### A. Economic Impacts

The magnitude of the overall global counterfeit problem is significant. Global counterfeiting across the range of sectors in 2003 was estimated at \$500 billion. More startling is that fact that this figure represents five to seven percent of total world trade volume.

Pirated movies and music are often the first things that come to mind for many people when they think about IP infringement. International intellectual property protection is about much more than defending Hollywood and other copyright industries, though that will always be an important component of the

battle. It is also about the safety of a wide variety of consumer products such as pharmaceuticals and motor vehicle parts whose industries are represented at the hearing today. IP protection is critical to the health and safety of American families as well as the economic health of the industries that manufacture these goods and the communities that support these industries.

Counterfeit parts and components for cars, trucks, buses and commercial vehicles pose a critical problem to the American economy and the supplier industry because of the wide range of counterfeit products manufactured and trafficked worldwide. Counterfeit goods cost motor vehicle suppliers at least \$3 billion in the United States and \$12 billion globally in lost sales. These losses correlate to at least 250,000 fewer motor vehicle supplier manufacturing jobs nationwide. Please note that these are conservative numbers based on a 1997 Federal Trade Commission study.

About 80 percent of all pirated goods seized at U.S. borders originate in China. And while it is clear in our industry that more pirated parts come from China than any other nation, we do face significant challenges from Russia, India and many other nations. The temptation might be to criticize the Chinese government for lack of intellectual property enforcement but our experience would say that is inaccurate and counterproductive. The counterfeiters that we deal with are for the most part rogue operators, criminals. The Chinese government pursues those criminals when our company presents evidence of our trademarks being violated. Enforcement issues are often caused by a lack of resources, particularly at the provincial and city level.

Since China joined the World Trade Organization in 2001, the government has upgraded intellectual property protections to world standards. In addition, we are getting data that enforcement is improving in China. For example, during a recent visit Gates representatives met with Chinese customs officials in four provinces. From these meetings, we understand that customs official's job performance is now linked to seizures of counterfeit goods. Gates is in the process of providing more detailed background information to the officials to support their important work directed to intercepting the flow of counterfeit goods out of China.

## B. Gates Corporation and Industry Intellectual Property, Health and Safety Issues

Even more disturbing than the economic impact of counterfeit motor vehicle parts is the fact that vehicle performance and safety is severely impacted by counterfeit products such as brakes and brake pads, brake fluid, tires, belts, and automotive lighting. The use of counterfeit parts can result in sudden, catastrophic engine failure, brake failure, or other system malfunction. Counterfeit parts can also fail to meet motor vehicle safety standards, which could cause injury or death.

Trademark or brand infringement is the most immediate problem we face at Gates Corporation since it is the most direct and easiest method for pirates to get their counterfeit goods into the market. Stolen trademarks give instant market credibility to pirated goods. The consumer who purchases the product with the pirated trademark faces immediate risk of loss of product and/or serious adverse safety impacts.

Another method used by pirates is to copy trade dress or the unique appearance of product packaging. Usually the pirates do not make perfect copies, instead making the packaging confusingly similar, to allow them to disingenuously claim that they are not infringing. The average consumer cannot always distinguish the two packages and erroneously concludes that the counterfeit package is also an authentic product. The pirate preys on the market recognition of the trade dress owner. Further, the infringed trademark owner may be faced with honoring warranty claims for pirate products or risk loss of customer confidence and loyalty. This is an added and unanticipated cost of doing business.

Counterfeit auto parts create real safety consequences for consumers. Gates is a major manufacturer of a range of belts used in motor vehicles. Timing belts allow the internal components of the engine to operate with proper timing; namely, the valves and pistons. A counterfeit timing belt may wear and fail prematurely causing serious cost, health, and safety ramifications for consumers.

We have tested pirated timing belts and have found they have a significantly shorter life when compared to our products. Unexpected and premature failure of a timing belt would be highly problematic to a motorist since it would result in the destruction of the engine for all practical purposes. Consequently, a broken timing belt could strand a motorist and cost several thousand dollars to repair the damaged engine. And a motorist stranded on the beltway in Washington, DC, may face serious hazards as he tries to cross multiple lanes to safety.

Let me give you some tangible examples of piracy involving Gates' belts that provide some additional background.

1. In March 2008, Taiwan customs notified Gates local counsel of a suspect shipment of 700 timing belts arriving from China. Gates local counsel immediately coordinated with Taiwan customs to advance the case. The case has been referred by Taiwan customs for further legal action. The name of the importer has not yet been shared with Gates. I think this is a good example of how governments around the world are helpful in the intellectual property battle. The fact is that most governments want to enforce the law against rogue operators.

2. In November 2006, in Puerto Rico, belts were sold to Gates representatives by a rogue operator for significantly less than the market price in legitimate outlets. This pirate distributor operated out of his home, using a trailer as his warehouse. The pirate also kept a booth at flea market in Arecibo. Gates

investigators tested several of the belts at the Gates facility in Siloam Springs, Arkansas. After receiving a cease and desist letter, the pirate disclosed a supplier in China. The pirate had in his possession over 600 belts. The pirate also disclosed that he sold pirate belts on various internet sites. The pirate ultimately agreed to suspend sales as well as disclose the infringing manufacturer in China.

