S. HRG. 109–989

PIRACY OF INTELLECTUAL PROPERTY

HEARING

BEFORE THE

SUBCOMMITTEE ON INTELLECTUAL PROPERTY

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

MAY 25, 2005

Serial No. J–109–22

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

38–864 PDF WASHINGTON : 2007

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON THE JUDICIARY

ARLEN SPECTER, Pennsylvania, *Chairman*

ORRIN G. HATCH, Utah
CHARLES E. GRASSLEY, Iowa
JON KYL, Arizona
MIKE DEWINE, Ohio
JEFF SESSIONS, Alabama
LINDSEY O. GRAHAM, South Carolina
JOHN CORNYN, Texas
SAM BROWNBACK, Kansas
TOM COBURN, Oklahoma

PATRICK J. LEAHY, Vermont
EDWARD M. KENNEDY, Massachusetts
JOSEPH R. BIDEN, JR., Delaware
HERBERT KOHL, Wisconsin
DIANNE FEINSTEIN, California
RUSSELL D. FEINGOLD, Wisconsin
CHARLES E. SCHUMER, New York
RICHARD J. DURBIN, Illinois

DAVID BROG, *Staff Director*
MICHAEL O'NEILL, *Chief Counsel*
BRUCE A. COHEN, *Democratic Chief Counsel and Staff Director*

SUBCOMMITTEE ON INTELLECTUAL PROPERTY

ORRIN G. HATCH, Utah, *Chairman*

JON KYL, Arizona
MIKE DEWINE, Ohio
LINDSEY O. GRAHAM, South Carolina
JOHN CORNYN, Texas
SAM BROWNBACK, Kansas
TOM COBURN, Oklahoma

PATRICK J. LEAHY, Vermont
EDWARD M. KENNEDY, Massachusetts
JOSEPH R. BIDEN, JR., Delaware
DIANNE FEINSTEIN, California
HERBERT KOHL, Wisconsin
RICHARD J. DURBIN, Illinois

BRUCE ARTIM, *Majority Chief Counsel*
BRUCE A. COHEN, *Democratic Chief Counsel*

CONTENTS

STATEMENTS OF COMMITTEE MEMBERS

Page

Biden, Hon. Joseph R., Jr., a U.S. Senator from the State of Delaware, prepared statement 33
Cornyn, Hon. John, a U.S. Senator from the State of Texas, prepared statement 35
Hatch, Hon. Orrin G., a U.S. Senator from the State of Utah 1
prepared statement 46
Leahy, Hon. Patrick J. Leahy, a U.S. Senator from the State of Vermont 15
prepared statement 56

WITNESSES

Hackford, Taylor, Board Member, Directors Guild of America, Los Angeles, California 22
Holleyman, Robert, President and Chief Executive Officer, Business Software Alliance, Washington, D.C. 27
Mendenhall, James, Acting General Counsel, Office of the U.S. Trade Representative, Washington, D.C. 8
Peters, Marybeth, Register of Copyrights and Associate Librarian for Copyright Services, Copyright Office, Washington, D.C. 3
Pinkos, Stephen M., Deputy Under Secretary of Commerce for Intellectual Property and Deputy Director, U.S. Patent and Trademark Office, Alexandria, Virginia 6
Smith, Eric H., President, International Intellectual Property Alliance, Washington, D.C. 19

SUBMISSIONS FOR THE RECORD

Hackford, Taylor, Board Member, Directors Guild of America, Los Angeles, California, prepared statement 37
Holleyman, Robert, President and Chief Executive Officer, Business Software Alliance, Washington, D.C., prepared statement 48
Mendenhall, James, Acting General Counsel, Office of the U.S. Trade Representative, Washington, D.C., prepared statement 58
NBC Universal Pictures, charts 70
Peters, Marybeth, Register of Copyrights and Associate Librarian for Copyright Services, Copyright Office, Washington, D.C., prepared statement 74
Pinkos, Stephen M., Deputy Under Secretary of Commerce for Intellectual Property and Deputy Director, U.S. Patent and Trademark Office, Alexandria, Virginia, prepared statement 87
Smith, Eric H., President, International Intellectual Property Alliance, Washington, D.C., prepared statement and attachment 102
Trainer, Timothy P., President, Global Intellectual Property Strategy Center, P.C., Washington, D.C., prepared statement 145

PIRACY OF INTELLECTUAL PROPERTY

WEDNESDAY, MAY 25, 2005

UNITED STATES SENATE,
SUBCOMMITTEE ON INTELLECTUAL PROPERTY,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 2:34 p.m., in room SD–226, Dirksen Senate Office Building, Hon. Orrin G. Hatch, Chairman of the Subcommittee, presiding.

Present: Senators Hatch and Leahy.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM THE STATE OF UTAH

Chairman HATCH. All right, we have had enough frivolity here. We have got to go to work, so welcome to today's hearing before the Intellectual Property Subcommittee.

Today, we will be examining a variety of problems and challenges involving international piracy, and that is international piracy of U.S.-owned intellectual property. This hearing will focus on copyright piracy, but I hope the Subcommittee will be mindful of the serious issues in the trademark counterfeiting and patent infringement realms as well.

Piracy and counterfeiting inflict significant and widespread harms on the American economy. Theft of intellectual property abroad is disastrous and very much disadvantages this country's entrepreneurs, innovators and, of course, the creative community. Ultimately, it also harms consumers, shareholders and American workers and their families.

The timing of this hearing was intended to coincide roughly with a number of recent developments and events relevant to our consideration of piracy issues. On April 29, 2005, the Office of the United States Trade Representative issued its decision resulting from the out-of-cycle review of China's enforcement practices, and completed the special 301 process. Much of the focus in that process and in USTR's conclusions remains on the inadequate enforcement of intellectual property rights in Russia and China.

Russia remains on the Priority Watch List this year due to continuing problems with its legal regime, which is described as having weak intellectual property enforcement and a lack of data protection. It appears that Russia's current intellectual property regime is inconsistent with its bilateral trade obligations and likely does not conform to the obligations which Russia needs to fulfill in order to join the WTO.

Other recent events that have prompted some additional interest and scrutiny on both sides of the Hill include a number of studies and reports on piracy and counterfeiting which indicate that we are not making much headway in many areas. And I might add that some of these suggest some very disturbing trends in other areas as well. For example, various analyses indicate that piracy level in many sectors are close to or exceed 90 percent in China. In Russia, the overall losses to copyright-related industries have continued to increase and are, at least in my opinion, at unacceptable levels.

Today, we will hear a description of the big-picture issues in the fight to protect U.S. interests and to ensure that American export products reliant on intellectual property rights receive appropriate attention and protection. We will also hear specific experiences and instances that illustrate how rapidly and widely pirated works reach countries around the globe. For example, it was recently reported that unauthorized disks of the new "Star Wars" movie were on sale on the streets of Beijing just days after the film's premiere. My understanding is that Mr. Hackford, who directed the movie "Ray," has had a very similar experience with his film.

We also will discuss the importance to the U.S. economy of the industries that rely most heavily on intellectual property rights. For example, according to the International Intellectual Property Alliance and other sources, the core U.S. copyright industries account for about 6 percent of our total United States gross domestic product. Employment in these industries has recently been estimated at 5.5 million workers, or 4 percent of total U.S. employment. Between 1996 and 2002, the information technology sector grew by 26 percent. This is a growth sector for the United States economy and in my own home State of Utah and one of the few areas in which we really have a positive balance of trade.

I also want to point out that piracy of entertainment products is not the sole concern in the copyright realm. Although movies and music receive a lot of attention today, we are going to hear this day from Mr. Holleyman of the Business Software Alliance about a recently released report indicating that software piracy just in the Asia-Pacific region alone cost manufacturers in this country an estimated $8 billion in 2004. Losses due to software piracy worldwide are estimated at more than $32 billion, with predicted piracy rates of 90 percent in some countries.

In preparing for this hearing, we asked witnesses to provide both a general description of the global state of affairs on intellectual property rights, as well as a discussion of specific areas of concern to them respectively. From the testimony, it appears that most of the witnesses have serious concerns about Russia and China. This is consistent with the feedback that I have received from a wide variety of sources.

I note, however, that recent reports have also highlighted longstanding and serious problems particularly in the area of optical media piracy in places such as Pakistan, Malaysia and the Philippines. And although there has been progress in some areas, it does not appear at least to me that consistent headway is being made in many countries.

Finally, I note that today's hearing is particularly timely because the Chinese delegation to the Intellectual Property Working Group

of the Joint Commission on Commerce and Trade is scheduled to meet here in Washington to discuss some of these issues with Government officials. Now, I am hopeful that some progress will be made, and I stand ready to provide whatever assistance is necessary to move forward on these very important issues.

Let me close by observing that during the Cold War it was said that the Soviet Union's style of negotiation could be summed up as follows: what is mine is mine and what is yours is negotiable. If Russia, China or any other government attempts to adopt this view with respect to their responsibilities to protect intellectual property under international trade law and agreements, I can assure you that public support for U.S. trade agreements will be undermined and there will be a strong resistance from, and appropriate action taken by, members of Congress.

To put a fine point on it, before the Congress votes in favor of Russia joining the WTO, many of us will have to be convinced that the Russian government is serious about cracking down on theft of U.S. intellectual property. As the ranking Republican on the Finance Committee and the Chairman of this Subcommittee, I have a particular interest in the intellectual property problems that will be outlined today, and I intend to work with members of both sides of the aisle and in both committees to ensure that these issues receive the attention and resolution they merit.

I know that Senator Leahy and many others, such as Senators and Cornyn and Feinstein, are concerned about these problems as well. So I look forward to hearing from the witnesses and I want to thank all of you for coming and for testifying here today and I believe this hearing should be a very good hearing.

[The prepared statement of Senator Hatch appears as a submission for the record.]

We will begin the hearing by turning to our stalwart, Marybeth Peters, who is Register of Copyrights and Associate Librarian for Copyright Services of the United States Copyright Office right here in Washington, D.C. After Marybeth, we will turn to Stephen M. Pinkos, the Deputy Under Secretary of Commerce for Intellectual Property and Deputy Director of the United States Patent and Trademark Office, in Alexandria, Virginia. Then we will turn to James E. Mendenhall, the Acting General Counsel of the Office of the United States Trade Representative.

We welcome all three of you here today and we look forward to taking your testimony at this time.

STATEMENT OF MARYBETH PETERS, REGISTER OF COPYRIGHTS AND ASSOCIATE LIBRARIAN FOR COPYRIGHT SERVICES, U.S. COPYRIGHT OFFICE, WASHINGTON, D.C.

Ms. PETERS. Thank you, Mr. Chairman. Thank you very much for the opportunity to speak to you today about one of the most pressing issues in copyright—international piracy. It is always a pleasure to appear before you, and I am pleased to see the reestablishment of the Subcommittee and I congratulate you on your chairmanship.

Mr. Chairman, in my nearly 40 years in the Copyright Office, piracy, and especially global piracy, has been an enduring problem. We can and should strive to reduce piracy to the lowest levels pos-

sible, levels that will not deny authors and copyright owners of the incentives to create and distribute the works that have made America's creative industries the envy of the world.

The Copyright Office has had a long history in working toward this goal both on its own initiative and in cooperation with other agencies of the Federal Government. In the ten years since the adoption of the TRIPs Agreement, there have been tremendous improvements worldwide in countries' legal frameworks for copyright protection. By incorporating the substantive copyright obligations of the Berne Convention and supplementing them the civil, criminal and border enforcement obligations, TRIPs established a minimum standard against which all countries' copyright regimes could be judged.

The Office's contribution to this success includes participation in the negotiation of the TRIPs agreement and other copyright treaties and agreements, as well as training of foreign officials. Our main program for training foreign copyright officials is our International Copyright Institute. This program exposes foreign officials from developing and countries in transition to a wealth of copyright knowledge and information presented by the U.S. Government and foreign and domestic industry experts.

The Copyright Office works hand in hand with USTR on bilateral and regional trade agreements, including negotiations implementing the free trade agreements. We also support USTR free trade agreements by providing technical assistance to our negotiating partners.

The Office is a major contributor to the strengthening of copyright protection through international organizations, notably the World Intellectual Property Organization. It played a key role in the negotiation of the WIPO Internet treaties which are substantially improving the legal framework for the protection of copyright in numerous countries around the world, including our own copyright law.

I believe United States copyright law does the best job of providing appropriate protections to authors and copyright owners, while still allowing for fair and reasonable use of copyrighted material. But our law is not perfect and when we go to other countries seeking improved copyright protection, they are quick to point out the deficiencies and gaps in our law.

For example, the United States has not amended its law to delete a provision of Section 110(5) added to our law in 1998 which significantly broadened the exemption for performance of musical works in public places like bars and restaurants. A WTO dispute resolution panel has determined that this expansion is inconsistent with our TRIPs obligations. Also, because our law has extremely narrow performance rights for sound recordings, many countries limit protection for U.S. rights-holders to only the protection that we provide, despite the popularity and widespread of U.S. recordings overseas.

No matter how good a country's law is on the books, enforcement of that law is essential to effective copyright protection, which is why the TRIPs Agreement contains specific provisions requiring adequate and effective enforcement measures.

Our FTAs have built upon the TRIPs enforcement text by adding specificity to what is found in TRIPs and other obligations not found in TRIPs. The FTAs also provide us with the flexibility to address enforcement problems that are particularly problematic in a given region or country.

The fact remains, however, that copyright enforcement in too many countries around the world is extremely lax. China is a good example of why enforcement is absolutely essential to the protection of copyright. As China joined the WTO in 2001, the Office worked with the USTR-led interagency team to provide technical advice and to urge the Chinese government to amend its law to be TRIPs-compliant. While its revision feel short in several important respects, the law is more than sufficient to provide some meaningful protection if it is enforced. Unfortunately, it is not.

Last year, China made a number of commitments to improve various aspects of its intellectual property regime, most notably with regard to enforcement. Shortly before meetings in which those commitments were made, the Office hosted a delegation of Chinese officials, led by the National Copyright Administration. We have enjoyed a 25-year relationship with them which has helped promoted greater understanding between our governments. But NCAC does not have the final say on copyright policy and enforcement in China and China's implementation of last year's commitments has been incomplete.

Russia has been on the Priority Watch List since 1997. According to IIPA, piracy rates in China in 2004 for most sectors are about 80 percent and losses are beyond $1.7 billion. Obviously, there is a serious problem in Russia. The Copyright Office is committed to be a member of interagency efforts to combat intellectual property violations in Russia. Certainly, statements by President Putin and other high-ranking government officials indicate a comprehension of the serious nature of the problem, but piracy remains and we haven't gotten the desired results.

There are two causes of inadequate enforcement: one, lack of competent police, prosecutors and/or judges, and, two, lack of political will to enforce copyright. We and others do our best through training programs to address the first problem. The second, lack of political will, is much more difficult.

Let me say something about the nature of piracy that we see in other countries. Much of it is done by for-profit criminal syndicates. Factories through China, Southeast Asia, Russia and elsewhere are churning out millions of copies of copyrighted works, sometimes before their authorized release. These operations most certainly involve other criminal activities, and although the information is sketchy at best, there have been a series of rumored ties between pirating operations and terrorist organizations.

What is problematic is that some American commentators who are prone to hyperbole are providing arguments and rationalizations that foreign governments are using to defend their failure to address this type of organized crime. The confusion wrought by the imprecision and lack of clarity in these commentators' statements is not helpful to achieving the goal for which there is no credible opposition—dramatic reduction in organized piracy of U.S.-copyrighted works abroad.

International piracy poses a tremendous threat to the prosperity of our creative industries and it deserves our utmost attention. This attention must be consistent and long-term if it is to be successful, but we must be realistic in our goals, lest we become discouraged. While it is not realistic to expect to eliminate all piracy, we can assist in improving the global situation to the benefit of authors and rights-holders here in the United States and throughout the world.

Thank you.

[The prepared statement of Ms. Peters appears as a submission for the record.]

Chairman HATCH. Thank you, Ms. Peters. We really appreciate that.

Mr. Pinkos, we will turn to you.

STATEMENT OF STEPHEN M. PINKOS, DEPUTY UNDER SECRETARY OF COMMERCE FOR INTELLECTUAL PROPERTY AND DEPUTY DIRECTOR, UNITED STATES PATENT AND TRADEMARK OFFICE, ALEXANDRIA, VIRGINIA

Mr. PINKOS. Thank you, Mr. Chairman, and I appreciate the opportunity to join with you today in a discussion about international piracy issues. I have a deep respect for the role that the Judiciary Committee plays, or the leading role that it plays in crafting our Nation's intellectual property laws and oversight of the agencies that implement them, and I think much of them is spawned from the fact that I spent six years as a staff member of the Judiciary Committee over on the other side of the Capitol.

In fact, I think my last memory of this room is being in here a couple of years ago as we negotiated the PROTECT Act while we tried to catch glimpses of the NCAA Championship game in the other room right there. Luckily, the result of the legislative effort was strong and the game depended on whether you were—I think it was Kansas or Syracuse that year.

I wanted to emphasize that the Bush administration is keenly aware and fully understands that intellectual property protection is critical to the competitiveness of our economy, and that U.S. businesses face enormous challenges in protecting their IP overseas.

Secretary of Commerce Gutierrez, who has just been on the job for five months or so, is also very aware of the significance of intellectual property for America and he has made combatting piracy one of his top priorities. The U.S. Patent and Trademark Office is dedicated to carrying out his vision of marshaling all U.S. Government efforts and agencies to reduce IP theft.

As you noted, Mr. Chairman, increasingly both the United States and our trading partners rely on IP to drive economic growth. The statistics you cited show that IP-based businesses such as software and entertainment now represent the largest single sector of our U.S. economy.

Unfortunately, the economic benefits of intellectual property have also captured the attention of thieves and organized crime and, as Marybeth mentioned, even terrorists. Because of that, the threats to U.S. economic safety and security, the administration is working hard to curb IP crime and to strengthen enforcement around the world.

I am certain that many of you and your colleagues have heard about the STOP initiative, which is the Strategy Targeting Organized Piracy. It is a White House-coordinated effort of all U.S. Government agencies that are involved in protecting IP and it is the most comprehensive U.S. Government-wide initiative yet. It is designed to simply eliminate trade in pirated and counterfeited goods worldwide, and the greatest benefit thus far has been bringing a lot of agencies together to discuss the different efforts that they have underway to stop trade in counterfeit and pirated goods.

We are seeing some results: a report on behalf of some of my other colleagues in the administration that the Department of Homeland Security is increasing seizures. They are applying new technologies and accounting methods to try to stop bogus goods coming over our borders. DOJ, as you are well aware in your oversight of that agency, is stepping up their prosecutions and increasing the amount of special units they have for IP crimes.

Over at the Department of Commerce, we are trying to inform U.S. businesses how to best protect their rights with a new hotline and a website and some training programs around the world. And specifically in the United States, Mr. Chairman, we started this week a series of seminars for small and medium-size enterprises. This applies more for the patent and trademark world, but we were out in Utah Monday and Tuesday of this week and we had over 200 businesses represented in our seminar out there. Jon Dudas represented the agency there and from all accounts, it was quite a success. We are expanding that around the country and we are having a couple that are China-specific as well. We did one in Baltimore and we are going to Detroit soon.

As I mentioned, USPTO is engaged in enforcement and training efforts around the globe and here. We have offered training and technical assistance to 55 different countries and we have trained hundreds, if not thousands, of officials—judges, prosecutors, legislators—in how to have a strong IP system and then how to enforce, as well.

We have had particular focus on China and one of the things we are trying to do in China is, as has been stated, they have some good laws on the books, but they need to implement them and they need to enforce them. They have one of the fastest growing patent and trademark offices in the world and we are trying to give them the technical assistance so that when U.S. businesses go to protect their property there, the offices actually function as they should.

As was mentioned by you, the Joint Commission on Commerce and Trade is meeting this week here in Washington, and the Working Group on IP, which is chaired by Mr. Mendenhall's colleague, Deputy Ambassador Josette Shiner, along with Jon Dudas, are meeting with the Chinese and we are pressing them to implement an IPR action plan that will address some specific IPR problems.

The PTO remains active at WIPO, which is always a unique institution to deal with. It is represented by developed and developing countries, but we work with them to set these international standards for IP protection and enforcement, and work to harmonize IP laws to the greatest extent possible. And we are trying to break some ground with a broadcasters treaty there, after the success of the Internet treaties.

USPTO is also working closely with the USTR to provide the support they need with free trade agreements, and we have been fortunate, I think, with some of the recent trade agreements with Singapore and Chile and Morocco to have state-of-the-art IP protections in those agreements—what we like to call TRIPs-plus, going above and beyond what TRIPs requires.

Mr. Chairman, just to say in closing counterfeiting and piracy do appear to be on the rise, but the administration, I think, is making progress in attacking the problem. There is a lot of work that needs to be done, but I am personally increasingly hopeful that with the continued coordination among agencies and the administration, work with this Subcommittee and other committees in Congress, and with private industry as well—they are a big partner in this—we can continue to do more to help American businesses protect their important intellectual property.

Thank you.

[The prepared statement of Mr. Pinkos appears as a submission for the record.]

Chairman HATCH. Well, thank you so much.

Mr. Mendenhall, we will take your testimony at this time.

STATEMENT OF JAMES MENDENHALL, ACTING GENERAL COUNSEL, OFFICE OF THE U.S. TRADE REPRESENTATIVE, WASHINGTON, D.C.

Mr. MENDENHALL. Thank you, Mr. Chairman, and thank you for inviting me here today and giving your attention to this critical issue to our economy.

The protection of intellectual property and access for U.S. goods dependent upon IP protection is at the top of USTR's enforcement agenda. In the area of trade, IPR protection is one of the most important and certainly one of the most complex issues that we face today. Yet, we are pursuing this issue with single-minded resolve. We are making some progress. Clearly, a lot of work needs to be done.

But to preserve our economic strength, we have to cultivate an atmosphere of creativity and innovation both in the United States and abroad. And if that atmosphere doesn't exist, we have to create it, and that means in part strengthening IP rules around the world. We had a good start with that with the TRIPs Agreement, the global rules on intellectual property. But without enforcement of those rules, those rules are meaningless.

Now, two points about enforcement. Ensuring enforcement is actually often harder than negotiating the rules themselves. Enforcement requires political will from legislators, prosecutors, judges, police and administrators at all levels of government, and that is hard to litigate. If we go to dispute settlement, it is hard to craft a rule which compels political will, but political will is essential if we are going to be successful in this mission.

Furthermore, ensuring enforcement is not solely about bringing dispute settlement cases against our trading partners. Dispute settlement is a valuable tool, but neither dispute settlement nor, in fact, any particular legal mechanism is the silver bullet here. When we talk about enforcement, we are talking about getting results. We need to think outside the box and it is not a one-size-fits-all so-

lution. The solutions involve pushing multiple levers in the right sequence and with the right amount of pressure.

Now, let me give you a couple of examples of what we have done over the past year where we have had some success. Every year, as you know, the U.S. Trade Representative's office issues a special 301 report cataloguing IPR problems around the world and putting countries in a hierarchy of wrongdoing, from Watch List, to Priority Watch List, to Priority Foreign Country. This year, we have done 50, 60 countries, perhaps more than that, in our special 301 report.

One of them, for example, is Pakistan, which you mentioned in your opening statement. Pakistan is on the Priority Watch List this year, as they have been for a while, in large part because they have within their borders a series of well-known plants churning out pirated copies of optical disks, millions of them over the past several years. We have taken every opportunity to raise the issue with Pakistan. We have put on the Priority Watch List again this year. Five days later, Pakistan shut down six of those plants.

We also use the carrot-and-stick approach that we have through using our preference programs, like the GAP program. Over the past six months or so, we have worked closely with Brazil, for example, where we have indicated to them that they would face the possibility of revocation of GAP benefits if they don't put their enforcement house in order. Recently, as a result of our efforts, Brazil has undertaken a very comprehensive action plan, including many elements, in fact, suggested by U.S. industry.

Now, with both Pakistan and Brazil, we have a lot of work to do, so I don't mean to say our work is done there. But there are many levers that we can use and that we need to bring to bear on this project. Dispute settlement, of course, is a key tool that we need to use, and we have used it and we will use it again if that is the most effective way to achieve our objectives. We recently won a case, for example, against the E on the protection of geographical indications. We are willing to do that again if, as I said, that is the most effective tool available to us, which brings us to China.

Now, it comes as no surprise to you or anyone in this room, I am sure, that China is perhaps our number one enforcement challenge when it comes to IPR. On China, when we have a problem, many folks have a knee-jerk reaction that we should go immediately to dispute settlement. We have gone to dispute settlement before with respect to China in other areas. In fact, the United States is the only country in the world that has ever challenged China in dispute settlement, which we did last year. We got a successful resolution of a case involving a tax matter.

We have utilized WTO procedures even earlier this week, when we requested consultations with China on a direct sales regulation that they are proposing. It is not formal dispute settlement, but they are WTO procedures that we are making use of, and we will continue to do that.

Now, WTO rules are clearly going to be helpful to us in IPR, which I will get to in a minute about how those two relate. But I want to give you a quick overview of what we have done on our China strategy over the past year.

First, we have held China to its existing obligations. We have negotiated new commitments, when appropriate, to fill any gaps that

may exist. Second, we have monitored progress on the ground in close coordination with our industry to ensure that those commitments are being implemented. And if not, we have ratcheted up pressure on China and will continue to do so to ensure that those commitments are fulfilled.

Now, over the past year we have moved through all these phases with China. Last year at the JCCT meeting, we negotiated a set of new commitments on IPR, with the overall objective of significantly reducing piracy and counterfeiting. A month later, we dedicated a section of our special 301 report indicating that we take those obligations seriously, that we would monitor their implementation and we would seek to ensure that they are implemented, and that we would review the matter in an out-of-cycle review that, in fact, we started in December of last year.

In the summer of last year, we took an unprecedented step of issuing an open letter to industry soliciting information on enforcement problems in China. We reiterated that request when we started the out-of-cycle review and again when we sent the questionnaire to every member of Congress asking that they work with us to inform their constituents of problems in China and help us build a database.

At the end of that process, the out-of-cycle review results in April, we put China on the Priority Watch List. We have ratcheted up the pressure on them. China wasn't happy with it, but we thought the report card that we gave them was appropriate, given the lack of progress that we have seen.

This week, as has been discussed, we are working with China through the IPR Working Group under the JCCT. In the coming weeks, we are going to be issuing a request through WTO rules seeking additional information from China on the status of enforcement in the country. And then we are going to be working with industry over the coming months to refine our arguments, collect additional information to fill any holes that we may have.

We have seen some progress in China. We saw China issue new judicial interpretations in December of last year making it easier to bring criminal cases. We have seen other steps they have taken, including a nationwide campaign, but we haven't seen enough progress and we need to consider carefully what our next steps will be.

Now, if we are going to go forward and we are going to utilize WTO procedures, we have to have our facts in order. We have to have a full and complete docier of information to prove our case. Everybody knows it is a problem. Everybody around the world knows it is a problem. The Chinese know it is a problem, but we have to have a full evidentiary basis to prove our case with them if we expect them to make serious progress. Now, we have worked with industry over the past couple of months to do that. We hope you and members of Congress will work with us to work with industry to gather that information as appropriate.

Just a word on Russia. Here again, we have got a serious enforcement problem well-known to you and others, of course. We have taken a series of steps to try to increase pressure on Russia to improve their IPR regime. We have raised the issue at the presidential level. We have put them on the Priority Watch List again

this year. We are having an out-of-cycle review on China later this year.

We continue to review the petition the copyright industry has filed to withdraw GAP benefits, and we are continuing to raise the issue as a critical issue to be addressed in the WTO accession negotiations. Ultimately, again, any progress in this area is going to depend on the political will of Russia's leadership. We will continue to press Russia to undertake that commitment to crack down and deal with this problem straight on.

Finally, just two closing remarks. As I indicated in the beginning of my statement, we have a good foundation with the TRIPs rules on enforcement. They need to be elaborated upon, they need to be fleshed out further. We have started that process with our FTAs, as my colleagues on the panel indicated. We have dedicated about half of our IP chapters and our FTAs to enforcement and we are working through the strategy targeting organized piracy to build a global consensus on the need for IP enforcement and build the machinery to ensure that we have the tools available to us, working with our trading partners, to cleanse international trading lanes of pirating counterfeit goods.

Thank you.

[The prepared statement of Mr. Mendenhall appears as a submission for the record.]

Chairman HATCH. Well, thanks to all three of you. Let me just ask a couple of questions.

The collective picture the administration witnesses paint of the problem of China is stark and unattractive to me. It is obviously disastrous for our software manufacturers that 90 percent of software installed on computers in China was as a result of pirating of intellectual property.

I understand that the American film industry used to be able to say that they had a positive balance of trade in every country in which they do business, but I also understand that this is no longer the case with one country, and that is China. This is not because they are an international film-making powerhouse, and while I am sure the Chinese are making some good films, I am also told that the Chinese will not let the American film industry compete fairly in China. I also understand that whenever a new American film opens, illicit copies are available on the streets in Beijing almost the same day as they are shown, or within days after they are shown. And all of this is taking place when we have big trade deficits with China.

You have all touched on this to a degree, but I would like you to just be more specific. What are you doing to fix the IP theft problem in China and what can Congress do to help you? What can we do, if anything, to help you in this area?

Mr. MENDENHALL. Clearly, the copyright problem—the movies, music, and so on—in China is an extremely serious issue that we take extremely seriously. We have worked very closely with our industries to get a sense for the real problems they face on the ground and figure out what the best steps forward would be.

When we talk about movies, in particular, which is what your question focused on, we have got a couple of problems. One is that China puts a cap on the number of movies that come into the coun-

try every year to be shown in theaters and such. As a result of that cap, China effectively creates a market for pirate movies to come in; that is to say for the 20 or so movies that are allowed in, there may be 30 additional movies that our industries would like to show and that people would like to see. As a result, there is a black market that grows up with respect to those particular movies. So we have a market access problem that contributes to the creation of a black market.

We also have the problems that we face in a lot of other sectors, including the fact that there just simply is a lack of enforcement in China. There are plants turning out millions of optical disks that aren't being shut down. If they are shut down, they may open the next day; the vendors, the same thing. They may be shut down and they open the next day.

Now, the steps that we have to take are complicated, as I indicated in my remarks. We have tried to work with the Chinese cooperatively. We have set for them overall objectives of significantly reducing piracy and counterfeiting, as well as specific objectives. The work plan that Mr. Pinkos referred to that we are talking to the Chinese about this year is quite detailed, asking them to take specific steps to build up their enforcement machinery at all levels, and we have worked very closely with the Chinese on that.

Now, the Chinese may balk at that. As I said, they think they are doing a lot. We haven't seen the results yet, so I can't tell you what the results of those discussions are going to be. If we don't see results, though, we do need to think about next steps we need to take in this area, and that may include working perhaps within the WTO procedures, as we indicated in our out-of-cycle review results. So we're working the diplomatic angle and the negotiation angle as much as we can. If there is nothing more to be gained about that, we do need to think about next steps and that may be for the utilization of WTO procedures.

Chairman HATCH. Is there anything we can do that we are not doing that would better help you there?

Mr. MENDENHALL. Well, as I indicated, I think what would be most helpful is if we all worked together cooperatively; the administration, Congress and the industry work together to, one, give a united and consistent message to the Chinese that this is a serious problem that has to be grappled with. Two, we need to impress upon—well, we need to work together to ensure that both the private sector and the Government bring the proper amount of resources to bear upon this issue, which includes not only resources for data collection purposes, but also legal resources appropriate for us to build and refine our arguments, build our database so that we can go to the Chinese and present a very solid case, backed up by evidence, that something needs to be done here.

Chairman HATCH. I guess I am asking you are there aspects of U.S. law that, in your opinion, need to be changed to assist you in your efforts to combat international piracy.

Mr. PINKOS. I don't know if there are laws that will help us deal specifically with China. I think the administration is working on a legislative package to submit to the Congress that will help rightsholders enforce their rights here in the United States a little more aggressively. The Department of Justice is working on that, and

the Patent and Trademark Office and Customs. So we would like to work with you on that as we bring some items forward.

Mr. Chairman, if I could suggest something that I think is helpful that I think many of you know intuitively, but when you all travel abroad to take a strong message, but not just to China, but really, as Mr. Mendenhall alluded to, this is going to require an effort in China specifically, among multiple nations.

Chairman HATCH. Well, I have the same basic question with regard to Russia. It is a big problem, too, and the question is what can we do now to stop the widespread and growing piracy of U.S.-owned and U.S.-developed intellectual property in Russia. It is a big, big problem over there, as well.

Mr. PINKOS. That is exactly right, and we are raising it at the highest levels, as Mr. Mendenhall said, with the President, and likewise analyzing their progress in terms of their WTO ascension, as you mentioned in your statement as well.

Chairman HATCH. Well, to be honest with you, I am not going to ask you what Congress can do to help with the situation in Russia because I hear a growing number of my colleagues are complaining and very upset and grumbling about their concern that if we go along with ascension to the WTO, Russia is going to become the new China, and they will do it blatantly when it comes to attempting to gain the benefits of free trade for its citizens at the same time it acts to hurt the interests of U.S. copyright-holders and U.S. workers and investors and their families by avoiding the responsibilities under the international trade agreements and in areas where both Russia and China almost blatantly flaunt their theft of U.S.-owned intellectual property materials.

Before I ask you to specifically comment on the situation in Russia, particularly on the role of organized crime in intellectual property theft over there, I want to make a few comments on the state of affairs between the Senate and the administration on trade issues.

Everyone knows that the situation with CAFTA is fraught with difficulties and that the administration is going to need every supporter that it can both on the Hill and in the public as well. Everyone on the Judiciary Committee members only too well the misadventures we had when USTR negotiators included immigration language in several trade agreements last Congress that caused enough furor on the Judiciary Committee to actually unite us on a bipartisan basis, and that was not easy to do on this Committee, I have to admit.

One of the messages we conveyed, and the House Judiciary Committee as well conveyed to the administration is that we want to be consulted and taken seriously on these types of issues. Many of us in the Senate have felt from time to time that either those in the administration who have been working directly are not taking back our concerns, or if they are, these concerns are not being effectively conveyed or listened to or considered.

I have been a strong supporter of free trade and everybody knows that, and I hate to see the increasing erosion of support among the public and within Congress for trade agreements especially with people like me. But one way to help reverse this growing tide against trade agreements is to be able to assure the public

and the Congress that the U.S. Government is standing up for our rights in areas where we lead the world, such as the intellectual property-dependent sectors of software, entertainment, information technology and biotechnology. There is a growing weariness that while we may have all the right words on the paper, at the end of the day there is no teeth in the words. And when it comes down to enforcing the laws against the outright, flagrant theft of U.S. intellectual property, there is no strength behind that.

So with that, I would just ask all of you to comment on the situation in Russia and whether the Russian government is effectively combatting IP theft by organized crime in Russia, and if you could comment very quickly because we will turn to Senator Leahy as soon as you are through.

Ms. PETERS. Clearly, the answer is no, they are really not doing enough. They actually do have an Internet piracy problem. Many of us realize that in the United States we also have a problem that you and Senator Leahy tried to address last year and time ran out, and we are waiting to see what happens in the Grokster case. But if it comes out, quote, "the wrong way"—

Chairman HATCH. We are all waiting for that, aren't we?

Ms. PETERS. If it comes out the wrong way, you may have to take the effort back up again because people will look to the kind of law that we have and how we protect our works in an Internet environment before we go there and tell them that they have their Internet problem and they are not solving it.

Chairman HATCH. Mr. Mendenhall, go ahead, or Mr. Pinkos. We will go right across.

Mr. MENDENHALL. Just a couple of points in response to what you said. Your question, I know, was directed at Russia, but you also mentioned in the course of your comment our free trade agreements, CAFTA and others, and I want to pick up on that because one of the problems that we have when we talk about the enforcement obligations in the WTO and elsewhere is that the rules that we have in TRIPs, for example, are fairly blunt instruments.

So what we have tried to do in CAFTA, as with our other trade agreements, is refine the enforcement rules. We have roughly 25 pages of our IP chapters dedicated solely to enforcement, much of it dedicated specifically at copyright enforcement to update the rules applicable in these countries, whether it be on the Internet, dealing with the specific issues related to the Internet, or even broader than that on other matters. So when it comes to our free trade agreements, we are refining and honing the rules and we have seen significant progress.

Now, in Russia specifically, I certainly share the frustration that you expressed with Russia's failure to adequately enforce IP rights. I think we all recognize that. That is why we put them on the Priority Watch List this year. That is why we are going to continue to monitor it closely through the out-of-cycle review toward the end of the year. And I can assure you that it is an issue that has taken a very high profile, very prominent, in our discussions in the accession process and our IPR bilateral dialogue with them. We will continue to do what we can to impress upon them to make progress, but it is a serious problem. We recognize that.

Chairman HATCH. Let me just ask one other question before turning to Senator Leahy. It is my understanding that the TRIPs provisions are a floor, not a ceiling, and I hope you agree with that statement.

Does anybody disagree with that?

[No response.]

Chairman HATCH. Okay. Can you comment on whether it is the policy of our Government to attempt to negotiate in a TRIPs-plus fashion, when appropriate, such as in the fast-changing IP areas? I will just mention one, e-commerce. These areas were not fully developed when the TRIPs provisions were adopted in the mid-1990s.

Do you care to comment about that?

Mr. MENDENHALL. Sure. I can start, but my colleagues may want to jump in. Yes, TRIPs is a floor. Yes, it is ten years out of date, in a sense. Since then, there have been new rules that have emerged, internationally but not universally accepted in WIPO, for example, to deal with the Internet issue. Our FTAs, as I said, have a very intense focus on enforcement, including on e-commerce and the Internet. They do need to be updated—not the FTAs; the global rules do need to be updated in some sense.

We are pressing in all of our bilateral dialogues, including with China, for example, the adoption of rules to bring their enforcement regimes up to snuff. Mr. Pinkos, I think, indicated that we are urging China to fully implement and adopt the WIPO Internet treaties. They have indicated to us that they would seek to do that this year, that the draft regulations in train, and we hold them to do that commitment. It is something that we have discussed at the JCCT, and we will continue to do that.

But we are pressing our trading partners through our FTAs and outside of our FTAs and in any other context we can raise it, including through the special 301 process, adoption of rules that modernize the enforcement regimes and go above TRIPs standards.

Chairman HATCH. Thank you.

Mr. PINKOS.

Mr. PINKOS. I think we have seen success with our FTAs in implementing TRIPs-plus, but it is increasing tough sledding in these multi-national settings like WIPO or at the WTO because there is really a very active anti-IP developing world sentiment. In these bodies that require consensus or near consensus to agree on things, it makes it particularly difficult to get further protections.

As we saw with the GI case, the geographical indications case, we even have some differences with our European trading partners on the height or strength of IP protection. So it is tough sledding, but I think we are working really hard in these international organizations to try to push through some things.

Chairman HATCH. Thank you.

Senator Leahy.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Senator LEAHY. Thank you, Mr. Chairman, and I am sorry that I was late. I want to commend you for having this hearing. I also wanted to submit for the record a statement by Senator Biden, who is on the floor, as you know, with a nomination.

Chairman HATCH. Without objection.

Senator LEAHY. We Americans think globally as we enjoy the fruits of a lot of creativity of other Americans. I was just getting some messages here on a Blackberry, but that is just one example. Unfortunately, a lot of other people think globally and enjoy the fruits of people's creativity and innovation and they do it because they steal it. I pay for those things I get, as does the Chairman, but a lot of the advances of the digital age have eliminated a lot of the barriers between buyers and sellers.

Software, music, photographs—any of those things can be sent around the globe. We saw the opening of the latest "Star Wars" movie. It had the biggest opening, I guess, of any movie in history, and within the first day they were downloading pirated copies and selling pirated copies overseas and some here in the United States. So it is a global problem.

Because we are the world leader in intellectual property, we at least should be acutely aware of the impact on U.S. industry and our own citizens' creativity. Intellectual property is vital to our health. According to the International Intellectual Property Alliance, in 2002 the various copyright industries accounted for 12 percent of the U.S. gross domestic product. That is $1.25 trillion, and 11.5 million people employed, but they still lose hundreds of billions of dollars to piracy every year.

The Business Software Alliance estimates its loss at $30 billion in software sales annually. The MPAA estimates it loses $3 billion a year to piracy. The International Intellectual Property Alliance reports that the U.S. lost more than $13 billion in trade due to copyright piracy in 2003. The FBI says that we lose $200 to $250 billion annually to counterfeiting alone.

You have people who work very hard to develop, to create something. This is their livelihood, this is what they are proud of, and it is just stolen. We all understand if you break into somebody's house or warehouse and steal what is there, but these people are broken into maybe from 10,000 miles away.

We focus today on China and Russia, and for good reason. The Chairman asked the pertinent question is Russia doing enough. Well, we all know the answer to that. China, in the year 2000, entered the World Trade Organization and I expressed concern about China's record on human rights and labor rights, a record which is terrible. When ultimately I voted in favor of establishing permanent and normal trade relations, I did note that isolationist policies do not work.

For several years now, we have been engaging China in attempts to improve its record on piracy. Instead of progress, the United States Trade Representative's 2005 special 301 report placed China on its Priority Watch List. The report notes that while China has expended efforts, we have not seen any meaningful reduction in infringement that China promised to attain. I sometimes wonder when you see raids for television, whether you raid the front end of the pirate business in China while work goes on at the back end. It has resulted in an estimated loss of $2.5 billion to $3.8 billion annually in pirated copyrighted works.

Russia, as the Chairman has mentioned, is on USTR's Priority Watch List. We know that while Russia has passed numerous laws

designed to improve intellectual property protection, enhanced enforcement has not followed. It is sort of like you pass a law and say we will have a law against burglary, but you can't put locks on your doors and the police won't ever bother to come around and check the place at night. Well, the law looks good on the books and nothing happens.

The piracy rate for the recording industry is 66 percent; for the movie industry, 80 percent. Among the many problems in Russia is that the pirated goods that are confiscated by law enforcement—think about this—the goods they do confiscate so they can show us how hard they are working, 70 percent of it is returned to the market. It is sort of like, hey, everybody, look at this, we are getting tough here in Russia, we are grabbing this stuff. Okay, the camera is gone, give 70 percent back. You have got to have more than a revolving door. The copyright industry's estimated loss in Russia is $1.7 billion.

