

As prepared for delivery

Our Economic Future at Risk

Next Steps in the Fight Against Intellectual Property Theft

*Delivered by Richard Cotton, Executive Vice President and General Counsel,
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Thank you. It is a pleasure to be here.

Let me begin by saying that I approach the task of speaking to a gathering of the leading specialists in intellectual property law with a great deal of humility. I am not a specialist by training in your area of expertise. But the circumstances of the television and movie business in which I work have placed the issue of intellectual property protection at the top of my agenda.

And I have recently taken on a leadership role in the CACP, the Coalition Against Counterfeiting and Piracy, a cross-sectoral coalition of over 200 companies and associations, organized through the U.S. Chamber of Commerce. My CACP role has offered me the occasion to look across sectors at the scope of counterfeiting and piracy afflicting both the U.S. and the global economy.

It is not news to this audience that this is not a pretty picture. I come here today to deliver and reinforce a simple and stark message. Despite much discussion over many years, despite the raising of many voices, despite many well-intentioned efforts and initiatives in both the private and public sectors, we are still losing ground.

In virtually every sector of the U.S. and global economy, the problem of intellectual property theft is getting worse, not better, with every passing day. It represents, in my judgment, the most significant threat there is to the future of global economic growth and security. In the long term, IP theft not only threatens to corrode the United States economy and the economies of other developed nations, it also threatens developing countries whose interests need to be recognized and respected with particular care.

We live in a technology-based, information-based society. As such, our economic growth depends almost entirely on innovation, invention, and creativity. Yet, especially in our post-9/11 world, the profound challenge to our future economic well-being represented by IP crime has not commanded the attention, the respect, the resources and ultimately the public policy response that is necessary. The scale of the problem is now so large and the organized crime tentacles into IP theft now so pervasive that modest measures and modest commitments have no hope of success.

We have to do a much better job of explaining and documenting the nature and extent of the threat to growth, jobs, and economic health, both in advanced economies and in developing countries. Working together, we must find ways to propel the issue of intellectual property protection to the top of the public policy agenda. Within the

Federal government, stemming the tide of IP theft deserves to be a Presidential and Cabinet Secretary level issue. At the state and city level, it should be a gubernatorial and mayoral priority. And within the business community the scale of IP theft demands that it be a CEO-level issue.

In addition, we must bring to the table key private sector players that enable, facilitate, or otherwise benefit from the distribution and sale of counterfeit and pirated goods. Law enforcement efforts cannot be effective if broad sets of private actors facilitate trade in counterfeit and pirated goods. We need sectors such as retail, shippers, distributors, wholesalers, Internet auction sites, financial intermediaries, and broadband telecommunication providers to become active parts of the solution. The days of take the money and run, of “hear no evil, see no evil” must end.

We need more from public officials than just acknowledging there is a problem. We need most particularly increased resources and increased organizational focus. We need major commitment and bold engagement, with significant legal reforms and serious commitments of technologically sophisticated law enforcement resources. I will speak directly to this in a few minutes. But first, we must acknowledge that part of our challenge is awareness and education. To move these issues up the policy agenda we must get better at communicating three key messages:

First: This is an issue with far-reaching economic implications, not just for developed nations but for any nation looking to build a vibrant economy.

Second: This is an issue that threatens the health and safety of the general public.

And third: Intellectual property theft has emerged as the new face of economic crime around the world, in scale greatly exceeding traditional property crime, which has historically been the focus of law enforcement resources. Public policy has struggled to recognize the magnitude of this seismic shift in the patterns of criminal activity and to adjust resources and strategies.

Let me say a few words about each of these themes.

First, the economic implications.

Various voices have been speaking out about the scope of counterfeiting for nearly two decades. Twenty years ago most estimates put losses from IP theft around 80 billion dollars. Today the scale of IP theft has skyrocketed into the many hundreds of billions of dollars, representing increases of easily five to ten times over what it was at the beginning of the 1990’s.