3. In December 2006, in China, a product analysis revealed the Gates logo was erased from the product and replaced with a trademark having the same form and font. A cease and desist was sent July 27, 2007. The case was settled after the infringer agreed not to use any Gates trademarks, not to re-label product, not to sell any product with confusingly similar trade marks, and agreed that the pirate's name will not be used in any form that can be confused with Gates; such as an oval or a script "G".

4. In October 2006, in Poland, suspect timing belts were purchased by Gates associates from a distributor in Poland. Gates filed a criminal complaint with Warsaw police, who raided the defendant's facility and seized other belts. The distributor admitted buying from a Chinese source. Criminal proceedings are on-going; with the Court appointing an expert to determine damages and if counterfeit belts would threaten the lives of drivers or passengers. Civil action also filed in Poland obliges the defendant to withdraw the belts from the market and to destroy the counterfeit belts.

#### C. Industry Experience

Counterfeit issues are wide-spread in the motor vehicle parts industry. For example, another MEMA member, Bendix Commercial Vehicle Systems LLC, headquartered in Elyria, Ohio, manufactures commercial vehicle safety technology and braking systems. Due to the broad scope of the products that they design and manufacture, Bendix has been faced with a wide range of counterfeit products, many of which are safety critical, not only for operation of the commercial vehicle on which these components are installed, but also for those who share the highways with these vehicles. Of particular note was a recent reported case involving air dryers for school buses. Air dryers are a critical component for vehicle braking systems. In this situation, a school bus equipped with what was thought to be a replacement genuine Bendix air dryer was causing a loss of air pressure and erratic operation of the vehicle, placing the safety of the students riding the bus in jeopardy.

#### D. Potential Solutions

You can see that a company like Gates faces a myriad of challenges to its intellectual property around the globe. In general, we strongly support what this Committee is attempting to do to combat the problem by encouraging better coordination by Federal agencies, greater penalties to infringers and greater resources for enforcement. Specifically, I urge you to consider some of the following ideas to

address the range of concerns that I have expressed today on behalf of Gates and the Motor & Equipment Manufacturers' Association.

These include:

? Better coordination of Executive Branch Enforcement efforts. I urge the committee to address the shortcomings in current domestic and international enforcement practices by better coordinating federal enforcement efforts in a government-wide approach. More broadly, there are at least three good bills currently being considered by the Congress that if enacted, could make a real positive difference in protecting intellectual property:

o S. 522, sponsored by Senators Bayh and Voinovich streamlines Executive Branch coordination, ensuring that the range of relevant IP agencies and policy issues are covered.

o H.R. 4279 which passed the House in May, includes a coordinating IP czar at the Department of Justice as well as additional enforcement funding and increased penalties for infringement.

o And last, but certainly not least, Mr. Chairman, your legislation S. 2317 offers some very constructive ideas in this arena. For example, the increased penalties in this legislation for trafficking in counterfeit labels or packaging are very welcome by our industry. Again, we look forward to working with you to perfect this legislation and to help you pass it this year.

? Protection for the range of IP tools internationally is a lead policy principle for any IP enforcement legislation. The inclusion of protections for trademarks, trade dress, patents, and copyrights is a critical component of any legislation that passes the Congress.

Other important objectives for legislation include:

? Additional resources in the traditional international trade agencies of Commerce and USTR to better equip these agencies for battle.

? Increased enforcement resources at the Department of Homeland Security and the Department of Justice as well as more personnel, training and technology to increase detection of counterfeit products in US ports and throughout the supply chain.

? Additional resources in the traditional international trade agencies of Commerce and USTR to better equip these agencies for battle.

? Increased enforcement resources at the Department of Homeland Security and the Department of Justice; more personnel, training and technology to increase detection of counterfeit products in US ports and throughout the supply chain.

? Strengthened border enforcement and tougher penalties for violations, including efforts to improve communications and coordination between and within agencies that patrol our borders.

? Increased investigations and arrests by Federal agents.

? Increased prosecutions for counterfeiting and other intellectual property rights crimes in our courts.

? Enhanced cooperation with the law enforcement agencies of other like-minded countries, leading to more vigorous enforcement of the existing IP laws of those countries.

Mr. Chairman, thank you again for the opportunity to testify. I welcome any questions that the Committee might have.

1 Gates Corporation is headquartered in Denver, Colorado, where it was founded in 1911. Gates is part of the Industrial & Automotive group of Tomkins plc, a global engineering group listed on both the London (TOMK) and New York (TKS) stock exchanges

2 The Motor & Equipment Manufacturers Association (MEMA) represents almost 700 companies that manufacture motor vehicle parts for use in the light vehicle and heavy duty original equipment and aftermarket industries.