Last week, Senator Cornyn and I introduced S. 1095, the Protecting American Goods and Services Act of 2005, to criminalize possession of counterfeit goods with intent to traffic, to close off the loopholes. In 1996, Senator Hatch and I worked together to pass the Anti-Counterfeiting Consumer Protection Act, which amended several sections of our criminal and tariff codes.

We know it is more than a problem for just a few of us. We have to ask if the United States Trade Representative has adequate tools to address this issue. Do we need to strengthen our domestic laws through legislation like the legislation Senator Cornyn and I recently introduced? Do we have to engage more vigorously with China, Russia and other countries that don't enforce IP enforcement? I think the answer to all those questions is yes.

I am probably preaching to a lot of the converted in this room, but, Mr. Chairman, we are hurting on this. The other thing is now we know it is not just some of these countries that are allowing this. We have organized crime syndicates turning to piracy. It is a lot easier than going out to rob banks. When they asked Willie Sutton why he robbed banks, he said, well, that is where the money is. Organized crime has always looked where the money is, whether it was selling liquor during Prohibition times, or drugs, or whatever. Piracy is a very easy way to go.

I read Eric Smith's written testimony and it was very much like Marybeth Peters', who is a person who has enormous credibility before this Committee on both sides of the aisle. They mention the very disturbing possibility that this piracy may be funding terrorist groups. That is something that worries me. If terrorist groups are looking for money, why not go to piracy?

Ms. Peters, did you want to add to that at all?

Ms. PETERS. Not really. I agree with you a hundred percent that the organized crime element that we see in the international arena should be of tremendous concern to everybody and not just the United States, but other countries.

Senator LEAHY. Well, you know, we put China as a member of the WTO on the idea that maybe this will help us get them to stop all the counterfeiting, but they keep right on doing it. Is there any reason to think that Russia will do any better if we put them in WTO, Ms. Peters, based on our experience so far?

Ms. PETERS. Well, I think that the possibility to bring about any kind of changes is during the entrance process, our ability to negotiate with them and what they need to do in order to become a WTO member, and make sure that they live up to those agreements. We hope that if the United States Government believes that that is where they should go that we will have managed to elicit more than promises, but effective actions.

Senator LEAHY. But have we seen much in what they have been doing so far to make us think that they are going to?

Ms. PETERS. No.

Senator LEAHY. Mr. Pinkos?

Mr. PINKOS. From what I understand—and Mr. Mendenhall may want to take a shot at this—it has been pretty tough sledding, pretty tough negotiations, but we have been pretty strongly insistent that they make the IP commitments before we are going to acquiesce to their ascension to the WTO.

Senator LEAHY. Mr. Mendenhall?

Mr. MENDENHALL. It is a difficult issue, obviously. It is a complex issue. We have been in negotiations with Russia for a long time. Through that time, we have seen incremental progress, for example, in having Russia get its laws in shape. As with China and as with a lot of these other countries, the laws on the books don't matter a whole lot if they aren't enforcing them.

But we have seen some progress in getting the laws in shape. We have emphasized to them that that is not enough, that they actually need to enforce those laws. They need to go forward and reduce the piracy and counterfeiting levels. We have made that a critical part of the accession package, the accession negotiations, as I indicated earlier. We have raised it at the highest levels and we will continue to do so to impress upon them the need to make progress on this issue as we go forward in the process.

Senator LEAHY. But what is going to make them do it? I mean, we can raise it to the highest level, but in the past nothing seemed to worry them. I bet you anything that if you go to downtown Beijing within hours of the time just about any movie comes out that is going to be kind of a blockbuster, or downtown Moscow, you can buy pirated copies. I have seen them there.

What is enough of either a carrot or a stick to make them change, especially when it seems to be governmental policy to allow this?

Mr. MENDENHALL. Well, of course, that is the $64,000 question. I mean, what is going to do it? As I indicated in my opening remarks, we have a series of tools that we have used—you mentioned China, in particular—to gradually escalate the issue—actually, not so gradually. We have escalated the issue over the past year with China, starting with diplomatic initiative through the JCCT, working through an out-of-cycle review, stepping up from there to make a finding of Priority Watch List which, as I indicated, China has taken seriously.

I can tell you that because they are here this week talking to us about it. They have expressed their concern about that listing as a Priority Watch List country. We are working with them further on developing an IPR action plan over the next couple of weeks and we are going to be resorting to WTO procedures, as I said, on the

transparency side in the coming weeks. And if we still haven't seen progress, we need to think seriously about next steps that we need to take in the WTO or otherwise.

So what we are doing is what I think we need to do with China, as we need to do with Russia. We need to speak with a unified and strong voice. We need to impress upon them the importance with which we take it, and I think it is almost important, frankly, to get them to change the mindset so they see it in their own interest. And we have started to do that through various training programs that the various agencies represented here have undertaken, as well as others have.

We will get there, but it is going to be a slow process because as I said in my remarks, this is not your typical trade case. This is not a case where you need to change a number in a tariff schedule. You need to change the mindset. You need to get political will at all levels of the government to take it seriously. And if you want to change the mindset, that takes time. It is not a matter of simply changing a number in a tariff schedule, but we are using all the procedures and all the levers we have at our disposal to do it.

Senator LEAHY. Thank you. Thank you, Mr. Chairman. I have a number of other questions, but I will submit them for record.

Chairman HATCH. Thank you so much, Senator Leahy.

We appreciate all three of you coming. You have been helpful to us here today and we are going to have to work on this together. I think the next panel will have a number of suggestions on what might be done and I hope you will pay strict attention to what they have to say, as well. Maybe there are some ideas there that might augment some of the ideas you already have.

We have got to put a stop to it. We have got to go after these people and we have got to go after these countries and get them to start being responsible to protect intellectual property. But we appreciate the work all of you do. Thanks for being here.

Mr. MENDENHALL. Thank you, Mr. Chairman.

Chairman HATCH. Thanks.

Our next three witnesses will be Eric Smith, President of the International Intellectual Property Alliance here in Washington, D.C., then Taylor Hackford, board member of the Directors Guild of America, from Los Angeles, California, and Robert W. Holleyman, President and Chief Executive Officer of the Business Software Alliance here in Washington, D.C.

So we will start with you, Mr. Smith, and then we will go across to Mr. Hackford and then to Mr. Holleyman. Mr. Smith, you are first.

STATEMENT OF ERIC H. SMITH, PRESIDENT, INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE, WASHINGTON, D.C.

Mr. SMITH. Thank you, Mr. Chairman and Senator Leahy, for again giving IIPA an opportunity to testify on the piracy problems the copyright industries are confronting globally. I am going to speak very generally on the topic and my colleagues here will speak to their particular industries in some more detail.

This oversight hearing is extremely timely, as you have mentioned, because at this very moment a delegation from China called the IPR Working Group is meeting with the U.S. Government as

we speak. In addition, USTR has just announced its special 301 decisions. This is the congressionally-created mechanism by which our Government seeks to improve IPR protection and enforcement globally, and to nurture those creative and innovative industries and individuals who contribute so greatly to our Nation's economic growth. Finally, there are currently ongoing talks between Russia and the U.S. looking toward Russia becoming a WTO member and to secure permanent normal trade relations. I want to briefly discuss our global problems and challenges, and then turn to the dire problems we face in Russia and China.

As you know, Mr. Chairman, we represent the U.S. copyright industries. We have six member trade associations, 1,300 companies, accounting for millions of U.S. jobs. You have mentioned those numbers. I won't repeat them. These companies and the individual creators that work with them are critically dependent on having strong copyright laws in place and having those effectively enforced.

On average, the copyright industries generate over 50 percent of their revenue from outside the United States, and in 2002 contributed over $89 billion in exports and foreign sales to the U.S. economy. Given the overwhelming global demand for the products of America's creative industries, all these numbers would be significantly higher if our trading partners, particularly those like Russia and China that continue to allow piracy to flourish in their own economies, were to significantly reduce piracy rates by actually enforcing their copyright laws vigorously.

First, I want to highlight the global problem. In our 600-plus-page report which we submitted to USTR, we highlighted problems in 67 countries and their impact on the U.S. economy and U.S. jobs. Rampant piracy in most of those countries highlighted in this report constitutes the copyright industry's greatest barrier to trade, costing U.S. jobs and contributions to the U.S. economy.

In our report, we identified six priorities or challenges we face in fighting piracy in partnership with our own Government. These challenges are amply illustrated by the two countries I want to especially highlight today—Russia and China.

These challenges are, very briefly, Internet piracy and its impact on the growth of electronic commerce; optical disk piracy and the need to regulate it at the production level; the role of organized criminal syndicates in the piracy business; the problem of losses caused by unauthorized use of business software in governments and small businesses, and Mr. Holleyman will speak about that; book and journal piracy, both traditional and online; and the cross-cutting challenge of securing compliance with the WTO TRIPs Agreement, and particularly its enforcement provisions, and how the new free trade agreements are helping to achieve better protection. Our industries face all these challenges in Russia and China, two countries that are highest priorities and where we suffer huge and growing losses.

First, Russia, and the problems in what it and the U.S. Government needs to do. Mr. Chairman, Russia is about to become the new China, as you have mentioned, as far as piracy is concerned. Let's look at a few statistics.

You have mentioned that we lose over $1.7 billion due to piracy in Russia. That was in 2004, and $6 billion over the last five years. At the same time, the U.S. has unilaterally granted Russia over $515 million in GAP benefits in 2004. With its record, Russia should not be considered eligible to receive those benefits.

As you have mentioned, piracy rates hover around 70 percent of the market, or higher, for every copyright sector. It has been recently estimated that Russia's annual manufacturing capacity for OD product now stands at 480 million disks. Demand for legitimate disks is unlikely to exceed 80 million in all formats. You can imagine what happens with the rest.

The government of Russia has said that there are 18 plants on restricted access property, military bases, where simple entry is denied law enforcement. Forensic evidence indicates that at least 24 of the 34 plants are known to be producing pirate product. Russian-produced optical disks have been positively identified in at least 27 countries, seized in 27 countries.

However, the statistics only tell a part of the story. What they do not show is the poor reaction over the past ten years of the Russian government to their piracy problems. IIPA first raised the OD problems with the Russian government in 1996 when there were just two plants. The reason the problem has been allowed to escalate to 34 plants has been the Russian government's continued and deliberate failure to act, despite repeated promises to our government and to our industries. In short, what we face in Russia is a legacy of failed commitments.

Let's look at the enforcement record. In 2004, there were eight actions taken by the Russian government against the optical disk plants, including raids and seizures of illegal materials. As Senator Leahy has said, 70 percent of the products seized went out the back door—unbelievable. All of the optical disk plants that were raided remained in operation after those raids. There are few, if any, criminal prosecutions. All that were prosecuted ended in suspended sentences. In ten years, there have been only two convictions with actual sentences.

We and the U.S. Government have recommended six straightforward steps to deal with the optical disk piracy problem. They are detailed in my written testimony. The conclusion: none of them have been done. So what needs to happen?

First, we cannot make the same mistake that was made with China, permitting Russia to enter the WTO without undertaking meaningful and WTO TRIPs-compatible enforcement actions. The actions we detail must be a pre-condition to such entry. These are not commitments we are looking for. This is action. We got commitments from China and now it is almost four years later.

Second, if Russia fails to act, it should be designated a priority foreign country after the ongoing out-of-cycle review by USTR—something that we recommended and was not done in this last round.

Third, we should deny Russia's eligibility for the generalized system of preference duty-free trade benefits. It has been five years since we filed that petition and it has been four years since USTR granted that petition. Russia has been on the Priority Watch List now for nine years. Mr. Chairman, it is time to act.

Let me now turn to China. Mr. Chairman, we are in dire straits in China. Piracy rates have hovered at and over 90 percent, as we have discussed here, in the more than 15 years that IIPA has been engaged with the U.S. and the Chinese government. Indeed, with the new digital copying technologies and the Internet, the situation has even worsened. Every year, industries have lost conservatively between $1.5 and $2.5 billion. In 2004, it was over $2.5 billion.

China is potentially the largest market in the world and is growing at a faster pace than virtually every country in the world. We have an important, in trade jargon, comparative advantage in the area of copyright, an advantage that hasn't even begun to be realized, while, as we know, China is continually taking advantage of their comparative advantage in so many areas, with a trade surplus with the United States of $162 billion.

Of all the industry sectors represented in the U.S. economy, the copyright industries face a market more closed to them than to any other. Not only is nine-tenths of the Chinese market closed through piracy, but our industries suffer under onerous and sometimes discriminatory market access barriers. China's denial of effective market access prevents us from getting to know the market and establishing a presence that would enhance our ability to fight piracy. Even if we were to reduce piracy by half in China, under the present circumstances most of our industries could not satisfy the huge local demand because of these barriers. In short, these two problems are indelibly interlocked.

Chairman HATCH. Mr. Smith, would you try to wrap it up?

Mr. SMITH. Yes.

Chairman HATCH. We allot five minutes. You are almost ten minutes.

Mr. SMITH. We believe that the failure to use the criminal law to fight piracy is a violation of China's TRIPs obligations. We believe that the Chinese criminal law, because it does not encompass all acts of copyright piracy on a commercial scale, also violates the TRIPs Agreement. Because of all this, IIPA has urged USTR to engage in a new multilateral dialogue with China. Following USTR's announcement of the results of their out-of-cycle review, we are closely to develop the elements of a possible WTO case.

We ask two things: first, that China immediately commence a significant number of criminal actions against pirates of our products and impose deterrent penalties; and, second, that China now eliminate the onerous and destructive market access barriers that prevent U.S. copyright-based companies from doing real business in China.

Thank you very much.

[The prepared statement of Mr. Smith appears as a submission for the record.]

Chairman HATCH. Thank you, Mr. Smith.

Mr. Hackford, we will turn to you.

STATEMENT OF TAYLOR HACKFORD, BOARD MEMBER, DIRECTORS GUILD OF AMERICA, LOS ANGELES, CALIFORNIA

Mr. HACKFORD. Senator Hatch, Senator Leahy, thank you for inviting me here. I am here today on behalf of the Directors Guild of America, which represents 13,000 directors and members of the

directorial team, which accounts for assistant directors, production managers, et cetera. Those teams work in feature films, television, commercials, documentaries and news. Our mission is to protect the economic and creative rights of directors and their teams.

I think most people tend to think of the movie industry as the glitz and glamour of Hollywood, movie stars, et cetera, but the reality is that most jobs are behind the camera and they are located all over this country. We are talking about those names that scroll up the screen at the end of a film, hundreds of names for every film, tens of thousands of people who work in this industry.

Now, those employees are just the ones that work in the film industry. There are a lot of other people, small businesses, that have their livelihood, their bread and butter, in the film industry also—cleaners that clean costumes, rental cars, trucking, many, many things. As you well know, the entertainment industry and the information industry in this country account as the second largest export that we have. All of these jobs and that industry are currently at stake, are at great risk, which you have heard about today.

Now, it is an incorrect assumption in the piracy debate, usually made by people who are interested in open access, that once a film is out and gone into the theaters, it is over and it just comes back then perhaps as profit to the studios. Nothing could be further from the truth. There is a process in the entertainment industry called residuals. This is a crucial element in our business and let me explain why.

We are not on a weekly salary, or a monthly or a yearly. We work freelance. Every single film we make, depending on its success, could be our last. Therefore, you work on a project, you put your lifeblood into it, and you hope in the long run that it is going to do well. The residuals from our productions that come back from free and pay television, through DVDs, through video cassettes—that money that comes in feeds our health and pension plan and is really the bread and butter that keeps us alive.

What we are facing today is a market where over 55 percent of the money that comes back from films comes from outside the United States. The whole issue of piracy, both within and especially from outside the United States, is seriously threatening our livelihoods, our bread and butter income.

So when pirates steal a movie—and that is exactly what it is; it is robbing—they are not just robbing revenues from the studios; they are taking our money that we need to live on and hopefully exist in the future. Moreover, it is not just the films that we make. It is about the films that have not yet been made, and let me explain.

When you go out to make a film as a film maker—and I am film director and producer—you don't just make it like this. I want to give you a case in point. I just made a film this past year called "Ray." It was a film about the life of Ray Charles. It took me 15 years to make this film.

Senator LEAHY. Incidentally, one of the best movies I have seen in years.

Mr. HACKFORD. Thank you very much, Senator.

Senator LEAHY. I am not trying to give plugs on it, but I went to that and I have urged all my kids to go to it. I have urged all my friends to go to it. It was a tough movie.

Mr. HACKFORD. It was.

Senator LEAHY. But it was a good movie, really good.

Mr. HACKFORD. Thank you very much.

I thought today one of the things that I could do was try to put a personal face on this issue and talk about a project like "Ray" that I was personally involved in, and you can see the process of what has happened with that particular film.

As I said, it took 15 years and it was not easy, for some reason. You have seen the film and you liked the film, but it was very hard in Hollywood to find anybody who would finance it. I had a passion for this film. I believed in it. I had made the commitment to Ray Charles himself and worked with him for 15 years, and in the process I finally came to the point where I did find somebody to make the film.

In this industry, it is a huge risk. People are putting up a lot of money, and with smaller films like "Ray" this is a much bigger problem than a film like "Star Wars" that everyone knows is going to go out and play in the theater and millions and millions and millions of people are going to see it. The smaller films, the riskier films, are the ones that are most affected like this, like "Ray" was.

Now, luckily for me, I convinced an individual to actually finance the movie. He was advised by everyone not to do it. Luckily for him, the film was done very, very film. Luckily, we had a distributor, Universal, that picked the film up and did a very, very good job. So, in reality, everybody made out, but you should realize that only four out of every ten films made makes it money back from theatrical receipts. Less than that number—I think it is something like only six films out of ten ever make their money back at all. So it is a hugely risky thing.

I want to give you the case of "Ray." When Universal released the film, it was the end of October. The same week it opened, I walked down Canal Street in New York City and the video cassette was on sale, complete with the art work. These people had done all the work ahead of time, and when they got the disk they put it out. Now, we happen to know from research that Universal has done that it was videotaped at the Raceway 10 Westbury Theater, the Loews Raceway 10 in New York and the Loews Jersey Garden Theater in Elizabeth, New Jersey.

Now, they immediately took that videotape and they put it on the Web. They sent it to Russia and China, and immediately started that process, the things that you were talking about of generating it. So the fact is that it was on sale a week after its release, or the week of its release—pardon me—because I saw it the day after it was released here in New York, California, Florida, Georgia, Texas and worldwide.

Chairman HATCH. When you talk about release, you are saying in the theaters.

Mr. HACKFORD. I mean the DVD was for sale.

Chairman HATCH. Yes, because the DVD you came out with later was like three months later.

Mr. HACKFORD. Three months later. This is an important thing. The DVD was on sale in Europe before—we didn't release the film in Europe for another two months.

Chairman HATCH. What you are saying is you had the film in the U.S. theaters. You hadn't yet hit Europe. You hadn't yet done your own DVD of it.

Mr. HACKFORD. We hadn't done our DVD.

Chairman HATCH. And a day after the film was released, you had DVDs on the street at a very discounted price.

Mr. HACKFORD. Absolutely. You had DVDs on the street.

Chairman HATCH. Without any payment of any copyright royalties at all.

Mr. HACKFORD. Nothing coming back.

Now, what then happened is three months later, at the beginning of February, we released the DVD. Immediately, that high quality—first of all, the camcorder version was not very good quality, but still that didn't stop millions of people from buying it. Then on February 1, we went out with a DVD, and immediately that went on the Web for downloads.

Now, just to give you an idea, last week, one day, May 19, on the peer-to-peer networks there were more than 476,000 requests for "Ray." Since the film was released and first pirated in October, there have been 42 million requests to download "Ray."

Chairman HATCH. That is without any payment of royalty or any copyright—

Mr. HACKFORD. Nothing, nothing. I think that kind of tells you what we are facing. If I had that much trouble raising the money to make the film—luckily, the film worked critically and commercially, and the people are going to make their money back. But those people didn't know that. They were told this was going to be a risk and they might not get it back.

Now, if you tell them that you can go out and you can make the film and before they can see anything back, millions and millions of copies—in fact, the other thing that is important to say is last year was the first time in history that DVD revenue exceeded box office. The future is clear. The DVD is going to be the profit leader in this industry.

So when I am going to an investor and trying to raise money for a film and that person already knows it is a big risk and now knows that before the film even plays in a theater, it can be on the street, it is going to be devastating to our business. And that means devastating loss of jobs and obviously, as I said before, to this country. If it is the second largest balance of trade export, it is going to be devastating to our economy, and obviously something things to be done.

Chairman HATCH. Plus, a loss of creativity, loss of star power, loss of people's opportunities to excel in the arts, et cetera.

Mr. HACKFORD. I think the important thing about the movie business—and again I don't want to put it all in commercial terms. I am an artist. I think when you put something together in a film—let's take Ray Charles. Ray Charles is to me the epitome of the American experience, and let's not talk about race. This is a blind man who in this country was able to make himself a legend,

who was able to, through his own talent and fortitude, go out there. That is a message that you send to the world about America.

If this industry and the things that we are communicating about this country and the industry that we are creating that will bring revenue back to this country is destroyed—and it will be unless we do something—I think that, yes, I am speaking personally. Myself, my colleagues, the people I work with—and again they are not just the movie stars, but all those people that go into—I don't work alone. I am not a painter at an easel or a novelist at my typewriter working alone. It is a collaborative effort. All those people go into making my film as good as it is, and those people are going to be out of work.

So I am here today to express this personal plea to you, and I want to also thank both of you and your Committee for all the work that you have done. Your interest in this has been pioneering. The laws that you have helped enact have really helped us. People are just now starting to wake up even in my industry. But we appreciate that and the Directors Guild is here to help you in any way we possibly can in the future because we share your concern and understand the vital nature of this problem.

Chairman HATCH. Thank you.

[The prepared statement of Mr. Hackford appears as a submission for the record.]

Senator LEAHY. Mr. Hackford, I think I can probably speak for both of us in saying that if you worked hard to create something, you ought to have the satisfaction of knowing it is your creation. Now, if you do a bad job and it doesn't sell, fine. That is a risk you take, whether somebody paints a picture, writes a song, writes a book or anything else, or does computer software.

But if you have done something good, you ought to get rewarded for it. It ought to be yours, in the same way that if you have got something in your own home, you shouldn't have somebody steal it. You shouldn't have something that is your creation be stolen.

Senator Hatch and I have wrestled with this and I think we have demonstrated to the country that it has not been a partisan issue. We are very concerned about this. I want people to be able to compete in the marketplace. If their product sells, they benefit by it. If it doesn't sell, well, that is the risk they take, as anybody does who goes into the marketplace. But it shouldn't be stolen any more than if you own a furniture store and you create nice furniture; somebody shouldn't break in and steal your furniture.

Mr. Chairman, I am going to have to leave at this point. I apologize. Mr. Holleyman, of course, has been so extraordinarily valuable to this Committee over the years, to all of us here. I have read the testimony and I will leave some questions for the record. It is unfortunate. I know you have had a million things going on today and I have got a conflict, but I thank you for holding the hearing.

I can't tell you how much I want to close the door. I am a former prosecutor and I would like to just be able to go out and prosecute everybody who is doing this. You probably would, too, but I wish there was some way we could close the door. We are never going to get it completely closed, but we can do a lot better job than we are.

Thank you.

Chairman HATCH. I just want to thank Senator Leahy because he takes a tremendous interest in these things, and we get together on these matters. We get together on a lot of things, but we particularly get together here. I don't think there is even a division between us in almost any area that affects you. I just feel it is a great privilege to work with him, as well, because he takes a great interest in these issues.

Let me just say that you are raising issues here that should affect everybody in America. This Committee is going to do everything it can, but we need more help from the intellectual property community as to how we might domestically pass some laws that might be of aid to you. We have been trying to do that, but they haven't exactly worked as well as would like them to work. They are working in some ways, but not as well as we would like.

So we need your help. We need the best thinkers in all of the aspects of the intellectual property community and the high-tech community to assist us. As you know, there is a real divide between some in the high-tech world and some in the intellectual property world, or should I say the copyright world. So we have got to bridge those gaps and try to be fair to everybody.

Let me just also say that I am also first ranking on the Senate Finance Committee and will take over as Chairman if I am fortunate enough to be reelected. We handle the trade issues and I can guarantee you I am not going to be very open to China and Russia if they are not going to clamp down and do something about it. I might as well warn the administration right now that unless they are willing to start demanding that they abide by international norms, they are going to lose a very advocate for free trade in me. I don't think it is a question of free trade as much as it is a question of thievery.

Mr. HACKFORD. Well, there is a free trade issue, too, Mr. Chairman.

Chairman HATCH. Well, there is.

Mr. HACKFORD. When they put a cap on and when they say that only 20 films from outside China can be distributed, what is also happening is the studios are thinking about going to China to make films to get around that, which means that takes jobs out of America to do that.

Chairman HATCH. That is one of their ideas to get you to go there.

Mr. HACKFORD. Yes.

Chairman HATCH. But I am very concerned about this, and it isn't just the movie industry. It is the publishing industry, it is the music industry. We have seen tremendous dislocations there.

We will turn to Mr. Holleyman, who will put a wrap-up on this.

STATEMENT OF ROBERT HOLLEYMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BUSINESS SOFTWARE ALLIANCE, WASHINGTON, D.C.

Mr. HOLLEYMAN. Mr. Chairman, I want to thank you and Senator Leahy for inviting the Business Software Alliance to testify at today's hearing and for your very persistent attention to the problem of piracy over the years.

As I think this panel has shown, piracy is an issue that affects individual creators. It affects collaborators, it affects shareholders, it affects national economies, and it affects future creators as well. Last week, the BSA and the IDC, which is the leading information technology market research firm, released a report showing that in 2004 the value of pirated software worldwide actually increased, despite a modest one-percentage-point decline in piracy rates.

In 2004, the world spent more than $59 billion for commercial packaged software. Yet, software worth over $90 billion was actually installed. So for every two dollars' worth of software purchased legitimately, one dollar's worth was obtained illegally.

The BSA has also worked with IDC in looking at the impact of reducing piracy on jobs and tax revenues. We have shown globally that a 10-point reduction in piracy can yield 1.5 million new jobs, $64 billion in taxes, and $400 billion in economic growth. And in North America alone, a 10-point reduction in software piracy would yield 145,000 new jobs, $150 billion in additional economic growth, and more than $24 billion in tax revenues.

While there are many countries that I could talk about, today I would like to focus on two—Russia and China. Both of these markets should be tremendous opportunities for our industry. The potential as software markets, and indeed as software suppliers one day, is significant, but it is today largely unfulfilled.

Russian software piracy last year—87 percent of the total market was pirated software. It has been stuck in the high 80s for several years. Russia has adopted a number of legal reforms over the past several years, and while they give us some hope that there may be improvements in the marketplace, we have yet to see that realized.

Indeed, the piracy situation on the ground in Russia is mixed. Our companies, on the one hand, are seeing some progress in addressing their channel enforcement issues by working with Russian law enforcement authorities. Yet, very little is being done to address end user organizational piracy, which is the largest single problem that the software industry faces in Russia, and indeed in every country around the world.

Internet piracy is also a growing challenge in Russia and an area where we have had little success. Pirated software from Russia is being promoted and sold all over the world using spam e-mail and delivery by e-mail. Mr. Chairman, I have examples that I have printed out of some of the spams that are being originated in Russia that are being sent to unsuspecting consumers in the United States and around the world that then link you to slick websites that advertise software for a fraction of the normal retail price. These prices, however, are high enough to convince some consumers that the offer is legitimate.

There are a whole host of other problems I can outline, but we are hopeful that the WTO accession mechanism will be the way that we can finally begin to see some improvements in Russia.

Switching to China, last year the piracy rate was 90 percent in China, down two percentage points from the year before, but still far too high. Much more needs to be done. Consider this: China is now the second largest market for personal computers in the world, but it is only the 25th largest market for software. The gap between hardware and software sales is huge and it is growing.

I would like to recommend for specific improvements for China and its IP regime. First, they must extend criminal liability to enterprise end user piracy. It is absolutely critical that there be criminal penalties for organizational end user piracy.

Two, they have to reduce and clarify criminal thresholds. Three, they have to increase the administrative penalties for infringement. Fourth, they need to ensure that the government itself is using only legitimate software. The goal of all of this is to increase the legitimate market for software in China, and that will benefit all software suppliers, whether they are U.S. or Chinese origin.

Let me say, Mr. Chairman, before I conclude that we have looked at a lot of measures in the past of how China addresses enforcement—the number of actions they are bringing, the publicity for those actions. We think those are important, but experience has now shown that that is insufficient. We have to look creatively at new benchmarks that we can put on the table that will not only show the number of cases, but that will also show demonstrable market growth. We are working with USTR and the Commerce Department now in looking at some options to put on the table in the context of JCCT that will expand the type of benchmarks that can be used.

Let me conclude, Mr. Chairman, by saying that we make the point here and with our allies around the world that reducing piracy benefits all creators. It benefits the entire channel for the distribution of legitimate product. It benefits U.S. companies, but it benefits domestic producers.

In each of these countries, I go hand in hand with local developers to make this case, but it has been through the persistent efforts of this Committee and the U.S. Government that we have been armed with the tools that we need. We look to you for continued help and you have our pledge of support.

[The prepared statement of Mr. Holleyman appears as a submission for the record.]

Chairman HATCH. Well, thank you. A lot of people don't know in this country that we are way behind some of these other countries, including China, with regard to some of the aspects of the high-tech world. A lot of those Ph.D.s and a lot of those highly educated engineers were educated right here in America, which is good, but then they go home and they know how to suck the lifeblood out of our economy.

Mr. Hackford, just a rough estimate. How many people totally were involved, from writing, to production, to post-production, to marketing, to DVDs in the film "Ray?" Let's just use that one film.

Mr. HACKFORD. Well, during the production I would say there were 150 people that were directly—we shot the film in Louisiana, in New Orleans, and we had a crew there. But in the post-production process and in the marketing, you could probably add another 150. I mean, that is for one film.

Chairman HATCH. But that doesn't count all the people in the movie houses and everybody else. It is hundreds of thousands of people.

Mr. HACKFORD. No, no. Then, in fact, as the film goes out and plays around the country, it is an interesting question.

Chairman HATCH. You are talking about hundreds of thousands of job for one film.

Mr. HACKFORD. In the movie industry, without question, without question. But the reality is that there is what we call a multiplier effect that I love. When we go into a community, people think it is just the crew that goes there, but when you go in, you have all the small businesses that literally make their—as I said before, make their livelihood based on films.

One of the things that is interesting that is happening right now in this country is it is spreading out from Hollywood. I mean, I happened to make "Ray" in Louisiana. They put up incentive, and thanks to you and other people we were able to get a Federal bill passed to bring jobs back to the United States.

But you can see what happens when an economy is infused. Louisiana went from $12 million a year in film production to in the last two years $500 million. People want to work in this country, and what is important is that jobs are being created in different States. The film community is not just in Hollywood, but this is a profession and the problem that I have is we create, we have the best talent in the world—and I am not talking about talent in front of the camera, I am not talking about actors. We have the best people and we have created an industry here.

Of course, we did create it from the outset, but it is still there. I would like to see that continue to flourish because it helps this country lead in the area of intellectual property.

Chairman HATCH. Well, I will go back to engineering and I will go back to experts in your field. If we don't do something to encourage kids to get into math and science, we are not going to have the engineers and we are not going to have the people who can even keep a film industry going the way it needs to go. And we are going to be out-competed all over the world, and it is inexcusable when we are the number one nation in the world in all of these aspects.

The same thing in music. You know, I know a number of writers who are just excellent and barely get by. You know actors that really are very, very good, but barely get by. There are some who hit it very big and that is great. You are one of the directors who has become very successful and wealthy in the process, but the fact of the matter is not many are able to do that.

And to find investors to go into these areas is very, very difficult because there is hardly anything more dangerous for investment than getting into the entertainment world. Unless you really know what you are doing and you really have top people, you are going to lose your shirt. It is just that simple, as a general rule, whether it is in movies, whether it is in books, whether it is in CDs, music, you name it, and it is totally unfair.

For instance, you are happy because "Ray" made some money and it made money for your investor.

Mr. HACKFORD. It could have made a lot more, as you can tell.

Chairman HATCH. Yes, and you could have become even more wealthy. But, see, that is the short-sightedness on this. What it meant is that the investor and you, if you had had the extra money, would be much more likely to take more risks and give other people an opportunity to greater films, do greater music.

A lot of these films take music, a lot of these films take special actors, a lot of these films take all kinds of sets and a lot of these films take geographic locations. There is an awful lot that goes into it. People just think it conjures out of the air. It is like our young people—you know, I told the whole recording industry they ought to capture Napster that was getting 80 million hits a day and then educate our young people that what they are doing is thievery and use Napster to do it.

Well, gradually, we have come a long way that way, but I still see a tremendous dislocation, except maybe in country music, in the music industry, because our young people are not downloading as much in the country area as they are in others. So the country area has been pretty good.

I can't tell you the really outstanding music writers that I know who have to take other jobs because they just simply can't make it on the current royalty system and the current stealing of their copyrighted works under current conditions. So, naturally, I am very concerned about this and I am very concerned about our movie industry. There are successes, of course. Like you say, six out of ten aren't so successful.

Mr. HACKFORD. Right. As a songwriter, you know how the music industry has been savaged because there is less information and it is easier to go. But the fact is that technology marches ahead. Right now, at Cal Tech in California they have developed a technology that will allow individuals to download a high-quality digital copy of any film in three seconds.

Right now, the only thing that has held it back is that it takes a long time. But as this technology starts to become part of our system, it will just be rampant. Again, there has got to be a technological solution, in addition to an educational solution. These are all things we have to work on.

Chairman HATCH. I agree with that. There has got to be some way. And, of course, you have people in the high-tech world who don't believe in copyright, even though they couldn't exist without copyright, but they take a short-sighted viewpoint. That is why we are all watching Grokster right now. We can't wait until that Supreme Court decision comes down, and at least from my perspective hopefully they won't treat it the same as betamax because there is only one reason for Grokster's existence as far as I can see and that is to enable the pilfering of copyrighted materials, illegal downloading of copyrights materials.

And when that is so, I mean you might be able to find some peripheral use of that, but that is the primary reason for that. And our young people are being led down a primrose path, too. I hope the Supreme Court thinks about that, that if they don't come up with the right decision in Grokster, they are aiding our young people to think that everything on the Internet is free, even though it is not and even though our copyright laws teach otherwise.

I have heard young people who say, who cares? It is my computer and I can do whatever I want to do. Once you have that attitude on one thing, it permeates a lot of other things and it deteriorates society far below what our society should be.

So I personally appreciate all three of you being here today. You have laid out some pretty important problems and you have made

some suggestions, but there are no simple solutions. We are a long way from having the trade agreements work perfectly and we are a long way from having China and Russia, two of the biggest thievery countries who just won't get this under control—and they have the capacity to do it. I know that, because they don't have nearly the stringent laws that we do and if they wanted to take care of this, they could take care of it. We know about the 30-plus facilities in Russia and if they want to take care of it, they can.

As far as I am concerned, they don't belong in the WTO until they do. I would be very strong supporters of theirs if they would straighten this out. And I have got to say if people like Orrin Hatch don't support them, they are not going to make it. It isn't that I am so great. It is just that I am in a position where I can do some things that some people can't. I just want freedom and fairness and decency and honor in our country, as well as their countries, and I am just hoping that some of them will be watching these hearings to realize that we mean business on this. We are sick and tired of it.

We want them to have a great film industry and we want them to have a great music industry, a great publishing industry, a great television industry, a great software industry, whatever you want to call intellectual property, ad infinitum. And we are willing to compete with them, but we want to do it on a fair basis.

Well, this has been a really wonderful hearing as far as I am concerned. It is highly technical maybe for some, but anybody watching it has got to say we have got to do something about these problems. And you guys are at the forefront of trying to do something about it and I just want to commend you for it, but take our request here and let's come up with some ways that will help us to pass the right laws so that we can help you more, because there are some things that we can do. And then we have to get to our young people and get them to realize there are right ways of doing things and wrong ways of doing things, and that they should be doing the right ways, not the wrong ways.

Well, with that, thank you all for your time. I am sorry to keep you so long, but it is an interesting area for, I think, so many of us, but especially for Senator Leahy and me, and we are grateful that you would come and testify today. Thanks so much.

With that, we will leave the record open for one week for additional submissions, anybody who would like to make those submissions. And if anybody has a good argument on the other side, I am interested in that, too. So we will leave the record open and recess until further notice.

[Whereupon, at 4:19 p.m., the Subcommittee was adjourned.]

[Submissions for the record follow.]

SUBMISSIONS FOR THE RECORD

Statement of Senator Joseph R. Biden, Jr.
Subcommittee on Intellectual Property
Committee on the Judiciary
United States Senate
Hearing on "Piracy of Intellectual Property"
May 25, 2005

Good afternoon. I would like to commend you, Mr. Chairman, and you, Senator Leahy, for taking the initiative in forming this new subcommittee, devoted to the issue of intellectual property. This subject area has grown increasingly important in recent years as the role of intellectual property in our economy has grown, while at the same time the prevalence of piracy has reached unprecedented levels.

As you know, Mr. Chairman, this topic has been of particular interest to me for a long time because it combines my two primary Committee interests in the Senate – crime and foreign relations. While there is no disagreement that this is largely an international issue, there are those who do not view this as a crime problem. But that's what it is.

Every day, thieves steal millions of dollars of American intellectual property from its rightful owners. By one estimate, they stole $25-30 billion last year alone. They are stealing every bit as much as I would be stealing if I stole someone's car. American innovation and creativity need to be protected by our government no less than our personal property, our homes and our streets.

But intellectual property is not just property; it is a crucial national resource. Failing to protect it is equivalent to letting coal be stolen from our mines, or water taken from our rivers. The copyright industries alone contribute over $600 billion to our national income. That is 6% of the U.S. economy. And these industries generate jobs - almost 4% of U.S. employment.

There is so much work to be done, and we are hard at work. I commend Chairman Hatch and Senator Leahy for their efforts to legislate in this area. As you know, last year we finally enacted my Anticounterfeiting Act, which I had introduced in 2002 to plug the hole that permitted some counterfeiters to go unpunished in the United States. We need to continue updating our laws to fight these crimes.

In addition, anyone interested in intellectual property matters is watching the Supreme Court closely this spring, as it prepares to issue a decision in the important Grokster case. No matter the outcome of Grokster, it is likely that we in Congress will soon be legislating on the matters at issue in that case.

But, as I noted at the outset, this is not just a domestic issue; it is a bone of contention between the United States and some of our trading partners. Software piracy alone approaches the 90% level in both Russia and China. That is simply unacceptable. It's one reason I have joined together with Senator Smith, and Congressmen Goodlatte

and Schiff, to form the International Anti-Piracy Caucus. In the year and a half that we have been in existence, we have worked to raise the profile of intellectual property piracy, both in the eyes of our own government and in the priorities of other key countries. We released a "watch list" of five countries with notable piracy problems; we wrote to the Secretary of Commerce to draw his attention to the problem of piracy in China; we wrote to the governments of each of the watch list countries to encourage action against piracy; we met with counterparts from Brazil who are working to stem the tide of piracy in their country; and we have written President Bush to urge him to raise the issue of piracy in his conversations with President Putin of Russia.

Ideas belong to people just as much as physical belongings do. They are a growing part of our economy, and we must protect them. I look forward to hearing from our witnesses today about what we can do to further these goals.

Hearing Statement of Senator John Cornyn
"Piracy of Intellectual Property"
May 25, 2005

Mr. Chairman, I want to congratulate you on holding this hearing dealing with the untold harm caused by international piracy. I note that this is just one of a series you are holding focused on intellectual property – and I thank you for continuing to raise the level of attention to these important matters.

Just last week, I was pleased to join Senator Leahy to offer important legislation in our continued bipartisan effort to combat the trafficking of illegitimate goods throughout the world.

Recently, we have worked together on another matter near and dear to my heart – good government legislation related to the Freedom of Information Act, and I look forward to working with him on this legislation as well.

S.1095, the *Protecting American Goods and Services Act*, is not complicated, it is not long – but its global impact will be significant. The legislation is designed to provide law enforcement with additional tools to curb the flow of illegitimate goods.

First, the bill would make it specifically illegal to import or export unauthorized copies of copyrighted works or counterfeit goods. Second, it would make it illegal to possess counterfeit goods with the intention of selling them. Finally, the bill would more clearly specify that it is illegal to give away counterfeit goods in exchange for some future benefit – in effect, the "bartering" of counterfeit goods in such a way that avoids criminality.

Each of these items was highlighted by the Department of Justice in its October, 2004 report on its Task Force on Intellectual Property. In it, the Department describes the significant limitation law enforcement often times faces in pursuing counterfeiters and offers, among others, the principles embraced in the *Protecting American Goods and Services Act*, as possible solutions to these obstacles.

Amazingly, it is estimated that between 5% and 7% of worldwide trade is conducted with counterfeit goods and services. According to FBI estimates, counterfeiting costs U.S. businesses as much as $200 - $250 billion annually – and that costs Americans their jobs – more than 750,000 jobs according to U.S. Customs.

In recent years, this plague on global trade has grown significantly. According to the World Customs Organization and Interpol, the global trade in illegitimate goods has increased from $5.5 billion in 1992 to more than $600 billion per year today. That is - $600 billion per year illegally extracted from the global economy…

But perhaps most troubling, the counterfeit trade threatens our safety and our security. Counterfeit goods undermine our confidence in the reliability of our goods and service.

For example, the Federal Aviation Administration estimates that 2% of the 26 million airline parts installed each year are counterfeit. And the Federal Drug Administration estimates that as much as 10% of pharmaceuticals are counterfeit. Worse yet – evidence indicates that the counterfeit trade supports terrorist activities. Indeed, Al Qaeda training manuals recommended the sale of fake goods to raise revenue.

The Cornyn-Leahy legislation, and other reforms, will help turn the tide of the growing counterfeit trade. The legislation is critically important to law enforcement – but it is even more critical for businesses, large and small, throughout America – including in my home state of Texas – as well as for ensuring the safety of consumers around the globe. Those who traffic in counterfeit goods put Americans in danger, support terrorism and undermine the health of our nation's economy. It is time to put an end to this scourge on society.

Hearings such as this help to bring these attentions to light, and I look forward to working with you, Chairman Specter, the Ranking member and all my colleagues to move this legislation forward, and in so doing, protect property rights, protect consumer safety, preserve American jobs and bolster the American economy.