And the number of sectors under attack is astounding: all the copyright industries—movies, music, software, books—as well as pharmaceuticals, auto parts, aircraft parts, consumer goods, footwear, fashion apparel, luxury goods, toys, electronics, food products, medical devices and health products, machine tools.

We’ve made some strides documenting the corrosive effect of IP theft on growth, jobs, and tax revenues. The fact is, we know that intellectual property is at the heart of high-value, high-wage economic growth, both in developed and developing

economies. We know this, but we still need to do a better and more consistent job to document it, quantify it, and convince policymakers to act on it.

I want to mention two studies we at NBC Universal were closely involved in that have helped advance our understanding of this issue in significant ways, and I would suggest that this analysis could fruitfully be expanded to more sectors and to countries around the world.

Two years ago, we commissioned a study designed to answer an important question: How dependent is the U.S. economy on those industry sectors that are driven by innovation, invention and creativity? The study aggregated industries that rely heavily on copyright or patent protection—and measured their revenue, employment, compensation to workers, and contribution to growth. The study found that these industries are huge contributors to U.S. GDP, responsible for 40% of U.S. exportable products and services to GDP. It found that they are by far the most important growth drivers in the U.S. economy, contributing nearly 60% of the growth of U.S. exportable products and services. And it found that these industries pay wages that are 40% more than the average wage in the U.S. This study put numbers on what was already quite evident: IP industries drive growth in today's world and hold the keys to a nation's future economic well-being.

These sectors are also the driving force behind long-term global competitiveness—meaning a country's ability to sell goods and services around the world and have those sales drive high-wage jobs at home. And they are precisely the sectors most at risk of counterfeiting and piracy.

But I want to make a further point. Nearly every study I have seen of counterfeiting and piracy speaks only in terms of lost revenue or reduced global trade to a particular company or sector. Talking about the impact of counterfeiting and piracy solely in these terms vastly understates the impact on a nation's economy. What does this mean in terms of lost output? What does it mean in terms of lost jobs? What does it mean in terms of lost tax revenue?

There is a ripple effect that greatly magnifies the losses suffered by any individual sector of the economy due to counterfeiting and piracy. For example, when a movie studio loses revenues to piracy, it doesn't have that money to reinvest into making more movies and television programs. Not only does this affect the individual studio; it also impacts *all* the companies that would have contributed to or benefited from these unmade productions. It reduces the revenue of the upstream suppliers to movie producers, including the caterers who prepare the lunches on the sets and the truckers that move the equipment, and of the downstream industries, like movie theaters, DVD retailers, and video rentals. The same is true for all sectors and for small- and medium-sized firms who depend on IP protection for a product they have created or pioneered.

Using analytical tools developed by the U.S. Bureau of Economic Analysis, a second study, carried out by the Institute for Policy Innovation, quantified this ripple effect in the U.S. movie industry. It determined that the "ripple effect" was a "triple effect". The all-in impact of movie piracy on the overall U.S. economy during one year is more than three times the revenue loss to the movie industry alone. The estimated \$6

billion in piracy revenue losses suffered by U.S. movie studios actually amounts to a \$20 billion loss in overall economic output to the U.S. economy. It translates into losses of 141,000 jobs, \$5.5 billion in lost worker earnings, and \$837 million in lost tax revenues.

This is a much more realistic and informed way to think about the economic costs of piracy. It starts to suggest the true and extraordinary extent of the damage. Imagine if we included the losses of other industries that are hard hit by IP theft. The numbers would be staggering. The cumulative ripple effect adds up to a tidal wave of economic losses to workers and to governments, to our economic future.

Second, health and safety. The fact is, a huge amount of counterfeiting and piracy poses a real threat to public health and safety. While stolen movies and music stifle creativity and economic growth globally, counterfeit drugs, counterfeit consumer goods, counterfeit medical supplies and devices, counterfeit auto and airplane parts, and counterfeit electronics all represent real threats to public health and safety.

These aspects of the global trade in counterfeiting and piracy have a deadly and disproportionate impact in developing and least-developed countries. According to the World Health Organization, in parts of Africa, Asia, and Latin America, up to 30% of the medicines on sale are counterfeit.