STATEMENT OF

Taylor Hackford
On Behalf of the Directors Guild of America

Before the

Committee on the Judiciary
Subcommittee on Intellectual Property

Hearing on Piracy of Intellectual Property

May 25, 2005
Washington, DC

Senator Hatch, Senator Leahy and members of the subcommittee:

My name is Taylor Hackford and I thank you for inviting me to appear before you today to discuss the issue of international film piracy and its impact on the entertainment industry.

I am here today on behalf of the Directors Guild of America (DGA), of which I am a National Board member, member of the Western Directors Council, and the Co-Chair of the *Leadership Council.*

Founded in 1936 by the most prominent directors of the period, the Directors Guild today represents almost 13,000 directors and members of the directorial team who work in feature film, television, commercials, documentaries and news. The DGA's goal is to ensure that our craft continues unimpaired for the benefit of film and television viewers worldwide, and that our members continue to be able to earn their living giving their talent to a craft they love. The Guild does this by protecting the economic and creative rights of directors and the directorial team.

That is the very reason I am here today. The DGA places the highest priority on the prevention of wide-spread pirating of movies, television programs and other creative works. Indeed the entire film production industry – from directors, writers, actors to the studios, independent production companies, and the tens of thousands of skilled below-the-line workers– has a tremendous stake in the growing problem of film piracy.

I know that when people think of the entertainment industry, the popular image of the glitz and glamour of Hollywood comes immediately to mind, along with the wealth and lifestyle portrayed in popular magazines

But in fact that is not the reality of our industry at all. The overwhelming majority of jobs in the film industry are held by

individuals who work behind the camera- the names that scroll by at the conclusion of a film – including such jobs as first assistant directors, unit production managers, set designers, carpenters, sound technicians, set painters, drivers, foley artists, lighting technicians, make-up artists, seamstresses, to name just a very few. We are talking about hundreds of jobs on a major motion picture.

And those are just the employees of the film production company. The making of a movie also generates substantial income for the scores of small businesses that provide supporting services and equipment that support all stages of production

An incorrect assumption has developed in the piracy debate. There seems to be an underlying belief that once a film or a television program is completed, its value to those who create it is gone. You hear this implication in the arguments of those who do not see piracy as theft but as "open access". **Nothing could be further from the truth.** The creators are very real stakeholders in the outcome of efforts to stop the frightening theft of copyrighted works.

In the entertainment industry our compensation and pension and health benefits depend greatly on residuals. Our industry's residual system—which in the DGA's case has existed for 40 years—is designed to provide appropriate compensation to those of us whose contributions are so fundamental that without us films cannot be produced.

Residuals are the fees paid for the reuse of our motion picture or television productions on free and pay television, and DVD and videocassette, in both the domestic and international markets. When films earn revenues in these markets, the income is shared among the people who work on the films.

Each year, DGA collects millions of dollars in residual payments on behalf of its members. This represents bread and butter income to us because we work in an industry based on the concept of freelance employment. We can't count on a regular paycheck. What we can count on is ongoing income in the form of residual payments that support our families and our pension plan.

This is an important point. When pirates steal movies, they are not simply robbing movie studios of revenue; they are also taking money directly from our pockets and the pension and health plans that support us and our families.

Moreover, the effect is not just to take income from us on the movies that are made, but also to take income from us on the movies that –thanks to piracy—may never be made.

Films are not created by the snap of a finger; nor do they materialize out of thin air. For directors, writers, actors and the many craftspeople we work with, it involves years of creative effort and hard work to put a vision on the screen. For the studios and investors, it involves tens, if not hundreds, of millions of dollars to make that vision a reality.

Getting a film financed is not easy—a reality faced by every one of us who is in this business. Consider that only one in ten films ever retrieves its investment from theatrical exhibition. And four in ten films never recoup the original investment at all.

Making films requires large capital investments—and these are highly risky investments since the return can not be known at the outset. In the worldwide marketplace in which we all now live, the sale of our works in foreign markets is an essential part of being able to finance a picture. Even more essential is the ability to recoup income from sales in ancillary markets – that is home

video, free and pay television, and foreign distribution. Quite simply without the revenue from those ancillary sales, pictures would not get made today.

Faced with these realities, the willingness and capacity of producers to invest in movies is significantly undermined when our films are pirated, either in mass production optical disc plants in other nations, or over the Internet. Rampant theft in foreign markets—theft of the very ancillary sales that are basic to the economic health of our industry is already taking its toll. When a greater share of potential income is siphoned off – stolen as a result of piracy -- risk rises, financing becomes more difficult, films are not made… and jobs are lost.

My most recent film, I have discovered, seems to be a good case in point. Last year, a film I spent 15 years of my life working on was released in the theaters. I not only directed the film, but was also a producer. Needless to say, it was a "labor of love" that I put a huge amount of my life into over a number of years. I was fortunate to have the support of Ray Charles when I made this film about his life, entitled "*Ray*". One reason it took so long to make "*Ray*" was the difficulty I had lining up financing. It is an enormous risk for any individual or company to put up tens of millions of dollars for a movie production without any clear prospects for profits.

I was fortunate with the movie "*Ray*". We had critical acclaim and did well at the theatrical box office, and importantly even better with home video sales. My co-producer and the movie's distributor will make money on the picture. <u>But that was not certain when the decision to invest was made.</u>

So you can imagine what it meant to all of us involved in "*Ray*" -- from myself, to my partners, to the financer, to the studio who distributed the film -- to discover that the piracy trail of our film was in place even before it opened in theaters. During "*Ray*'s" first week

of release, I was walking along Canal Street in New York and there, right before my eyes, the DVD of "Ray" was already on sale! Film pirates had taken the time to prepare the fake DVD cover, including all the credits, photographs and logos you would see on a legitimate cover. You would have thought this was the studio-released DVD -- but that DVD was not available until February 1st, more than three months later.

I have since discovered that "*Ray*" was camcorded from day one at the Loews Raceway 10 in Westbury, New York, and at the Loews Jersey Garden Theater in Elizabeth, New Jersey. It was immediately put on the web to be downloaded at a mass production optical disc plant in Russia, or in China. So within days of the films release, copies of these stolen "camcord editions" were found not only on Canal Street, but all over New York, California, Florida, Georgia, Texas – and worldwide – in Europe, Russia, China and many other countries. Just last week on May 19th, through peer-to-peer networks, more than 476,000 requests were made to download "*Ray*". There have been 42 million such requests since my film was first pirated in October 2004. The Internet piracy of "*Ray*" has been identified in 68 countries since that time. And that's just what we have data on.

The reality we face is that a film that I, and others, worked so hard on for many years is being stolen every day around the world. That is income directly taken away from me, my financier, the studio, and scores of skilled workers on the film, and the economy of this country. Believe me, film piracy—I prefer to call it thievery—is not an abstraction to filmmakers.

The biggest problem with mass produced DVD piracy is occurring in Russian and China. If the problems in these two countries are not resolved then the problem of worldwide piracy will never be solved. If we do nothing about the rampant piracy in China and Russia is it

not safe to assume we will soon see the same piracy in other countries?

In the last few years we have seen the real face of piracy in Russia. There has been a tremendous growth in the number of optical disc plants in Russia, rising from two known plants in 1996 to 34 plants today. Most of these plants are producing pirated discs, with a capacity that far exceeds the needs of the Russian domestic market. Over 80 percent of all DVDs marketed in Russia are estimated to be pirated.

The excess capacity is of course being shipped out of the country, making Russia one of the largest exporters of illegal discs, which show up in 27 international markets. For the film industry, the problem has been particularly acute in Europe, where demand is high and legitimate product simply can't compete.

The motion picture industry estimates over $275 million was lost last year due to Russian piracy of U.S. film and television, and the problem is growing worse. This problem is exacerbated and even encouraged by a weak legal and regulatory system and the almost complete failure of the Russian government to enforce the law.

Fortunately, the U.S. government is in a position today to leverage changes in the Russian system. We are now in bilateral trade negotiations with Russia on its accession to the World Trade Organization.

We join with others in the copyright industry in asking the members of the Judiciary Committee to strongly urge the Bush Administration to use these negotiations to secure fundamental changes in Russia's system for protecting intellectual property rights. And regardless of what changes are made in the law, Russia should not gain entry to the WTO until it enforces the law and punishes the film pirates.

While the piracy problem in Russia has mushroomed in recent years, the problem in China—with its huge marketplace and market restrictions---simply remains out of control. Today approximately 95 percent of all films sold in China are pirated, with estimated annual losses to the industry amounting to about $300- million. Pirated DVDs of the latest U.S. movies releases are available in China immediately with their theatrical release.

As with Russia, the problem largely stems from optical disc plants producing pirated products, but with far greater capacity to ship illegal goods around the world, even including to the United States.

In China, the piracy problem is made worse because the government maintains a strict quota on foreign films, limiting such films to 20 per year. The limitation on legitimate films creates greater opportunities for pirates to fill domestic demand with illegal films.

At the same time, the U.S. is an open market for Chinese films and some such as "Crouching Tiger Hidden Dragon" have done quite well. That movie alone grossed over $125 million in the United States. Meanwhile, the total gross for all U.S. films in China amounted to about $60 million, with the Chinese government claiming 87% of that money.

Think about this situation. The United States is the largest market for Chinese goods, and China is our second largest source of imports. Our trade deficit with China last year was more than $175 billion. At the same time, the U.S. film industry is one of the nation's most successful export industries accounting for a positive trade balance of $50 billion in 2004.

Yet the nation which sells us the most goods, and with whom we have the largest trade imbalance, virtually shuts out our most successful export industry from their market. And, at the same time,

China is the largest source of pirated products of our most successful export industries, eroding our revenues around the world.

This situation should not be allowed to continue. China should live up to its commitments made to the U.S. in the Joint Commission on Commerce and Trade in April 2004.

The U.S. should vigorously insist that China follow through with its commitments, and should pursue consultations at the World Trade Organization to discuss China's failures to deal with piracy of intellectual property. If those consultations do not produce results, we should consider launching a dispute settlement action.

In closing, I want to thank Senator Hatch, and Senator Leahy, for convening this hearing on piracy, and for the leadership on this issue that you both have shown over the years. We appreciate the work you began in the last Congress with the introduction of the "Inducing Infringement of Copyright Act". We also thank you for the enactment of the Artists Rights and Theft Prevention Act of 2005. The Directors Guild looks forward to working with you on this issue in the future.

NEWS RELEASE

ORRIN HATCH

United States Senator for Utah

FOR IMMEDIATE RELEASE
May 25, 2005

CONTACT: Adam Elggren (202) 224-3370

Statement of Senator Orrin G. Hatch
before the
U.S. Senate Judiciary Committee
Subcommittee on Intellectual Property

"Piracy of Intellectual Propery"

Welcome to today's hearing before the Intellectual Property Subcommittee. Today we will be examining a variety of problems and challenges involving international piracy of U.S-owned intellectual property. This hearing will focus largely on copyright piracy, but I hope the subcommittee will be mindful of the serious issues in the trademark counterfeiting and patent infringement realms as well.

Piracy and counterfeiting inflict significant and widespread harms on the American economy. Theft of intellectual property abroad disadvantages this country's entrepreneurs, innovators, and creative community. Ultimately, it also harms consumers, shareholders, and American workers and their families.

The timing of this hearing was intended to coincide roughly with a number of recent developments and events relevant to our consideration of piracy issues. On April 29, 2005, the Office of the United States Trade Representative issued its decision resulting from the out-of-cycle review of China's enforcement practices and completed the "Special 301" process. Much of the focus in that process and in USTR's conclusions remains on the inadequate enforcement of intellectual property rights in Russia and China.

Russia remains on the Priority Watch List this year due to continuing problems with its legal regime, which is described as having weak intellectual property enforcement and a lack of data protection. It appears that Russia's current intellectual property regime is inconsistent with its bilateral trade obligations and likely does not conform to obligations which Russia needs to fulfill in order to join the WTO.

Other recent events that have prompted some additional interest and scrutiny on both sides of the Hill include a number of studies and reports on piracy and counterfeiting, which indicate that we are not making much headway in many areas and that suggest some disturbing

If Russia, China, or any other government attempts to adopt this view with respect to their responsibilities to protect intellectual property under international trade law and agreements, I can assure you that public support for U.S. trade agreements will be undermined and there will be strong resistance from – and appropriate action taken by – members of Congress. To put a fine point on it, before the Congress votes in favor of Russia joining the WTO, many of us will have to be convinced that the Russian government is serious about cracking down on theft of U.S. intellectual property.

As the ranking republican on the Finance Committee and the Chairman of this subcommittee, I have a particular interest in the intellectual property problems that will be outlined today, and I intend to work with members from both sides of the aisle and in both committees to ensure that these issues receive the attention – and resolution – they merit. I know that Senator Leahy, and many others, such as Senators Cornyn and Feinstein are concerned about these problems.

I look forward to hearing from the witnesses and thank them for testifying today.

# # #

Testimony of Robert Holleyman
President and CEO
Business Software Alliance

Before the
Senate Intellectual Property Subcommittee

May 25, 2005

Good afternoon. My name is Robert Holleyman. I am the President and CEO of the Business Software Alliance.[1] The Business Software Alliance is an association of the world's leading software companies and their key hardware partners. BSA's members create approximately 90% of the office productivity software in use in the U.S. and around the world.

I thank the subcommittee for the opportunity to testify here today. The theft of intellectual property, commonly known as "piracy", is a matter of great concern to the business software industry. Piracy costs the industry billions of dollars in lost revenues each year. It reduces investment in creativity and innovation. And it harms national economies including our own.

In my testimony, I intend to give a brief overview of the contributions that the business software industry has made and continues to make to the global economy and to describe how piracy has undermined those contributions. I will next describe the evolving challenges the software industry faces with respect to piracy and explain the steps industry is taking to address these challenges. I will outline the challenges we face in two particularly difficult markets: China and Russia. Finally, I will summarize the lessons that we have learned regarding how best to end piracy both here at home and abroad.

First, though, let me begin by thanking the members of the subcommittee for hosting this hearing. BSA and each of its member companies commend you for recognizing the software industry's important contributions to the global economy and the serious threat posed to the industry by software piracy.

Software Industry Contributions and the Impact of Piracy

[1] The Business Software Alliance (www.bsa.org) is the foremost organization dedicated to promoting a safe and legal digital world. BSA is the voice of the world's commercial software industry and its hardware partners before governments and in the international marketplace. Its members represent one of the fastest growing industries in the world. BSA programs foster technology innovation through education and policy initiatives that promote copyright protection, cyber security, trade and e-commerce. BSA members include Adobe, Apple, Autodesk, Avid, Bentley Systems, Borland, Cadence Design Systems, Cisco Systems, CNC Software/Mastercam, Dell, Entrust, HP, IBM, Intel, Internet Security Systems, Macromedia, McAfee, Microsoft, PTC, RSA Security, SAP, SolidWorks, Sybase, Symantec, The MathWorks, UGS and VERITAS Software.

Information technology has changed the world in which we live. It has made us more efficient, more productive and more creative. Software has been at the heart of this technology revolution. Software facilitates the dissemination of knowledge, drives global communication and promotes continued innovation. It helps us to solve problems and generate new ideas, gives us the power to create and to collaborate and fosters self-expression in a range of spheres.

The information technology sector, driven by the software industry, has also proven to be a remarkable engine for global economic growth. According to a 2003 survey on the economic impact of piracy by IDC, a major IT research firm, the IT sector employs more than nine million people worldwide in high-wage, skilled jobs, raises more than $700 billion in taxes annually and contributes nearly a trillion dollars each year to global economic prosperity. Between 1996 and 2002, the IT sector grew 26%, creating 2.6 million new jobs and adding a cumulative $6 trillion to economies around the world. Each year, the packaged software sector alone contributes in excess of $180 billion to the global economy.

While these numbers testify to the economic force of the software industry, this sector has yet to reach its full economic potential. This is due, in large part, to piracy. In 2004 we measured the global piracy rate at 35%. In many countries the piracy rate exceeded 75%, reaching highs of 90% or more in some markets. Although piracy levels in the U.S. historically have been low as compared to other countries, the figure is far from negligible. In 2004 the U.S. piracy rate was 21%. More than one in every five copies of business software in use in this country today is stolen. There are few industries that could endure theft of its products at this level.

Piracy inflicts significant financial harm on U.S. software companies. Piracy in the U.S. alone cost the software industry almost $6.6 billion in 2004. Worldwide, piracy led to estimated losses of over $32 billion. Publishers invest hundreds of millions of dollars every year and immeasurable amounts of creativity in designing, writing and bringing new products to market. They depend upon the revenue they receive from those products to obtain a return on their investment and to fund the development of new products. Piracy undermines this model.

Of course, the impact of piracy extends beyond lost sales. Pirates steal jobs and tax revenues as well as intellectual property. The IDC economic impact survey cited above found, as a general rule, that there is an inverse relationship between software piracy rates and the size of the IT sector as a share of the gross domestic product. As piracy is reduced, the software sector grows. This creates a ripple effect that stimulates other parts of the IT sector and of the economy overall. The equation is a basic one: the lower the piracy rate, the larger the IT sector and the greater the benefits. Putting this into real numbers, the IDC survey concludes that a 10 point reduction in the global piracy rate over four years could deliver 1.5 million new jobs, $64 billion in taxes and $400 billion in new economic growth. In North America alone, benefits would include 145,000 new jobs, $150 billion in additional economic growth and more than $24 billion in tax revenues.

Reducing piracy delivers indirect benefits as well. Society benefits from new technological innovations. Consumers benefit from more choices and greater competition. Internet users benefit from new ways of communication and expanded creative content made available online. And national economies benefit from enhanced productivity leading to higher standards of living.

Piracy: Defining the Problem

In its simplest terms, "software piracy" generally refers to the reproduction or distribution of copyrighted software programs without the consent of the copyright holder. In most countries around the world, the law makes clear that when a person copies or distributes software, they must have authorization from the copyright holder through a license agreement or otherwise, unless the copyright law provides a specific exception for such activity. Otherwise, such activities constitute piracy.

Piracy of software can take several forms:

- **Organizational end-user piracy**

The business software industry's worst piracy problem traditionally has involved its primary users – large and small corporate, government and other enterprises – that pirate our members' products by making additional copies of software for their own internal usage without authorization. We commonly refer to this activity as "organizational end-user piracy".

- **Counterfeiting**

Counterfeit software, often packaged to appear nearly identical to the genuine article, continues to pose a serious problem for BSA's members. Over the past several years, BSA has seen a dramatic increase in the amount of high quality counterfeit software imported into the U.S. from overseas, especially from Asia. Compilation CD-ROMs containing a large selection of software published by different companies also pose a problem. Although compilation CDs do not exactly replicate the packaging of genuine software, unsophisticated consumers are often led to believe that they are legitimate promotional products.

- **Internet piracy**

The Internet is the future of global communication and commerce. It creates tremendous opportunities for faster, more efficient and more cost-effective distribution of information, products and services across the globe. Unfortunately, the emergence of the Internet also has added a new dimension to software piracy by permitting electronic sales and transmission of illegal software on a global scale. Today, computer users can and do download infringing copies of BSA members' products from hundreds of thousands of locations on the Internet all over the world.

- **Industry Efforts against Piracy**

The Business Software Alliance and its individual members devote significant financial and human resources to preventing piracy worldwide. Our efforts are multi-faceted.

First, we are engaged in extensive educational efforts, designed to increase public understanding of the value of intellectual property and to improve overall awareness of copyright laws, on a global basis. Among other resources, we provide school curricula to promote responsible internet behavior among students, and guides and technologies that assist end-users in ensuring that their installed software is adequately licensed. We likewise offer tips to consumers so that they can be confident that the software they acquire on-line is legitimate.

Second, we work closely with national and international bodies to encourage adoption of laws that strengthen copyright protection and promote an environment in which the software industry can continue to innovate.

Finally, where appropriate, BSA undertakes enforcement actions against those involved in the unlawful use, distribution or sale of its members' software. On the Internet, for example, BSA conducts a far-reaching "notice and takedown" program. BSA's members have also filed suit against individuals offering pirated software for free download and over auction sites. BSA also engages in civil litigation against corporate end-users who are using our members' products without authorization.

Of course, technology plays a role in protecting intellectual property rights as well. Content owners must take responsibility to ensure that their works are not easily subject to theft, rather than rely wholly on others to protect their intellectual property. Accordingly, BSA's members have invested hundreds of millions of dollars and thousands of engineering hours in developing technologies to protect content and intellectual property. Our companies have worked diligently, voluntarily and cooperatively with content providers and consumer electronics companies to create systems that will foster the legitimate distribution of digital content. Experience clearly demonstrates, however, that there is no silver bullet technological solution that will solve the problem of piracy. Nor are government mandates the answer. Technology develops most effectively in response to market forces; government mandates would stifle innovation and retard progress.

Piracy Abroad

Last year, the worldwide rate of personal computer (PC) software piracy decreased by one percentage point to 35 percent. This occurred despite an influx of new PC users from high piracy market sectors — consumer and small business — and the increasing availability of unlicensed software on Internet peer-to-peer (P2P) file-sharing sites. That's the good news.

Unfortunately, the total value of pirated software worldwide actually increased, despite the modest decline in the piracy rate. This was a result of the fact that the global PC software industry grew over six percent and the U.S. dollar fell by more than six percent against the world's other currencies. In 2004, the world spent more than $59 billion for commercial packaged PC software. Yet, software worth over $90 billion was actually installed. For every two dollars' worth of software purchased legitimately, one dollar's worth was obtained illegally.

The software industry suffers piracy losses in countries all over the globe. Two of these stand out for having very high piracy rates, combined with high PC penetration and large potential markets: China and Russia. These countries should both be tremendous opportunities for our industry. Their potential as software markets – and, indeed as software suppliers, will remain largely unfulfilled until they bring the piracy situation under control.

- **China**

Despite repeated commitments, legal reforms, episodic crackdowns against retail piracy and the personal intervention of Vice Premier Wu, China's market is awash with pirate and counterfeit copies of practically anything that is worth pirating or counterfeiting. Nine out of every ten copies of software installed on PCs in China last year were

pirated, representing a loss to the U.S. software industry of about $3.6 billion. This, of course, is not a complete picture of the harm caused by piracy in China, since China is also the world's leading producer and exporter of counterfeit software. Piracy on such a massive scale has significant ramifications for the U.S. software industry and our national economy.

Rampant piracy has effectively stalled growth in U.S. software exports to China, despite China's escalating use of computer and software technologies. Consider that in 1996 China was the sixth largest market for personal computers and the 26th largest for software; it is now the second largest market for personal computers but still only the 25th largest market for software. This growing gap between hardware and software sales is the inevitable consequence of a market that does not respect intellectual property rights or reward the significant investment required to develop and market innovative software products.

China's failure to protect and enforce intellectual property rights has also hindered its ability to grow a domestic software industry (a problem that China is attempting to cure through protectionist and discriminatory industrial policies). According to 2003 report by the market research firm IDC, a ten percent reduction in piracy could help the Chinese IT sector grow nearly fourfold in four years.

Two key reasons for China's failure to make significant inroads into software piracy are deficient IPR laws and an enforcement regime that is not deterrent.

The WTO TRIPs agreement requires China to criminalize copyright piracy on a commercial scale, including enterprise end use piracy of computer software. Unfortunately, end user piracy is not regarded as a crime in China, so there has never been a criminal prosecution of this activity.

TRIPs also requires enforcement of intellectual property rights to be deterrent in practice. Through a combination of inadequate dedication of resources and lack of significant penalties for piracy, China's enforcement regime simply does not deter piracy.

As the U.S. government works implements its strategy for addressing the piracy problem in China, BSA urges the government to demand the following four improvements to China's IPR regime:

Extend criminal liability to enterprise end user piracy. The relevant provisions of China's criminal code - Articles 217 and 218 - do not treat corporate end user piracy as a criminal offense, despite its devastating effect on software industry revenues and growth. China's failure to extend criminal remedies to enterprise end user piracy violates its WTO-TRIPS obligations and should be rectified immediately.

Reduce and clarify criminal thresholds. In late December, the Supreme People's Court and Supreme People's Procuratorate released amended Interpretations of Articles 217 and 218 of the criminal code which lower the thresholds for establishing a criminal copyright violation. Unfortunately the thresholds are still too high, particularly because the phrase "illegal income" is unclear and in certain cases (*e.g.*, enterprise end user piracy) may be difficult to prove.

Increase administrative resources and penalties. Administrative enforcement actions against software piracy can be brought by the National Copyright

Administration of China (NCAC) and local Copyright Administrations (CAs). In our experience, however, neither the NCAC nor the local CAs has the resources or interest to exercise this authority. When administrative actions are taken, fines are rarely issued and the outcome is rarely publicized. The end result is that administrative actions provide virtually no deterrent value.

Legalize the government sector and state-owned enterprises (SOEs). BSA and its member companies are heartened by China's commitments to legalize software use within the public sector, which represents China's largest consumer of software. These policies should also extend to SOEs. The assurances on government legalization will be of limited value, however, if China proceeds with its proposal to impose severe restrictions on procurement of software from non-Chinese suppliers.

All of these steps are necessary to address unacceptable software piracy rates in China that cost the U.S. software industry billions of dollars in lost exports and stifle the development of a domestic software industry. No single step is sufficient on its own. The goal, of course, is to increase the legitimate market for software in China, to the benefit of all suppliers, Chinese and foreign. Ultimately, China's success or failure on this issue must be measured against that goal, not against the completion of any particular step along the way. To this end, we are working to develop new benchmarks to measure progress on this issue.

- **Russia**

At 87%, Russia's software piracy rate is only a three points lower than that in China, and has not improved over the past several years. Russia has adopted a number of legal reforms over the past several years and it is our hope that, once they come fully into force, they will lead to improvements in the marketplace.

In 2003, the Russian criminal code was amended to clarify the previously ambiguous standard for triggering a criminal infringement case. In 2004 Russia adopted copyright law amendments that, in addition to extending protection to certain pre-existing works and sound recordings, implement a number of provisions of the WIPO Internet Treaties. This amendment included the creation of an exclusive right of making available, which will be critical to enforcement against Internet piracy once it goes into effect in September 2006.

The piracy situation on the ground in Russia is mixed. Our companies that engage in channel enforcement have reported that they are receiving cooperation from Russian law enforcement authorities, and are achieving some successes. There is little enforcement against end-user piracy in Russia, but we are working in Russia to change that.

Internet piracy is one piracy challenge in Russia where industry efforts have met with little success in the past few years. The business software industry faces a persistent problem of pirated software promoted and sold all over the world using unsolicited e-mail advertisements (spam) and via mail-order. The spam emails link consumers to slick websites that advertise "OEM versions" software for a fraction of the normal retail price. The prices, however, are high enough to convince some consumers that the offer is legitimate.

These spam e-mails originate from an organization operating under various names: CD Cheap, OEM CD Shop, OEM Software, and other aliases. The spam and scam operation

is apparently run by a well-connected, sophisticated Russian criminal network operating in Moscow and in the Sverdlovsk region. In January and February 2004 two police raids and related arrests were carried out in Yekaterinburg, near Sverdlovsk, but the key figures were not touched and there was no noticeable impact on this criminal enterprise. The FBI has opened a case file on this operation and is attempting to work with Russian law enforcement.

BSA urges the U.S. government to use the leverage provided by Russia's WTO accession negotiations to obtain binding commitments in the Working Party report to resolve the range of outstanding IPR problems. The Russian government should begin addressing these issues immediately, in order remove this continuing irritant from Russo-American trade relations.

The Role of Government

Multilateral and bilateral trade alliances must be fully backed by governments' firm commitment to respect and enforce intellectual property rights within the public and private sectors; to treat the manufacture and sale of counterfeit software as a crime warranting tough enforcement and penalties; and to ensure that its laws and enforcement regimes adequately address all forms of piracy. The Administration and Congress can help promote this commitment to intellectual property protection by:

- ensuring that governments worldwide fulfill their obligations under the WTO TRIPs Agreement by adopting and implementing laws that provide for effective enforcement against piracy;
- encouraging implementation of the WIPO Copyright Treaty and strong criminal enforcement of the measures therein; and
- urging countries to dedicate resources to the investigation and prosecution of piracy in all its forms, as well as to training, technical assistance and mutual cooperation.

- **Strong, workable enforcement regimes, as required by TRIPs**

While substantive copyright protections are essential to bring piracy rates down, experience has demonstrated that these protections are meaningless without adequate mechanisms to enforce them. The 1994 World Trade Organization Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) provides the framework for such mechanisms.

TRIPs requires that intellectual property rights enforcement regimes meet specific "results-oriented" performance standards. Specifically, each member's enforcement regime must "permit effective action against infringement" and "constitute a deterrent to further infringements." Moreover, enforcement procedures cannot be "unnecessarily complicated or costly," or "entail unreasonable time limits or unwarranted delays." Thus, in assessing TRIPs compliance, it is critical to review and monitor all aspects of a country's enforcement regime, including the adequacy of procedural remedies and penalties, as well as their effectiveness in deterring piracy.

- **Full and faithful implementation of the WIPO Copyright Treaty**

In direct response to the growing threat of Internet piracy, the international community in 1996 adopted the WIPO Copyright Treaty to ensure protection of copyrighted works in the digital age. Among other measures, the WIPO Treaty (i) makes clear that a copyrighted work can be placed on an interactive network only with the consent of the relevant right holder; (ii) makes clear that the Berne Convention's reproduction right applies to electronic uses of works; (iii) protects all forms of expression of computer programs; and (iv) prohibits "hacking" of technical protections that have been applied to works. These measures ensure that authors' rights will be respected in cyberspace, and are urgently needed on a global basis. While many countries have taken steps toward improving and enforcing laws in this regard, much more remains to be done.

- **Dedicated resources to fight piracy**

Ending the theft of intellectual property is a low priority in many countries. Piracy investigations are often delegated to law enforcement units with little or no training in intellectual property crime and given local rather than national attention, in competition with many other types of crime for attention and resources. Although copyright crimes often involve cross-border activities, there is frequently a lack of coordination among various countries' law enforcement agencies when investigating and prosecuting pirates. Even where procedures for cross-border coordination do exist, such procedures can be cumbersome and ineffective.

To ensure effective action against piracy, national authorities should establish specialized intellectual property enforcement units at a national rather than local level, who can react quickly and knowledgeably to incidents of IP crime. Better training of law enforcement and the judiciary is equally important, to ensure these bodies are equipped to deal with these cases. Likewise, better cross-border cooperation among police and other government officials, and improved availability of evidence and judgments for cross-border use, are also essential.

Conclusion

Software contributes profoundly to the world in which we live. It allows us to share, to create and to innovate in ways previously unimaginable. Software-driven productivity strengthens national economies, including our own, and makes them more competitive and more prosperous. Unfortunately, piracy prevents the software industry from realizing its full potential. We urge the U.S. Government and other governments worldwide to help us solve this problem. We thank you for the efforts made to date.

Thank you again for the opportunity to testify here today. I look forward to your questions and to continued dialogue on this important topic in future.

Statement of Senator Patrick Leahy
Intellectual Property Subcommittee of the Committee on the Judiciary
Hearing on "Piracy of Intellectual Property"
May 25, 2005

More and more Americans today "think globally" as they enjoy the fruits of others' creativity and innovation. Unfortunately, those who profit by stealing intellectual property are doing exactly the same thing. The technological advances of the Digital Age have eliminated many of the barriers between buyers and sellers. Digital content, today, be it software or music or video, can be distributed almost instantly via the Internet, and optical discs can be reproduced almost perfectly in massive numbers. Thus, piracy has blossomed into a global problem as well, and because the United States is the world leader in intellectual property, we are – or at least we ought to be – acutely aware of its impact on U.S. industries and our citizens' own creativity and innovation.

Intellectual property is vital to the health and strength of the U.S. economy, and the estimated financial losses in a number of industries due to piracy are significant. According to the International Intellectual Property Alliance, in 2002 the various copyright industries accounted for 12 percent of the U.S. Gross Domestic Product (about $1.25 trillion) and employed nearly 11.5 million workers. As profitable as these industries are, the U.S. loses hundreds of billions of dollars to piracy every year. The Business Software Alliance estimates its losses at $30 billion in software sales annually, and the MPAA estimates that it loses $3 billion a year to piracy. The International Intellectual Property Alliance reports that the U.S. lost more than $13 billion in trade due to copyright piracy in 2003. And the FBI estimates that we lose $200-$250 billion annually to counterfeiting alone. These numbers reflect a crisis that demands immediate and meaningful solutions.

Much of our focus today will be on China and Russia, and for good reason. In 2000, when China entered the World Trade Organization, I expressed concerns about China's record on human rights and labor rights. When ultimately I voted in favor of establishing Permanent Normal Trade Relations, I noted that isolationist policies do not work. For several years now, we have been engaging China in attempts to improve its record on piracy. Instead of progress, however, the United States Trade Representative's 2005 Special 301 Report placed China on its Priority Watch List. The report notes that while China has expended significant efforts, we have not seen the meaningful reduction in infringement that China promised to attain: "China's inadequate IPR enforcement is resulting in infringement levels at 90 percent or above for virtually every form of intellectual property…" This has resulted in estimated losses of $2.5 billion to $3.8 billion annually in pirated copyrighted works.

Russia, too, is on USTR's Priority Watch List. The Special 301 report notes that while Russia has passed numerous laws designed to improve intellectual property protection, enhanced enforcement has not followed. The piracy rate for the recording industry is 66 percent; for the movie industry that rate is 80 percent. Among the many problems in Russia is the fact that of the pirated goods that are confiscated by law enforcement, 70

percent get returned to the market. Meaningful enforcement needs to involve more than a revolving door. The copyright industries estimate losses in Russia of $1.7 billion dollars.

I remain committed to working on solutions to these problems. Last week, Senator Cornyn and I introduced S. 1095, the Protecting American Goods and Services Act of 2005, which will criminalize possession of counterfeit goods with intent to traffic, close off loopholes under current law in the definition of "trafficking", and criminalize the importation and exportation of counterfeit goods. In 1996, I worked with Senator Hatch to pass the Anti-counterfeiting Consumer Protection Act, which addressed counterfeiting by amending several sections of our criminal and tariff codes.

Intellectual property theft is more than a problem faced by a few. It is a crisis with the potential to drastically impact our economy, and both Congress and this Administration must work to ensure that we are up to the task of fighting increasingly sophisticated piracy operations. To that end, I am pleased that we have two distinguished panels of witnesses today. My hope is that from these witnesses both in and out of government we will hear not only about the size of the problem but about solutions to this growing scourge. Does the United States Trade Representative have adequate tools to address this issue? Do we need to strengthen our domestic laws through legislation like the bill Senator Cornyn and I recently introduced? Must we engage more vigorously with China, and Russia, and other countries too lax in their IP enforcement?

I suspect the answers are all "yes," and I am eager to "think globally" with all of you about how to take the next steps toward improving the situation.

# # # #

Testimony of

James Mendenhall

General Counsel for the Office of the U.S. Trade Representative (Acting)

Before the

Committee on the Judiciary

United States Senate

May 25, 2005

Global Piracy of Intellectual Property Rights:

Challenges, Enforcement Efforts and Results

Good afternoon Mr. Chairman, Senator Leahy and Members of the Committee. Thank you for the opportunity to speak to you today about the challenges posed by piracy of intellectual property rights (IPR), and the enforcement tools that USTR and other agencies are utilizing to protect U.S. IPRs in foreign markets.

The theft of intellectual property worldwide is an enormous and growing problem. As a result of this criminal activity, many foreign markets for products protected by IPRs are simply evaporating. In China, industry estimates that piracy levels in many sectors are close to or exceed 90 percent. In Russia, piracy levels for movies and music have also continued to increase, as well as overall losses to copyright-related industries. That said, the protection of IPRs in some countries has actually improved. Yet, while these improvements have sometimes been dramatic, the levels of piracy and counterfeiting in many countries remain unacceptably high.

We understand the growing sense of frustration among U.S. industry and Congress about the lack of enforcement of IPRs by our trading partners. USTR and other agencies are continuing to work to address this situation – one made complex not only by its sheer scale but by the multiple underlying causes.

A little over a year ago in testimony before this subcommittee, I outlined key challenges facing the United States on protection of IPRs such as the global nature of pirate operations and distribution chains and the lack of the rule of law that allow criminal enterprises to flourish in countries such as China and Russia without effective enforcement or deterrent penalties. These challenges still remain and in the case of piracy, technological advances have allowed pirates to further streamline and expand their operations. Over the past year USTR, working with other agencies, has vigorously

utilized the Special 301 process and other tools at our disposal, and initiated new efforts to strengthen enforcement. I would like to provide an update on our recent efforts as well as some examples of success in combating and reducing levels of piracy and counterfeiting in our trading partners.

Tools and Measures to Combat Piracy and Strengthen Enforcement

USTR has taken a comprehensive, multi-faceted approach to address the complexity of the global piracy problem. We have been vigorously employing all tools and resources at our disposal to bring pressure to bear on countries to reform their intellectual property regimes, and we will continue to do so.

Special 301/Section 301

As we do in April of each year, USTR issued the 2005 Special 301 Report on April 29, which catalogues the IPR problems in dozens of countries around the world and places them in a hierarchy – ranging from the lowest ranking of Watch List ("WL") to the mid-level Priority Watch List ("PWL") to the ranking reserved for the worst offenders, Priority Foreign Country. The 2005 report lists 52 trading partners and gives special attention to the need for significantly improved enforcement against piracy and counterfeiting. This year, we identified 1 Priority Foreign Country; 14 on the Priority Watch List and 36 on the Watch List (see attachment at the end for a list of the countries designated in the Special 301 Report). Two countries are being monitored under Section 306 and USTR will conduct 7 "Out-of-Cycle" reviews (OCRs), namely for Canada, EC, Indonesia, Philippines, Russia, Saudi Arabia and Ukraine.

As I just mentioned, Priority Foreign Country is the most serious designation; USTR is obligated to decide whether to initiate an investigation under section 301 against any country designated a PFC. Priority Watch List indicates that the United States has a high level of significant concerns. Watch List indicates that there are serious IPR issues in that country that warrant attention. "Section 306 monitoring" indicates that a country is taking action to address concerns raised in connection with a section 301 investigation and are monitoring whether that country is satisfactorily implementing those actions. USTR conducts OCRs for countries that appear to be on the verge of having their status on the Special 301 list changed because of either significant improvements or problems.

A country's ranking in the report sends a message to the world, including potential investors, about a country's commitment to IPR protection. We have used this exercise to great effect, as each year we see countries coming forward with reforms or reform proposals to avoid elevation on the list.

For example, after elevating Korea to PWL last year, it took significant steps over the past several months to strengthen protection and enforcement of IPR such as, introducing legislation that will explicitly protect sound recordings transmitted over the Internet (using both peer-to-peer and web casting services); implementing regulations to

address film piracy; and increasing enforcement activities against institutions using illegal software. Taiwan is another example of where we achieved positive results utilizing the Special 301 process. In response to our out-of-cycle review, Taiwan's legislature approved a number of amendments to its copyright law that provide greater protection for copyrighted works and increase penalties for infringers. In addition, Taiwan authorities made permanent an IPR-specific task force that has increased the frequency and effectiveness of raids against manufacturers, distributors, and sellers of pirated products.

We have also used the Special 301 Report to highlight the longstanding and serious problems of optical media piracy in Pakistan, Malaysia and the Philippines. Over the past year both Malaysia and the Philippines have made measurable progress in enforcement against optical media piracy I am particularly pleased to report here today that five days after the release of this year's Special 301 Report, Pakistan officials raided six optical media plants in Karachi and seized over 150,000 discs of pirated software, movies and DVDs, and over 6000 stampers. In addition, authorities made several arrests and the plants have been sealed and placed under 24 hour police surveillance. A follow up raid on the registered office and warehouse of one of the plants seized another 5,500 stampers and more pirated optical media.

In yet another example, Canada RCMP officers recently seized more than $800,000 worth of goods, including more than 30,000 DVDs, 3,000 video games and 1,600 multi-game cartridges, suspected of being bootlegged. The seizure came days after the United States put Canada on the watch list due to concerns over weak enforcement of IPR.

Finally, Ukraine, which is designated as a PFC and has been under sanctions since 2001, has recently indicated that it is committed to address our long-standing piracy concerns as a result of the new government's desire to have these sanctions removed and is currently involved in reforming its optical disc laws.

Trade Agreements

Another very useful tool is our free trade agreements and ongoing FTA negotiations. In the past three years, we have completed and received Congressional approval of free trade agreements with Chile, Singapore, Australia and Morocco, have concluded negotiations with Bahrain and CAFTA-DR and have launched free trade agreement negotiations with 13 more countries (Panama, Thailand, the Andeans, UAE, Oman, and SACU countries). Consistent with the guidance Congress provided in the Bipartisan Trade Promotion Authority Act of 2002, we require that our free trade agreement partners bring their IPR regimes up to standards consistent with U.S. law.

Our FTAs contain the highest level of IPR protection of any international agreements in the world, and they directly address many of the key challenges regarding enforcement which I discussed earlier. They contain provisions dealing with the whole range of IPR, including such issues as curbing the use of equipment used to circumvent

anti-counterfeiting technology and dealing with sector-specific problems such as optical disk or broadcast piracy. They also strengthen enforcement by streamlining procedural rules for bringing copyright claims, and providing for higher damage awards(including statutory damages), expeditious *ex parte* searches to gather evidence, and civil remedies to seize and destroy infringing goods. Our FTAs also provide for improved border enforcement to stop imports and exports of pirate and counterfeit goods and stronger criminal enforcement.

We recognize that in order for these FTA provisions to be effective, they must be properly implemented and enforced. Over the past year, we have directed our efforts in ensuring that our new FTA partners meet their obligations both in implementation and enforcement. We have spent many hours working closely with Australia, Singapore and Chile and have been successful in ensuring that their implementing legislation fully meets their FTA obligations to protect and enforce IPR. We have also – with support and cooperation from our embassies and industry – heightened our vigilance to quickly respond to concerns over possible lack of compliance or enforcement of FTA obligations. As we continue to make progress in concluding new FTAs, we realize that a key priority must be to enforce our FTA partners' compliance with their obligations to protect IPR.

WTO

USTR has the lead in working closely with other agencies in addressing IPR issues multilaterally through the WTO.

The initiation of dispute settlement proceedings is the most forceful expression in the WTO of dissatisfaction with a country's IPR protection and can be an effective way to achieve reform. USTR has brought 12 TRIPS-related dispute settlement cases against 11 countries and the EC. Of these 12 cases, one is in consultations, eight were favorably resolved by mutually-agreed solutions between the parties, and three resulted in favorable rulings for the United States. Just a few months ago, a WTO panel upheld the U.S. WTO challenge against an EC regulation on food names – i.e., the EC regulation on geographical indications for food and agricultural products – that unfairly discriminated against foreign producers and products. This finding is an important victory for all American food producers of quality regional products – who are entitled to equal access to the EC system of protection for geographical indications – and also for all U.S. producers owning trademarks in Europe. In nearly all of the 11 cases, U.S. concerns were addressed via changes in laws or regulations by the other party.

We also regularly review countries' IPR laws and practices through the WTO Trade Policy Review Mechanism (TPRM). WTO members recently reviewed included China late last year. In addition, the TRIPS Council regularly reviews implementing legislation, providing a forum for USTR to provide comments on existing and draft legislation and an opportunity for bilateral meetings to discuss specific concerns.

Preference Programs

USTR also administers the Generalized System of Preferences (GSP) program and other tariff preference programs. The "carrot" of preserving GSP benefits is an effective incentive for countries to protect IPR. In fact, the filing of a GSP review petition or the initiation of a GSP review has in some cases produced positive results. For example, in response to an extended GSP review of Brazil this past year, the Government of Brazil adopted a new National Action Plan to enforce copyrights and reduce piracy. According to our industry, the Brazilian Government appears to be moving in the right direction and is now committing significant fiscal and personnel resources to anti-piracy efforts. The recent efforts to integrate the enforcement efforts and informational exchange channels of the Federal Police, Federal Highway Patrol, and Internal Revenue Service, are evidence of that the Plan is being implemented. Over the past two months hundreds of thousands of pirated products have been seized and destroyed, and dozens of individuals have been arrested.

India, expressing its desire to have GSP benefits reinstated, just passed a new patent law, providing patent protection for pharmaceutical products thus providing this form of intellectual property to our innovative pharmaceutical companies.

The Strategy Targeting Organized Piracy (STOP!) Initiative

Through a new initiative, the Administration is taking comprehensive action to block trade around the world in pirated and counterfeit goods. The Strategy Targeting Organized Piracy (STOP!) Initiative is a U.S. government-wide initiative begun in October 2004 to empower U.S. businesses to secure and enforce their intellectual property rights in overseas markets, to stop fakes at U.S. borders, to expose international counterfeiters and pirates, to keep global supply chains free of infringing goods, to dismantle criminal enterprises that steal U.S. intellectual property and to reach out to like-minded U.S. trading partners in order to build an international coalition to stop counterfeiting and piracy worldwide.

Last month, a delegation representing the seven federal agencies participating in STOP! visited Singapore, Hong Kong, Japan and Korea generating much interest and fruitful discussions. A few countries proposed avenues of cooperation, one in particular in the area of peer-to-peer file sharing that may be useful to our copyright concerns. In the coming months, we will continue our outreach so as to determine the interests of other countries for activities that provide opportunities for cooperation. Next month we will be sending a similar delegation to Europe.

I would now like to turn to two particular countries that pose the greatest challenges to protecting and enforcing American IPRs.

China

As Ambassador Portman stated in his confirmation hearing testimony, IPR is a top priority in our trade relationship with China. We have a number of challenges to

resolve in this relationship that, as you are all aware, have been ongoing for some time. A chief concern among these challenges is the rampant piracy of our movies, music and software. Illustrative of this point are industry statistics showing that last year 85 percent of the sound recordings and 95 percent of films in China were pirate product. These are disconcerting figures which as Ambassador Portman stated we will focus on cutting. The reported loss of sales affecting U.S. industry ranges from $2.5 to $3.5 billion annually as described in our Special 301 Out-of-Cycle Review (OCR). Such losses are not sustainable and, as demonstrated by the report's more aggressive stance, are of significant concern. We want and look forward to working closely with you and your staff in combating the theft of American innovations in China.

The Special 301 OCR

On April 29, USTR reported the results of its OCR on the IPR situation in China. In this report, we concluded that while China has undertaken a number of serious efforts at the national level to address our IPR concerns, particularly by amending laws and increasing raids against those selling pirated goods and operating illegal production facilities, China is still not deterring rampant piracy. Our industries report that piracy and counterfeiting remain at high levels, a situation hurting our individual right holders, and small and medium size businesses the hardest. As a consequence, we outlined five actions to address our concerns:

1) Working with U.S. industry and other stakeholders with an eye toward utilizing WTO procedures to ensure that China is in compliance with its WTO TRIPS obligations.

2) Invoking the transparency provisions of the WTO TRIPS Agreement, which will require China to produce detailed information on certain aspects of IPR enforcement that affect U.S. rights under the TRIPS Agreement.

3) Elevating China onto the Priority Watch List on the basis of serious concerns about China's compliance with its WTO TRIPS obligations and commitments China made at the April 2004 U.S.-China Joint Commission on Commerce and Trade (JCCT) to achieve a significant reduction in IPR infringement throughout China, and make progress in other areas.

4) Continuing to monitor China's implementation of its commitments under our 1992 and 1995 bilateral agreements (including additional commitments made in 1996).

5) Using the JCCT, including its IPR Working Group, to secure new, specific commitments to significantly improve IPR protection and the enforcement environment in China.

China must expend the political capital necessary to deliver on its promise to "substantially reduce IPR infringement." China's Vice Premier Wu Yi committed to this

at the April 2004 JCCT and in our 1995 bilateral Memorandum of Understanding on IPR. In order to achieve this goal, China must resolve critical deficiencies in IPR protection and enforcement, while providing for a level of transparency that allows for a thorough accounting. We will work with our counterparts on the Chinese side, beginning with tomorrow's JCCT IPR Working Group, to impress upon China that patience within the Administration and on Capital Hill has run and that now is the time for results.

Working with Industry

On the domestic front, we are working with the U.S. copyright industry to identify problems and address trade complaints related to China, as we did during the OCR. This includes cooperating with companies and associations to monitor China's WTO TRIPS implementation, and using WTO procedures to address our serious concerns about China's compliance. Industry's daily operations throughout China provide insight into that country's IPR regime, particularly at the local and provincial levels, where piracy is most egregious. This dialogue points to serious concerns with China's implementation of Articles 41 and 61 of its TRIPS obligations to provide that for effective enforcement of IPR including remedies that produce deterrence against pirating.

TRIPS Transparency Provision

In the next couple of weeks, we will begin the process of filing a request for information under TRIPS transparency provisions (Article 63) so that China must provide information on its IPR regime and recognize the serious deficiencies in its system. The request will focus on specific judicial decisions and administrative rulings that pertain to IPR, including penalties, fines and prison terms actually imposed in individual IPR infringement cases. We believe such a request should address some of the concerns industry has had with complaints it has leveled in the Chinese system, while demonstrating to the Chinese our belief that a transparent IPR regime is a staple of good governance.

China's response to our request will be the first public test of whether it is serious about addressing rampant piracy and counterfeiting. It will also compel its officials to revisit China's enforcement practices, the IPR violations it pursues and the results of these cases. We look forward to China's earliest response to that request.

The Priority Watch List

China's placement on the Priority Watch List (PWL) indicates that particular problems exist in that country with respect to IPR protection, enforcement and market access. Copyright concerns include:

1. Market access and investment barriers that prevent the copyright industry from serving China's market in a timely manner.

2. China's exports of pirated movies, music and software.

3. China's failure to impose penalties that deter or punish, or incapacitate these thieves.

4. Rapid growth of Internet piracy.

Monitoring U.S.-China Agreements

We will continue monitoring China's yearly performance in the Special 301 process in part based upon commitments it made in our bilateral agreements. Although the importance of these agreements has decreased since China became a member of the WTO in December 2001 (requiring adherence to TRIPS), some of the provisions in these agreements remain significant.

The JCCT IPR Working Group

In our OCR Report, we identified for China six specific results that in our view would be evidence of promoting better IPR protection. During this week's JCCT IPR Working Group meetings, we will provide the Chinese suggestions on how to achieve the results we're seeking and impress upon them the importance of action. Among others, we are looking for China to enhance its criminal enforcement system, provide for a deterrent administrative enforcement system, allow for fair market access for legitimate products, secure its borders against exports of pirated products, protect copyrights in the context of the Internet, and increase the transparency of its legal system. China must now take ownership of these concerns and exercise the political leadership needed to show improvements in stopping piracy.

Simultaneously during the JCCT IPR Working Group's meetings, we will share our technical expertise with China on how to meet the many challenges in its IPR regime. Along with representatives from the Departments of Commerce (including the U.S. Patent and Trademark Office), Food and Drug Administration, Homeland Security (Customs and Border Protection), Library of Congress (Copyright Office), Justice, and State, we will cooperate where possible to ensure that China addresses the concerns raised.

Finally, we ask Congress to join us in encouraging industry's robust participation in each of these efforts through increased monitoring, data collection and devoting resources to this effort. Their engagement and support on IPR issues this year is key to our efforts to improve IPR protection in China.

Russia

We also remain very concerned about high levels of piracy of optical media (CDs and DVDs) and the growing problem with Internet piracy of copyrighted works in Russia. Protection and enforcement of American IPRs in Russia is an issue that is of

utmost concern to USTR and the Administration. Due to the importance of this issue and the prevalence of piracy in Russia, Presidents Bush and Putin have discussed improving protection of IPRs in Russia at several recent summits, including at their meeting earlier this month in Moscow. Successfully combating the rampant piracy and counterfeiting that currently exists in Russia is a top priority.

The level of copyright piracy in Russia has increased dramatically and the adverse effects on American owners of copyrights are compounded by the fact that Russia has become a major exporter of pirated materials. In addition to sales in Russia of illegal music, movies, and computer software, Russia's pirates are exporting large volumes of illegal products to other markets. As a result, Russia is on the 2005 Special 301 Priority Watch List. In addition, due to the severity of the problem in Russia, the Administration will conduct an out-of-cycle review this year to monitor progress by Russia on numerous IPR issues. We are also continuing interagency review of a petition filed by the U.S. copyright industries to withdraw some or all of Russia's GSP benefits.

USTR Efforts

USTR and other agencies have been and will continue to be very engaged with the Russian Government at all levels to develop an effective IPR regime and strengthen enforcement in Russia. We have an ongoing bilateral working group with the Russian Federal Service on Intellectual Property, Patents, and Trademarks (Rospatent), the agency responsible for most IPR matters in Russia, which has convened several times this spring to discuss a wide range of IPR issues. Recent discussions have focused on Russia's enforcement regime, legislative deficiencies – including the need for a comprehensive regulatory regime on optical media production, and Internet piracy.

We are also working on IPR issues in the context of Russia's WTO accession negotiations. We have continuing concerns that Russia's current IPR regime does not meet WTO requirements related to protection of undisclosed pharmaceutical testing data, geographic indications and enforcement. We are raising these and other concerns in the accession negotiations and have made it clear to the Russian Government that progress on IPR will be necessary to complete the accession process.

Supplementing these efforts directly with Russia, the Administration is also seeking to address Russia's growing exports of pirated and counterfeit products as part the STOP! Initiative I mentioned earlier.

Our work has brought about some improvements, particularly with respect to the content of Russia's laws, but much more will need to be done in order to reduce the level of piracy and counterfeiting. As part of its effort to bring Russia's IPR regime into compliance with the obligations of the TRIPS Agreement, Russia amended its Copyright Law in 2004 to provide protection for pre-existing works and sound recordings. Russia has amended a number of other laws as well, including its laws on patents and protection of computer software and databases. Although these amendments demonstrate Russia's

commitment to strengthening its IPR laws, further improvements in Russia's laws are necessary.

Stronger Enforcement Measures Necessary

On the enforcement side, we have seen far less progress. While Russian law enforcement agencies have taken some actions, including an increased number of raids by police, these actions have not deterred the significant increase in piracy that our industry has observed in Russia. Enforcement efforts in Russia must increase dramatically in order to combat rising piracy and counterfeiting levels. We need to see improvements in enforcement of Russia's criminal laws against piracy and counterfeiting, improved enforcement at the border to prevent exports of pirated and counterfeit products and better administrative and civil procedures for IPR enforcement, such as providing for *ex parte* procedures in civil cases.

We are very concerned with the amount of excess optical media capacity in Russia and with Russia's lack of a comprehensive regulatory regime to control illegal optical media operations. Our industry estimates that the capacity of known plants in Russia is 371.6 million discs while legitimate domestic demand is around only 30 million discs. Illegal optical media from Russia has been found in markets around the world. Russia lacks an effective system for inspection of optical media production plants to ensure that only authorized product is being made.

On the criminal enforcement side, we see frequent delays in prosecutions and then imposition of minimal penalties, including many suspended sentences. Frequently, pirated goods that have been seized in a case are not destroyed, but are returned to the market. The U.S. copyright industry estimates that 70 percent of seized pirated product goes back into the stream of commerce. We are also seeing an increase in piracy on the Internet. Several major illegal websites are operating out of Russia, one of which our industry reports is now the largest portal for pirated product in the world. We have raised these issues with Russia and are seeking decisive actions to address these growing problems, such as inspecting optical media plants, permanently shutting down illegal production, and taking down Internet sites that are spreading pirated material.

We share in our industries' frustration over the lack of significant progress on the part of Russia's authorities. USTR is committed to utilizing effectively the tools currently available to us to press Russia to act immediately to implement concrete measures to combat piracy and counterfeiting operations and reduce the losses to U.S. industries. Despite our close engagement and continued work with the Russian Government, Russia has made little progress in permanently closing down illegal production and bringing offenders to justice. Political will at the highest levels will be needed in order to see a reduction in piracy levels in the near term.

USTR will continue to monitor Russia's progress in bringing its IPR regime in line with international standards through the Special 301 out-of-cycle review, the ongoing GSP review, bilateral IPR working group discussion and WTO accession discussions.

Progress will be critical for our bilateral relationship with Russia and will have implications for Russia's accession to the WTO. Ultimately, success will depend on the political will of Russia's leaders to tackle the underlying problems of corruption and organized crime. We remain committed to working with the Congress and this committee in particular in pressing Russia to combat and reduce the unacceptable levels of piracy and counterfeiting which plague our industry.

Conclusion

Dealing with the problem of piracy requires a comprehensive, intensive and sustained effort. The new USTR Ambassador Portman has identified enforcement of IPR and ensuring compliance with obligations by our trading partners such as China and Russia as a top priority. We are strongly committed to continuing to bring all of USTR's weapons to bear on this issue and to maintain the pressure year after year. We have made progress, but enormous challenges remain.

I look forward to working with you and your staffs to continue to devise solutions for dealing with this critical matter.

Thank you.

Special 301 Country Designations

Priority Foreign Country

Currently, one country (Ukraine) is designated to be in this category and remains subject to $75 million in sanctions.

Note: Countries identified as Priority Foreign Countries can be subjected to a Section 301 investigation and face the possible threat of trade sanctions. These are countries that fail to enter into good faith negotiations or make significant progress in bilateral or multilateral negotiations to provide adequate and effective protection of IPR.

Priority Watch List

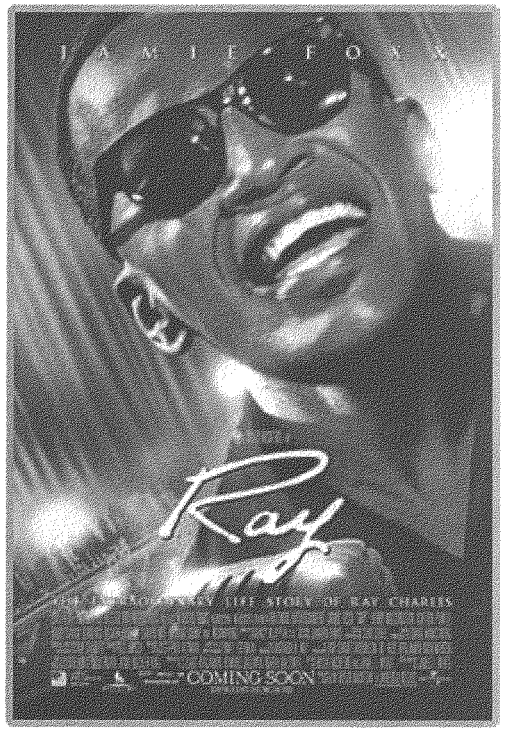
Fourteen trading partners have been placed on the Priority Watch List. These countries are: Argentina, Brazil, China, Egypt, India, Indonesia, Israel, Kuwait, Lebanon, Pakistan, the Philippines, Russia, Turkey, and Venezuela.

Note: Countries on the Priority Watch List do not provide an adequate level of IPR protection or enforcement, or market access for persons relying on intellectual property protection.

Watch List

Thirty-six trading partners are placed on the Watch List. These countries: Azerbaijan, Bahamas, Belarus, Belize, Bolivia, Bulgaria, Canada, Chile, Colombia, Costa Rica, Croatia, Dominican Republic, Ecuador, European Union, Guatemala, Hungary, Italy, Jamaica, Kazakhstan, Korea, Latvia, Lithuania, Malaysia, Mexico, Peru, Poland, Romania, Saudi Arabia, Slovakia, Taiwan, Tajikistan, Thailand, Turkmenistan, Uruguay, Uzbekistan, and Vietnam.

Note: Countries on the Watch List merit bilateral attention to address underlying IPR problems.

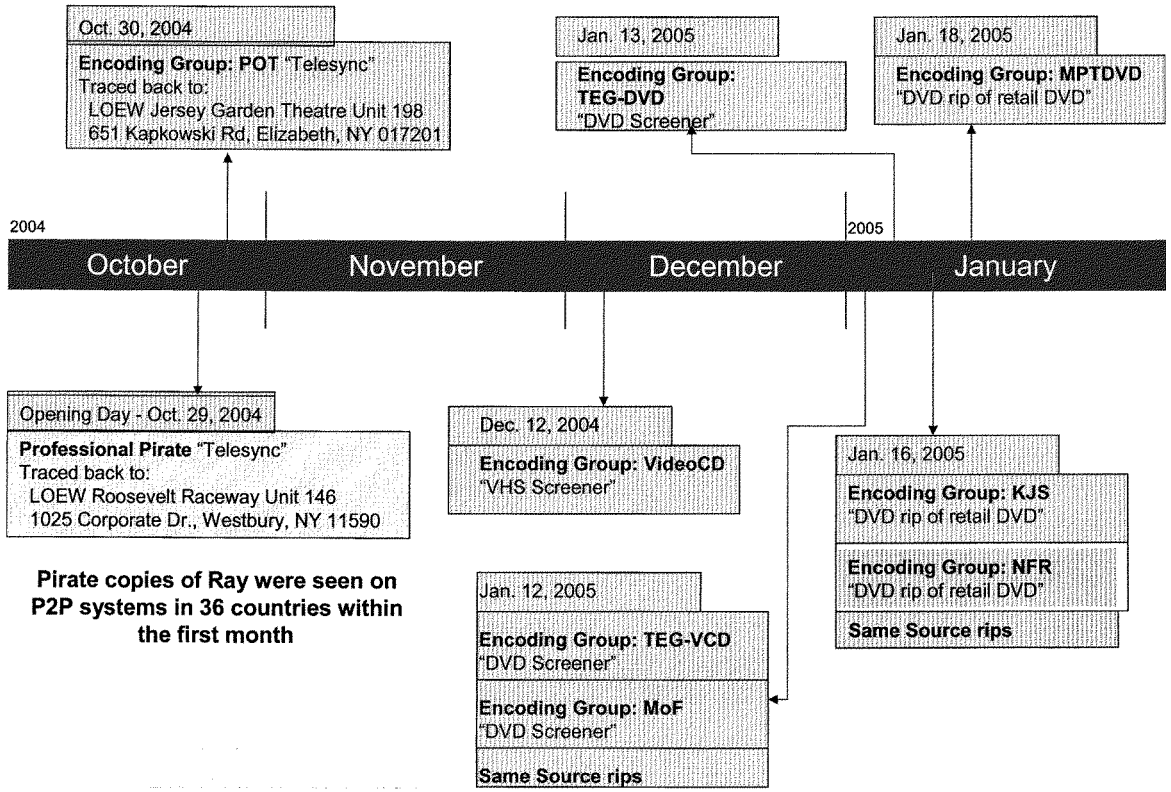


NBC Universal Pictures

A Chronological Look at

Movie Piracy

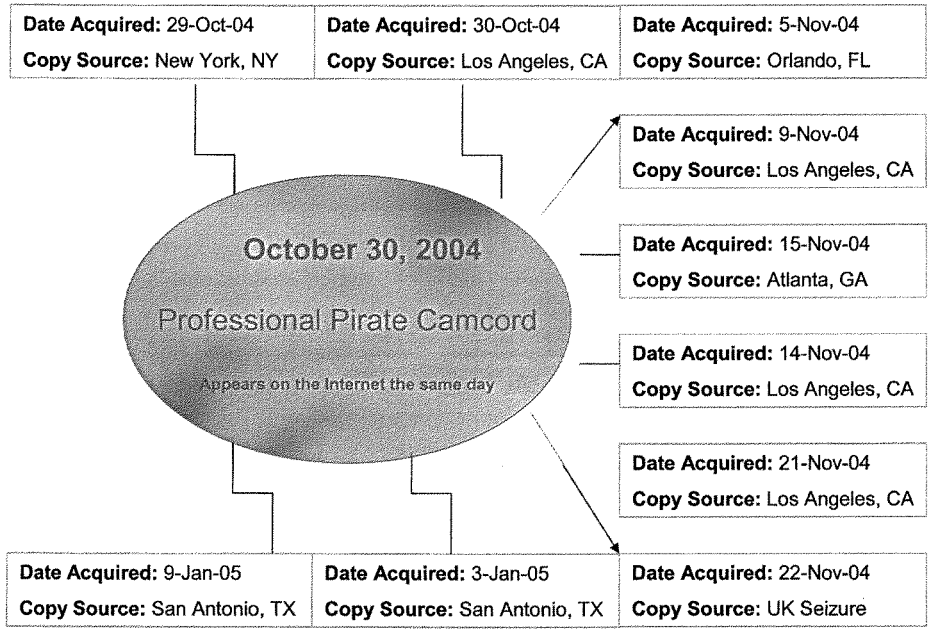
Internet Propagation of Pirate Copies of "Ray"



Pirate copies of Ray were seen on P2P systems in 36 countries within the first month

Global DVD Piracy & Propagation

from just one source



Pirate DVDs of Ray are to be found in every major market around the world

Impact of Internet Piracy of Ray

- 476,746 P2P requests to download Ray on Thursday, May 19, 2005.
- Over 23,000 copies may have been download just on Thursday (if only 5% succeeded in downloading)
- Over 42 million requests to download since it was first pirated in October 2004.
- 21,720 copyright complaints and DMCA notices have been sent regarding P2P infringements of Ray. (as of May 12, 2005)
- The Internet piracy of Ray has been identified in 68 countries since October 2004.

Testimony of Marybeth Peters
Register of Copyrights
Before the
U.S. Senate Judiciary Committee
Subcommittee on Intellectual Property
May 25, 2005

"Piracy of Intellectual Property"

Mr. Chairman, Senator Leahy, Members of the Subcommittee, thank you for the opportunity to speak with you today about one of the most pressing issues in copyright today – international piracy. It is always a pleasure to appear before you, and I was pleased to see the reinstallment of the Subcommittee, and wanted to congratulate you on your Chairmanship.

I. Introduction

Mr. Chairman, in the nearly forty years that I have worked in the Copyright Office, piracy, and especially global piracy, is probably the most enduring problem I have encountered. As with some other illegal activities, there will always be at least a small segment of any population who cannot be deterred from this theft of others' creativity. Thus, I fear that it is simply not realistic to speak of eliminating all piracy around the world, or even within the United States.

What we can and should strive for is the reduction of piracy to the lowest levels possible; levels that will not rob authors and copyright owners of the incentive to create and distribute the works that have made America's creative industries the envy of the world. The Copyright Office has a long history of working toward this goal, both on its own initiative and in cooperation with the other agencies of the Federal Government. My testimony today will describe those efforts and their effectiveness.

II. Legal Framework

Broadly speaking, there are two elements to the protection of copyright. The first element is a legal framework that provides the basic rights to copyright owners and establishes procedures for the enforcement of those rights. Those procedures must provide the opportunity to obtain adequate remedies when those rights are violated as well as the possibility of punitive monetary judgments and, in appropriate cases, imprisonment of the infringer. The second element of copyright protection is the application of these legal rules to ensure that copyright owners have actual, effective protection against infringement of their rights.

In the ten years since the conclusion of the Uruguay Round of the WTO, and the concomitant adoption of the TRIPS Agreement,[1] there has been tremendous improvement worldwide in countries' legal framework for copyright protection. By incorporating the substantive copyright obligations of the Berne Convention, and supplementing them with civil, criminal, and border enforcement obligations, TRIPS established a minimum standard against which all countries' copyright regimes could be judged.

Since 1995, the number of WTO member countries has nearly doubled. By including the TRIPS Agreement in the WTO obligations, and thus subjecting the obligations therein to international dispute resolution, we have been able to advance copyright protection in all 148 WTO member countries further and faster than would have been possible without it.

The Copyright Office is proud of its contributions to this success, which include participation in the negotiation of the TRIPS Agreement and other copyright treaties and agreements, as well as training of foreign officials. Our main program for training

[1] Trade Related aspects of Intellectual Property.

foreign copyright officials is our International Copyright Institute ("ICI"). This week-long program exposes foreign officials from developing countries and countries in transition to a wealth of copyright knowledge and information, presented by U.S. Government, and foreign and domestic industry experts. Thanks to the Congress, we are able to attract the best participants from around the world by offering this training program at no cost to them or their governments.

Part of the reason the ICI is such a success is that it is not merely a week of lectures. We provide ample time for the delegates to interact and learn from each other. Similarly, we learn valuable information about the law in their countries, including new developments not necessarily available to the public. Perhaps most important of all, we strengthen the relationship with those countries. Many ICI participants have been high-ranking officials or have gone on to high-level government positions. The relationships we establish at the ICI enhance our ability to negotiate with the officials and countries we have hosted.

In addition to the ICI, the Copyright Office makes its experts available to speak around the world at various conferences and training programs. In the past twelve months, we have spoken at WIPO seminars, academic conferences, and events sponsored by other U.S. Government agencies, such as a State Department Intellectual Property Roundtable and the Patent and Trademark Office's Visiting Scholars program. I personally have been very active in the State Department's Distinguished Speaker program, giving presentations in Chile and Uruguay last year, and am scheduled to speak in Germany, Brussels, and Brazil this year.

We also supported USTR's free trade agreement ("FTA") negotiations by providing technical assistance to our negotiating partners. We were pleased to send experts to the two intellectual property and telecommunications programs that the State Department organized for its embassy officers throughout Europe and east Asia.

The Copyright Office is also a major contributor to the strengthening of copyright protection through international organizations, notably the World Intellectual Property Organization ("WIPO"). The Copyright Office played a key role in the negotiation of the WIPO Copyright Treaty ("WCT") and the WIPO Performances and Phonograms Treaty ("WPPT"). Those treaties supplemented the Berne Convention and the TRIPS agreement with updated obligations that are especially important in the digital age. As you know, the United States implemented the WCT and WPPT through the Digital Millennium Copyright Act ("DMCA"), which stands as a model for the world. Those treaties and the model of the DMCA have also been the source of a substantial improvement of the legal framework for the protection of copyright in numerous countries around the world. The work at WIPO neither began nor ended with the WCT and the WPPT, and the Copyright Office continues to work in support of the proposed treaties on audio-visual performances and on broadcasting, cablecasting, and webcasting, among many other initiatives.

There are also many opportunities to promote copyright protection through the World Trade Organization ("WTO"). The Copyright Office works closely with the U.S. Trade Representative's Office ("USTR") to take full advantage of each of them. As countries not currently in the WTO seek to join, we evaluate their existing copyright laws, advise USTR of TRIPS deficiencies, and support pre-accession negotiations. Once countries are WTO members, they are subject to a periodic review of their laws. Again,

we advise USTR of any TRIPS deficiencies and draft questions for those countries, seeking explanations from their governments and highlighting the problems in a global forum. Most seriously, if and when the dispute resolution procedure of the WTO is invoked for a copyright issue, we support USTR in this litigation effort with our expertise.

The Copyright Office also works hand-in-hand with USTR on bilateral and regional trade negotiations, including negotiations and implementation of FTAs. In the past twelve months, we participated in bilateral negotiations with Russia, Saudi Arabia, China, South Korea, Japan, Taiwan, Philippines, Vietnam, Germany, Israel, Kazakstan, Brazil, Yemen, and Kuwait. During that time, we played a key role in negotiating the intellectual property chapters of the FTAs with Panama, the Andean FTA group, Oman, United Arab Emirates, and Thailand. We have also worked hard to ensure the proper and full implementation of our FTAs, most notably with Singapore and Morocco.

I am confident that we have a lot to show for our efforts and I am proud of that. American creative industries now have improved legal regimes around the world, increasing their opportunity to sell their products and services on a level playing field. This generates an incentive to create and distribute new and better works for the benefit of Americans and the world. It also creates jobs, both here and abroad.

My discussion of the legal frameworks for protecting copyright would not be complete if I did not add a few words about the U.S. Copyright Act. While there are many ways to approach an issue and many good laws around the world, I believe that on the whole, the U.S Copyright Act does the best job of providing appropriate protections

to authors and copyright owners, while still allowing for fair and reasonable use of copyrighted materials.

But our law is not perfect, and when we go to other countries seeking improved copyright protection, they are quick to point out the deficiencies and gaps in our law. For example, the U.S. has not amended its law to remove a provision of section 110(5), an exemption for performing musical works in public places like bars and restaurants that was broadened in 1998. A dispute resolution panel of the WTO ruled that the expansion of the exemption was inconsistent with the United States' TRIPS obligations. Also, although we ask foreign governments to extend all the rights they afford under their law to their domestic right holders in sound recordings to American right holders as well, many countries point out that the scope of such rights under U.S. law is narrower than theirs, depriving their right holders of the reciprocal protections in the United States. I know that these are controversial subjects, but if we are going to take a frank look at how to solve the problems of international piracy, we need to look at our own deficiencies as well.

III. Enforcement

The second element to the protection of copyright is the enforcement of the rights provided by the law. We all recognize that without adequate and effective enforcement, the laws are not worth very much. Accordingly, we place a great deal of emphasis on enforcement in our conversations with foreign officials.

The TRIPS agreement was the first international instrument to contain extensive copyright enforcement obligations, covering the necessary authority of policing, customs, and judicial authorities, setting standards for the application of criminal penalties, and

establishing the overall standard that countries must provide "effective action against any act of infringement... and remedies which constitute a deterrent to further infringements."[2] The TRIPS agreement has been a tremendously valuable tool in advancing the development of legal structures to support enforcement of copyright around the world. There remains, however, substantial work to be done in making sure that those structures provide *effective* enforcement of copyright.

Our FTAs have built upon the TRIPS enforcement text by adding specificity to what is found in TRIPS, and other obligations not found in TRIPS at all. For example, where TRIPS requires criminal penalties for all "wilful... copyright piracy on a commercial scale..."[3], the FTAs specify that criminal penalties must be available for all wilful infringements for purposes of commercial advantage or private financial gain, or significant wilful infringements, regardless of motivation. This reflects the experience in the U.S. in dealing effectively with various forms of piracy and is broader than many countries' existing criminal copyright provisions.

The FTAs also provide us with the flexibility to address enforcement problems that are particularly problematic in a given country or region. For example, some of our FTAs include a side letter imposing a unilateral obligation on our trading partner to regulate the manufacture of optical discs.[4] This is a reflection of the fact that much of the world's pirated optical discs are manufactured in certain regions, perhaps most notably, southeast Asia.

---

[2] TRIPS Art. 41(1).
[3] TRIPS Art. 61.
[4] The phrase "optical disc" is an umbrella term that includes DVDs, CDs, CD-ROMs, VCDs, etc. containing movies, recorded music, computer programs, and videogames.

In another example, one that is specific to a single country, there is a provision in the Singapore FTA which was carefully crafted to address the serious concerns with pirated products being trans-shipped through Singapore and out to the rest of the region and the world.

A. Serious Challenges Remain

Despite all these accomplishments, the fact remains that copyright enforcement in too many countries around the world is extremely lax, allowing staggeringly high piracy rates and massive losses to American companies. In its most recent Special 301 submission, the International Intellectual Property Alliance ("IIPA") estimated that global piracy cost U.S. copyright industries over $13 billion in 2004 alone.

1. China

China is a good example of how laws are not enough -- enforcement is absolutely essential to the protection of copyright. As China joined the WTO in 2001, the Copyright Office worked with the USTR-led interagency team to provide technical advice and to urge the Chinese government to amend its law to be TRIPS-compliant. While it fell short in several important respects, the law is more than sufficient to provide some meaningful protection to copyrighted works if it is properly enforced. Unfortunately, China's enforcement efforts remain inadequate as is illustrated by the industry reports that the piracy rates continue to hover around ninety percent for all forms of copyrighted works, as they have for years.

Last year, China made a number of commitments to improve various aspects of its intellectual property regime, most notably in regards to enforcement. Shortly before the meetings at which those commitments were made, the Copyright Office hosted a

delegation of Chinese copyright officials led by the National Copyright Administration of China ("NCAC"). We have enjoyed a cooperative relationship with the NCAC for nearly 25 years, and that relationship has helped to promote greater understanding between our governments. We have learned, though, that China's government is complex, and that the NCAC frequently does not have the final say on copyright policy and enforcement in China.

China's implementation of last year's commitments has been incomplete. For example, a major impediment to increased criminal copyright prosecutions has been a series of Judicial Interpretations of the criminal code, which set minimum monetary thresholds for the scope of infringements capable of giving rise to a criminal conviction. While a new set of interpretations with lower thresholds was issued, it contains several flaws, such as calculating whether the thresholds are met based on the artificially low pirate price, rather than the price of the legitimate version of the product being infringed. Further, while Vice Premier Wu Yi did hold public events to draw attention to the problem of piracy in China, the government has still not ratified the WCT or WPPT.

2. Russia

Russia has been on the Special 301 Priority Watch List since 1997. Today Russia's copyright piracy problem remains one of the most serious of any country in the world. According to the IIPA, piracy rates in Russia for most sectors are estimated at around 80% in 2004 and losses exceed $1.7 billion. In the past few years there has been an explosion in the growth of illegal optical media disc plants run by organized crime syndicates with widespread distribution channels. Russia has also developed a serious

online piracy problem, as exemplified by the offering of pirated materials on the website, "allofmp3.com," which has yet to be taken down by Russian authorities.

The U.S. Copyright Office is a committed member of the United States Government interagency efforts to combat intellectual property violations in Russia. There have been some positive steps in Russia which include passing copyright amendments last year that, among other things, remedied a long-standing and serious deficiency in the protection of pre-existing works and sound recordings of U.S. right holders. Statements by President Putin and other high-ranking government officials indicate that the Government of Russia comprehends the serious adverse effects of piracy and counterfeiting on U.S. companies, Russia's domestic creative industry and its economy. Not all of these encouraging statements have produced the desired results, such as the Russian Government's statement that it would eradicate all music piracy within two years. Now, two years since then, piracy has not decreased, but instead has increased by 30%, and industry estimates that Russia is now the world's largest exporter of pirated music products. Nevertheless, we must encourage the Russian Government to remain committed, and meet its enforcement problems head-on. We will continue to work with USTR using every possible forum to build on the positive steps Russian lawmakers have taken.

B. Treaties Cannot Compel Enforcement

For all the progress that we have made through TRIPS, the WCT and WPPT, and our FTAs, the fact remains that enforcement requires action. Laws do not enforce themselves. In my experience, there are two causes of inadequate enforcement: lack of competent police, prosecutors, and/or judges and lack of political will to enforce

copyright. We do our best through the training programs I have described to address the first problem. The second, lack of political will, is much more difficult.

I firmly believe that both history and logic demonstrate that a good system of copyright protection is a critical ingredient to developing vibrant domestic creative industries. Just recently, Bill Gates spoke at the Library of Congress and questions were raised concerning outsourcing. He responded that Microsoft would continue to operate out of the United States because the United States is the country with the most respect for intellectual property. That statement is a testament to how intellectual property goes hand-in-hand with substantial economic development.

We must recognize the reality that some countries do not share this view. They sacrifice the long term social and economic development benefits in favor of instant gratification; pirate operations provide jobs and income in many developing countries. Some also take the unfortunate view that paying for legitimate copies of works is just an exercise in sending money out of their country to foreign right holders. This approach undermines the ability of copyright to encourage and develop a nation's own creative industries and culture. It also overlooks the benefits of tax revenue from legitimate business and the good jobs and income that come with the increase in foreign investment that is encouraged by a good regime of copyright protection.

Such countries are simply unwilling to commit resources to provide effective enforcement of copyright. At best, they will do the minimum they need to do in order to prevent excessive trade friction with the United States or other trading partners. In recent years, some like-minded countries have worked together to present arguments on the international level that seek to weaken existing international standards of copyright

protection. Couched in terms of encouraging development or cultural diversity, these arguments are premised on the notion that copyright protection is antithetical to the interests of developing countries. What we are facing is an attempted backlash against the TRIPS agreement and our other successes. While we need to continue to work hard for short-term progress on enforcement in individual countries, we must also keep a close eye on these attempts to undermine established international standards of copyright protection.

IV. Not all Piracy is Alike

Before I conclude, Mr. Chairman, I would like to distinguish the type of piracy we see in the United States and what we see in many other countries. To be sure, piracy anywhere is serious and cause for concern. I have testified extensively on the very real dangers of domestic piracy, particularly the massive amount of piracy that dominates many peer-to-peer networks. As you know, these issues have given rise to the type of vigorous public debate on which the United States prides itself. But all too often, what we see abroad bears no resemblance to college students downloading their favorite songs and movies.

Much of the foreign piracy about which we are speaking today is done by for-profit, criminal syndicates. Factories throughout China, southeast Asia, Russia, and elsewhere are churning out millions of copies of copyrighted works, sometimes before they are even released by the right holders. These operations are almost certainly involved in other criminal activities. Several industry reports in recent years suggest that dueling pirate operations have carried out mob-style "hits" against their criminal

competitors. And, although the information is sketchy at best, there have been a series of rumored ties between pirating operations and terrorist organizations.

What is problematic is that some American commentators who are prone to hyperbole about what they see as an imbalance in the U.S. Copyright Act are providing arguments and rationalizations that foreign governments use to defend their failure to address this type of organized crime. The confusion wrought by the imprecision and lack of clarity in these commentators' statements is not helpful to our achieving the goal for which there is no credible opposition: dramatic reduction in organized piracy of U.S. copyrighted works abroad.

V. Conclusion

International piracy poses a tremendous threat to the prosperity of one of America's most vibrant economic sectors: its creative industries. Accordingly, it deserves our utmost attention. This attention must be consistent and long-term if it is to be successful. At the same time, we must be realistic in the goals that are set, lest we become discouraged in spite of our successes. While it is not realistic to expect to eliminate all piracy, I do believe that we can continue to improve the global situation, to the benefit of authors and right-holders here in the United States and throughout the world.

STATEMENT OF

STEPHEN M. PINKOS

DEPUTY UNDER SECRETARY OF COMMERCE FOR INTELLECTUAL PROPERTY
AND
DEPUTY DIRECTOR OF THE UNITED STATES PATENT AND TRADEMARK OFFICE

BEFORE THE

COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON INTELLECTUAL PROPERTY

United States Senate

"Piracy of Intellectual Property"

MAY 25, 2005

Introduction

Chairman Hatch, Ranking Member Leahy, and Members of the Subcommittee:

Thank you for this opportunity to appear before you to discuss international intellectual property (IP) piracy and counterfeiting problems and the Department of Commerce's role in protecting IP abroad. Secretary Gutierrez is keenly aware of the increasing significance of IP protection for American businesses and innovators and has made combating piracy and counterfeiting a top priority for the entire Department. As Deputy Under Secretary of Commerce for Intellectual Property and Deputy Director of the United States Patent and Trademark Office (USPTO), I am dedicated to marshalling U.S. government efforts to reduce the toll that IP theft takes on American IP owners. I am very appreciative of the Subcommittee's interest in addressing additional ways to protect U.S. IP owners' assets, and I commend you for holding today's hearing on IP piracy and counterfeiting, with an emphasis on China and Russia.

Scope of Global IP Piracy and Counterfeiting Problem

Increasingly, both the United States and our trading partners are relying on IP to drive economic growth. This is because competitive success in a market economy depends more and more on the IP assets held by an institution -- from the skills of its employees to the results of its latest research. IP-based businesses, such as the software and entertainment industries, now represent the largest single sector of the U.S. economy.

According to the International Intellectual Property Alliance, U.S. copyright industries continue to lead the U.S. economy in their contributions to job growth, gross domestic product (GDP), and foreign sales/exports. Between 1977 and 2001, the U.S. copyright industries' share of the GDP grew at an annual rate more than twice as fast as the rest of the U.S. economy. In 2002, the U.S. "core" copyright industries' activities accounted for approximately 6 percent of the U.S. GDP

($626.6 billion).[1] In 2002, the U.S. copyright industries achieved estimated foreign sales and exports of $89 billion, leading all major industry sectors, including motor vehicles (equipment and parts), aircraft and aircraft parts, and the agricultural sector.[2]

Unfortunately, the economic benefits of capitalizing on intellectual property rights (IPR) have captured the attention of pirates, organized crime, and terrorists. The global criminal nature of IP piracy has effects in other areas as well. As former U.S. Attorney General John Ashcroft reported: "In addition to threatening our economic and personal well being, intellectual property crime is a lucrative venture for organized criminal enterprises. And as law enforcement has moved to cut off the traditional means of fund-raising by terrorists, the immense profit margins from intellectual property crimes risk becoming a potential source for terrorist financing."

USPTO and DOC Efforts to Combat Problem

Given these threats to U.S. economic interests and our national security, the USPTO and our colleagues in the Department of Commerce are working hard to curb IP crime and strengthen IP enforcement in every corner of the globe. Indeed, former Secretary Evans heavily emphasized this issue, and Secretary Gutierrez has indicated it is a top priority for the entire Department. Because American IP owners compete in a global marketplace, we must expand our efforts to promote IP protection internationally. We must make sure that American IP owners have sufficient knowledge and legal tools to fight piracy and counterfeiting. We also must provide foreign countries technical assistance on drafting and implementing effective IP laws and promoting the effective enforcement of IP rights.