But let's acknowledge a problem. Many sectors with severe counterfeiting problems that raise health and safety issues do not want to talk loudly about this in public. Yet by not consistently and vigorously raising the health and safety dimension of the counterfeiting issue with the public and with public officials, we again allow its importance to be downplayed.

And this brings me to my third point: Counterfeiting and piracy must move higher on the law enforcement agenda. We're not just talking about economic losses. We're talking about criminal activity, and we are talking about organized crime on a national and international scale. Professional criminals go where the money is ... and the money is in piracy and counterfeiting.

The FBI reports that in the U.S., all traditionally defined property crimes accounted for \$16 billion in losses in 2005. The best estimates we have for losses from piracy and counterfeiting exceed that number by five or ten times. The law enforcement response needs to commensurate with the scale of the threat and to the gravity of the injury to our economy and our safety.

There's been a paradigm shift ... but governments have not kept pace. The resources provided to the law enforcement community have not adjusted. And the attitudes and priorities of the law enforcement community do not yet reflect the scope and scale that IP crime has now assumed into today's economy. Frankly, every sector that I have talked to reports that law enforcement officials of general jurisdiction at every level feel that they cannot devote more than modest resources at best to IP crime given the challenges of anti-terrorism and other aspects of the law enforcement agenda.

In stark terms, this all-pervasive reality leads to a fairly simple conclusion: in the real world, improvement in IP crime law enforcement requires specialized resources. At a minimum it requires dedicated investigative and prosecutorial resources. It probably also requires designated senior leadership positions within the appropriate cabinet departments of the federal government, and comparable leadership positions and dedicated resources at the state and local levels.

This is an enormous challenge. It requires major changes in our law enforcement apparatus. And at least as importantly, we cannot look solely to law enforcement. We need a major increase in commitment by key private sector businesses to become allies in the battle against IP crime. Much counterfeiting and piracy depends on legitimate businesses for distribution and resale. It is these businesses that we need to enlist in reducing trade in counterfeit and pirated product.

Shippers and warehouse operators need to make sure they know their customers. Retailers need to be vigilant about the integrity of their supply chains from pharmaceuticals to food to footwear to DVDs. In my business, broadband providers need to have effective policies to discourage illegal download activity, which currently can consume as much as 60% or more of their bandwidth. I am pleased to say that—gradually—responsible broadband providers have concluded that perpetuating a situation where more than half of the carrying capacity of a legitimate business is devoted to the transport of stolen material—subsidized incidentally by law-abiding citizens who use far less capacity—makes no sense. Similarly, video sites like YouTube need to adopt filtering technologies to prevent indiscriminate display of unauthorized copyrighted material. We are seeing progress in this area led by companies like MySpace, Microsoft and Yahoo.

Technology has a big role to play here. We need technology-based authentication processes. In media, for example, we have the ability to watermark our content. But we need cooperation from our partners in the consumer electronics and information technology industries to detect this watermark and disable the playback of pirated content.

Others sectors are developing their own tailored technologies, such as RFID trackers and scannable shipping labels that allow shipments to be authenticated on a real-time basis, and distributors and resellers must utilize these validation tools. Dialogue and progress on these fronts is urgently needed if we are to reduce traffic in counterfeit and pirated goods.

Legitimate businesses have to step forward and declare they will not profit on the back of IP theft. They need to develop codes of conduct for their industries that will help raise the level of vigilance and security against illegal activity. And if they don't step forward, governments need to consider laws to require cooperation.

What kinds of proposals, what kinds of concrete steps could begin to make a real difference?

On the business side, brand owners, manufacturers, and producers, of course, need to get the consumer proposition right. Quality products need to be available to the consumers with good value propositions delivered through distribution systems that

consumers find attractive and easy to access. Most sectors and most businesses are working hard at these challenges and embracing new technology to accomplish these goals. In the video business where I work, hardly a day goes by without an announcement by content companies making deals to enable new and more rapid digital distribution. But businesses that make huge investments in developing creative innovative products cannot compete with free—cannot compete with thieves distributing stolen counterfeit products.