American Inventors Protection Act of 1999

The passage of the American Inventors Protection Act of 1999 (AIPA) (P.L. 106-113) set the stage for the USPTO to advise the President, through the Secretary of Commerce, and all Federal agencies, on national and international IP policy issues, including IP protection in other countries. USPTO is also authorized by the AIPA to provide guidance, conduct programs and studies, and otherwise interact with foreign IP offices and international intergovernmental organizations on matters involving the protection of intellectual property.

Our established Offices of International Relations and Enforcement carry out the functions authorized by the AIPA. These include (1) working with Congress to implement international IP treaties; (2) providing technical assistance to foreign governments that are looking to develop or improve their IP laws and systems; (3) training foreign IP officials on IP enforcement; (4) advising the Department of State and the Office of the U.S. Trade Representative (USTR) on drafting/reviewing of IP sections in bilateral investment treaties and trade agreements; (5) advising USTR on intellectual property issues in the World Trade Organization (WTO); and (6) working with USTR and industry on the annual review of IP protection and enforcement under the Special 301 provisions of the Trade Act of 1974. The USPTO also represents the United States in United Nation bodies, such as the World Intellectual Property Organization (WIPO), to help set the international standards for IP protection and enforcement.

[1] "Copyright Industries in the U.S. Economy: The 2004 Report," Stephen E. Siwek, Economists Inc., prepared for the International Intellectual Property Alliance. "Core" industries include: newspapers, publishing, recording, music, motion pictures, radio, television broadcasting and computer software.
[2] "Id.

National Intellectual Property Law Enforcement Coordination Council (NIPLECC)

The USPTO serves as the co-chair of the National Intellectual Property Law Enforcement Coordination Council (NIPLECC), which is tasked with coordinating domestic and international intellectual property law enforcement. NIPLECC was launched in 1999 to ensure the effective and efficient enforcement of intellectual property in the United States and worldwide. NIPLECC's coordination activities ensure that government enforcement efforts are consensus-based and non-duplicative. NIPLECC has developed a comprehensive database that includes all recent IP law enforcement training provided by the U.S. government and many associations to developing and least developed nations. It is also developing legislative suggestions to improve domestic IP laws related to enforcement. We look forward to continuing our efforts in NIPLECC.

Strategy Targeting Organized Piracy (STOP)

Further, the Strategy Targeting Organized Piracy (STOP) Initiative, which has been developed over the last year, is the most comprehensive U.S. government-wide initiative ever advanced to demolish the criminal networks that traffic in fakes, stop trade in pirated and counterfeit goods at America's borders, block bogus goods around the world, and help small businesses secure and enforce their rights in overseas markets. I will discuss this important initiative in more detail later.

Enforcement Training and Technical Assistance

The USPTO provides a variety of IP enforcement training and technical assistance activities. These programs are designed to foster respect for IP, encourage governmental and right holders' efforts to combat infringement, and promote best practices in the enforcement of IPR. Our technical assistance and capacity building initiatives grew out of a desire to promote IP protection and assist developing countries in meeting their obligations under the WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement. In addition, we have responded to an increasing number of requests by foreign governments for such training and technical assistance activities. Our efforts have had positive results in some countries, measured by decreasing levels of IP piracy and counterfeiting, and the implementation of stronger legal protections in many of the countries in which we have provided such training. Still, much work remains, including in China and Russia, where IP theft has not decreased.

Today, our efforts are aimed at: (1) assisting developing and least developed countries to meet international standards in the protection and enforcement of IP; and (2) assisting administrative, judicial, and law enforcement officials in addressing their enforcement issues.

Trade-Related Aspects of Intellectual Property Rights Agreement (TRIPs)

At the conclusion of the Uruguay Round in 1994, the resulting TRIPs Agreement presented WTO members with new obligations and challenges. The TRIPs Agreement sets minimum standards of protection for the various forms of IP and requires WTO members to provide for "enforcement procedures ... that permit effective action against any act of infringement of intellectual property rights." The TRIPs Agreement includes detailed provisions on civil, criminal and border enforcement measures designed to provide the owners of IP with the tools to protect and enforce their rights. Today, Developing Countries obligations' under the TRIPs Agreement have fully

entered into force. Least Developed Countries have until 2006 to comply with the bulk of the provisions, including the enforcement obligations.

Over the last several years, the USPTO has assisted countries around the world in establishing adequate enforcement mechanisms to meet their obligations under the TRIPs Agreement. In bilateral negotiations, we work closely with USTR to seek assurances from our trading partners of even higher levels of IP enforcement than those set forth in the TRIPs Agreement. We provide technical advice through the annual Special 301 process, the GSP review, the TRIPs Council review of implementing enforcement legislation, and in the negotiation of free trade agreements (FTAs).

Our approach to the on-going FTA negotiations has been to build upon the TRIPs Agreement. In other words, our negotiating position is that these trade agreements should follow a "TRIPs Plus" format by, among other things, expanding the minimum standards set out in the TRIPs Agreement. For example, by incorporating provisions of the WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty, the FTA updates copyright protections and enforcement for the digital environment. In our advisory capacity, we will continue to work with the Department of State and USTR to conclude FTAs that reflect the level of protection and enforcement of IP rights in the United States.

Intellectual Property Issues and USPTO Approach in China and Russia

Due to the rapid increases in piracy and counterfeiting in China and Russia, we recognize that U.S. companies face enormous IPR protection and enforcement challenges in these countries and that their losses are mounting daily. At the same time, the pressures of the competitive global marketplace, criminal elements, and protectionist and non-tariff barriers, make these challenges increasingly more sophisticated. That is why the USPTO's team of experts has developed comprehensive work-plans to address the rising IP problems facing these countries. While the USPTO does not have the lead on trade policy issues, which is the mandate of USTR, we have devoted significant resources to making progress in improving China and Russia's IPR regimes for our industries, right holders and this Administration.

The Bush Administration understands that IP is a vital component of our nation's economy and that this Administration's focus on combating global piracy and counterfeiting has produced a solid track record of real results. The STOP Initiative, which I mentioned earlier and will discuss in more detail later, is a continuation of these efforts by providing additional tools to protect American workers from counterfeiters and pirates who are robbing billions of dollars from the U.S. economy.

China

The U.S. has long been concerned about IP protection dating back to the founding of our country. For example, Gilbert Stuart's Athenaeum portrait of George Washington was replicated without authorization by a Philadelphia merchant, who was later sued for copyright infringement. Our first engagement with China on IP dates back to the early 20th century. In early 1903, at the end of the Qing dynasty, the U.S. government entered into the first bilateral agreement between China and the United States to protect IP. Our first commercial agreements in the 1970s with the People's Republic of China contemplated that China improve its IP system. Our current Ambassador to China, Clark Randt, was involved in some of these early negotiations.

Unfortunately, problems persist and our concerns about IP enforcement in China continue to grow. Despite China's membership in the WTO and its requirement to comply with the TRIPs Agreement, as well as a series of bilateral commitments made over the past 10 or more years, the lack of effective IP enforcement in China is a major problem for U.S. business interests, costing billions of dollars in lost revenue and perhaps tens of thousands of U.S. jobs. While China has done a generally good job of creating laws to comply with its WTO commitments, IP enforcement problems remain pervasive. These problems run the gamut from rampant piracy of movies and business software to counterfeiting of consumer goods, electrical equipment, automotive parts, and pharmaceuticals.

I was very pleased that Secretary Gutierrez stated the following during his confirmation hearing with respect to intellectual property rights: "We actually lived through this as a food company, ironically, where we found that our brand was actually being copied and used in some markets and obviously without any authorization. One of the great assets that we have as a country is our brands, our technology. I think this is a matter to focus on. I think it is a big issue." Secretary Gutierrez also cited IP protection as a key issue in U.S. trade ties with China, and he has reiterated his commitment to addressing this issue to me.

IP Problem in China

Estimates from the computer software and automotive parts industries are illustrative of the scope of the problem. The software industry estimates that more than 90 percent of all software installed on computers in China in 2003 was pirated.[3] The automotive parts industries estimate that counterfeit automotive parts production costs the industry billions of dollars in lost sales. China is a leader in counterfeit goods in this industry.

In the automotive arena, most counterfeiting involves parts that need to be replaced frequently, such as oil filters, headlamps, batteries, brake pads, fan belts, windshields, and spark plugs. For example, DaimlerChrysler, BMW, Audi, Volvo, Mitsubishi, and Toyota report that even though a factory in Guangdong Province has been raided three times in a two-and-a-half-year period, it has been allowed to continue making windshields stamped with their brand names for sale in the world market. One industry group estimates that legitimate automotive companies could hire 210,000 more employees if the counterfeit auto parts trade is eradicated.[4]

According to the World Health Organization (WHO), 10 percent of the medicines in the world are counterfeit, with China being one of the main centers of counterfeit production. Rudolph Giuliani offered the following testimony before a Senate Committee in June of last year:

> "An August 30, 2002, Washington Post story cites the Shenzhen Evening News in reporting that an estimated 192,000 people died in China in 2001 because of counterfeit drugs. Another news story reported that as much as 50 percent of China's drug supply is counterfeit (Investor's Business Daily dated October 20, 2003)."[5]

---

[3] Ibid. Key Findings: BSA and IDC Global Software Piracy Study.
[4] Motor and Equipment Manufacturers Association, September 2003.
[5] *See* Statement of Rudolph W. Giuliani before the Senate Government Affairs Committee, Permanent Investigations Subcommittee, *Oversight Hearing on Safety of Internet Drugs* (July 16, 2003).

While no definitive statistics exist on total U.S. job losses attributable to IP piracy and counterfeiting in China, there is no doubt piracy and counterfeiting deprive the government of billions of dollars of much needed tax revenue, cost thousands of jobs, and injure the domestic software industries.

China's Enforcement Issues

The Chinese IPR enforcement environment today is complicated by a variety of different Chinese and foreign interests, including Chinese industrial policies, trade policies, the interests of foreign investors, and the interests of Chinese domestic enterprises. In this environment, our right holders increasingly look to adequate enforcement of criminal IPR laws in implementation of China's WTO commitments as a key to reducing counterfeiting and piracy rates in China. China, it should be noted, does not lack for quantitative enforcement. Each year, tens of thousands of enforcement actions are undertaken. However, these actions are typically pursued by administrative agencies, which impose non-deterrent penalties.

This Administration has been pressing China to impose prison sentences and/or stiffer fines on violators of IPR since fines and other penalties imposed are too modest and provide little or no deterrence. In December 2004, two branches of China's government – the Supreme People's Court and Supreme People's Procuratorate (prosecutor) issued a new "Judicial Interpretation" for criminal IPR infringements. The new Interpretation expanded the scope of violations punishable by prison sentences by lowering the value threshold necessary to initiate a prosecution, but on the enforcement side took a significant step backwards with respect to violations committed by repeat offenders. The new Interpretation was also deficient in many other areas of concern to industry and foreign governments, including, for example, coordination among China's civil and administrative systems as well as the relationship with other IP laws. Furthermore, the new Interpretation complicated matters by allowing infringing goods to be valued based on their street value, not their legitimate value, thus sanctioning declarations by the infringer as a measure for determining whether or not Chinese valuation thresholds were met dictating prosecution. Equally disconcerting was that unfinished or offsite products were exempt in assessing that value.

Many of the challenges that China encounters are at least partially due to deficiencies in its own system, including extensive corruption, local protectionism, and lack of interagency coordination. Some of the issues we have raised with Chinese colleagues include: the use of mandatory sentencing guidelines for IPR crimes; support for specialized IPR courts which have greater independence from local financing and control; establishing appropriate procedures for investigation, prosecution, and conviction of IPR criminals; and effectively addressing trans-border IPR crime, as well IP crime committed over the Internet.

It is important to recognize that there is a Chinese domestic constituency also seeking enhanced IPR protection and enforcement, and that pirates and counterfeiters do not necessarily discriminate against Americans or just against Americans lacking political influence. As the economy grows, domestic interest in IP, particularly in the more developed cities on China's seaboard, is increasing dramatically. China's deficient IP protection and enforcement hinders Chinese software engineers, inventors, and movie producers who have to struggle with a severely deficient domestic market as their principal source of income. Chinese IP owners have become increasingly vocal proponents of stronger IP protection. One indication that IPR is attaining increased domestic importance is the number of trademark applications received by the Chinese Trademark Office (CTO). For the past two years, the CTO received more trademark applications than any country in the world. The State

Intellectual Property Office is also growing rapidly and receives some of the highest number of filings for patent applications worldwide.

Growing domestic interest in IP protection and enforcement may be of small comfort to U.S. industry when the impact of piracy and counterfeiting on U.S. industry appears to be growing. U.S. Government statistics show a worsening situation. For example, USTR's 2004 Special 301 Report states that during 2003, 66 percent of all of the IPR-infringing goods seized at the U.S. border came from China.[6] Many industries also increasingly suspect that the Chinese government, by restricting market access, is providing free rein for counterfeiters, pirates, and criminals to exploit the void created by the lack of legitimate products. Many U.S. companies also complain of industrial policies that help create conditions for production of infringing products. Counterfeit Viagra, for example, dominates the Chinese market, while the legitimate product has been hampered by market access restrictions. Pirated movies appear in the Chinese market long before censors have approved the legitimate product. Other high-tech companies complain of standards setting, such as in wireless networking technology, which limits introduction of legitimate products or mandates technology transfer.

USPTO's Efforts in China

Under the direction of this Administration, the USPTO has been working extensively to reduce piracy and counterfeiting activity in China. First, we provide technical support to all agencies of the U.S. Government that are addressing these issues, including USTR, the Department of Commerce/International Trade Administration (ITA), the U.S. Department of Justice, the Department of Homeland Security, and the State Department.

The USPTO has an established team of experts on Chinese IP matters, which includes IP attorneys with detailed knowledge and background on patents, trademarks, copyrights, enforcement issues, and WTO/WIPO issues. Our cooperation with other U.S. government agencies extends beyond the trade agenda to providing support on strategies and to addressing transnational crime and transnational trade in counterfeit goods, as well as other issues.

TRIPS review. For example, we take an active role in the annual review of China's TRIPs commitments at the WTO, including primary responsibility for drafting many of the TRIPs-related questions. Three USPTO officials attended China's WTO review last year. We also actively participate in the APEC Intellectual Property Experts Group, which plays a constructive role in developing regional standards for IP, including cooperation on enforcement matters. Further IP initiatives in China supported by the USPTO are described below.

IP attorney at U.S. embassy. For two summers, with the active support of U.S. Ambassador Clark Randt, we stationed one of our IP enforcement attorneys, who is fluent in Mandarin, in our embassy in Beijing to help with IP enforcement issues in the region. Last fall, the USPTO was proud to continue this support by detailing this individual as attaché to the U.S. Embassy in Beijing for a three-year appointment to continue our Government's efforts to combat piracy and counterfeiting. This is the first time the USPTO has sent an official abroad for an extended period of time to assist in improving IP protection in a specific country, which highlights the seriousness of IP violations in China. Having an attaché stationed in China has enhanced the USPTO's ability to work with

[6] http://www.ustr.gov/Document_Library/Reports_Publications/2004/2004_Special_301/2004_Special_301_Report_Section_306.html.

Chinese government officials to improve IP laws and enforcement procedures in addition to assisting U.S. businesses to better understand the challenges of protecting and enforcing their IPR in China.

Meetings with Enforcement Officials and Other Influences. One of the greatest challenges in China is ensuring that localities fully enforce national laws. To that end, the USPTO has held meetings with numerous local copyright, trademark, judicial, police, and prosecutorial enforcement officials throughout China to ensure that local officials fully understand their international obligations. We have hosted numerous delegations at the USPTO, with the objective of addressing this challenge. We have also worked with U.S. non-governmental organizations in support of rule of law efforts and training programs, including a Temple University program and Franklin Pierce Law School's annual summer program on intellectual property law in Beijing for American and Chinese law students.

Training. Recent efforts in China that we have supported include: training on criminal IPR with the support of the British Government and China's Ministry of Public Security; training on patent data protection and patent linkage with the State Intellectual Property Office and State Food and Drug Administration; training on "business methods patents" with the State Banking Regulatory Commission, State Council Legislative Affairs Office and the Development Bank of China; training with the World Customs Organization on border measures and criminal IPR; participation in Chinese sponsored programs on IP protection in Shanghai and on IPR strategies for multinational companies in Beijing; and a joint U.S. Semiconductor Industry Association and Chinese Semiconductor Industry Association training program on IPR in high tech industries, to name but a few.

Bilateral meetings with trade groups. We have also participated in a range of bilateral meetings and consultations with visiting U.S. trade associations such as the Intellectual Property Owners, U.S. Information Technology Office, Research and Development Pharmaceutical Association of China, Quality Brands Protection Committee, American Bar Association, International Federation of Phonographic Industries, Motion Pictures Association, Entertainment Software Association, Business Software Association, Association of American Publishers, U.S. Chamber of Commerce, to name just a few. We have also worked with some of these organizations to host enforcement conferences in such major cities as Beijing, Shanghai, Guangzhou, Wuhan, Nanjing, and Chengdu.

Both domestically and in Beijing, we have provided briefings for visiting congressional and judicial delegations, and we have provided training for State Department and Commerce Department officials at our various consulates, including participation at a regional training program in Hong Kong sponsored by the Economic Bureau of the State Department. Working with the Department of Commerce's Technology Administration and the International Intellectual Property Institute, we have provided technical assistance on copyright protection in Dalian and Shenzhen.

Public relations efforts. The USPTO continues to work through our own office of public affairs and the public diplomacy offices of the Embassy and consulates on providing an informed perspective on IP matters to the Chinese public and Chinese decision makers. Additionally, we are supporting State Department efforts to provide informational materials on U.S. IP practices to the Chinese public. We have also had several meetings at Chinese Universities. Under Secretary of Commerce for Intellectual Property and Director Jon W. Dudas delivered a talk at Qinghua University, one of China's leading law and engineering institutions, on IP protection. In addition, my staff has delivered presentations at Sichuan Normal University Law Faculty, Qinghua Law Faculty, People's

University and other institutions, as well as appearing on several television shows and being featured in newspaper articles.

Supporting Businesses and Working with Law Enforcement in China

Apart from these advocacy and training efforts, we are involved in developing practical strategies to support our businesses in handling problems in China. We have worked extensively with the Commerce Department on improving methods for handling business complaints involving unfair IP practices in China and have become involved with the STOP Initiative whereby we handle complaints involving IP, many of which involve China. We have worked on two leading programs associated with the U.S. Embassy involving IP: a "toolkit" on IP matters for U.S. businesses on the Embassy's website, and the "IPR Roundtable" that the Ambassador hosts each year.

Meetings in China. We have held meetings at the Canton Trade Fair to discuss IPR enforcement and complaints filed. We continue working with ITA, the American Bar Association, and many other organizations to provide better assistance to U.S. small and medium businesses. USPTO attorneys have been meeting with other foreign missions and trade associations to exchange ideas on innovative ways to promote better protection of IPR in China.

Training programs for American businesses. We have participated in training programs for our business people in the United States, to better enable them to forcefully address the IPR challenges they experience in China and, when necessary, bring well-founded complaints to our attention. Typically in conjunction with the Department of Commerce, members of our China team have participated in programs in such cities as: Cincinnati, Ohio; Grand Rapids and Pontiac, Michigan; Charlotte, North Carolina; Miami, Florida; Minneapolis, Minnesota; Wichita, Kansas; St. Louis, Missouri; New York City and Long Island, New York; Waterbury, Connecticut; Boston, Massachusetts; Providence, Rhode Island; Portsmouth, New Hampshire; Fresno, San Jose and San Francisco, California; Salt Lake City, Utah; and Washington, D.C. A major focus of these efforts has been to address problems of small and medium enterprises, although larger enterprises have also benefited from participation in many of these programs as well.

Workshops about China. In addition to our work with the Department of Commerce, our China team is planning to roll out a series of intensive China workshops and seminars in several cities throughout the United States in 2005-2006. The first of these seminars is planned for Detroit, Michigan, in June. The program will provide companies with information about several useful topics, ranging from an overview of the IP protection and enforcement environment in China, specific information on how to file patent and trademark applications in China, how to use China's administrative and judicial systems to enforce IPR, and useful tips about how to locate and hire a local company to investigate IP infringement in China.

Another activity, as part of our ongoing efforts to assist U.S. businesses and IP owners in protecting their rights overseas, includes a seminar on the Chinese criminal justice system for IP offenses that we held in February of this year. The seminar introduced the Chinese criminal justice system to U.S. industry, government agencies, IP owners, and legal practitioners and included information on the recently amended Judicial Interpretation so they may better understand the system and use this information to their full advantage to combat counterfeiting and piracy. We sponsored a follow up program in April of this year.

Our China team has supported a number of programs to advise our companies on how to file a criminal IPR case in China. These programs have already been held in Guangzhou, Beijing, and Hong Kong with an additional program planned for Shanghai. In addition, we provide support to our own law enforcement authorities where possible on IP criminal matters. For example, we have supported the Joint Liaison Group on criminal justice cooperation in its efforts to facilitate better criminal IPR cooperation, and joined in training programs run by a number of different government agencies on criminal IPR matters. Our China team works closely with the Customs Attaché and Legal Attaché at the U.S. embassy as well as the Bureau of International Narcotics and Law Enforcement at the State Department on these matters.

More United States Government Efforts in China. Like Secretary Gutierrez, former Secretary of Commerce Evans believed in the strong enforcement of our trade laws and took innovative and proactive measures to strengthen the enforcement and compliance of our trade agreements. During his tenure, he tasked Commerce agencies, such as USPTO and the new Investigations and Compliance Unit within ITA's Market Access and Compliance Group, to coordinate their efforts to vigorously pursue allegations of IPR violations wherever they occur, especially in China.

Delegations to China. In 2003, then-Commerce Secretary Evans led a mission to China and highlighted China's lack of IPR enforcement. The Secretary met with high-ranking Chinese officials and reiterated a continuing concern -- that effective IPR protection requires that criminal penalties for IP theft and fines are large enough to be a deterrent, rather than a business expense.

As a follow-up to the October 2003 trip, Under Secretary and Director Jon W. Dudas led two delegations in 2004 for consultations with senior officials at China's patent, trademark, copyright, and other IP agencies. Our delegation also met with U.S. companies facing IP issues in China. The primary focus of these trips was to further the Administration's goals of improving the IP environment for U.S. companies doing business in China, and specifically of addressing widespread counterfeiting and piracy. We discussed several issues, including the need for improved criminal, civil, and administrative enforcement, the need for protecting copyrights over the Internet and China's accession to the WIPO Internet Treaties.

In January 2005, Under Secretary Dudas traveled to Beijing as part of a second Evans-led delegation. He was fortunate to be able to meet with Chinese Premier Wen Jiabao and Vice Premier Wu Yi to discuss concerns over China's enforcement of IPR of American businesses. Ambassador Randt also hosted the third roundtable on Intellectual Property Rights, which was attended more than 250 government officials and business and industry representatives from the USPTO, the European Union, Japan, and China's IP agencies. In addition to providing the luncheon keynote address during the January roundtable, Under Secretary Dudas announced the USPTO's new plans for IP technical assistance for Chinese IP–related agencies. He was pleased that the USPTO's offers of cooperative assistance were well received, and we are in the process of implementing these as well.

U.S.-China Joint Commission on Commerce and Trade (JCCT) Working Group on IPR

In an effort to address problems in China, the U.S. and China created a "working group on IPR" that resulted from the April 2004 session of U.S.-China Joint Commission on Commerce and Trade. We are pleased that Under Secretary Dudas co-chairs this working group with Deputy U.S. Trade Representative Josette Shiner.

Through the JCCT and other avenues, the U.S. hopes to continue to work with closely with China to improve the situation for U.S. rights holders. During the April 2004 session of the JCCT, China presented an action plan designed to address the piracy and counterfeiting problems faced by U.S. companies. Under the plan, China committed to: (1) significantly reduce IPR infringement levels; (2) issue a judicial interpretation for criminal enforcement of IPR cases by end of year; (3) conduct nation-wide enforcement campaigns; (4) ratify and implement the WIPO Internet Treaties as soon as possible, and (5) agree to establish an IPR working group under the JCCT. In line with the JCCT mandate, the working group will seek to ensure that China significantly reduces IPR infringement to levels consistent with standards required by WTO rules.

Challenges and Recommendations concerning China

While our trips to China have been well received, and we are pleased to note a continuing and increasing awareness among Chinese officials of the importance of IP protection and enforcement, we have not yet seen significant progress on most of the key issues. These issues include enhanced criminal enforcement, a deterrent administrative enforcement system, protecting copyrights over the Internet, and stopping the export of counterfeit goods. We are also interested in other developments, such as China's efforts to develop an IPR Strategic Plan for development of its IP assets, other industrial policy goals, legislative efforts to draft a Civil Code that may include IPR, and general rule of law efforts that could significantly affect the protection of IPR over the long run.

While we fully recognize that China needs to make drastic improvements in its IPR system to ensure that our right holders are fairly protected, we should not underestimate the steps that our businesses and government can take to reduce the risks of piracy and counterfeiting. The USPTO will continue working with small and medium-sized companies on how best to protect their valuable IP rights in China. One particular example is for companies to register all their trademarks promptly in China, especially their Chinese language trademarks. Given the fast pace of China's economic development and the huge volume of trademark applications in China, companies should file for their marks early in their marketing cycle.

Globalization means that competitors can retrieve information about products not yet introduced in their country from a U.S. company's web site. Counterfeiting and piracy also originates from employees, agents, or distributors who have taken confidential information to engage in a competing operation. China's practice regarding protection of trade secrets by former employees who have signed non-compete agreements is different from the United States. We will continue to educate companies on how best to protect their intellectual property rights.

It is especially important we encourage our industries to work with us and the other U.S. agencies involved in improving China's IP protection and enforcement environment by: urging the fair and transparent implementation of China's IPR system; fully exploiting this system; providing us with detailed information on its deficiencies in order to reduce future risks of such activities; and supporting our bilateral and multilateral efforts to reduce the impact of these problems.

Russia

As indicated by the listing of Russia as a priority watch list country in the 2005 Special 301 Report, copyright piracy in Russia is of serious concern. In 2004, industry estimates that more than $1.7

billion in losses occurred in Russia.[7] Due to poor enforcement, industry calculates more than $7 billion in losses to the copyright industries in the last eight years. Estimated copyright piracy levels in the Russian Federation in 2004 were estimated by industry at 80 percent for motion pictures, 66 percent for records and music, 87 percent for business software, and 73 percent for entertainment software. The production of optical media in Russia far exceeds legitimate demand. According to industry, in the last three years, the number of optical disc plants that manufacture and distribute optical media has more than doubled. In the past four years, production capacity of optical media in Russia has nearly tripled.

Issues in Russia

While the Russian government has made significant progress in improving the legal framework for IP protection, current laws and regulations in the Russian Federation have not had a significant impact on controlling illegal optical disc production. Although raids and seizures at optical disc plants increased last year, in most cases, according to industry, plants continue to operate after the raids and little meaningful action is taken against the plant operators. These raids did not have an appreciable effect on reducing optical disc piracy, especially in cases where effective prosecution by the Procuracy were lacking. Industry reports that piratical product seized from raids sometimes returns to the market. The lack of effective criminal enforcement of IP theft in the Russian Federation is a concern. The involvement of organized crime in the manufacture, distribution and exportation of piratical entertainment software is also of concern.

The banning of street sales, including kiosks of audio and audiovisual products, was encouraging, initially; but industry reports that the prohibition is not regularly enforced and that pirated music compact discs continue to be available on the streets. In 2004, the industry reported that 1,300 administrative raids against music pirates were undertaken, resulting in numerous administrative actions. The average administrative penalty in these cases was approximately $50. This level of fines cannot be considered a deterrent to piratical activity. The majority of administrative actions involving storeowners and sellers averaged $200. Unfortunately, industry reports that the supply and distribution sources are rarely pursued. Effective enforcement of IPR at the borders of the Russian Federation is in need of improvement as well. Industry indicates that piratical optical media was forensically identified as being exported from Russia to over 25 countries.

Russian steps to reform and deficiencies

Last year, Russia took some steps in reforming its laws for compliance with the 1992 U.S.-Russian bilateral trade agreement. For example, Russia did amend its laws on trademarks, appellations of origin, patents, designs for integrated circuits, plant varieties, computer software, and databases.

Serious concerns remain about Russia's denial of national treatment for protection of geographical indications (GIs). Further, significant shortcomings remain with Russia's trademark laws, especially provisions dealing with geographical indications. There do not seem to be any provisions in the Russian law that ensures that the principles of priority and exclusivity are preserved for trademarks and geographical indications. These rights are required under the TRIPs Agreement, which requires that owners of trademarks established prior to a later in time GI should be able to assert the exclusivity of their prior rights.

[7] http://www.iipa.com/rbc/2005/2005SPEC301RUSSIA.pdf

IPR Initiatives concerning Russia

USPTO continues to provide capacity building assistance to the Russian Federation focusing on the enforcement of IPR. In December 2001, we hosted the United States-Russia Intellectual Property Rights Enforcement program in Washington in cooperation with the Commercial Law Development Program. The conference was attended by Russian officials representing various government agencies involved in the enforcement of intellectual property rights in Russia. The conference included a discussion of judicial administration issues involving IPR, discovery, interim measures and damages in civil infringement cases, arbitration, deterrent criminal penalties and border measures.

In November 2002, we cosponsored and participated in a United Nations Economic Commission for Europe seminar in Moscow on IPR enforcement in Russia. The seminar was attended by Russian government officials representing the State Duma and the Ministries of Defense, Culture, Education, and Science. This summer, USPTO will be co-sponsoring a three-day workshop in St. Petersburg on border enforcement of IPR in coordination with the International Intellectual Property Institute, U.S. Customs and Border Protection and Russian Customs.

In addition, the U.S. Embassy in Moscow has had ongoing collaboration with relevant Russian entities to provide training to the Russian law enforcement agencies and the Procuracy on IPR enforcement. The Embassy sponsored a series of seminars last year, both in Moscow and in the regions, and plans to offer more training this year.

With U.S. copyright industries losing more than $1 billion a year to copyright piracy in Russia, we look forward to increased effective enforcement efforts in Russia. We continue to urge the closure of plants producing illegal optical discs, increased raids and prosecution of optical disc piracy, and the adoption and implementation of an effective optical media regulation and enforcement regime. Moreover, any organized crime involvement in counterfeit goods and piratical works must be addressed through increased investigative efforts and stronger criminal penalties. The Russian government must also strengthen its border enforcement, combat counterfeiting and piracy, and address deficiencies in its intellectual protection laws. We have enjoyed a cooperative working relationship with the Russian Federal Service on Intellectual Property, Patents, and Trademarks headed by Boris Simonov, and we continue a productive dialogue with him and the Russian law enforcement agencies on ways to improve Russia's IP record. However, for our efforts to be truly effective in reducing IP violations in Russia, we need genuine commitment from all levels of the Russian government to view this as a priority problem and take meaningful steps to combat it.

The Global STOP Initiative

We are pleased to discuss with you the STOP Initiative, the most comprehensive intergovernmental agency initiative ever advanced to smash the criminal networks that traffic in fakes, stop trade in pirated and counterfeit goods at America's borders, block bogus goods around the world, and help small businesses secure and enforce their rights in overseas markets. There are several important features of the STOP Initiative that I'll mention:

Hotline and Website

First, the USPTO participates heavily in this initiative by managing a hotline, 1-866-999-HALT, established by the Department of Commerce to help business protect their IPR at home and

overseas. The goal of the hotline is to empower U.S. business to secure and enforce their IPR by providing them the information they need to secure their patents, copyright and trademarks, and to enforce these rights here in the U.S. and abroad.

Callers receive information from IP attorneys with regional expertise on how to secure patents, trademarks, and copyrights, and on the enforcement of these rights. Businesses and innovators now have access to a place to learn more about the risks of global piracy and counterfeiting and how to protect their IP rights in both individual countries and in multiple countries through international treaties. In addition, we have established a link from our USPTO website to www.stopfakes.gov on the Department of Commerce's website, which provides in depth detail of the STOP Initiative.

No Trade in Fakes Program

The Department of Commerce is in charge of another important component of the STOP Initiative, the no-trade-in-fakes program that is being developed in cooperation with the private sector. This is a voluntary, industry-driven set of guidelines and a corporate compliance program that participating companies will use to ensure their supply chains and retail networks are free of counterfeit or pirated goods.

Increasing and Communicating Enforcement

The STOP Initiative will raise the stakes for international IP thieves by more aggressively pursuing perpetrators of IP crimes and dismantling criminal enterprises. STOP also seeks to increase global awareness of the risks and consequences of IP crimes through public awareness campaigns, and creating and operating a website publicizing information about international criminal IP enforcement actions.

Building Coalitions

The ultimate success of the STOP Initiative involves building coalitions with many of our like-minded trading partners, such as Japan, the United Kingdom, and France, who have all recently launched similar initiatives. We are seeking to continue working with our partners in the G-8, Organization for Economic Cooperation and Development (OECD) and the Asia-Pacific Economic Cooperation (APEC) forum. Cooperation on new initiatives to improve the global intellectual property environment is essential to disrupting the operations of pirates and counterfeiters.

International Outreach

A delegation of U.S. officials from seven federal agencies, including myself, recently kicked-off our international outreach effort to promote STOP internationally. Last month we visited various capitals in Asia generating much interest and fruitful discussions. On each leg of the trip, U.S. officials shared information on our efforts to combat the theft of inventions, brands and ideas. This first leg abroad is advancing our commitment by enlisting our trading partners in an aggressive, unified fight against intellectual property theft. Outreach to Asia will be followed by visits to other capitals later in the year, for example, next month we plan on visiting Europe. We have tentatively planned that countries receptive to cooperation on STOP will be invited to attend a meeting in Washington, D.C. (likely in the fall of 2005) designed to formalize their participation and finalize a work plan.

Future STOP Activities

The USPTO has several future planned activities supporting our initiatives under STOP. The first involves our public outreach efforts. In addition to our China-related workshops and seminars for 2005-2006, my staff will also be embarking on an educational road show to various cities in the United States to educate small- and medium-sized business on what IPR are, why they are important, and how to protect and enforce these rights domestically and internationally. The first of these workshops took place earlier this week in Salt Lake City, Utah, and already, we have found an enormous amount of interest in the program. We will replicate this program in other cities throughout several regions of the U.S. in the coming months.

We continue to work in WIPO to seek to simplify, streamline, and improve the cost efficiency of the trademark application process across borders to provide more efficient and less burdensome systems for right holders.

We will continue to work closely with the IP community, STOP team, and you to promote a legislative agenda that is designed to meet the huge challenge of combating piracy and counterfeiting. Tougher enforcement of our international trade laws is necessary for the growth of our economy and the creation of new jobs. In order to fully implement the STOP Initiative, it may be necessary to reassess current legislation.

Conclusion

Mr. Chairman, the requirements on the Department of Commerce and USPTO's expertise in the international arena have grown dramatically in the last few years. These demands will continue to increase in the next few years, along with our obligations to meet our core patent and trademark examination functions.

As we look to the future, however, let me conclude on a positive note. Although by all accounts counterfeiting and piracy appear to be growth "industries," there have been some recent successes in attacking the problem. Between 2001 and 2002, the software industry estimates that software piracy in Indonesia decreased from 89 percent to 68 percent. In South Africa, it fell from 63 percent to 36 percent. The motion picture industry has reported a decrease in piracy levels in Qatar from 30 percent in 2001 to 15 percent in 2002. In Bahrain, there have been dramatic and systemic improvements in IP protection and enforcement over the past few years. These include the signing of numerous international IP conventions and the virtual elimination of copyright piracy and counterfeiting in retail establishments.

There is some reason for optimism. I remain hopeful that with the continued support and partnership of the Subcommittee, we will be able to do even more to provide American businesses and entrepreneurs with the IP knowledge and protection they need. Clearly, in terms of the economy and national security, much is at stake. That is why our dedicated team of experts will continue to work tirelessly to protect American products all around the globe.

Thank you very much.

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE

1747 PENNSYLVANIA AVENUE, NW • SUITE 825 • WASHINGTON, DC • 20006-4637 • TEL (202) 833-4198 • FAX (202) 872-0546 • WWW.IIPA.COM • EMAIL: INFO@IIPA.COM

Written Statement

of

Eric H. Smith
President, International Intellectual Property Alliance (IIPA)

before the

Subcommittee on Intellectual Property
Senate Judiciary Committee
on

"Piracy of Intellectual Property"

May 25, 2005

Chairman Hatch, Senator Leahy and other distinguished Committee members, IIPA and its members thank you for the opportunity to appear today to speak to the damage that global piracy does to the U.S. economy, U.S. jobs, and to the U.S. copyright industries. This oversight hearing is extremely timely since at this very moment, a delegation from China, called the IPR Working Group, headed by Madame Ma of MOFCOM, is meeting with the U.S. government as part of the Joint Commission on Commerce and Trade (JCCT) process. In addition, USTR has just announced its decisions in the Special 301 process which is, as you know, the Congressionally-created mechanism by which our government seeks to improve IPR protection and enforcement globally and to nurture those creative and innovative industries and individuals who contribute so greatly to our nation's economic growth. We think it is particularly important that Russia, China and other key trading partners are made aware of the keen interest of the U.S. Senate in these issues, and particularly, to illuminate the ongoing talks with China – and with Russia in the WTO accession process.

IIPA represents the U.S. copyright industries. Its six member trade associations consist of over 1,300 U.S. companies, accounting for millions of U.S. jobs. The copyright industries, in 2002, contributed over $625 billion to the GDP, or 6% of the U.S. economy and almost 5.5 million jobs or 4% of U.S. employment. These companies and the individual creators that work with them are critically dependent on having strong copyright laws in place around the world and having those laws effectively enforced. On average, the copyright industries generate over 50% of their revenue from outside the U.S., contributing over $89 billion in exports and foreign sales to the U.S. economy. Given the overwhelming global demand for the products of America's

creative industries, all these numbers would be significantly higher if our trading partners, particularly those, like China and Russia, that continue to allow piracy to flourish in their own economies, were to significantly reduce piracy rates by actually enforcing their copyright laws vigorously.

IIPA's Special 301 Report on Global Piracy

I have appended to my written testimony a copy the transmittal letter covering IIPA's comprehensive February 2005 Special 301 submission on piracy in 67 of our key trading partners. This 600-plus page report, which IIPA submits annually to USTR, details specific statutory and enforcement deficiencies in these countries and highlights their impact on the overall U.S. economy and on the U.S. creative industries. The entire report can be found on the IIPA website at www.iipa.com. In the attached transmittal letter, IIPA summarizes the key global priorities of our industries and summarizes the conclusions of the overall report. It highlights that our industries conservatively lost an estimated $12 billion in these countries/territories in 2004 (data for all countries was not available) and IIPA estimates that its global losses in all countries were an estimated $25-30 billion.

Rampant piracy in most of the countries highlighted in this report constitute the copyright industries' greatest barrier to trade, costing U.S. jobs and contributions to the U.S. economy. This Subcommittee is aware that part of this damage is due to inadequate laws on the books in some countries, including with respect to effective legal protection for copyrighted material transmitted over the Internet. Today, however, unlike in the 1980's and 1990's, the problem has less to do with inadequate laws and more with ineffective and non-deterrent enforcement systems. This is particularly true in two countries that IIPA highlights in its report and which we wish to highlight in this statement, namely Russia and China. Before doing so, however, let me set out the six areas that reflect the copyright industries' initiatives/priorities and global challenges (further detailed in the transmittal letter to our Special 301 report).

- A major priority/challenge is in the area of Internet piracy, as it impacts the future of electronic commerce. Internet piracy is growing at alarming rates as more and more of the world's population gets connected to the Internet. The first order of business to combat this problem is to establish an effective legal infrastructure which includes ratification and full implementation of the WIPO "Internet" treaties (the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty). While the treaties are now fully in force, much work needs to be done to secure further ratifications by our trading partners and full implementation of the treaties' obligations. The healthy growth of e-commerce – critically dependent on securing a safe environment for the global transmission of valuable data, much of it protected by copyright laws – hangs in the balance.

- Optical disk piracy and the effective regulation of optical disk production in countries that have been unable to effectively deal with this problem is another key challenge and priority. Global production capacity far outstrips global demand; using that excess capacity for pirate production has flooded the world's market with pirate optical disks containing all types of copyright material. Securing effective regulation of plants in

problem countries and enforcement is an ongoing initiative and challenge for the U.S. government and the copyright industries.

- Piracy by organized crime syndicates is rife particularly throughout Asia and Central Asia and Eastern Europe. Because piracy is so lucrative and in many of these countries enforcement is weak or governments are not strong enough to combat these syndicates effectively, they have taken over the business of piracy, as but another part of their illegal activities including the financing of terrorism. Our report details many examples of how organized crime syndicates go about the business of piracy. Only government intervention and government cooperation internationally can stem this growing problem – the private sector is unable to do so on its own. The U.S. government must be at the center of this effort.

- The unauthorized use of business and productivity software by governments, state-owned enterprises and private sector companies causes the largest losses globally to one of the most productive and fastest-growing sectors of our economy. IIPA member, the Business Software Alliance, just recently announced that the global personal computer packaged software industry (beyond just U.S. software publishers) lost more than $32 billion in 2004 (counting both business and consumer software).

- Piracy of books and journals, in English and in translation, by traditional printing means and by commercial photocopying of entire editions, remains a major problem for the U.S. publishing industry. Increasingly sophisticated technologies allow for pirate hard copies of books that are becoming more and more competitive with authorized editions. In addition, publishers are suffering from significant online piracy, mostly in the form of peer to peer trading or commercial sale of scanned versions of bestsellers and academic texts. This type of piracy also affects professional and scholarly journals already put into electronic form by the legitimate publisher, as sites containing these products are compromised by unauthorized users. Piracy of both hard copies and electronic files deprives the publishing industry and our economy of both revenue and jobs.

- Finally, a cross-cutting priority/challenge, affecting all our industries, is bringing all countries into compliance with their enforcement obligations in the WTO TRIPS Agreement and by using the U.S.'s Free Trade Agreement process to raise the level of statutory protection to encompass new technological challenges, like the Internet, and to obligate governments, in return for more open access to the U.S. market, to "open" their markets by significantly improving the enforcement of their copyright and related laws to significantly reduce the high rates of piracy. Piracy severely inhibits the growth of the copyright industries in these countries, including our own companies.

I would now like to turn the subcommittee's attention to two countries where our piracy problems are truly severe and growing. These countries provide vivid illustrations of all the challenges referred to above. They are Russia and China. I will speak first about Russia because Congress has a direct role to play in determining whether Russia should be a WTO member and receive PNTR status when it has failed to meet even its minimal enforcement obligations under the WTO TRIPS Agreement.

Russia: The New China

Russia's copyright piracy problem has become enormous. IIPA has worked on U.S. – Russian copyright matters for over 16 years trying to improve the legal regime in Russia – including adoption of better copyright and related enforcement laws, as well as working to improve on-the-ground enforcement. The present piracy problem in Russia is the worst it has been in our 16 years experience. Piracy of all copyright materials – motion pictures, records and music, business and entertainment software, and books – is at levels ranging from a low of about 66% to a high of 87% – totally unacceptable for a country and economy the size and sophistication of Russia.

Let me begin by describing the scope and nature of the problem in Russia from our vantage point.

Scope and Nature of the Piracy Problem in Russia

Russia has one of the worst piracy problems of any country in the world, second only to China. The IIPA estimates that the copyright industry lost over $1.7 billion due to piracy last year, and over $6 billion in the last five years in Russia. As noted, the piracy rates hover around 70% of the market or higher for every copyright sector. In short, Russia's criminal enforcement system has failed to stem persistent commercial piracy.

The number of optical disk (i.e., CD and/or DVD) plants in Russia has more than doubled in just the last three years to number at present, at least 34 plants, including eight dedicated DVD plants. There are a total of 80 known operational production lines. Production capacity has nearly tripled as criminal operations have encountered little hindrance in expanding their activities. Even more troubling, IIPA is aware of nine production plants located on the facilities of the Russian government, so-called restricted access regime enterprises (although the Russian government has publicly acknowledged that there may be as many as 18 such plants). Russia's annual manufacturing capacity now stands conservatively at over 370 million CDs and additionally over 30 million DVDs, despite the fact that the demand for legitimate disks is unlikely to exceed 80 million in all formats.

Forensic evidence indicates that at least 24 of the 34 plants are known to be producing pirate product. Of course, without proper surprise inspection procedures in place, there is no way of knowing for certain the size and scope of what all the plants are producing. Russian-produced optical disks (CDs) have been positively identified in at least 27 countries. So, the harm illegal Russian plants are doing far exceeds the Russian marketplace.

In 2004, there were eight actions taken by the Russian government against the optical disk ("OD") CD/DVD plants, including raids and seizures of illegal materials according to our industry, and Russian government, reports. The raids would appear to be a positive step, but the outcome of the raids is telling:

First, 70% or more of the seized material ends up back in the marketplace either through lax enforcement (or corruption), laws permitting charitable sales of such property, or the conclusion without prosecution of criminal investigations. As an example, over one million of the2.5 million illegal CD and DVD copies seized in a raid last year "disappeared" before the case went to trial.

Second, all of the optical disk plants that were raided in 2004 remained in operation after those raids. In some cases, truckloads of illegal material were seized from the same plants by Russian government enforcement officials – and still these same plants remain in operation.

Third, the plant owners remain unscathed by the criminal justice system. A few people employed by the plants were convicted – after extensive delays in criminal investigations – but all received suspended sentences. So, there is no deterrence to continuing to conduct commercial piracy in Russia at present.

In fact, the recording industry reports that in the past two years, of the 24 cases they are cooperating on, 21 of those 24 cases remain without a resolution – that is, no prosecutions of the operators of illegal CD plants, as investigations have dragged on. In the other three cases, the pirate CDs were destroyed, but no deterrent sentences were handed down. The only exception to this pattern (which has been true for years) was in June 2002 when the Disk Press MSK plant (raided in September 1999) was finally closed and a Zelenograd court handed down 4-year prison sentences to two operators of the plant. In February 2004, there was a one-year conditional sentence given to a manager of the Zelenograd plant which was raided in December 2002, resulting in the seizure of 234,493 pirate CDs (over 59,000 were music CDs). The more typical case is that of the Synograph plant, raided in October 2000. There was a four year criminal investigation aimed at the director of the plant; a court hearing is scheduled for 2005, and the plant is still in operation.

The optical disk problem that IIPA confronts in Russia is one that has been regulated in virtually all other countries where we have found these levels of massive production of pirate product – countries like Taiwan, China, Hong Kong, Macau, Bulgaria and Malaysia. Russia's regulation of the plants is virtually non-existent, and based on a weak 2002 licensing law. Quite simply, Russia is the largest un-regulated and un-enforced producer of pirate optical disk product in the world.

To solve this problem, Russia must undertake vigorous criminal enforcement backed by the highest political officials in the government, since much of the piracy is undertaken by organized criminal syndicates. For example, according to the ESA, Russian crime syndicate pirates of videogame material are so well-entrenched that they "label" their product. The MPA reports that producers of motion picture DVDs produce export-only copies of DVDs because they are in seven or eight foreign languages, not including Russian.

Most of our description of piracy in Russia has been limited to problems pertaining to hard-copy piracy, but there are growing problems related to digital piracy as well. In fact, the world's largest server-based pirate music website – allofmp3.com – remains in operation after a criminal prosecutor in early 2005 reviewed the case and determined (wrongly) that current

Russian copyright law could not prosecute or prevent this type of activity. This decision not to prosecute has been upheld on appeal. In fact, this interpretation of the Russian law is contrary to all the assurances the Russian government gave the U.S. government and private sector during the years-long adoption of amendments to the 1993 Copyright Law; those amendments were finally adopted in July 2004.

The business software industry, represented by IIPA member, BSA is confronting its own unique digital piracy problem relating to copyright enforcement. In short, the Russian government has failed to take effective action against the broad distribution of counterfeit software over the Internet, primarily through unsolicited e-mails (spam) originating from groups operating in Russia. Separately, BSA has had success with Russian law enforcement agencies taking action against channel piracy (i.e., illegal software preloaded on computers sold in the marketplace), not only in the Moscow area, but also in other Russian regions, and has made some progress in software legalization in the public sector.

The book publishing industry, represented by IIPA member, AAP reports widespread piracy of an array of reference works and textbooks, increasingly a large market in Russia as the penetration of English-language materials in the market grows. Lax enforcement, including poor border enforcement – endemic to all copyright sectors – results in the import (and export) of illegal materials. In the book industry this includes unlicensed imports of pirated reprints from neighboring countries, and pirated reference books and medical texts; there is also widespread illegal commercial photocopying, especially in the academic sector.

We have indicated the devastating consequences to the U.S. copyright owners and authors. The harm to the Russian economy is enormous as well. The motion picture industry alone estimates lost tax revenues on DVDs and videos in Russia was $130 million last year. In another study undertaken by the software industry, it was estimated that if levels of piracy could be reduced to regional norms (that is, realistic levels); ten of thousands of jobs and several hundred million dollars in tax revenues would be realized from that sector alone in Russia.

The Russian Government's Legacy of Failed Commitments

The performance of the Russian government over the past decade can be summed up as representing a legacy of failed commitments on obligations to the United States and the broader international community. A short list of these failed commitments is as follows:

Optical Disk Enforcement Commitments: The most egregious problem is that illegal production has devastated the domestic Russian market, and exports of Russian-produced pirated optical media (CDs, DVDs, etc.) are causing serious damage to legitimate market worldwide, as witnessed by the huge amount of pirated material originating in Russia that is found abroad.

In 1996, IIPA first identified optical disk plant production as a problem and suggested the need for an enforcement "action plan" to address this problem, including legislative reforms. Two optical disk ("OD") plants were identified in IIPA's February 1996 Special 301 Report. As noted, there are now 34 CD plants, with a total capacity of 370 million disks per year.

At all levels of the Russian government there have been promises to address this problem (starting in 1999) including a pledge, never met, in 2002 to issue an "action plan"— but to date, there has been virtually no action taken against the plants, no comprehensive plan of action issued by the Russian government, and no legislative reforms on this point have even been introduced. Now ten years after IIPA (and the U.S. government) raised the issue, there is no excuse for why the Russian government has been unable to properly license and inspect all the known (now 34) plants, and to close and repeal the licenses of those engaged in illegal production and distribution, as well as to criminally prosecute the plant owners and operators.

As one example of the failure to regulate the plants: late in 2004, in bilateral talks with the U.S. government and IIPA, the Russian government promised it would "meet with the 18 plants" (their figure) on restricted access (i.e., military) property to ascertain the legal or illegal status of their production, and to report back to the U.S. government. The meeting, scheduled for December, was cancelled and has not been rescheduled. The reason: the Russian government confessed it was unable to determine all the owners of the plants from its records (because of its inadequate licensing law) and therefore could not identify with whom the government needed to meet.

Promised Legal Reforms: The Russian government has for 13 years, obligated itself in bilateral and multilateral negotiations to adopt necessary legal reforms. A short list of the failed commitments relating to legal reforms includes:

In 1995, the Russian government agreed to provide *ex parte* search provisions – critical enforcement tools, especially in the software industry. These were adopted in part in the Arbitration Procedures Code in 2002, however the proper provisions were never implemented and are absent from the Civil Procedure Code (enacted in 2003).

In 1995, the Russian government agreed to provide the police and prosecutors with proper authority to confiscate illegal material and *ex officio* authority to commence criminal investigations. The 1996 Criminal Procedure Code reversed that authority, and required right holders to formally press charges to commence investigations in some instances, thus thwarting effective enforcement.

In 1995, Russia acceded to the Berne Convention but failed to comply with Article 18 to provide protection for pre-existing works. That same year, Russia acceded to the Geneva Phonograms Convention but provided no protection for pre-existing foreign sound recordings prior to the accession date of March 13, 1995. These were commitments Russia made to the U.S. government in the 1992 Bilateral NTR Trade Agreement – Russia agreed to have these commitments in place by the end of 1992. Finally, in July 2004, Russia adopted provisions to its law to provide protection for foreign pre-existing works and sound recordings – however, the 12 year delay in adopting these provisions has resulted in flooding the marketplace with illegal product that will take years to enforce, even if Russian enforcement were effective (which it is not).

In the 1992 Bilateral NTR Trade Agreement, the Russian government committed to provide effective criminal penalties and enforcement. In 1996, Criminal Code amendments were

adopted (after a 1995 veto) but a deficient provision (a "grave harm" threshold) prevented effective enforcement. In 2003 an amendment to "fix" the grave harm provision was finally adopted, but implementation of these criminal provisions remains a matter of concern, and there is no initiative to use these tools, if they even work properly, as part of effective enforcement.

In short, the Russian government has made promise after promise to the U.S. (and other foreign) governments to develop an effective legal regime, including strong copyright and enforcement laws, and strong on-the-ground enforcement. It has failed to meet its commitments while it has enjoyed trade benefits and preferences with the U.S. that are the *quid pro quo* for these benefits and preferences.

Steps the Russian Government Can Take to Properly Enforce IPR Crimes – Focusing on Optical Disk Piracy

There are six critical steps that the Russian government could take immediately to effectively confront its optical disk piracy problem:

- Inspect, on a regular, unannounced and continuous basis, each of the 34 known OD plants, and immediate close and seize the machinery of any found to be used to produce pirate product (some of these steps require additional legislative or regulatory measures);

- Announce, from the office of the President, that fighting copyright piracy is a priority for the country and law enforcement authorities, and instruct the Inter-Ministerial Commission, headed by the Prime Minister, to deliver reports every three months to the President on what steps have been taken to address the problem;

- Adopt in the Supreme Court a decree setting forth sentencing guidelines for judges—advising the courts to impose deterrent penal sanctions as provided under the penal code as amended (Article 146);

- Immediately take down websites offering infringing copyright materials, such as allofmp3.com, and criminally prosecute those responsible;

- Initiate investigations into and criminal prosecutions of organized criminal syndicates that control piracy operations in Russia (including operations that export pirate material to markets outside Russia); and

- Introduce either via executive order or legislation, the necessary modifications of the optical disk licensing regime so that it clearly provides more effective control over the operations of the plants, including the granting of licenses to legal plants and withdrawing and sanctioning of illegal plants; stricter controls on the importation of polycarbonate and machinery; mandatory seizure and destruction of machinery used to produce pirate materials; and the introduction of criminal penalties for the owners of such plants.

There are, obviously, may other steps the Russian government could take to combat commercial piracy in Russia, including, but not only related to, optical disk piracy. These steps, including other enforcement and legal reforms necessary in Russia, are detailed in our Special 301 Report of February 2005 (see www.iipa.com/rbc/2005/2005SPE301RUSSIA.pdf)

We also want to address one issue that has been raised by certain senior members of the Russian Government in our meetings, which raises serious questions about its commitment to fighting piracy. We have seen a number of reports in which Russian officials have suggested that the prices for legitimate goods and the lack of local manufacturing of legitimate products are to blame for the piracy problem. This comment reflects both an ignorance of what is happening in the marketplace, and a misunderstanding of the nature of the problem that we confront in Russia. The organized criminal enterprises manufacturing and distributing pirate product are largely servicing foreign markets (local manufacturing capacity is at least a multiple of six or seven times that of local demand), making the Russian price for legitimate materials wholly irrelevant to their motivation or profitability. As noted earlier, Russian manufactured product has been found in over 27 countries over the past two years.

In addition, existing efforts by certain industries to offer low cost Russian editions have not had the effect of reducing local piracy rates. The record industry, for example, is already manufacturing locally, and sells legitimate copies for an average price of $6.00 to $8.00 U.S. dollars—a price that is extremely low not just in relation to prices for music elsewhere, but also with respect to other consumer goods sold in Russia. It is not the price of legitimate product that is creating opportunities for piracy—it is the opportunity for easy profits that has brought criminal enterprises into this business, and Russia should stop offering such excuses for its continuing inaction.

Another matter that the Russian government continues to raise is the need for the U.S. copyright industries to use civil remedies for effective enforcement. The copyright industries (especially the record industry) have recently attempted to bring civil cases against illegal plant operators – although procedural hurdles are significant.

However, in no country of the world, including Russia, can copyright owners be left to civil remedies in lieu of criminal remedies to effectively address large-scale organized crime commercial piracy. The government of Russia needs to play a major role in an effective criminal enforcement regime. The copyright industries generally report good police cooperation with raids and seizures, mostly of smaller quantities (with some exceptions) of material, but prosecutorial and other procedural delays and non-deterrent sentencing by judges remains a major hindrance to effective enforcement.

What Can the U.S. Government Do?

There are three things the U.S. government can do to mandate Russia compliance with international norms and obligations to provide "adequate and effective protection and enforcement" for U.S. copyright material:

- Condition Russia's entry into the World Trade Organization (WTO) on meaningful copyright law enforcement;
- Designate Russia as a Priority Foreign Country (PFC) after the on-going out of cycle review by U.S.T.R.; and
- Deny Russia's eligibility for the Generalized System of Preferences (GSP) duty-free trade benefits.

1. Condition Russia's Entry into the World Trade Organization (WTO) on Meaningful Progress in Enforcing its Copyright Laws

The Russian IPR regime is not in compliance with the WTO TRIPS obligations, especially pertaining to enforcement. As a consequence, the U.S. government should not assent to Russia's accession into the World Trade Organization until its copyright regime, both legislative and enforcement, is brought into compliance with the WTO TRIPS obligations. It is essential that we learn from the China experience. WTO accession should simply not take place until the necessary TRIPS-mandated actions—and not just commitments—have taken place.

Russia is not providing adequate and effective enforcement as required for entry into the WTO, certainly not the enforcement standards required as "effective" (Articles 41 through 61 of TRIPS).

The U.S. can and should condition Russia's entry into the WTO on Russia making positive and meaningful enforcement progress – for example, by licensing and inspecting all the known 34 optical disk plants, closing those engaged in illegal activities, and criminally prosecuting those involved in this commercial illegal activity, and ensuring imposition of deterrent (not suspended) sentences.

2. Designate Russia as a Priority Foreign Country (PFC) When the Current Out-of-Cycle Review is Complete

The U.S. Trade Representative's announcement on April 29, 2005 that Russia would be left on the Priority Watch List (for the ninth straight year) noted "[w]e will continue to monitor Russia's progress in bringing its IPR regime in line with international standards through out-of-cycle review, the ongoing GSP review that was initiated by USTR in 2001, and WTO accession discussions."

The situation has gotten significantly worse, not better, in the past few years. IIPA recommended in February, and continues to recommend as part of the out-of-cycle review, that it is time to designate Russia a Priority Foreign Country to force Russia to properly enforce its laws or face the trade sanction consequences.

3. Remove Russia's Eligibility for Generalized System of Preferences (GSP) Benefits

In August of 2000, IIPA filed a petition asking the U.S. government to open an investigation into Russia's practices and outlining a variety of ways in which Russia failed (and continues to fail) to meet the GSP criterion of providing adequate and effective protection for intellectual property. That petition was accepted by the U.S. government on January 10, 2001. IIPA has since testified twice before the U.S. government GSP interagency committee (March 2001; September 2003) and submitted a number of materials and briefs in this matter since then.

IIPA believes it is time to revoke Russia's eligibility from the GSP program. Russia is not providing the U.S. GSP mandated "adequate and effective protection" as required by Sections 502(b) and 502(c) of the 1974 Trade Act (the intellectual property provisions in the GSP statute are at 19 U.S.C. §§ 2462(b) and (c)).

It has been almost five years since the IIPA petition was filed, and over four years since the U.S. government accepted the petition, which at least as a threshold matter, acknowledged the potential of Russia's shortcomings under the GSP program. The Russian government has had years to move to fix these problems and they have not done so adequately.

* * * *

Unfortunately, the Russian piracy problem has been allowed to grow significantly worse in the past ten years, and the IIPA members' losses have continued to increase. Most obviously, the past five years have witnessed an explosion of optical disk manufacturing capacity without the concomitant controls to ensure that this capacity was used only for legitimate purposes.

Russia's anti-piracy efforts remain severely hampered by flawed legislation, ineffective enforcement by the Russian authorities and insufficient deterrent penalties in the courts. The Russian government needs to address legal reforms in the copyright law (even after the adoption of the 2004 amendments), the criminal code, the criminal procedure code, and the administrative code, but more importantly, it needs to provide stronger and more effective enforcement compatible with international norms, and WTO TRIPS (and the WIPO digital treaties). The Russian government has taken a few steps towards addressing copyright piracy, such as adopting improvements in its copyright law in 2004, and including by taking some actions against pirate optical disk plants, adopting a ban on the sale of certain products at kiosks and other street locations. This is a start, but it is only that. IIPA suggests that the U.S. government should adopt positions, and a timetable, to ensure that Russia is significantly moving towards achieving meaningful and lasting progress to meet its international obligations – especially IPR enforcement.

In sum, Russia's commercial piracy problem must be addressed immediately by the Russian authorities. IIPA recommends that the U.S. government take the necessary trade steps

to deny Russia trade benefits (such as GSP) and entry into the World Trade Organization until Russia takes clear and effective steps to bring this illegal activity under control. This country can no longer afford inaction.

Piracy in China: A Lack of Political Will?

IIPA's comprehensive report on the piracy and legal situation in China as of February 2005 can be found on the IIPA website at www.iipa.com/rbc/2005SPE301PRCrev.pdf. In that report, IIPA called, *inter alia*, for entering into a new, multilateral dialogue in the WTO with the Chinese government as a way to persuade it to take aggressive action – as promised in the Joint Commission on Commerce and Trade (JCCT) meetings over one year ago – to significantly reduce the rate of piracy in all IPR sectors including the copyright sector. We then provided a summary review of what had happened in China over the last year to redeem that commitment. Our conclusion: China has failed to comply with its commitment made over one year ago in the JCCT to significantly reduce piracy rates. While some modest reductions have occurred in some sectors, by no measure have piracy rates been significantly reduced. In fact little has changed in the marketplace for our members and their companies, despite reports of increased raiding activity and seizures of many pirate products. In my testimony today, I would like, for the record, to update that report and in the process to summarize it where appropriate. Our report tells the sad, frustrating story of the failure of an enforcement system to deter rampant piracy in the potentially largest market in the world.

Recent Actions by the U.S. Government on China

On April 29, 2005, USTR issued its decision resulting from the out-of-cycle review of China's enforcement practices announced on May 3, 2004. USTR reflected in this decision its deep concern over China's lack of progress in the enforcement area by elevating China to the Priority Watch List. It also announced a number of other initiatives, one of which was to work closely with our industries with an eye on utilizing WTO procedures to bring China into compliance with its WTO obligations. Since that time we have met with USTR to begin this process and will work intensively with USTR toward the mutual goal of bringing China into compliance with its WTO TRIPS obligations, its bilateral obligations to the U.S. in the 1995 and 1996 IPR agreement and action plan, and its commitments made to our government in the JCCT process.

This process has now commenced in earnest. USTR will also be seeking information from the Chinese government under the transparency provisions of the TRIPS agreement, and is committed to using the JCCT process to encourage the Chinese government to implement key reforms on both the enforcement and the all-important market access front.

The Chinese Marketplace for Copyright Products: A Record of Frustration and Failure

Mr. Chairman, our industries are deeply frustrated by the lack of real progress by China in taking effective action to deter piracy and to open up its market to legitimate cultural and high

technology copyright products. China remains one of the most closed markets in the world for the U.S. copyright industries. Onerous market access restrictions affect all our industries. Notwithstanding Premier Wen's pledge to address the $162 billion trade imbalance between the U.S. and China by increasing China's imports from the U.S., China is retaining – and, in some sectors, augmenting – market access restrictions for creative and high-tech products that represent America's comparative advantage.

Copyright piracy represents perhaps the largest barrier to effective market access in China. An average (and truly staggering) 90% piracy rate has persisted for years despite repeated "strike hard" enforcement campaigns, steamroller campaigns, and public statements from many high level government officials supporting stronger enforcement. While our Special 301 submission highlights the current situation in China, I wanted to give you a brief flavor of what copyright companies confront in trying to do business in China in face of these trade barriers and these inexcusably high piracy levels.

The Plight of the Copyright Industries Due to Piracy in China

The Business Software Industry

Taking the business software industry first – one of our nation's most productive and important creative sectors: The software industry faces piracy rates in China of 90%, one of the highest in the world for that industry. China leads the world in the production and export of counterfeit software – software packages that are purposely designed to replicate the original legitimate product. Losses to U.S. software publishers were estimated by IIPA member, the Business Software Alliance (BSA), at $1.47 billion in 2004. China was the 6th largest market in the world for personal computers and ranked 26th in legitimate software sales. This increasing disparity not only damages the U.S. industry but hurts Chinese software developers as well.

China has failed to criminalize the most damaging type of piracy to the business software industry – the unauthorized use of software within businesses and government institutions. This is a violation of the TRIPS Agreement. Combined with the total absence of a criminal remedy is the absence of all but a few administrative actions against this type of piracy with woefully low and non-deterrent fines. As a consequence, piracy rates continue to remain at staggering levels.

To make matters worse, China is on the verge of shutting down access for U.S. and other foreign companies to the largest purchaser of software in China: the Chinese government. It would accomplish this by adopting draft government procurement regulations that would expressly favor Chinese software only. In short, the situation for this critical copyright sector is truly dire in China with no significant improvement in sight.

The Motion Picture Industry

The U.S. motion picture industry is facing a 95% piracy rate in China (the highest in the Asia Pacific region, and among the highest in the world) which represents a worsening of the situation from the previous year. Losses to just the motion picture industry, from 1998 through 2004, are estimated at over $1 billion (not including losses from Internet piracy, which are

growing alarmingly). While raids and seizures have increased somewhat following Vice Premier Wu Yi's 2004 enforcement campaign, administrative fines remain far too low to deter pirate activity and, as I will describe later, criminal cases have been extremely rare despite Chinese promises to use this TRIPS-required remedy. According to a recent newspaper report, the legitimate home video market in China represents about 5% of the estimated total market of $1.3 billion (which is itself a very conservative estimate). Of the 83 optical disk factories licensed by the government (and an unknown number of "underground" unlicensed plants), many continue to churn out pirate DVDs. The export of pirated home video product, which had slowed to a trickle after the U.S. Section 301 action (and threatened retaliation) in 1995-96, has resumed and is growing. The total optical disk plant production capacity, a significant amount of which is devoted to producing pirate product, is now close to 2.7 billion units annually. Optical disks sourced in China and containing pirated films have been seized in over 25 countries around the world. The massive quantity of pirated movie product available in China is evidenced by the fact that pirate prices start around $0.60 per unit, the lowest price in Asia. As with the other copyright industries, any enforcement that occurs is conducted by administrative agencies, with overlapping jurisdiction and often little coordination, and fines imposed are a mere "cost of doing business." A recent study, conducted by IIPA member, the Motion Picture Association (MPA) revealed that the average fine imposed per pirate home video product (DVD, VCD) seized in raids resulting from MPA complaints is only slightly higher than the cost of purchasing a blank disk – clearly of no deterrent value. The lack of deterrent administrative penalties is a key reason, in addition to the almost complete lack of criminal enforcement that piracy rates persist at 90% of the market and above.

Accompanying and reinforcing this piracy situation are onerous market access restrictions, including a Government-owned, monopoly importer, very limited competition in distribution, and a quota of 20 theatrical films allowed into China annually on commercial terms. The pirates capture 100% of the market for films not permitted legally in China. Even those films permitted theatrical release suffer piracy rates of 70-75%, because of the long delays before most American films are given screen time. Another consequence of the lack of competition in importation and distribution is the non-competitive pricing in the Chinese market. Cumbersome licensing requirements burdens the retail sale of legal home entertainment product, holding down revenue potential and helping keep the market in the hands of the pirates. These barriers and those to all our industries must be removed in the JCCT process.

The Entertainment Software Industry

The entertainment software industry, one of the fastest growing copyright-based industries, faces similar high piracy rates and estimates the value of pirated videogames in the market at $510 million in 2004. Demand for entertainment software products is growing rapidly but is being soaked up primarily by the pirates. This demand is exemplified by the exploding popularity of "massively multiplayer online role-playing games" (MMORPGs) where literally thousands of players can compete against one another simultaneously. Demand for MMORPGs in China grew at 40-45% over expectations in 2004. This increasing demand has fueled, in part, the growth of Internet cafés in China. (It is estimated that there are close to 200,000 Internet cafes in the country, with a seating capacity of between 100-300 seats, of which 60% are involved in game play.) While U.S. game publishers, represented by IIPA member, the

Entertainment Software Association (ESA), have engaged in some licensing of the cafes, the vast majority of the product used is pirated, either available at the café or downloadable from the Internet. This dire situation has been all the more exasperating since the Chinese government extensively regulates the activities of these Internet cafes and often and vigorously revokes licenses for actions the government deems inappropriate. However, as far as we know, the government has never sought to include in this extensive regulatory scheme prohibitions against the widespread and blatant piracy at these cafes in its business licenses (which are otherwise very thorough). Moreover, no copyright enforcement of any kind has occurred. The legal infrastructure governing the Internet still is not helpful to copyright enforcement. Takedown of pirate sites is negligible; penalties non-existent.

Cartridge-based handheld games are also hard hit by the pirates with manufacturing and assembly operations throughout China with exports throughout Asia, Latin America, the Middle East and Europe. Enforcement attempts have been relatively successful in terms of raids and seizures but, like with other industries, administrative fines are non-deterrent and criminal enforcement action very rarely undertaken, even against factories generating millions of dollars in illicit profits. Entertainment software products are also subject to a protracted content review process, by two separate agencies contributing to market entry delays. Given the immediate nature of the demand and lifecycle of best selling games, this leaves the pirates virtually uncontested in the market prior to the official release of a new title. There are also Internet and investment restrictions that must be significantly eased or abolished.

The Book Publishing Industry

The U.S. book publishing industry, represented by IIPA member, the Association of American Publishers (AAP), faces both significant printing of pirated books, in both English and translated editions, and massive commercial photocopying of textbooks and reference books on and near university campuses. There are over 500 licensed state-owned publishers in China. There are a few privately-owned publishers that must buy publishing rights from the state-owned publishers. U.S. publishers issued a significant number of translation licenses in 2004, but the numbers remain far below China's potential. All the best selling books are virtually immediately pirated by outlaw "printers" and made available through independent bookstores, stalls and street vendors. To give an example, the local Chinese publisher of the famous self-help bestseller Who Moved My Cheese estimates sales of over 3 million copies in China. It is estimated, however, that the pirates sold another 6 million copies, and that there were between 70 and 100 *different* pirated editions on the market! The Harry Potter® books and other best sellers like Senator and President Clinton's books, Living History and My Life, John Grisham's books, former General Electric President Jack Welch's biography Winning and others all face a similar fate

English language textbooks are also heavily photocopied in their entirety, often at on-campus textbook centers actively or tacitly sanctioned by the universities. In addition, there are several known websites making available scanned versions of entire textbooks for download.

Enforcement against this vast piracy is spotty and all done administratively through the local and national copyright bureaus. Any resulting administrative fines are non-deterrent. We

know of no criminal enforcement against piracy of books not originating in China (books for which the copyright is held by a foreign entity).

Finally, the book publishing industry faces significant market access barriers – U.S. publishers are not permitted to publish, sign authors, or print their books directly in China. These restrictions vastly increase the cost of doing legitimate business, hindering U.S. publishers' abilities to tailor products to the Chinese market and make products available that have any hope of competing in the marketplace with pirated materials.

The Recording Industry

The recording industry, represented by IIPA member, the Recording Industry Association of America (RIAA) did experience a minor reduction in the piracy rate for sound recordings, from 90% in 2003 to 85% in 2004 in "hard goods" piracy, but with significant increases in Internet piracy. Losses remain in excess of $200 million per year from continued optical disk manufacture and distribution within the Chinese market and significant levels of audiocassette piracy (still an important format in China). The recording industry faces many of the same problems with optical disk piracy confronting the motion picture industry. Millions of pirated music CDs are readily available throughout China. Some of these pirate products have found their way into the export market. China continues to rely on its failed administrative enforcement system, which relies on numerous inspections, product seizures and, when the pirate doesn't flee, the imposition of small, non-deterrent fines.

Internet piracy in China, as in other countries in the world, has become a huge problem for the recording industry. Thousands of active websites such as www.9sky.com and www.chinaMP3.com are giving away, or offering links to, thousands of pirated songs. (These not-for-profit acts of piracy are not criminalized in China, as they are, for example, in the U.S.). International criminal syndicates are apparently using Chinese servers to hide their illicit activity (www.boxup.com) and many Asian pirate sites are doing a thriving business in China, such as www.kuro.com from Taiwan.

Market access restrictions are severe, contributing to piracy and market losses. U.S. record companies cannot "publish" or release a recording without permission of a state owned company and cannot manufacture, distribute or engage in retailing of its products, which artificially segments the market and makes it extraordinarily difficult for this world class industry to participate in the Chinese market. Its products are subject to censorship while domestic (as well as pirate) recordings are not – a national treatment violation.

All in all, the copyright industries estimate their total losses in excess of $2.5 billion in 2004 due to piracy in China. The simple fact remains that these losses and the 90% piracy rates will NOT be significantly reduced without subjecting major piracy to criminal enforcement accompanied by deterrent penalties and substantially increasing the administrative fines specified in the copyright law and imposing them in practice. To date, even after the JCCT commitments, this has NOT happened and there is a real question whether the Chinese government as a whole (Vice Premier Wu Yi has been a staunch defender of better enforcement) can muster the political will to take these absolutely necessary actions – actions that have been key to significant

reductions in piracy levels in other countries in which our companies operate. China cannot exempt itself from the rules – that enforcement against piracy requires deterrence and criminal remedies. The global community recognized this when it fashioned the Article 61 criminal obligation in TRIPS and it has proven to be the case in practice.

Actions to Be Taken by the Chinese Government

If piracy rates are to be significantly reduced as committed by Vice Premier Wu Yi in the JCCT and if China is to come into compliance with its TRIPS obligations, it must take the following actions.

- China should significantly liberalize and implement its market access and investment rules, including and in addition to those already made in the WTO, and improve the overall business climate in China to permit effective operations by all copyright industries. This should be a major objective in the JCCT.

- Immediately amend the new Judicial Interpretations to include sound recordings.

- Immediately commence criminal prosecutions using both the monetary and new copy thresholds and carry these forward promptly to impose deterrent penalties. The Economic Crime Division of the Public Security Bureau should be made responsible for all criminal copyright enforcement and be provided sufficient resources and training to very substantially increase criminal enforcement under the new Judicial Interpretations.

- Under the leadership of Vice Premier Wu Yi, constitute a single interagency authority at the national and provincial/local levels to undertake administrative enforcement against piracy of all works. This authority would have the would have the full authority to administer fines and to refer cases to the Ministry of Public Security and the Supreme People's Procuratorate for criminal prosecution, under referral guidelines that are equal to or better than the Judicial Interpretations. Such authority must have the full backing of the Party Central Committee and the State Council. Far greater resources must be provided to this enforcement authority. All administrative enforcement, and enforcement by Customs at the border, must be significantly strengthened.[1]

- Adopt, in a transparent manner with the opportunity of public comment, a full and comprehensive set of regulations governing protection and enforcement on the Internet, including the liability of Internet Service Providers, which follow the recommendations made in IIPA's Special 301 submission, including effective "notice and takedown" mechanisms and without unreasonable administrative evidentiary burdens. Establish within this single interagency authority described above special units (at the national, provincial and local levels), whose purpose is to enforce the law and these new regulations against piracy on the Internet.

[1] In the area of trademark enforcement undertaken by one ESA member company and involving handheld and cartridge based games, the new Judicial Interpretations are unclear on whether the authorities are able to seize components and parts that make up the counterfeit products. This is essential and must be clarified.

- Amend the Criminal Law to comply with the TRIPS Article 61 requirement to make criminal all acts of "copyright piracy on a commercial scale." These must include infringing acts not currently covered, such as end user software piracy and Internet offenses conducted without a profit motive. Also amend the Criminal Code provisions requiring proof of a sale, to require instead proof of commercial intent, such as possession with the intent to distribute.

- Significantly increase administrative penalties/remedies, including shop closures and monetary fines and impose them at deterrent levels.

- Permit private companies and trade associations to undertake anti-piracy investigations on the same basis as local companies and trade associations.

- Through amended copyright legislation or regulations, correct the deficiencies in China's implementation of the WCT and WPPT, and ratify the two treaties.

- Significantly ease evidentiary burdens in civil cases, including establishing a presumption with respect to subsistence and ownership of copyright and, ideally, permitting use of a U.S. copyright certificate, and ensure that evidentiary requirements are consistently applied by judges and are available in a transparent manner to litigants.

The copyright industries will be working closely with USTR to prepare the necessary elements of a WTO case should the TRIPS obligations of China described above and in our submission not be fully implemented. This work is now ongoing.

* * * *

Chairman Hatch, we are grateful for the your support and that of members of this Subcommittee in working with IIPA and its members to meet the global copyright and enforcement challenges we have highlighted and in working with us to monitor and encourage both Russia and China's sorely-needed progress. The Congress, the Administration and the private sector must work together to ensure that they take these actions. It is in no one's interest for these issues to escalate into further trade confrontation.

Thank you.

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE

1747 PENNSYLVANIA AVENUE, NW • SUITE 825 • WASHINGTON, DC • 20006-4637 • TEL. (202) 833-4198 • FAX (202) 872-0546 • WWW.IIPA.COM • EMAIL: INFO@IIPA.COM

February 11, 2005

Mr. James Mendenhall
Assistant USTR for Services, Investment
and Intellectual Property
Office of the United States
Trade Representative
600 17th Street, N.W., Room 303
Washington, D.C. 20508

Re: Request for Public Comment on the Identification of Countries under Section 182 of the Trade Act of 1974 (as amended) ("Special 301"), 70 Fed. Reg. 134 (Jan. 3, 2005)

Dear Mr. Mendenhall:

This filing responds to the Request for Written Submissions appearing on January 3, 2005 in the Federal Register. The request invites submissions from the public on policies and practices that should be considered in connection with designating countries as Priority Foreign Countries pursuant to Section 182 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. § 2242 ("Special 301"). The Special 301 provisions call upon the United States Trade Representative to identify countries which, *inter alia*, "deny adequate and effective protection" to U.S. intellectual property or deny "fair and equitable market access" to U.S. persons who rely on intellectual property protection.

The International Intellectual Property Alliance (IIPA) submits our discussion of the status of copyright law reform and enforcement in 42 separate country reports and identifies two countries where FTA dispute settlement proceedings should be initiated if changes in implementing legislation/regulations aren't promptly made. We also highlight six challenges and initiatives in this letter that define our agenda for the coming year. Finally, we mention 23 additional countries/territories that we have not recommended be on a Special 301 list but which merit attention by the U.S. government.

A. IIPA AND THE COPYRIGHT INDUSTRIES IN THE U.S. ECONOMY

The International Intellectual Property Alliance (IIPA) is a private sector coalition formed in 1984 to represent the U.S. copyright-based industries in bilateral and multilateral efforts to improve international protection of copyrighted materials. IIPA is comprised of six trade associations, each representing a significant segment of the U.S. copyright community. These member associations represent over 1,300 U.S. companies producing and distributing materials protected by copyright laws throughout the world—all types of computer software, including

business applications software and entertainment software (such as videogame CDs, DVDs and cartridges, personal computer CD-ROMs and multimedia products); theatrical films, television programs, home videos and digital representations of audiovisual works; music, records, CDs, and audiocassettes; and textbooks, tradebooks, reference and professional publications and journals (in both electronic and print media).

In October 2004, the IIPA released an economic report entitled *Copyright Industries in the U.S. Economy: The 2004 Report*, the tenth such study written by Stephen Siwek of Economists Inc. This report details the economic impact and contributions of U.S. copyright industries to U.S. Gross Domestic Product, employment, and trade. The latest data show that the "core" U.S. copyright industries[1] accounted for 6% of U.S. GDP or $626.6 billion in value-added in 2002. In the last 25 years (1977-2002), the core copyright industries' share of GDP grew at an annual rate more than twice as fast as the remainder of the economy (7.0% vs. 3.0%). Also over these 25 years, employment in the core copyright industries grew to 5.48 million workers (4% of total U.S. employment). In 2002, the U.S. copyright industries achieved foreign sales and exports of $89.26 billion. The copyright industries' foreign sales and exports continue to be larger than other major industry sectors, including chemicals and related products, automobiles, parts and accessories, and aircraft and associated equipment sectors. It is essential to the continued growth and future competitiveness of these industries that our trading partners provide not only free and open markets, but also high levels of protection to the copyrights on which this trade depends. This protection upon which so much U.S. economic performance rests is under constantly evolving threats, and it is critical to sustaining U.S. economic competitiveness that our response remains flexible, innovative and committed. There are certain sectors of the U.S. copyright community, notably the music sector, that are already witnessing significant declines in foreign sales as a consequence of increased levels and new forms of piracy, and it is essential that we address these problems on an urgent basis.

B. OUTLINE OF IIPA'S SPECIAL 301 SUBMISSION

As in prior years, IIPA's submission contains several separate sections. It is important for the reader to review not only each country survey in Appendix C, but also the other appendices that describe key elements (e.g., industry initiatives, methodology) that may be referenced in the country survey. Included in this year's submission are the following:

- This letter, which (1) outlines IIPA's recommendations for cross-cutting initiatives to be undertaken by the copyright industries and the U.S. government for 2005; (2) summarizes our submission this year; and (3) points the reader to various appendices;
- Appendix A, which contains IIPA's country placement recommendations, estimated trade losses due to piracy, and estimated levels of piracy;
- Appendix B, which describes our members' methodology for calculating estimated trade losses, piracy levels, and global data on optical disc factories and production capacity;
- Appendix C, which includes all the country surveys[2] and at the end lists 23 countries/territories that deserve continued U.S. government attention but which we have not recommended for placement on the Special 301 lists;

[1] The "total" copyright industries include the "core" industries plus those that, under conservative assumptions, distribute such products or other products that depend wholly or principally on copyrighted materials. The "core" copyright industries are those that create copyrighted materials as their primary product.

[2] Country surveys were prepared by Eric H. Smith, IIPA President; Steven J. Metalitz, IIPA Senior Vice President; Maria Strong, IIPA Vice President and General Counsel; Eric J. Schwartz, IIPA Vice President and Special Counsel; Michael Schlesinger, IIPA Vice President and Associate General Counsel, and Ryan Lehning, counsel to IIPA, and

- Appendix D, which provides a historical chart of countries/territories' placement on Special 301 lists by USTR since 1989; and
- Appendix E, which contains the Special 301 histories of countries/territories which we have recommended for placement on a list this year, many other countries that have appeared on USTR's lists in the past and are still candidates for monitoring intellectual property practices, and certain other countries/territories that have never appeared on a USTR list but which deserve attention.

C. COPYRIGHT INDUSTRIES' INITIATIVES AND CHALLENGES IN 2005

The goal of this submission is to improve copyright protection by employing the various bilateral, plurilateral and multilateral tools available to the U.S. government. Without these trade tools and their full implementation, the U.S. copyright industries would still be facing a world of inadequate copyright laws—a world which our industries faced in the early 1980s. This was a world where most countries' laws did not even protect U.S. works at all, and 90% to 100% piracy levels prevailed in most developing countries. Since the first marriage of intellectual property and trade in the Trade and Tariff Act of 1984 and formation of the IIPA, the later adoption of the "Special 301" provisions in the 1988 Trade Act, and the adoption or modification of the U.S. unilateral trade preference programs, such as GSP, CBERA, ATPA and others, U.S. government initiatives have produced significant legal and enforcement improvements. This largely untold success story has produced billions of dollars of increased revenue and millions of new jobs to both U.S. and local copyright industries. However, despite these successes, the U.S. copyright industries (and copyright creators and their industries worldwide) still face grave, and in many respects, growing, threats in the 21st century. These threats emanate largely from the growth of digital and on-line technology, the increased organization of commercial pirates, and the failure of governments to adequately enforce their new laws. An effective response to these challenges will require a renewed commitment to use both the old and new tools available to industry and governments.

In our last six Special 301 filings, IIPA outlined a series of challenges facing the copyright-based industries. This year, we have updated these challenges/objectives to take into account new developments and new challenges.

The copyright industries are extremely grateful for the U.S. government's efforts in promoting copyright reform and effective enforcement. But, as is clearly demonstrated in the country surveys included in this report, organized commercial piracy, whether digital or analog, tangible or over the Internet, threatens to outpace the fight to combat it. IIPA believes that a significantly heightened effort is called for to make further progress on these objectives in 2005. We believe the tools exist to make significant progress—the issue is whether all governments have the political will to take the actions necessary to address piracy meaningfully and to lower piracy rates locally and globally. The following objectives are not necessarily listed in order of priority, since different issues may demand priority attention in different countries.