On the public policy side, we need to begin evaluating action that could attack the problem of counterfeiting and piracy from every angle: from law enforcement and border control to state and local efforts and public education.

The bill recently introduced in the Senate by Senators Bayh and Voinovich, called “The Intellectual Property Rights Enforcement Act,” represents a major step in the right direction. It would elevate IP protection to the Cabinet level and put the coordination and accountability of our enforcement strategy within the White House to ensure it gets the attention it deserves. This is the kind of proposal and the kind of action that we need.

But clearly we need to consider additional steps.

First, enforcement. We need to consider appropriations for additional dedicated IP resources across the board: for our enforcement agents, for our prosecutors and potentially even for our courts.

At the Department of Justice, we need an increase in the number and staffing of Computer Hacking and Intellectual Property, or CHIP, units, with at least one prosecutor in each unit dedicated to IP. Senator Leahy, a great friend of intellectual property, has also advocated allowing DOJ attorneys to bring civil cases in circumstances where criminal law tools may not be appropriate, a creative idea worthy of support.

Prosecutors can be powerful weapons but without investigators they have no ammunition. Thus, in addition, we need to consider appropriating money for at least two IP-dedicated FBI agents assigned to each CHIP unit. And based on my conversations, in today’s world, if these positions are not specifically dedicated, they will be diverted.

At the Bureau of Customs and Border Protection, we need to consider ensuring the deployment of agents at every significant point of entry whose exclusive responsibility is protecting against the smuggling of counterfeit and pirated goods.

The BCBP may also need support for a host of new tools, most urgently a technological infrastructure that allows them to have watch lists at all points of entry and the ability to instantly share data across their network. And the BCBP may need revised procedures and even legislative authority to share information effectively with affected businesses.

A similar boost of IP resources should be considered for U.S. Immigration and Customs Enforcement, including at least 25 IP-dedicated agents at headquarters and

in the field. To coordinate these efforts across the Department of Homeland Security the DHS should consider the creation of a high-level office responsible for overseeing anti-counterfeiting activities at both BCBP and ICE.

How do we change perceptions about the seriousness of the threat posed by counterfeit goods? This is a tough challenge. If we are serious about stemming the worldwide tide of counterfeiting, we can no longer tolerate the huge divide between words and deed, between our actions as individuals and our public policy and laws. We cannot wink and nod at the purchase and possession of counterfeit goods, and then ask law enforcement to be more aggressive against those who make or sell them.

We must debate, for example, the wisdom of maintaining the current personal exemption for individuals who bring counterfeit goods into the country. The world is looking to the United States for leadership in this fight, and we can't provide it if we are not prepared to act on our convictions. Other countries in Europe and elsewhere have taken strong action, and the U.S. needs to consider setting an example here as well.

Such a step would then support a very powerful way to send the anti-counterfeiting message: an additional question on the customs declaration form asking arriving travelers if they are bringing counterfeit goods in to the United States. And we need an aggressive messaging campaign at every border point informing incoming travelers that trafficking in counterfeit goods is illegal and is subject to serious penalties.

At the judicial level, we need to debate whether specialized courts for intellectual property crimes—at both the federal and state levels—might be valuable. Here is the challenge: In many circumstances, particularly at the state and local level, courts of general jurisdiction do not always take IP crimes seriously enough. If judges offer only a slap on the wrist to offenders and particularly to repeat offenders, the message ripples throughout the whole system and seriously undermines enforcement.

Specialized judges and specialized IP crime courts would send a strong signal to the law enforcement community that such crimes are serious and deserved priority. Internationally, the U.S. frequently pressures other countries to establish such specialized courts to handle IP crimes. We need to take this possibility seriously in the U.S.

It's also time to review an increase in statutory damages for trademark and copyright infringements. These penalties have not kept pace with the burgeoning growth of the problem. We also should review the sentencing guidelines for counterfeiting and piracy offenses to assure that they represent an adequate deterrent in light of the deep involvement of organized crime.