Internet Piracy, Electronic Commerce and the WIPO Internet Treaties

The Scope of the Problem: Copyright piracy on the Internet, a serious problem for the past several years, has undergone explosive growth, and threatens to undermine the very

---

are based on information furnished by IIPA member associations. We also thank Smith & Metalitz law clerks Frank Lattuca and Helena Robinson, and the Smith & Metalitz staff, Pam Burchette, Melissa Braford, Lauren Braford, and Kristen Schumacher for their contributions in preparing, producing and distributing this submission.

foundations of electronic commerce in this new millennium. While broadband offers exciting prospects for the legitimate dissemination of copyrighted materials of all kinds, too often access to high-speed Internet connections is being used to distribute unauthorized copies of sound recordings, software, videogames, literary material, and motion pictures. This has suppressed legitimate consumption.

The unprecedented growth of the Internet and increased availability of broadband connections, coupled with the absence of adequate copyright law and/enforcement in the online environment in many countries, has provided pirates with a highly efficient distribution network to reach the global market. Pirates offering and distributing infringing product can now reach any part of the world with ease, no matter where they are located. Consequently, the U.S. copyright industries face the daunting task of trying to enforce their legal rights in an online world where borders and distances have decreasing practical significance.

Quantifying the economic losses due to Internet piracy and allocating those losses to particular countries are extremely challenging problems. Because of these challenges, IIPA's estimates of piracy levels and of trade losses due to piracy do not yet take into account piracy on the Internet. Internet piracy is growing rapidly and an urgent response is greatly needed. We must act quickly and on a global basis to secure the adoption of legal provisions that will prevent piracy and create a legal and regulatory environment that will facilitate the growth of legitimate on-line delivery of copyrighted materials.

The Legal and Enforcement Solutions: IIPA recommends that USTR work with our industries to adopt a focused and comprehensive strategy to attack Internet piracy. The challenge is two-tiered. First, governments need to adopt stronger laws that are tailored to address online copyright piracy. Second, those laws must be vigorously enforced.

Well established international norms such as the WTO TRIPS Agreement contribute valuable elements to the needed legal infrastructure to protect electronic commerce and combat Internet piracy. In particular, WTO TRIPS contains a technology-neutral obligation to provide "expeditious remedies to prevent infringements and remedies which constitute a deterrent to future infringements" (Article 41). The fight against this new form of piracy must be conducted under the copyright principles contained in this agreement, and particularly through application of the existing enforcement tools described there. In addition, the two treaties adopted by the World Intellectual Property Organization (WIPO) Diplomatic Conference in Geneva in December 1996 provide an additional and more tailored framework for what is needed to protect the transmission of content in e-commerce. These treaties, the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT), are now in force, and their effective implementation is critical in the fight to control this new and ominous threat. These treaties are part of the international legal standards that countries must comply with in order to provide the "adequate and effective" copyright protection that is demanded under the Special 301 program. These standards include clarifying exclusive rights in the online world, and, in addition, specifically prohibiting the production of or trafficking in tools that circumvent technological protection measures (TPMs) for copyrighted works.

IIPA and its members have joined with their counterpart copyright industries around the world to push for ratification and full implementation of the WCT and WPPT in all countries. The first phase of these efforts—bringing the treaties into force through the accession to each of at least 30 countries—was completed in 2002. As of February 4, 2005, official deposits of the treaties with WIPO stand at 51 for the WCT and 49 for the WPPT. More and more countries are now beginning to legislate in this area.

Ensuring that these standards are effectively embodied in national law is the heart of the critical second phase of the WIPO Treaties implementation effort. Since the treaties were adopted, IIPA has been monitoring those countries that are amending their statutory regimes to make them compatible with their TRIPS obligations as well as with the WIPO Internet Treaties. If countries delay in making these needed changes, the prejudicial impact on electronic commerce and the protection of intellectual property online might be irreversible. The coming into force of the WCT and WPPT provides a powerful additional reason for countries to make the necessary legal changes now. The U.S., which has already implemented the changes to its laws needed to meet the standards of the treaties by enacting Title I of the Digital Millennium Copyright Act (DMCA), should continue to make it a priority to encourage other countries to follow this path.[3]

Even in the online world, there is no substitute for vigorous enforcement of new and existing laws. To protect the revenue streams and millions of new jobs created by the copyright industries, governments must become flexible and fast moving if they want to deal with a medium that is constantly shifting and evolving. Renewed emphasis on training is vital to giving enforcement authorities the tools to quickly locate infringing Internet sites and pursue actions against the offenders who commit the most damage and/or refuse to remove the infringing content. Public education about the dangers of online infringement must be emphasized as well. As global boundaries continue to lose much of their practical relevance because of Internet growth, so must the usual lines separating the roles of industry and government in policy, enforcement and education. Close coordination will be the key to success in this challenging new environment. We also mention that efforts should be undertaken to encourage global adoption of the Council of Europe Cybercrime Convention, which requires countries to adopt effective remedies for online copyright infringement, and which facilitates law enforcement cooperation across borders—something which must develop if governments are to be successful in addressing this pressing problem.

These law reform and enforcement measures are critical to deter pirates from destroying the incredibly promising new tools for making copyrighted products available globally before right holders have had a chance to gain a foothold. IIPA members have significantly increased their monitoring of pirate product traveling over the Internet in many of the countries discussed in this submission. Webcrawlers and other search technologies have been employed to ferret out piracy occurring in many languages in addition to English. One essential tool that should be made available globally is notification of ISPs by copyright owners through cease and desist letters in order to obtain their cooperation to "take down" or block access to infringing material immediately, and otherwise to prevent infringing conduct of all kinds. The effective use of such a "notice and takedown" tool is, in turn, dependent on a system of secondary liability, which exists in some but not all countries, and which must be effectively multilateralized to encourage responsible conduct at all levels of the delivery chain. Finally, as we know from our own experience here in the U.S., we must find a global solution that discourages unauthorized peer-to-peer file sharing, through aggressive enforcement against unauthorized uploaders of infringing product, whether of musical recordings, movies, business or entertainment software or literary material, as well as against services that provide these tools for the purpose of encouraging and profiting from infringement. For new legal Internet-based services for delivery of copyrighted material to succeed, we all need to ensure that legal services do not face unfair competition from unauthorized sources.

---

[3] Digital Millennium Copyright Act of 1998, Pub. L. No. 105-304, 112 Stat. 2860 (1998). The United States deposited instruments of accession for both treaties on September 14, 1999.

It is critical that governments, educational institutions and similar enterprises that provide broadband interconnections to their employees, students or others be encouraged to develop executive orders and other strong internal policies to prevent illegal file sharing of copyrighted materials, including through the use of peer-to-peer technologies. In addition, governments should help to ensure that Internet cafés use only legitimate software in the operation of their business, and that they prohibit use of their facilities for the commission of further infringements

Industry has been hard at work on these critical issues, but we need the help of the U.S. and foreign governments to make the Internet safe for e-commerce in copyrighted material.

Optical Disc Piracy and Its Effective Regulation

Piracy of optical disc (OD) products today causes grave losses to all the copyright industries. Increasingly, all sectors of the copyright industry are using a common set of media to distribute their products worldwide. These "optical disc" products include formats such as compact discs (CD), video CDs (VCD), CD-ROMs, CD-Recordables (CD-Rs), digital versatile discs (DVDs) and DVD-Recordables (DVD-Rs). An explosion in the world's capacity to produce optical disc products has been driven by the ever-growing worldwide demand for copyrighted high-tech and entertainment products and the potential for pirates to generate billions of dollars in illegal income. Unfortunately, production capacity now greatly exceeds legitimate demand, with the difference inuring to the benefit of illegal pirate enterprises. Increasingly, recordable optical media are also used to "burn" unauthorized copies on a commercial basis. Pirate CDs, VCDs, CD-ROMs and DVDs containing protected music, sound recordings, audiovisual works, business and entertainment software and books and journals have quickly decimated the market for legitimate U.S. products.

The growth in the number and capacity of optical disc factories around the globe has been staggering. Based on our survey of optical disc production in 77 countries/territories:

- There were as many as 973 optical disc production plants producing "finished" optical discs worldwide, having 4,405 production lines, with a production capacity of nearly 16 billion discs in 2004.[4]
- Well over 1,100 optical disc plants exist worldwide producing both finished and blank discs, having over 7,800 production lines, with a production capacity of more than 27.8 billion discs in 2004.
- Production capacity of finished discs shot up to as much as 16 billion discs in 2004, from a reported 9.5 billion discs in 2003, a 66% increase in reported production capacity over the previous year.

The following chart details this information. It is noteworthy that the greatest optical disc piracy threat continues to be in Asia and Eastern Europe/Russia. Also, it is important to note that while this chart provides capacity for finished and blank discs, it does not report the number of blank discs being used for CD-R burning, a global problem the impact of which is especially severe in Asia; in several European countries, such as Italy, Germany and Spain; and in Latin America.

[4] For several major optical disc producing countries, there is no breakout between plants producing finished optical discs and blank CD-R/DVD-R.

ESTIMATED OPTICAL DISC PRODUCTION CAPACITY IN 77 COUNTRIES/TERRITORIES[5]

	PLANTS (EXCL. CD-R)[6]		ESTIMATED PRODUCTION LINES (EXCL. CD-R)		ESTIMATED CAPACITY IN MILLIONS (EXCL. CD-R)		PRODUCTION LINES (INCL. CD-R)		ESTIMATED CAPACITY IN MILLIONS (INCL. CD-R)	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
ASIA										
AUSTRALIA	11	9	59	19	206.5	66.5	59	96	206.5	374
BANGLADESH	2	NA	6	NA	21	NA	6	NA	21	NA
BURMA	1	1	2	1	7	3.5	2	1	7	3.5
CAMBODIA	1	1	1	1	3.5	3.5	1	1	3.5	3.5
CHINA	83	71	763	569	2,670.5	1,191.5	763	808	2,670.5	3,875
HONG KONG	88	112	455	623	1,592.5	2,181	805	538	2,817.5	2,455
INDIA	12	9	35	14	122.5	49	378	334	1323	1,353
INDONESIA	40	27	75	31	262.5	108.5	75	37	262.5	197
JAPAN	21	34	237	NA	829.5	231	297	941	1,039.5	2,783
KOREA	32	31	72	96	252	336	72	93	252	404
LAOS	0	2	0	2	0	7	0	2	0	7
MACAU	4	2	5	2	17.5	7	16	NA	56	0
MALAYSIA	32	38	93	86	325.5	301	126	NA	441	1,871
PAKISTAN	10	8	25	25	230[7]	180[8]	25	25	230	140
PHILIPPINES	16	7	26	21	91	73.5	26	21	91	73.5
SINGAPORE	14	15	76	29	266	101.5	96	169	336	698
SRI LANKA	2	NA	2	NA	7	NA	2	NA	7	NA
TAIWAN	44	61	315	310	1,102.5	1,085	2,818	2,171	9863	7,779
THAILAND	40	39	135	126	472.5	441	157	98	549.5	556
VIETNAM	4	3	12	3	42	10.5	12	3	42	10.5
SUB-TOTAL	457	470	2,394	1,958	8,521.5	7,177	5,736	5,338	20,218.5	22,583
EASTERN EUROPE/CIS[9]										
BELARUS	1	NA	1	NA	5.2	NA	1	NA	5.2	NA
BULGARIA	8	7	12	7	55	24.5	12	9	55	19
CROATIA	1	NA	1	NA	3.5	NA	1	NA	3.5	NA
CZECH REPUBLIC	4	4	44	25	154	87.5	44	43	154	193
ESTONIA	1	NA	1	NA	3.5	NA	1	NA	3.5	NA
HUNGARY	4	3	14	3	49	10.5	14	7	49	37
KAZAKHSTAN	1	1	1	1	8.1	3.5	1	0	8.1	0
LITHUANIA	1	1	2	1	7	3.5	2	1	7	5
POLAND	9	9	101	48	597.2	385.6	101	154	597.2	501
ROMANIA	1	1	2	2	7	7	2	1	7	6
RUSSIA	34	32	80	52	390	371.6	83	52	390	220
SERBIA AND MONTENEGRO	4	NA	5	NA	25	NA	5	NA	25	NA
SLOVENIA	2	NA	5	NA	17.5	NA	5	NA	17.5	NA
UKRAINE	5	4	11	7	42.5	24.5	13	5	49.5	31
SUB-TOTAL	76	62	280	146	1,364.5	918.2	285	272	1,371.5	1012
WESTERN EUROPE[9]										
AUSTRIA	4	NA	6	NA	21	NA	6	NA	21	NA
BELGIUM	4	NA	25	NA	87.5	NA	25	NA	87.5	NA
DENMARK	4	NA	16	NA	56	NA	16	NA	56	NA
FINLAND	3	NA	6	NA	21	NA	6	NA	21	NA

[5] The methodology used by IIPA to calculate the estimated capacity in 2003 and 2004 for production of finished optical media product encoded with infringing content, as well as a combined estimated capacity for production in 2003 and 2004 of finished as well as "blank" media such as CD-R and DVD-R, is described in Appendix B of IIPA's 2005 Special 301 submission at www.iipa.com/pdf/2005spec301methodology.pdf.

[6] For the following major optical disc producing countries, there is no breakout between plants producing finished optical discs and blank CD-R/DVD-R, but it is believed that most of the capacity in these countries is devoted to finished discs: Australia, China, Indonesia, Korea, Pakistan, Philippines, Bulgaria, Czech Republic, Hungary, Poland, Belgium, Denmark, France, Germany, Ireland, Luxembourg, Netherlands, Spain, Sweden, Switzerland, United Kingdom, Argentina, Canada, Colombia, United States, Venezuela, Israel, Turkey, Nigeria, and South Africa.

[7] Pakistan: This number represents what is believed to be actual production based on polycarbonate imports and various countries' customs data.

[8] In Belarus, Bulgaria, Kazakhstan, Poland, Russia (2003 number), and Serbia and Montenegro, the capacity numbers are based either on more specific on-the-ground knowledge of a plant's production capacity, or different numerical methodologies than that described in Appendix B at www.iipa.com/pdf/2005spec301methodology.pdf.

[9] Plant numbers are not broken out by finished and blank (CD-R/DVD-R) production for the following countries in Western Europe: Austria, Belgium, Denmark, France, Germany, Ireland, Luxembourg and Netherlands; and Canada and the United States.

ESTIMATED OPTICAL DISC PRODUCTION CAPACITY IN 77 COUNTRIES/TERRITORIES[5]

	PLANTS (EXCL. CD-R)[9]		ESTIMATED PRODUCTION LINES (EXCL. CD-R)		ESTIMATED CAPACITY IN MILLIONS (EXCL. CD-R)		PRODUCTION LINES (INCL. CD-R)		ESTIMATED CAPACITY IN MILLIONS (INCL. CD-R)	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
FRANCE	23	NA	156	NA	546	NA	156	NA	546	NA
GERMANY	44	NA	132	NA	462	NA	132	NA	462	NA
GREECE	5	5	19[10]	11	66.5	38.5	40	73	140	NA
IRELAND	8	NA	70	NA	245	NA	70	NA	245	NA
ITALY	23	23	102	51	357	178.5	119	182	416.5	801
LUXEMBOURG	2	NA	19	NA	66.5	NA	19	NA	66.5	NA
NETHERLANDS	18	NA	62	NA	217	NA	62	NA	217	NA
PORTUGAL	3	NA	5	NA	17.5	NA	5	NA	17.5	NA
SAN MARINO	2	NA	NA	NA	NA	NA	NA	NA	NA	NA
SPAIN	16	12	123	98	430.5	343	123	100	430.5	600
SWEDEN	7	NA	9	NA	31.5	NA	9	NA	31.5	NA
SWITZERLAND	3	NA	11	NA	38.5	NA	11	NA	38.5	NA
UNITED KINGDOM	19	NA	90	NA	315	NA	90	NA	315	NA
SUB-TOTAL	188	40	851	160	2,978.5	560	889	355	3,111.5	1401
WESTERN HEMISPHERE[11]										
ARGENTINA	11	10	26	26	91	91	26	26	91	142.8
BRAZIL	11	9	88	11	308	38.5	91	128	318.5	624.9
CANADA	17	NA	78	NA	273	NA	78	NA	273	NA
CHILE	2	2	5	2	17.5	7	5	3	17.5	19
COLOMBIA	2	2	9	8	31.5	28	9	8	31.5	48
COSTA RICA	1	NA	1	NA	3.5	NA	1	NA	3.5	NA
DOMINICAN REPUBLIC	1	1	1	1	3.5	3.5	1	1	3.5	7
MEXICO	12	12	211	136	738.5	476	231[11]	101	808.5	514
PARAGUAY	1	NA	1	NA	3.5	NA	1	NA	3.5	NA
PERU	3	3	5	5	17.5	17.5	5	3	17.5	17
UNITED STATES	143	NA	348	NA	1,218	NA	348	NA	1,218	NA
URUGUAY	1	NA	1	NA	3.5	NA	1	NA	3.5	NA
VENEZUELA	2	2	7	4	24.5	14.0	7	7	24.5	40
SUB-TOTAL	207	41	781	193	2,733.5	675.5	804	277	2,814	1412.7
MIDDLE EAST										
ALGERIA	3	NA	NA	NA	NA	NA	NA	NA	NA	NA
EGYPT	4	4	6	6	21	21	6	4	21	23
IRAN	2	NA	2	NA	7	NA	2	NA	7	NA
ISRAEL	7	5	18	5	63	17.5	18	23	63	114
JORDAN	1	NA	NA	NA	NA	NA	NA	NA	NA	NA
LEBANON	1	1	1	1	3.5	3.5	1	1	3.5	7
PALESTINIAN AUTHORITY	3	2	4	2	14	7	4	4	14	23
SAUDI ARABIA	3	1	6	1	21	3.5	7	NA	24.5	NA
SYRIA	1	1	1	1	3.5	3.5	1	NA	3.5	NA
TURKEY	8	8	23	18	80.5	63	23	NA	80.5	NA
SUB-TOTAL	33	22	61	34	213.5	119	62	32	217	167
AFRICA										
NIGERIA	8	NA	25	NA	87.5	NA	25	NA	87.5	NA
SENEGAL	1	NA	1	NA	3.5	NA	1	NA	3.5	NA
SOUTH AFRICA	3	3	12	7	42	24.5	12	NA	42	NA
SUB-TOTAL	12	3	38	7	133	24.5	38	NA	133	NA
TOTALS	973	638	4,405	2,498	15,945	9,474	7,814	6,275	27,7865.5	26,575.7

The growing optical disc problem confronting the copyright sector, now familiar to governments worldwide, has demanded new and creative legislative and enforcement solutions. Traditional enforcement mechanisms have not been sufficient to prevent optical disc piracy from spinning out of control and flooding national, regional, and even global markets with millions of high-quality pirate products. As part of countries' WTO TRIPS obligations to provide deterrent enforcement against piracy "on a commercial scale," every country whose optical disc production facilities are producing significant pirate product should create and enforce a specialized regulatory framework for tracking the growth of optical disc production capacity,

[10] Greece: Most DVD capacity in Greece is hybrid CD/DVD-5.
[11] Mexico: There are believed to be several "underground" mass duplication CD-R replicators in Mexico

including the cross-border traffic in production equipment and raw materials, principally optical-grade polycarbonate. These regulatory regimes must include strict licensing controls on the operation of optical disc mastering and replication facilities, and the requirement to use identification tools that identify the plant in which production occurred and that help lead the authorities to the infringer. So far such regimes have been established in Bulgaria, China, Hong Kong, Malaysia, Philippines, Singapore, Taiwan and Macau, and are under consideration in Thailand, India and other countries. Ukraine has adopted a system of regulatory controls as well, but this law is flawed and must be corrected.[12] Increasingly, pirate optical disc production is migrating from jurisdictions with optical disc production regulatory regimes to countries that as yet have not adopted these regulatory tools, such as Russia, Pakistan, India, Thailand, Vietnam, and many others mentioned in this submission. We urge the U.S. to press every country in the regions most affected by pirate optical disc production and export—including East Asia, South Asia, Eastern Europe, Russia and the countries of the former Soviet Union—to put comprehensive optical disc regulatory controls into place promptly. Otherwise, pirate syndicates will continue to transfer their optical disc operations across borders in an effort to stay one step ahead of enforcement efforts.

IIPA and its members have developed a number of resources to help governments in fashioning an effective optical disc regulatory system. We also note that governments have recognized the importance of effective regulations. In October 2003, APEC leaders agreed on the need to "stop optical disc piracy" and endorsed on a set of "Effective Practices" which we suggest that governments addressing this problem carefully study. We stand ready to work with USTR to assist governments in understanding, drafting and implementing these recommendations into national law.

As these regimes have been adopted and enforcement under them has matured, the pirates have again taken advantage of technological developments, and moved production increasingly from the "factory" locus to smaller venues that are more private and harder to police. The newest generation of pirates uses much less expensive and more portable consumer "recordable" technology—CD and DVD "burning" on CD-Rs and DVD-Rs. That technology has now advanced so that with a very small investment, pirates can easily and cheaply replicate thousands of copies of copyrighted products for commercial sale. We refer here not to individual consumers "burning" copies but to aggressive commercial exploitation—often by the very same syndicates that operated the factories and generate millions of dollars for the pirate operators. In some countries, like Taiwan, Brazil, Mexico, Spain and many others, seizures of pirate product in 2004 were overwhelmingly of "burned" product. This new development calls for innovative responses—in this case, through improved enforcement machinery aimed at implementing zero tolerance policies against the offer for sale of pirate product. If pirates have no place to sell their products, their ability to manufacture becomes superfluous. Some countries are already responding by enacting absolute bans on street sales, with some positive results. Commitment from more countries to do the same is sorely needed.

In sum, regulations controlling and monitoring production need to be adopted, implemented and enforced, and must be accompanied by general copyright enforcement. Governments must be given the authority to conduct surprise inspections of optical disc production facilities to ensure full compliance, and to deal effectively with commercial "burning" operations, and they must use that authority vigorously. Deterrent penalties—including license revocation, confiscation of equipment and raw materials, and heavy fines and imprisonment—

[12] As a consequence, the U.S. government has levied sanctions against Ukraine under Special 301 and removed its GSP benefits. Such sanctions remain in place today.

must be consistently and efficiently imposed on optical disc pirates, and governments must adopt and implement zero tolerance policies on the sale of infringing materials.

Piracy by Organized Crime Syndicates

Because of the immense profits that can be garnered by producing pirate optical disc products, this illegal business has been taken over in many countries by organized crime syndicates, making it even more difficult for local authorities to combat the problem. These criminal syndicates are highly organized, are linked across national boundaries, and have powerful friends within governments. They have access to and control of large amounts of capital, and exploit complex distribution networks to engage in many kinds of criminal activity. In many cases, these powerful criminal networks are involved in multiple lines of criminal activities, including copyright piracy, drug smuggling, trade in illegal munitions, and money laundering. In some cases, the proceeds of copyright piracy have been used to fund terrorist organizations.

These syndicates control not only the production but the distribution of pirated and counterfeit optical disc products within the domestic market and around the world. For example, syndicates with optical disc production facilities in Southeast Asia work with partners in South America to conduct a thriving trans-Pacific trade in pirate music CDs, entertainment software, and other optical disc products. These criminal networks are highly sophisticated and are becoming increasingly dangerous to deal with. Starting in 2003, responding to improved enforcement against factory pirate production, the syndicates began moving their illegal trade into CD-R and DVD-R "burning" and to the Internet (see, for example, the country survey on Taiwan). This phenomenon will be even more pronounced in 2005.

Time/Europe[13] has reported that a drug dealer pays about $47,000 for a kilo of cocaine, and can sell it on the street for about $94,000, a 100% profit. But for $47,000 and with a lot less risk, a pirate can buy or produce 1,500 pirated copies of Microsoft's Office 2000 Professional and resell them for a profit of 900%! Examples of the involvement of organized crime on a global basis include:

- In August 2004, the owner of a pirate video shop in a popular Bangkok, **Thailand** shopping mall was shot dead in the Mall by an assailant on a motorbike. Police suspect the murder was ordered by the criminal gang that controls the piracy business in this and other malls. Police believe the murdered man was trying to break the protection racket that insulated the shops from possible police raids.

- In **Australia**, by the middle of 2004 the number of stalls selling pirated film DVDs at Melbourne's Caribbean Gardens Markets had increased fivefold (to more than 135 stalls); the price of pirated DVDs had substantially dropped (from AU$15-$20 per disc to AU$10); traders not affiliated with two main organized criminal gangs were forced to pay protection money or were simply muscled out of the market; and a well-organized lookout system had been put in place. In August 2004, the Caribbean Market hosted the largest concentration of DVD sellers under one roof in the Asia-Pacific region and an at times armed battle for control between two criminal gangs resulted in physical intimidation of investigators from the motion picture industry's Australian anti-piracy program.

[13] "Busting Software Pirates," *Time/Europe*, November 18, 2002.

- In March 2002, the largest seizure ever in **Australia** took place—35,000 pirate VCDs and DVDs. The disks were produced in **Malaysia** and a Malaysian national was arrested at the time. Further investigation led to the arrest of another Malaysian entering Australia with false documents. The authorities determined that this was a well organized syndicate including Malaysian and Australian nationals operating in cell-type structures to protect the ultimate kingpins. Unfortunately, both suspects were assessed inadequate fines, and were deported without the fine being paid.

- In 2004, enforcement authorities in the United Kingdom uncovered the involvement of Triad and Snakehead gangs in **China** in forcing illegal immigrants from China to sell pirate DVDs on the street to pay for their illegal passage to the UK.

- An April 2004 Interpol report on the links between terrorism and IPR crimes noted a year 2000 case of a CD plant in **Russia** run by Chechens who remitted funds to the Chechen rebels. The average monthly earnings of the organization were estimated at US$500,000-$700,000. During the raid on suspects' houses, a number of explosives and arms were seized.

- In 2004, turf wars between syndicates operating out of **Russia** and Bulgarian organized crime gangs were numerous, particularly over control of piracy at some of **Bulgaria**'s most blatant pirate hotspots. Bulgaria's anti-organized crime agency has acknowledged the involvement of these syndicates in the pirate distribution business.

- A recent press report noted that a new OD factory had been set up in **Burma** close to the border with northern Thailand near Chiang Rai. The plant produces pirate CDs, VCDs, and DVDs and is owned by the notorious drug lord Wei Hseuh-kang. The production lines reportedly were imported from China and the blank discs are reportedly also from China. Annual profit from this plant was estimated at US$6.5 million. Pirates in the border town in Thailand near the plant sold pirate product from the plant and DVDs of the newest U.S. films imported from China.

- In November 2004, police in Bangkok, **Thailand** raided a night market at King Rama I Bridge and were attacked by 30 piracy gang members. Some of the officers were injured.

- A pair of shipments intercepted by **Australian** Customs in October 2003 and described as containing "staircase fittings" was found to contain four steel cylinders large enough to hold 200 DVDs each. The airfreight shipments, seized in Sydney on October 17, 2003, were intended for an importer well-known to the Motion Picture Association (MPA) and involved in previous pirate disc smuggling operations. The "staircase fittings" shipment was intercepted as part of a long-term investigation into a very well organized syndicate operation.

- In late 2004, **Hong Kong** Customs smashed an extensive OD piracy syndicate allegedly run by a woman dubbed the "queen of piracy" and her sons. Ten locations were raided and close to US$200,000 worth of pirate copies and equipment were seized. It was estimated that this ring generated more than US$1.5 million per year over a four year period. In this same period, another sweep led to the arrest of 284 organized crime gang members with more than US$330,000 worth of pirate product seized. The raids were aimed at the revenue sources of Triad societies in West Kowloon. The sweep involved over 500 law enforcement officials.

- Also in 2004, **Hong Kong** Customs ran "Operation Sunrise," which disrupted a criminal syndicate run by the Sun Yee On Triad Society, yielding the arrests of 30 people, including a 12-year-old girl. Police raided 435 locations and inspected 1,921 entertainment premises, making arrests at 18 gambling establishments, 9 pirate optical disc shops, 23 brothels and 6 drug dens. Seizures included 1,700 Ecstasy tablets, 200 grams of ketamine, weapons, 160,000 pornographic or pirate optical discs, 9,500 liters of unlicensed gasoline and about 3.9 million cigarettes. The operation followed another successful anti-organized crime operation on June 25, 2004 when Hong Kong police and other agencies conducted a three-day operation code-named "Windpipe" that resulted in the arrest of 499 people and the seizure of over 12,200 copyright-infringing items including pirate optical discs.

- In August 2004 in **Malaysia**, it was reported that one of the suspected members of a Malaysian criminal syndicate distributing pirate ODs crashed his van into several vehicles while attempting to escape MDTCA officers. The suspect was apparently unloading 250,000 discs of local and international musical repertoire worth US$400,000.

- In July 2001 in a **Malaysian** city, a City Council President received a personal death threat along with a threat that his daughter would be raped if he continued his crackdown on the city's illegal VCD traders. He also received a handwritten letter containing a ten-centimeter-long razor blade. Newspaper reports noted seven death threats reported to the police in the months following aggressive action by the enforcement officers against VCD pirates. The then-Minister of the Domestic Trade and Consumer Affairs Ministry (MDTCA)—the main enforcement arm in Malaysia—also received a personal death threat. The Deputy Prime Minister stated publicly that it was clear that piracy is linked to criminal elements in Malaysia.

- Also in **Malaysia**, the police reported in October 2002 that pirate production of thousands of copies of protected films were carried out aboard ships anchored in international waters off the Malaysian coast. The ships later offloaded their cargo at obscure points along the coast.

- In February 2001, **Indonesian** police broke into a heavily fortified factory and discovered four production lines, three of which were in operation. During the search the raiding team was forced to abandon the premises after a local armed militia group sought to engage the police in a firefight in an effort to recover the premises.

- A raid in **Taiwan** in May 2001 turned up several illegal firearms, along with 70,000 suspect CD-Rs and other optical disc products containing music and pornography. This led to the discovery of an illegal arms factory alongside a sophisticated CD-R facility.

- In September 2002, in central **Taiwan,** the police arrested a 19-year-old in connection with the production of firearms to equip gang members protecting the local marketplace of a pirate optical disc production syndicate.

- In **Hungary**, criminal syndicates have assumed control of illegal CD-R burning, as well as all other aspects of duplication and distribution of entertainment software. For example, these criminal groups are using the Petöfi Stadium, which belongs to the local

municipality, as a distribution point to supply the surrounding region, including into Germany.

- In **Lithuania**, distribution of pirated entertainment software product (especially manufactured discs produced in Russia) is controlled by Russian organized crime syndicates that are now affixing their own logos and brand names to their illicit products. These pirated materials are then stored in Lithuania for distribution locally and throughout Eastern and Central Europe.

- CDs carrying extremist propaganda found in **Argentina, Mauritius, Pakistan** and **Paraguay** have been demonstrated to come from the same source as much of the illegally produced music in these regions. Other extremist or terrorist groups, for example in **Northern Ireland,** are partly funded by music piracy.

- In **Paraguay**, in April 2004, a key organized crime leader, Antonio Gonzalez Neira, was jailed for seven and a half years. The conviction was for the illegal import of blank CD-Rs suspected of being used in piracy. Neira was one of the most powerful pirates in Paraguay, and his family has a long and documented history of assisting Chinese and Taiwanese organizations involved in smuggling in the country.

- In **Brazil**, the notorious piracy kingpin Law Kim Chong was arrested in June 2004 for attempting to bribe the Chairman of Brazil's Congressional Anti-Piracy Committee. As part of the follow-up to this arrest, authorities raided one warehouse owned by Chong at which over 7.5 million blank CD-Rs and 3.5 million blank DVD-Rs were seized. The bribe was alleged to be for between US$1 million and $2.3 million. Chong owned numerous shopping centers and supplied product from China to over 10,000 points of sale throughout the country. Chong is now in jail and the investigation continues.

- In **Mexico**, police discovered a massive CD-R operation in raids in October 2001 on 11 houses, three linked internally by tunnels. Over one million blank CD-Rs, half a million pirated CD-Rs and 235 CD burners were found. Together the operation had the capacity to produce 14 million CD-Rs annually. It is believed the profits were invested in narcotics and prostitution.

- In February 2003, a high level Camorra crime boss in Naples, **Italy**, Luigi Giuliano, confessed to Italian prosecutors that the Camorra gang earned €100,000 per week (US$125,000 or US$6.5 million annually) from the drug trade, extortion and video and music piracy. In late 2004, a Naples Fiscal Police officer was shot at by suspected Mafia gang members. He was uninjured and was the coordinator of "Operation Jolly Roger," which had recently uncovered a major criminal syndicate producing and distributing pirate CDs and DVDs. During the Jolly Roger raids, seven people were arrested and more than 3 million music and movie CDs and DVDs were seized.

- In early 2004, a series of 13 raids by the National Police in Madrid, **Spain** led to the arrest of 40 persons involved in the mass duplication of CD-Rs. The suspects, many of whom were illegal immigrants from China and who had been brought to Spain by the other members of a criminal gang, were found in possession of 346 high speed burners, 168,400 blank CD-Rs, 24,450 recorded CDs, 39,000 DVDs, 10,500 VCDs containing movies, 515,000 jewel cases, 210,000 inserts and €48,000 (US$60,000) in cash. The

gang used a number of computer shops and restaurants to launder the money generated by the pirate product.

- In **Germany** in August 2004, law enforcement authorities seized a major "release group" server (named "dRAGON") at a university in Frankfurt. The server was being used by three of the largest release groups believed by the authorities to be responsible for up to 80% of online releases of German-language versions of movies, since a prior operation in March 2004 resulted in closing down 19 such servers. The server contained approximately 180 copies of newly-released films and about 20 interactive games. It was being used as a so-called mux-server (combining picture material with German soundtracks) by three of the largest and recently reorganized release groups, FLT (Flatline), TOE (Titans of Entertainment) and BBP (Block Buster Productions).

- Interpol has reported that in **Lebanon**, in February 2000, an individual was arrested for piracy and suspected of fundraising for Hezbollah. The individual sold pirated music CDs, Sega, Sony and Nintendo game discs to fund a Hezbollah-related organization. Among the discs recovered were discs containing images and short films of terrorist attacks and interviews with suicide bombers. The discs were allegedly used as propaganda to generate funds for Hezbollah.

- One individual, who has been identified by the U.S. Treasury Department as a "Specifically Designated Global Terrorist," is understood be a principal financier of one or two of **Pakistan**'s largest optical media plants.

The copyright industries alone cannot fight such organized criminal activity. Company representatives and counsel have in some countries already experienced threats on their lives or physical intimidation when their investigations began to make progress. In some cases, this has prevented any enforcement activity by the private sector. We look to the U.S. government for additional leadership, both here and in the appropriate bilateral and multilateral fora, to assist in placing the issue of effective copyright piracy enforcement on the agenda of agencies dealing with organized economic crime—generally, cybercrime, fraud, extortion, white-collar crime, drug enforcement, money laundering, and border and customs control. The U.S. government should encourage countries with existing anti-organized crime laws and investigative procedures to bring them to bear against syndicate operations involved in piracy. Where such laws and procedures are not in place, the U.S. government should encourage governments to adopt them and to include, among predicate offenses, intellectual property right violations.

End-User Piracy of Business Software and Other Copyrighted Materials

The unauthorized use and copying of software by businesses result in tremendous losses to the U.S. and global economies. The great majority of the billions of dollars lost to U.S. software companies from business software piracy in 2004 was attributable to this end-user software piracy. To safeguard the marketplace for legitimate software, government must have in place both substantive standards of protection and adequate enforcement mechanisms.

For the business software industry, it is particularly critical, given the growing use of electronic networks to make software available commercially to corporate and other end users, to ensure that the reproduction right covers both temporary as well as permanent reproductions. It is likely that very soon, virtually all consumers will engage in the full exploitation of software they license and receive over a network without ever making a

permanent copy on their hard drive. They will simply access the software, in accordance with mutually agreed license terms, then load it into the random access memory (RAM) of their workstation or server, use the software and, when finished, close the program or shut down the computer—all without the software ever being permanently stored on the computer's or server's hard drive. Failure to make clear that such temporary reproductions are covered by the exclusive reproduction right is a violation of the Berne Convention, the WTO/TRIPS Agreement and the WIPO Copyright Treaty. Great progress has been made globally on this critical issue, and IIPA calls upon the U.S. government to continue to seek legislative changes and clarifications on this point. As of today, at least 90 countries either provide express protection, or do so by interpretation, for temporary reproductions, or have committed to provide such protection.

Enforcement is a critical part of reducing global piracy rates for business software, which exceed 50% in the developing world. The biggest challenge to the business software industry is to persuade governments to take effective enforcement action against enterprises that use unlicensed software in their businesses. To effectively enforce against corporate end-user piracy, it is critical that countries provide an effective civil system of enforcement, provisional remedies to preserve evidence, and deterrent criminal penalties for piracy. More specifically, it is critical that countries provide *ex parte* search orders in an expeditious manner, deterrent civil damages and criminalization of corporate end-user piracy as required by Article 61 of TRIPS. Industry, along with USTR, has raised the need for strong procedural and remedial enforcement measures around the world. Although some countries have made attempts to improve enforcement through special enforcement periods and action plans, most of these proposals for action have not been sustained over time or resulted in deterrent criminal fines and jail terms. Additionally, most countries still do not criminalize corporate end-user piracy or provide civil *ex parte* measures—both in violation of their TRIPS obligations.

End-user piracy is of course not limited to software but, in part because of the Internet, now affects all copyright sectors. Hard goods piracy using the Internet to advertise and sell pirate product, and unauthorized downloading of music, movies, videogames and books from websites as well as through peer-to-peer file swapping services have all skyrocketed. Unauthorized digital streaming, where bandwidth permits, is also growing. A great deal of this activity is being conducted through government-owned Internet Service Providers and from servers owned and operated by governments, schools and universities. Likewise, in government, school and university facilities photocopy machines are routinely used for commercial scale book piracy. Where the government is directly involved or directly responsible for the facilities and implements used, policies and decrees must be promulgated and strictly enforced to ensure that these facilities are not used for infringing conduct.

Where the activity is confined to the private sector and to private individuals, the mechanisms for strict enforcement against pirate websites, P2P services and against individual uploaders and downloaders must be put into place and deterrent penalties imposed. Where lacking, legislation must be passed clarifying secondary liability as well as infringement liability for unauthorized uploading and downloading. Statutory notice and takedown regimes, with narrowly-crafted safe harbors for ISPs, should be adopted, which allow for expedited action (with minimal and reasonable notification procedures) to block access to infringing material or take down infringing websites or FTP sites. Piracy directly by individual or enterprise or government end-users is on the increase; the appropriate and effective enforcement tools must be put into place immediately.

Piracy of Books and Journals

The book and journal publishing industry faces not only the same challenges encountered by other entertainment and high-tech industries (digital and online piracy), but must contend with other methods of infringement as well. This piracy comes primarily in two forms—commercial photocopying and print piracy.

Unauthorized commercial-scale photocopying of books and journals is responsible for the industry's biggest losses in most territories worldwide. This photocopying takes place in a variety of venues—commercial photocopy shops located on the perimeters of university campuses and in popular shopping malls; on-campus copy facilities located in academic buildings, libraries and student unions; and wholly illicit operations contained in residential areas or other underground establishments. Publishers also suffer from unauthorized photocopying for commercial research purposes in both for-profit and non-profit institutions (often accompanied by failure to compensate reprographic rights organizations ("RROs") in countries where they exist to collect photocopying royalties). These operations are highly organized and networked, and technology advances are making the problem worse. Digitally scanned covers, for instance, allow pirates to conceal text that is often of poor quality, misleading consumers into believing they are purchasing a legitimate product, and electronic files containing book text are now routinely recovered as part of enforcement actions against copyshops.

In addition, the U.S. publishing industry continues to lose hundreds of millions of dollars per year from unauthorized printing of entire books, including academic textbooks, professional reference books and trade books. These printers come in two varieties. Often, they are licensed printers or distributors who are engaged in offset printing beyond the scope of a valid license granted by the publisher. Others are wholly illegal pirate operations that have no license from the copyright owner at all. Print piracy is especially prevalent in Egypt, Pakistan, India and China, where printing is to some extent still less expensive for pirates than photocopying. Sophisticated printing technologies result in extremely high-quality pirate editions of books, making it difficult for users to distinguish between legitimate and pirate products.

Publishers continue to suffer from unauthorized translations of books and journals of all kinds and genres, as well as counterfeiting in the form of "bogus" books or trademark misuse. Plagiarism also abounds, most often in the form of compilations of English language material or directly translated material marketed as a local professor's own product.

These types of piracy call for the same kind of aggressive enforcement techniques discussed throughout this submission, accompanied by the political will and awareness of governments to recognize the serious damage done to economies, culture and the educational environment by letting such infringements persist. IIPA urges the U.S. government to ensure that such acts of piracy are fully covered in all bilateral, plurilateral and multilateral engagements.

Improving Copyright Protection and Enforcement, Including Through Free Trade Agreements

The tools available to the U.S. government to improve copyright laws around the world and to ensure that these laws are effectively enforced are many and varied. They include not only the Special 301 mechanism, but various trade preference programs, such as the Generalized System of Preferences (GSP) program, which incorporate copyright (and other

IPR) criteria as conditions for continuing benefits. Along with these bilateral tools, the TRIPS agreement in the WTO has also caused many countries not only to improve their statutory laws to meet their new international obligations to protect intellectual property rights, but also to improve their enforcement systems to bring them into compliance with the new enforcement obligations in TRIPS. As we have noted, most countries have now brought their substantive laws into compliance with the TRIPS substantive law obligations. The same cannot be said, however, for the TRIPS enforcement obligations, and this submission is a testament to the need for WTO members to do much more in this critical area. The enforcement challenge is now accompanied not only by the need to upgrade substantive laws to deal with the new digital and online world, through implementation of the WIPO Treaties, but also to ratchet up enforcement systems once again, to match the technological challenges brought on by factory pirate OD production, OD burning, and the rising tide of Internet piracy.

The first yardstick that countries must measure up to is their obligation under the TRIPS agreement, both in respect of substantive law and enforcement. In addition, the U.S. government, beyond the bilateral and multilateral tools available to it, is now making effective use of the Free Trade Agreement process to adjust protection and enforcement to the new piracy and technology challenges of the 21st century. The biggest challenge today, of course, is correcting enforcement deficiencies. The TRIPS agreement and the FTA process are central to this effort.

The TRIPS Agreement: On January 1, 1996, the World Trade Organization (WTO) TRIPS Agreement entered into force for the U.S. and for all other WTO members that do not qualify for, and take advantage of, the transition periods of four and ten years.[14] Even for WTO members that did qualify for a transition period, the national treatment and MFN provisions of TRIPS applied fully as of January 1, 1996.[15]

On January 1, 2000, all TRIPS copyright obligations, including providing effective and deterrent enforcement, entered into force for all the world's developing countries (except those classified by the U.N. as the "least" developed countries). Before 2000, many of these countries successfully amended their statutory laws to bring them into compliance (or close to compliance) with TRIPS obligations. As we note throughout this submission, compliance with TRIPS *enforcement* obligations remains sparse, but is essential to returning the commercial benefits that were envisioned at the conclusion of the Uruguay Round.

Non-Compliance with TRIPS Enforcement "Performance" Requirements: A good number of developing countries simply have not taken sufficient measures to ensure that their laws and enforcement regimes (civil, criminal, provisional remedies, and border measures) are compatible with their TRIPS obligations. TRIPS obligations, both with respect to substantive law and to enforcement, are the worldwide "floor" for copyright and other intellectual property protection. Compliance with TRIPS obligations is necessary, though not alone sufficient, to

[14] Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Articles 65 and 66.

[15] TRIPS, Article 65.2, provides that "any developing country Member is entitled to delay for a further period of four years [following the expiration of the one year period after the entry into force of the WTO generally] the date of application, as defined in paragraph 1 above, of the provisions of the Agreement other than Articles 3, 4 and 5 of Part I." Articles 3 and 4 establish the national treatment and MFN obligations of the Agreement and Article 5 excludes these obligations with respect to WIPO treaties. This exception to the use of transition is also provided in all other categories of countries that may take advantage thereof. As of February 11, 2005, 148 countries were members of the WTO, including all countries surveyed in this submission with some exceptions, e.g., Lebanon, Russia, Saudi Arabia, and Ukraine.

meet the Special 301 statutory standard of "adequate and effective" protection.[16] Accordingly, in the country surveys and as part of the Special 301 process itself, IIPA has paid special attention to the extent to which the countries (or territories) surveyed in this submission are in compliance with these obligations. Where TRIPS incompatibilities are found, they can appropriately be dealt with in the context of Special 301, as well as directly through the initiation of a dispute settlement proceeding in the WTO.

All countries must acknowledge that the TRIPS enforcement text requires effective enforcement against all types of infringements and particularly against copyright piracy on a commercial scale. This includes not only the new forms of piracy discussed throughout this submission, such as piracy of movies, records and music, entertainment and business software and books and journals on optical disc formats and on, or involving, the Internet, but also piracy of works in traditional formats. We refer here to piracy of movies on VHS tapes, as well as broadcast/cable/satellite piracy and unauthorized public performances, music on audiocassette, entertainment software in cartridge format, and traditional textbook, trade book and journal offset printing piracy, as well as commercial photocopying.

U.S. Government Actions on TRIPS: USTR has already brought a number of successful cases in the WTO against developed countries for violations of TRIPS copyright and copyright enforcement obligations. Five of the copyright cases which the U.S. has brought have been resolved to the satisfaction of the U.S. and U.S. industry, without proceeding to a formal decision by a panel: (1) Japan, for its failure to provide 50 years of retroactive protection to U.S. sound recordings; (2) Sweden, for its failure to provide civil *ex parte* searches; (3) Ireland, for its inadequate copyright law; (4) Greece, for its failure to enforce its laws against broadcast piracy; and (5) Denmark, for its failure to provide civil *ex parte* searches.[17]

IIPA continues to urge USTR and the U.S. government as a whole to use the Special 301 process as a leverage and consultation tool to move developing countries, whose obligations under TRIPS became fully effective on January 1, 2000, toward bringing their laws and particularly their enforcement regimes fully into compliance with TRIPS. This year we have, in particular, highlighted China's failure to meet its TRIPS obligations in the enforcement area and have recommended that consultations be commenced in the WTO in a new effort to persuade the Chinese authorities that complying with their international obligations is not only their duty as global citizens, but is firmly in the interest of China itself. We have also highlighted the need for Pakistan to comply with the enforcement obligations of TRIPS, given its nearly 100 percent piracy rate and the massive exports of pirated product flowing out of Pakistan.

---

[16] Uruguay Round Agreements Act, Pub. L. No. 103-465, § 314(c), 108 Stat. 4809 (1994) (also known as the URAA).

[17] Snapshot of WTO Cases in the United States (updated Jan. 15, 2005 at http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/asset_upload_file287_5696.pdf. The case numbers at the WTO are: WT/DS 28 (Japan), WT/DS 86 (Sweden), WT/DS 83 (Denmark), WT/DS 125 (Greece), WT/DS 82 (Ireland).

IIPA urges USTR to use all the tools available to it, including GSP,[18] CBI,[19] CBTPA,[20] ATPA,[21] ATPDEA,[22] and AGOA,[23] to reach the objective of strong global copyright protection, including, as the "floor" of this protection, compliance with TRIPS. IIPA identifies TRIPS-inconsistent laws or practices in the country surveys.

The Free Trade Agreement Process: The negotiation of bilateral and regional free trade agreements (FTAs) now occupies a place of overriding importance to the copyright industries and to U.S. trade policy. These negotiations offer an important opportunity to persuade our trading partners to modernize their copyright law regimes so they can maximize their participation in the new e-commerce environment, and to improve enforcement procedures. Since copyright issues are not being addressed in the Doha Round of multilateral negotiations under the World Trade Organization, the FTA process has become by far the most fruitful avenue to address the law reform challenges brought on by developments in technology. At the time of this letter, FTAs with Singapore, Chile, Australia, Jordan and Morocco have entered into force. FTAs with Central America, the Dominican Republic and Bahrain have been concluded. Negotiations with Panama and the Andean Pact countries of Colombia, Ecuador and Peru are slated to end soon, and negotiations with Thailand have begun. IIPA trusts that the valuable precedents established in these earlier agreements will be carried forward to the ongoing FTA negotiations with the South African Customs Union (SACU) and also to the newly announced negotiations with the United Arab Emirates and Oman, and hopefully many more to come. In all these negotiations we have achieved, and will continue to seek, full implementation of the WIPO Internet Treaties; stronger substantive protection in other areas, including the extension of the term of copyright; and detailed and effective enforcement obligations that make clear the requirement to enforce copyright in all areas, including on the Internet, with expeditious and deterrent civil and criminal remedies. We again compliment the Administration and Ambassador Zoellick for moving swiftly and aggressively to secure new high levels of protection and enforcement that will be critical to the development of e-commerce in the coming years. Finally, we next expect all this effort to come together in an unprecedented Free Trade Agreement of the Americas in which the standards of copyright protection and enforcement continue to reflect the new global framework of protection established in the FTAs negotiated to date. IIPA looks forward to working closely with U.S. negotiators to achieve these goals in the FTA and FTAA fora.

---

[18] Generalized System of Preferences Renewal Act of 1984, Pub. L. No. 98-573, tit. V, 99 Stat. 2948 (1984) (codified at 19 U.S.C. § 2461 *et seq.*).

[19] Caribbean Basin Economic Recovery Act, Pub. L. No. 98-67, Tit. II, 97 Stat. 369 (1983) (codified at 19 U.S.C. § 2701 *et seq.*).

[20] U.S.-Caribbean Trade Partnership Act, Trade and Development Act of 2000, Pub. L. No. 106-200, tit. II (May 18, 2000) (codified at 19 U.S.C. § 2703 *et seq.*).

[21] Andean Trade Preference Act of 1990, Pub. L. No. 102-182, Tit. II, 105 Stat. 1233 (1991) (codified at 19 U.S.C. § 3201 *et seq.*).

[22] Andean Trade Promotion and Drug Eradication Act, Pub. L. No. 107-210 (2002) (codified at 19 U.S.C. §3201 *et seq.*)

[23] African Growth Opportunities Act, Trade and Development Act of 2000, Pub. L. No. 106-200, tit. I (May 18, 2000) (codified at 19 USC § 2461 *et seq.*).

D. IIPA RECOMMENDATIONS FOR THE 2005 SPECIAL 301 LISTS

This year IIPA has considered deficiencies in copyright protection in 42 countries/territories and has recommended them for placement in the categories of Priority Foreign Country, Priority Watch List, Watch List, and Section 306 Monitoring. We also identify two countries that have failed to comply with their copyright or enforcement obligations under FTAs currently in force. Finally, we mention specific issues in 23 additional countries/territories that deserve increased U.S. government attention.

IIPA recommends that USTR designate Russia as a Priority Foreign Country in 2005 and that Russia's eligibility for GSP benefits be immediately suspended. Russia's copyright piracy problem remains one of the most serious of any country in the world. Piracy rates for most sectors are estimated at around 80% in 2004 and losses exceed $1.7 billion.[24] Despite the repeated efforts of industry and the U.S. government to convince the Russian government to provide meaningful and deterrent enforcement of its copyright and other laws against OD factories and all types of piracy—including some of the most open and notorious websites selling unauthorized materials such as www.allofmp3.com—little progress has been made over the years. Meanwhile, piracy continues unabated in the domestic market and pirate exports continue to flood both Eastern and Western Europe.

IIPA also recommends that Pakistan be designated as a Priority Foreign Country. The government of Pakistan has largely ignored the growing production of pirate U.S. copyrighted products by illicit optical disc factories. Exports of these pirate goods are flooding the world market. Efforts to persuade the Pakistani government to halt such pirate production and export have, to date, produced few results. Furthermore, the Pakistani government has failed to take adequate measures to stop rampant book piracy and commercial photocopying, which decimate the market for legitimate publishers.

IIPA recommends that USTR should keep Ukraine as a Priority Foreign Country and that trade sanctions should continue accordingly in 2005. This includes the continued suspension of Ukraine's duty-free trade benefits under the Generalized System of Preferences ("GSP"); those benefits were suspended in August 2001 for Ukraine's copyright shortcomings. We make these recommendations because Ukraine's copyright piracy problem remains very serious almost five years after it agreed to a Joint Action Plan signed by then-President Clinton and President Kuchma which Ukraine has neither effectively nor completely implemented. By its failure to fully implement an optical disc regulatory scheme and by its overall criminal enforcement failures, Ukraine is not in compliance with the June 2000 bilateral agreement, nor with the 1992 Bilateral NTR Trade Agreement with the United States (which Ukraine agreed to implement by December 31, 1993). IIPA hopes that last year's historic elections will produce an environment conducive to the resolution of these long-standing issues, and that Ukraine will take the necessary steps to restore its trading benefits with the United States.

IIPA recommends that the remaining countries/territories be placed on, or maintained on, the Priority Watch List or the Watch List, where they are subject to ongoing bilateral scrutiny.

---

[24] The methodology used by IIPA member associations to calculate these estimates is described in IIPA's 2005 Special 301 submission, at www.iipa.com/pdf/2005spec301methodology.pdf. For example, ESA's reported dollar figures reflect the value of pirate product present in the marketplace as distinguished from definitive industry "losses."

IIPA recommends that 15 countries be placed on the Priority Watch List: Argentina, Brazil, Bulgaria, Chile, Colombia, the Dominican Republic, Egypt, India, Indonesia, Kuwait, Lebanon, the People's Republic of China, the Philippines, South Korea, and Thailand. IIPA also recommends that 23 countries/territories be designated or kept on the Watch List. We also recommend that out-of-cycle reviews be taken in three countries that already appear on the various 301 lists: Malaysia, the People's Republic of China, and the Philippines.

With respect to the People's Republic of China, IIPA recommends that USTR immediately request consultations with China in the World Trade Organization, and that it place China on the Priority Watch List pending an out-of-cycle review to be concluded by July 31, 2005, at which time further appropriate multilateral and bilateral action, including the possible establishment of a dispute settlement panel in the WTO, would be considered. China has failed to "significantly reduce piracy rates," as promised by China's Vice Premier Wu Yi at the Joint Commission on Commerce and Trade (JCCT) meetings in April 2004. Piracy rates continue to hover around 90%, where they have been for years, and losses are estimated at $2.5 billion in 2004.[25] While there have been some raiding improvements, the copyright industries are concerned that, without moving to a hopefully more effective forum and a new dialogue, little will happen in the near term to change the current dismal picture.

IIPA commends Paraguay for the efforts that it has made over the course of this past year, and recommends that USTR continue to monitor developments in Paraguay under Section 306 of the Trade Act of 1974.

Appendix C contains a survey of a total of 67 countries or territories. The countries/territories appear by recommended category and in alphabetical order within each category.

[25] See footnote 24, *supra*.

Priority Foreign Country	Priority Watch List	Watch List	Section 306 Monitoring	FTA Dispute Settlement	Other Countries Deserving Special Mention
Pakistan (GSP) Russia (GSP) Ukraine	Argentina Brazil (GSP) Bulgaria Chile Colombia Dominican Republic Egypt India Indonesia Kuwait Lebanon (GSP) PRC + OCR Philippines + OCR South Korea Thailand	Bolivia CIS (5)[26] Belarus Kazakhstan (GSP) Tajikistan Turkmenistan Uzbekistan (GSP) Ecuador Hungary Israel Italy Latvia Lithuania Malaysia +OCR Mexico New Zealand Peru Poland Romania Saudi Arabia Serbia and Montenegro Taiwan Turkey Venezuela	Paraguay	Jordan Singapore	Bahamas Bangladesh Bosnia and Herzegovina Burma Cambodia Canada CIS (2) Azerbaijan Georgia Croatia Cyprus Czech Republic Estonia Greece Hong Kong +OCR Iceland Kenya Laos Macedonia Nigeria South Africa Spain Switzerland Vietnam
3	15	23	1	2	23

Appendix D provides a history of countries/territories appearing on IIPA and USTR lists since 1989, a year after the Special 301 legislation became effective. Fifteen of these countries/territories have appeared on a Special 301 list each year since 1989, and are recommended by IIPA to appear there again. A 1994 amendment to Section 182 of the Trade Act, dealing with identification of "priority foreign countries," provides that the U.S. Trade Representative must take into account "the history of intellectual property laws and practices in the foreign country, whether the country has been identified as a priority foreign country previously, and U.S. efforts to obtain adequate and effective intellectual property protection in that country."[27] Under this criterion, these 15 countries/territories named by IIPA are particularly vulnerable, having failed to correct their piracy and/or market access problems during the 17 years that Special 301 has been in existence.

Ongoing GSP IPR Reviews: IIPA also calls attention to ongoing intellectual property rights reviews under the Generalized System of Preferences (GSP) trade program. IIPA has been a strong supporter of the GSP program and over the years has filed petitions requesting the U.S. Government to initiate review of copyright law and enforcement practices in targeted

[26] "CIS" in this filing denotes ten former Soviet republics. Russia and Ukraine are treated separately from the CIS in this filing.

[27] Uruguay Round Agreements Act Statement of Administrative Action, *reprinted in* H.R. Doc. No. 103-316, vol. I, at 362 (1994).

countries. In June 1999, IIPA filed 11 GSP petitions against: Poland, Peru, Lebanon, Dominican Republic, Ukraine, Moldova, Uzbekistan, Armenia, Kazakhstan, Belarus, and the Kyrgyz Republic. On February 7, 2000, IIPA withdrew its petition against Peru in light of the commitments made by that country to improve enforcement. On February 14, 2000, USTR accepted IIPA's GSP petitions against six countries: Dominican Republic, Ukraine, Moldova, Uzbekistan, Armenia, and Kazakhstan. Our Belarus petition was not accepted because GSP benefits were being withdrawn from that country for other reasons. Hearings on these six countries were held on May 12, 2000.

In August 2000, IIPA filed five more petitions for GSP reviews of the copyright practices of Brazil, Russia, Guatemala, Costa Rica, and Uruguay as part of the 2000 Annual Review. On January 10, 2001, USTR decided to initiate GSP IPR reviews against Brazil and Russia. GSP hearings were held on March 9, 2001. USTR announced that it was terminating the GSP review against Moldova due to legislative progress recently made in that country. For the 2001 GSP Annual Review process, IIPA filed GSP petitions against Lebanon, Pakistan and Uruguay. A coalition of six copyright-based associations also submitted a petition against Thailand. On August 6, 2002, the GSP program was renewed for four years through December 31, 2006.

On September 3, 2003, USTR announced its decisions in both the 2001 and 2002 GSP Annual Reviews for country practices. USTR accepted IIPA's GSP IPR petition against Lebanon; acknowledged IIPA's requests to withdraw its petitions against Thailand and Uruguay; announced the termination of the IPR reviews against Armenia and Turkey; and postponed its decision whether to accept or reject IIPA's petition against Pakistan. GSP hearings were held on October 7, 2003, and IIPA presented testimony in the cases against Brazil, Russia, the Dominican Republic, Kazakhstan, Uzbekistan and Lebanon. On July 2, 2004, USTR announced its decisions in seven copyright cases in the 2003 GSP cycle by accepting the Pakistan petition, extending a special 90-day review in the Brazil case, terminating the investigation against the Dominican Republic, and keeping the cases open against Russia, Lebanon, Kazakhstan and Uzbekistan. On December 6, 2004, USTR extended its investigation of Brazil through March 31, 2005.

E. FTA DISPUTE SETTLEMENT COUNTRIES

As discussed above, the FTAs negotiated to date have set new global precedents in copyright protection and enforcement, providing further impetus to e-commerce and to global economic growth and employment. However, these benefits will not be realized unless the obligations agreed to are rigorously implemented into the national laws of our FTA partners. In the submission we identify two such partners—Jordan and Singapore—which have not yet fully implemented their FTA obligations. Unless the current issues with these countries are promptly and satisfactorily resolved in current informal negotiations, the U.S. should not hesitate to use the FTA dispute settlement process set up for just this purpose.

F. COUNTRIES DESERVING SPECIAL MENTION IN 2005

In addition to the 42 countries/territories for which IIPA has provided comprehensive country reports, IIPA also highlights issues in 23 countries/territories which deserve special attention this year but which are not recommended for placement on the Special 301 Lists. These countries/territories and the problems encountered in them can be found at the end of Appendix C in a new Section entitled "Countries Deserving of Special Mention." These countries/territories are: Azerbaijan, Bahamas, Bangladesh, Bosnia and Herzegovina, Burma,

Cambodia, Canada, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Greece, Hong Kong, Iceland, Kenya, Laos, Macedonia, Nigeria, South Africa, Spain, Switzerland, and Vietnam.

G. ESTIMATED LOSSES DUE TO PIRACY

As a result of deficiencies in the copyright regimes of the 67 countries/territories highlighted in this submission, the U.S. copyright-based industries suffered estimated trade losses due to piracy of $13.4 billion in 2004.[28] On a global basis (that is, in all countries/territories including the U.S.), IIPA conservatively estimates that total losses due to piracy were at very minimum $25-30 billion in 2004, not counting significant losses due to Internet piracy, for which meaningful estimates are not yet available.

Appendix A presents a chart which quantifies losses for the five copyright-based industry sectors—the entertainment software, business software, motion picture, sound recording and music, and book publishing industries—for 2003 and 2004. In most surveys, IIPA has described the piracy levels in each of the sectors in each of these countries/territories (where available). This should prove helpful in identifying trends and in determining whether enforcement efforts have actually been successful in reducing piracy levels in the particular country.

ESTIMATED TRADE LOSSES DUE TO COPYRIGHT PIRACY IN 67 SELECTED COUNTRIES IN 2004 (in millions of U.S. dollars)

Industry	Estimated Losses
Motion Pictures	**1,800.7**
Records & Music	**2,657.4**
Business Software	**6,448.0**
Entertainment Software[29]	**1,847.5**
Books	**603.0**
Total	13,356.6

Appendix B summarizes the methodology used by each IIPA member association to calculate these estimates. They represent a crushing burden on the U.S. economy, on U.S. job growth, and on world trade generally. They result from the blatant theft of one of this country's most valuable trade assets—its cultural and technological creativity. Appendix B also describes how IIPA and its members estimate global OD production capacity, including factories, types of

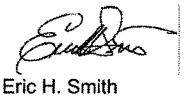
[28] The methodology used by IIPA member associations to calculate these estimates is described in IIPA's 2005 Special 301 submission, at www.iipa.com/pdf/2005spec301methodology.pdf.
[29] ESA's reported dollar figures reflect the value of pirate product present in the marketplace as distinguished from definitive industry "losses." The methodology used by the ESA is further described in Appendix B of this report.

OD production lines, and capacity for both production of content and blank media (CD-Rs and DVD-Rs). The use of recordable media has now come close to becoming the pirate's tool of choice, particularly as enforcement pressure on factory production has increased.

H. CONCLUSION

Special 301 remains a cornerstone of U.S. intellectual property and trade policy. We urge the Administration to use Special 301—as well as the tools available under the GSP, CBI, ATPA, CBTPA, and AGOA programs—to encourage the countries/territories identified in our recommendations this year to make the political commitments, followed by the necessary actions, to bring their copyright and enforcement regimes up to international standards. The U.S. government should also use the multilateral tools in the WTO dispute settlement machinery to encourage countries/territories to bring their substantive and enforcement regimes into compliance with their international obligations under TRIPS. We look forward to our continued work with USTR and other U.S. agencies to bring about major improvements in copyright protection and enforcement worldwide.

Respectfully submitted,



Eric H. Smith
President
International Intellectual Property Alliance

"PIRACY OF INTELLECTUAL PROPERTY"

(GLOBAL PRODUCT COUNTERFEITING)

Written Testimony of

Timothy P. Trainer
President
Global Intellectual Property Strategy Center, P.C.

Before the
United States Senate
Committee on the Judiciary
Subcommittee on Intellectual Property

May 25, 2005

Mr. Chairman and members of the Subcommittee, this hearing to examine intellectual property (IP) theft, specifically, copyright piracy, is a worthy pursuit in view of the global onslaught to steal these valuable assets.

I take this opportunity to submit these comments due to the ongoing global assault on trademark assets owned by U.S. companies, large and small, and companies elsewhere that are victimized by counterfeit goods. These comments are not submitted on behalf of any entity, but are offered due to my continuing work in the area of intellectual property enforcement. My work in this area has included both public (U.S. Customs Service and the U.S. Patent and Trademark Office) and private (Arter & Hadden law firm and the International Anti-Counterfeiting Coalition, Inc.) experience.

In part, I restate the testimony presented on March 23, 2004, before the Senate Judiciary Committee as well as the testimony I presented before the U.S. China Commission in February this year.

RECOMMENDATIONS

At the outset, these recommendations are put forward for further consideration by this Committee, the Administration and industry to combat the scourge of counterfeiting and piracy that exist and will be elaborated upon further in the following pages:

- Take immediate steps to introduce a Senate companion to H.R. 32 "Stop Counterfeiting in Manufactured Goods Act";
- Protect IP rights as part of C-TPAT and CSI programs;
- Impose aggressive IP enforcement provisions, including enforcement in free trade zones, on trading partners entering into bilateral trade agreements with the U.S. ;
- Increase efforts to have trading partners improve enforcement at the border;
- Request less burdensome enforcement data from industry;
- Seek immediate increase in criminal enforcement in China; and
- Consider whether notions of territoriality prevent small and medium enterprises from obtaining effective enforcement in foreign markets.

1. GENERAL BACKGROUND

Trademark counterfeiting is as complex and difficult to combat as copyright piracy. While copyright owners confront pirates who use technology to steal content before products are available to consumers,[1] trademark owners are also combating sales of

[1] *See*, Joshua Chaffin and Scott Morrison "Online Pirates Beat Star Wars Rush for Premiere," Financial Times (May 19, 2005). "Online pirates beat the rush to the theatre and were already downloading the film from file-sharing websites on Wednesday".

Global Intellectual Property Strategy Center, P.C., 910 17th Street, N.W., Suite 800, Washington, D.C., 20006
Telephone 202-955-1144 • Facsimile 866-338-7158 • ttrainer@globalipsc.com

counterfeit goods on the internet[2] and the manufacture, distribution and sale of physical goods around the world. In view of the counterfeiters' expansion into more product areas, the paramount issue related to trademark counterfeiting, i.e., product counterfeiting, is public health and safety as all types of products are now being counterfeited:

- Pfizer's Vice Chairman states that between 10% and 15% of all drugs sold in the world are fakes;[3]
- Fourteen died from fake alcohol in China;[4]
- CBS's Chicago affiliate uncovers counterfeit extension cords in discount stores;[5]
- Police arrest individuals involved in dealing in counterfeit cosmetics;[6]
- Approximately $10 million dollars worth of fake auto parts seized (filters, pistons, brake pads, and more) in the United Arab Emirates, including tens of thousands of counterfeit GM products;[7]
- South African authorities uncover tons of staple foods bearing fake marks;[8]
- "Disney Acts on Fake Asian Toys";[9]
- Hair dryers and extension cords found bearing counterfeit UL marks seized in Canada;[10]
- Counterfeit shampoos and hair oils concern Indian industries;[11]
- "Unsafe condoms sold under Durex name";[12]
- Counterfeit Kiwi shoe polish, power drills, motor oil, and teas are subject to counterfeiting;[13] and
- Authorities seize counterfeit shampoos, creams, toothpaste, soaps and hair oil found in warehouses in Sharjah, UAE.[14]

From a public policy perspective, these examples provide ample reason for increased government enforcement efforts as counterfeiters continue to invade a broad array of product areas and put consumers in harm's way.

In addition to the public health and safety risks related to counterfeiting, there is the continuing reference to organized crime involvement. The U.S. Attorney's office in New

---

[2] "Golfers Get Clubbed by Cheap Chinese Knock-offs," The Globe and Mail (May 18, 2005). Internet auction sites offer counterfeit golf clubs, motivating Callaway, Nike and others to combat counterfeiters together.
[3] Agence France Presse (May 18, 2005).
[4] Xinhua News Agency (May 18, 2005).
[5] CBS News, Chicago CBS Channel 2 (May 9, 2005).
[6] The Monitor (Uganda) (May 5, 2005).
[7] Gulf News (April 19, 2005).
[8] Sunday Independent (Johannesburg) (April 17, 2005).
[9] Dominion Post New Zealand (April 13, 2005) (Disney acts because of small parts that pose a choking hazard and paints with high levels of metal such as lead.).
[10] Ottawa Citizen (April 2, 2005).
[11] Financial Times (March 17, 2005).
[12] Irish Times (March 15, 2005).
[13] Business Week (February 7, 2005).
[14] Khaleej Times (August 17, 2004).

York charged 51 individuals, arresting 29, from rival Chinese gangs for their involvement in international smuggling activities and gambling. The charges involved smuggling immigrants and importing counterfeit goods from China, as well as additional charges for attempted murder, extortion and money laundering.[15] The recognition of the organized crime element is not limited to the United States and Western Europe. Recently, authorities in the Philippines have expressed their belief that Chinese-Filipino syndicates are flooding Philippine markets with counterfeit goods, ranging from clothes and shoes to medicines from China.[16]

Adding to the organized crime and dangerous products concerns arising from counterfeits is yet another issue that raises social issues: child labor. Reports have begun to surface that underage children are employed by those engaged in the production and distribution of counterfeit and pirate product. Industry[17] and a human rights organization[18] have raised this issue as it relates to China. However, it is not limited to China as other reports have been provided by industry to trade associations regarding the use of underage children to be runners and look-outs in South America.[19]

As trade in counterfeiting and piracy continue to expand and envelope ever more criminal activities, the cases of authorities detecting more shipments attempted to be transported across borders increase. During the first three-quarters of 2004, the European Union's national border enforcement authorities conducted over 16,300 enforcement actions resulting in the seizure of over 74 million counterfeit and pirated items.[20] Japan's Ministry of Finance reported record seizures of counterfeit and pirated products at its borders for 2004, reporting a 23% increase over 2003 with seizures of goods from China doubling.[21] The Bureau of Customs and Border Protection, U.S. Department of Homeland Security, reported that for fiscal year 2004, Customs seized over 7,200 shipments containing counterfeit and pirate goods, valued at over $138 million dollars.

While understandable that the American, European and Japanese markets would be targets of counterfeiters, even Malta is now finding significant quantities of counterfeits. In a five month period, Malta's authorities have detected the equivalent of 14 full containers of counterfeit goods.[22] The goods are usually from the Far East and destined for other markets.

Rich and poor countries alike are combating the massive movement of counterfeit and pirate products. This brief snapshot of some of the counterfeiting and piracy activity provides a glimpse into a bad situation that appears to be getting worse, not better. The

---

[15] Julia Preston, "U.S. Charges 51 with Chinatown Smuggling," New York Times (November 13, 2004).
[16] Manila Standard (April 28, 2005).
[17] Evening Standard (London) (February 11, 2005).
[18] Daily Mail (UK) (March 14, 2005).
[19] In February 2005, the International AntiCounterfeiting Coalition, Inc., asked its member companies to provide any information they might have regarding the involvement of child labor in counterfeiting and piracy. Responses were limited.
[20] http://europa.eu.int/comm/taxation_customs/counterfeit_piracy
[21] Daily Yomiuri (Tokyo) (April 4, 2005).
[22] Paul Cachia, Di-ve News (May 17, 2005)

ongoing counterfeiting enterprises continue because of the continuing large scale profits that can be realized in the face of weak enforcement efforts and non-deterrent penalties.

There is no doubt that industry and government must redouble their efforts in various areas in order to make "progress", which in some countries is simply slowing the growth rate of counterfeiting. Unfortunately, the list of substandard and dangerous products made and distributed around the world makes anyone anywhere a potential victim of counterfeit products.

2. *LEGISLATION*

In the United States, legislation needs to be strengthened at all levels, local, state and federal. A recent traffic stop along Interstate 80 resulted in police charging two individuals who were found with $680,000 dollars worth of counterfeit luxury goods in their vehicle.[23] In November 2004, New York City's Comptroller estimated that the City loses over a billion dollars in tax revenues due to sales of counterfeit and pirate goods.[24] Both suggest that the statistics issued by the Bureau of Customs and Border Protection reflect a tiny fraction of the counterfeiting activity within the United States.

Strategies here and abroad suggest potential ways forward in combating counterfeiting and piracy. On April 19, 2005, trademark owner Louis Vuitton (LV) won a preliminary injunction against a landlord who owns seven storefronts on Canal Street in New York City. The landlord agreed to take action to prevent the sales counterfeit LV goods on his properties.[25] In Scotland, city council licensing officials have taken the unprecedented step of banning sales of DVDs, CDs, videos and computer games at a flea market in a crackdown on pirated goods, demonstrating the need for more aggressive enforcement actions.[26]

Government and industry must consider a combination of new and old approaches to combat counterfeiting and piracy, whether civil or criminal penalties. There is no doubt that in many cases of product counterfeiting, the individuals involved have no regard for either the consumer or the trademark owner. In recent years, there has been only one piece of federal legislation aimed at strengthening the criminal law against trafficking in trademark counterfeit goods. Both last year and this year, Representative Joe Knollenberg's "Stop Counterfeiting in Manufactured Goods Act" has been introduced.[27] It would strengthen the criminal provision, Title 18, U.S.C., Section 2320. The legislation does take steps forward to eliminate loopholes that currently exist. Therefore, companion legislation in the Senate is needed for this section of the federal criminal law to be strengthened.

---

[23] Pittsburgh Post-Gazette (May 22, 2005). He Dejin and XiaoLaning charged with having counterfeit purses, watches and other items bearing Chanel, Coach, Prada, Burberry and Gucci marks.
[24] Eric Dash, "The Handbag? Total Knockoff. The Price Tag? All Too Real," New York Times (November 23, 2004).
[25] Julia Boorstin, "Louis Vuitton Tests a New Way to Fight the Faux," Fortune Magazine(May 3, 2005).
[26] Evening News (Edinburgh) (May 21, 2005).
[27] H.R. 32 was introduced in January 2005.

3. CBP INITIATIVES

Recognizing that both the Container Security Initiative and the Customs-Trade Partnership Against Terrorism are intended to safeguard the United States from terrorist acts and weapons of mass destruction, these programs can also contribute greatly to our economic security with an emphasis on IP protection. In view of the huge quantities of counterfeit goods entering the U.S. market, these programs should not provide foreign exporters and domestic importers with "guarantees" of getting goods into the U.S. market once they become participants of these programs.

Despite the increased CBP IP seizure statistics for FY 2004, it is requested that Congress monitor these programs and require that these programs include a strong and aggressive IP enforcement component in order to combat counterfeiting and piracy. As noted in this submission, combating IP theft targets organized crime groups operating abroad that engage in other types of illegal activity. By looking at IP theft too narrowly, we fail to appreciate how criminals here and abroad use IP theft to fund other illegal conduct.

4. BILATERAL AGREEMENTS

The strong enforcement provisions of the Free Trade Agreements (FTAs) that have been concluded are positive steps toward combating counterfeiting. Future FTAs should clearly indicate that, in addition to *ex officio* authority for goods intended for export and moving in-transit, goods in free trade zones are also subject to the same enforcement requirements.

Despite ongoing and aggressive efforts to address counterfeiting in the countries of manufacture, the concentration of Asian-made counterfeit goods being sent to every region of the world should be sufficient grounds to redouble the Administration's efforts to require improved enforcement in the countries of importation. Thus, all forms of bilateral trade agreements should be enhanced to heighten enforcement efforts at the border by all trading partners.

5. GOVERNMENT REQUEST FOR DATA

In September 2004, the Office of the U.S. Trade Representative (USTR) requested industry data regarding specific cases pursued in China. With the exception of a few, companies did not respond in sufficient numbers to provide USTR with a reliable picture of what happens to cases pursued in China. To some extent, detailed information on each case pursued by a company was deemed to be too burdensome for IP owners to respond. In the future, there may be alternative data elements that could be requested and still provide the type of "picture" of IP theft that is occurring and causing harm to companies or industry sectors. As an alternative, USTR could seek more general information from companies, for example:

1) Total number of raids in (name of country) (identify time period);
2) How many times a particular facility was raided/results;

3) Total of items seized/destroyed (identify type of product) (identify time period);
4) Total number of arrests;
5) How many cases were pursued with criminal investigations/prosecutions;
6) Disposition of defendants in administrative/criminal cases (e.g., level of fines imposed/paid, prison sentences imposed and served);
7) Information regarding the disposition of the equipment used to produce goods;
8) Information about facility (shut down or not);
9) Seizures of country X origin goods in 3d markets; and
10) Identify the type of IP (copyright, trademark, etc.) and, if a trademark, the marks used by the counterfeiters.

These data elements are suggested and would allow the submitting company (or companies in an industry sector) to submit aggregated data. Because these are not case specific, it might result in more industry representatives submitting data. It is not likely that any entity will be able to provide data as to all the elements above, but these or other data elements may be easier to obtain and to provide than the specific case information previously requested. Ultimately, industry should be able to develop its own data elements that it can provide either individually or as a group of affected companies.

6. CHINA CHALLENGE

For most trademark owners, China continues to present the greatest challenge to efforts to protect and enforce their rights. Having said this, some trademark owners find other countries to be worse than China in their efforts to protect their rights.[28] Despite the chorus of complaints regarding deficiencies in China's domestic market and border enforcement systems, trademark owners have reported that

- Many raids have been conducted;
- Significant quantities of counterfeit goods have been seized;
- Criminal prosecutions have been initiated;
- Shipments have been stopped by Chinese Customs; and
- Prison sentences have been imposed.[29]

Still, China has no equal either as a source of counterfeit and pirated goods to the world or as a market in which fakes are produced and sold locally. Despite significant improvements in China's IP legal regime over the last few years, the enforcement system continues to be fraught with weaknesses and inefficiencies that facilitate massive counterfeiting and piracy.

The exports of counterfeit and pirated products continue to flow from China to every corner of the world causing lost sales and damage to brand image and, as noted above,

[28] *See*, International AntiCounterfeiting Coalition, Inc.'s (IACC) 2005 Special 301 submission and the Canada report at p. 8 (February 11, 2005). At the time of this submission, I was president of the IACC.
[29] China's official Xinhua News Agency reported on April 21, 2005, that over 50,000 trademark infringement and counterfeiting cases were investigated and dealt with in 2004.

pose health and safety concerns. China sourced counterfeits range from counterfeit medicines and auto parts to home electrical products to apparel and footwear.[30] China's counterfeiting industry has a direct impact on foreign governments. For FY 2004, the U.S. Department of Homeland Security's Bureau of Customs and Border Protection (CBP) reported the seizure of 2826 shipments from China containing counterfeit and pirated product, having a domestic value of over $87 million dollars.[31] Based on these statistics, China accounted for 63% of the total monetary value of intellectual property seizures in FY 2004. The export of counterfeit and pirate products impose significant pressures on foreign customs administrations and law enforcement entities to combat China's counterfeit exports.

While China's counterfeiting industry churns out massive amounts of counterfeit goods, the government has made changes to the legal regime. Two sets of changes involve the customs regulations and the recently issued judicial interpretations regarding criminal cases, the latter being issued in late December 2004.

The most recent amendments to the Customs regulations went into effect on March 1, 2004, and replaced earlier regulations from 1995 on the protection of IP rights by local customs offices. As a result of the regulatory changes, Customs issued new implementing rules that took effect July 1, 2004. Several issues remain problematic. The issues that continue to cause right owners problems are:

- The monetary range of the value of the bonds that can be required when ex officio action is taken (0% to 100% of the value of the counterfeits);
- Long term storage costs of the goods during the pendency of legal actions, which right holders believe should be paid by the infringers; and
- Auctioning of counterfeit goods rather than destruction of counterfeits as the routine remedy.

The result of some of the procedures now in place can deter right holders from using the enforcement system because it ties up valuable revenues. Given some of the expenses involved, e.g., storage, the right holder, not the infringer, continues to be subjected to additional further damage as the result of its effort to protect its rights.

Turning to the judicial interpretations concerning criminal enforcement, these were recently issued by the judicial authorities. The criminal enforcement system—police, prosecutors and the courts—will have to demonstrate a willingness to impose higher level penalties on counterfeiters and pirates. Any assessment of the future effectiveness of the new judicial interpretations should be accompanied by greater transparency of the judicial process so that right holders can more easily learn whether defendants receiving prison terms do, in fact, serve the prison sentences or pay monetary fines that are imposed.

---

[30] *See*, "Fakes!", Business Week at p. 54 (February 7, 2005).

[31] Both of these statistical measures were increases over FY 2003 when CBP seized 2,056 shipments with a domestic value of over $62 million.

While the problems in China's enforcement system are many, a basic starting point should be the consistent application of the enforcement mechanisms at all levels, city, provincial, and national. At these levels, the system must impose a level of penalty that will deprive the individuals involved of any economic benefit and impose a monetary fine or prison sentence so that the penalty is greater than the rewards of returning to the illegal activity of counterfeiting and piracy.

The new judicial interpretations continue to have obstacles to effective enforcement, including:

- Minimum thresholds for criminal liability;
- Significantly higher thresholds for corporate counterfeiters;
- Weak valuation of counterfeit goods—using the value of the illegal merchandise; and
- Reliance on an extensive administrative enforcement system.

Another significant gap in the interpretations is the absence of language addressing the problems caused by counterfeiters who operate underground factories/facilities without the necessary business/commercial licenses from the government. There should be no minimum monetary standard required for criminally pursuing counterfeiters who operate these types of underground facilities. Article 225 of the Criminal Code provides up to five years imprisonment for engaging in "illegal operations." While the Article 225 provisions may be intended for products specially regulated by the government (such as cigarettes, telecommunications and publishing), it should apply to all underground and illegal operations.

The text of the new interpretations, while important, should not be the sole focus of our efforts. Whatever steps the Chinese take – new regulations/interpretations, increased training, more funding, IP specialized PSB divisions, etc. -- such steps must result in more criminal prosecutions, heavier fines, more jail sentences and a reduction in the overall counterfeiting levels. The natural solution is for Chinese police to take a leading role in the investigation of counterfeiting cases. Additionally, the AICs, Customs, TSBs and other administrative enforcement bodies need to cooperate more closely with Chinese police and Public Security Bureaus (PSBs) and promptly transfer those cases that meet the standards for criminal investigation and prosecution.

The U.S. will have to continue its ongoing engagement with Chinese authorities, constantly identifying the obstacles to enforcement and how these obstacles can be reduced and eliminated. In order for the system to have the desired effect, the national government will have to ensure that its stated policy is implemented at all levels. Thus, greater political will should be demonstrated through more aggressive use of the criminal enforcement system.

Global Intellectual Property Strategy Center, P.C., 910 17th Street, N.W., Suite 800, Washington, D.C., 20006
Telephone 202-955-1144 • Facsimile 866-338-7158 • ttrainer@globalipsc.com

7. *IMPACT ON SMEs*

The China export machine has caused companies of all sizes to experience the counterfeiting problem. Companies that have any great national success within an industry and have risen to be a leader within an industry must increase their awareness of the possible threats posed by counterfeiters and pirates. Those that may not be active in multiple global markets may still be victims of IP theft simply due to their national success. Thus, a U.S. company that may not view itself as a global "player" can still have parts of its IP portfolio stolen and its future market taken.

Along these lines, the U.S. Government is increasing its efforts to raise awareness among small and medium enterprises (SMEs). Many successful SMEs may not be aware of the IP assets they have or how they might protect those assets. Thus, this requires a proactive education program. Because of today's technology and instant communication, a successful national enterprise can easily become a global target of counterfeiters.

The challenges posed by the massive quantities of counterfeit and pirated products made in China and elsewhere and exported throughout the world have exposed the IP system to a collision. Counterfeiters and pirates operating in China have swamped markets with substandard and dangerous products with no regard for national borders and with no respect for the rule of law. The speed with which IP criminals can be on the market has placed law abiding companies at an extreme disadvantage in combating IP crimes.

Because the global IP system has rules, legitimate IP owners that are the victims are also failing to make progress in this battle because of the territorial nature of some IP rules,[32] which help counterfeiters and pirates exploit an established system. In view of the current system where criminals make, trade and sell in practically every country, IP owners are disadvantaged because they are likely to receive protection of their rights only where Governments have granted rights. In view of the collision between the global scourge of counterfeiting and piracy and the territoriality of some types of intellectual property, perhaps it may be appropriate to consider how a distinction can be made between the acquisition of rights and the ability of IP owners to protect and enforce their rights so that protection and enforcement can be obtained in more countries in a timely fashion even absent the grant of rights in all the countries where one is victimized by counterfeiters.

For SMEs that do not have trademark registrations in dozens of countries, but whose success leads to criminal IP theft, there needs to be criminal enforcement against those who engage in global counterfeiting. Civil remedies will not deter today's criminal counterfeiter.

---

[32] The territoriality of some types of intellectual property, e.g., patents and trademarks, hinder the ability of owners to seek protection and enforcement against counterfeiters.