Many of you no doubt saw the profile in *The New Yorker* on private investigator Harley Lewin. Here's what he said on this particular issue: "Counterfeiting is more profitable than narcotics, and your partners don't kill you. ... And in narcotics if you get caught you go to jail for the rest of your life. If you get caught counterfeiting, you go to jail for three months. Not even." This must change.

Moving from the federal to the state and local levels, we must do more to increase the capacity to fight IP crimes on the state and local levels, where the vast majority of law enforcement activities take place in the U.S. We should consider the possibility of a federal block grant program that would develop model approaches to the problem of IP theft around the country, so that we can develop best practices.

For example, such a program could start with a targeted \$20 million five-city pilot program to establish and fund specialized units aimed at attacking manufacturing and distribution of counterfeit and pirated goods. This could include resources for training state and local judges and prosecutors. Such an effort could enable us to see whether such specialized, coordinated resources have an impact at the state and local level.

As I mentioned earlier, it is essential that we enlist intermediary businesses in our efforts. Let me make an analogy to money laundering. When the issue of money laundering became a national priority, we turned to the banking community and asked banks—as well as others involved in significant financial transactions—to do certain due diligence with respect to their customers and with respect to the sources of funds being deposited.

In the case of counterfeiting, we need to look at the supply chain. How do counterfeit goods get to the ultimate purchaser? Frequently, many legitimate intermediaries are involved in—and make money from being part of—the counterfeiters' shipping, distribution, wholesale, and/or retail sale process to move the counterfeit goods to the ultimate purchaser.

As with money laundering, any effort to reduce the tidal wave of trade in counterfeit goods requires that legitimate businesses involved in the supply chain commit themselves to reasonable levels of due diligence to assure that they are not enabling or facilitating the trade in counterfeit goods.

We need to explore what levels of diligence are reasonable and how they might be implemented. Voluntary codes of conduct may be achievable, but there may also be a role to play for legislation, either in general or in key sectors. Legislation may be needed to assure a level playing field, so that intermediaries that abide by such codes of conducts are not put at a competitive disadvantage in comparison with those that do not.

Technology will play a big role in best practices for protecting the integrity of the supply chain and in interdicting the flow of counterfeit products, including RFID technology and scannable shipping labels, as I mentioned earlier. The organized crime syndicates that are behind the trade in counterfeit and pirated products are growing in technological sophistication, and we must respond in kind.

Lastly, we need a nationwide public education campaign led by the federal government. This would include a PR campaign delivering the message that buying counterfeit goods is illegal and wrong. That it is an economic security issue, a health and safety issue, and an activity driven by a dangerous criminal element.

The efforts should include provisions focusing on grade school, high school and college students and enlisting school systems and universities for their help in

spreading this message. The reality is that protecting IP is at its core protecting the future economic well-being of our future generations. They need to understand that as part of their basic education.

In the particular arena of music and movies, which is where many youngsters first confront the issue of IP theft, these efforts could involve grants to develop, test, and deploy filtering on campus IT networks, to reduce copyright infringement. Such efforts would create a technology environment that itself delivers the message that IP theft is not the norm and is not “OK.”

If we are serious about stemming the tide of counterfeiting and piracy, these are the kind of action steps we need to consider. And we need to consider them with a sense of urgency.

In closing, let me repeat the message I began with. Today we are losing the battle to stem the debilitating and escalating trade in counterfeit goods. Make no mistake: Left unchecked, the continued growth of counterfeiting and piracy will undermine the future economic vitality of the U.S. economy.

The members of this audience work daily in these fields and work with law partners, with business partners and with government officials who have significant voices in setting our public policy agenda. I urge you to lend your voices to support the need to escalate dramatically our public policy response in combating counterfeiting and piracy, and to insist that efforts to combat IP crime do not get diverted, diminished and ultimately backburnered amidst a welter of other priorities. Our future economic security deserves a priority comparable to efforts to protect our physical security.

Thanks for the opportunity to speak today and thanks for listening.