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INTERNATIONAL AND DOMESTIC INTELLECTUAL PROPERTY ENFORCEMENT

HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

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CONTENTS

	Page
Statement of Jack Valenti, President and Chief Executive Officer, Motion Picture Association of America	3
Prepared Statement	5
Statement of Mitch Bainwol, Chairman and Chief Executive Officer, Recording Industry Association of America	9
Prepared Statement	11
Statement of Douglas Lowenstein, President, Entertainment Software Association	17
Prepared Statement	18
Statement of Robert W. Holleyman, II, President and Chief Executive Officer, Business Software Alliance	25
Prepared Statement	27
Prepared Statement of Senator Ted Stevens	33

INTERNATIONAL AND DOMESTIC INTELLECTUAL PROPERTY ENFORCEMENT

THURSDAY, APRIL 29, 2004

U.S. SENATE,
SUBCOMMITTEE ON COMMERCE, JUSTICE, AND STATE,
THE JUDICIARY, AND RELATED AGENCIES,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:03 a.m., in room SD–192, Dirksen Senate Office Building, Hon. Judd Gregg (chairman) presiding.

Present: Senators Gregg, Stevens, and Murray.

Senator GREGG. We are going to get started. We have votes coming up and I want to make sure we have time for our witnesses. Mr. Valenti, I know, is on the way, so there will be plenty of time for him to get here and make his statement. But I did want to proceed with discussion.

This meeting today is about intellectual property rights and the many ways it is being managed and abused and pirated by the international community and the concerns we have in the United States, the fact that the intellectual property rights are being stolen once produced.

As a society, I think we understand that one of the primary engines of our economic growth and especially of our trade balances is the intellectual property that is produced here in the United States. We are a value-added society when it comes to the issue of producing goods, which we are competitive in in the international market, and one of the places where we are most effective at adding value is in intellectual property.

That being said, we also recognize that many of the products of our society in the area of intellectual property, whether it is recording, software, movies, or other activity, is being stolen and pirated by various communities across the country and across the world and it is in some cases a very orchestrated theft. That is having a huge impact on us. We are talking hundreds of billions of dollars of lost income for American entrepreneurs and inventors as a result of this piracy and theft.

The reason our committee has decided to pursue this is that we are uniquely situated. This committee has jurisdiction over all the major Federal agencies which have a role in asserting our rights on intellectual property. We fund the Commerce Department, and the USTR. We fund the PTO. We fund the Justice Department, obviously a key agency in this exercise. And we fund the State Department. So if you list the agencies which can have an impact, especially in the area of how our intellectual property is used inter-

nationally, it is this committee which draws them all together and we are the only committee in the Senate that has that sort of jurisdiction on this issue.

So I felt it would be important for us to hear from the industry, specifically as to how we are going to proceed, and then as a practical matter, what I am most interested in hearing about is how these Federal agencies are coordinating. My concern is that many of these Federal agencies are approaching it as a stovepipe and that they do not have the overlapping communications and coordination which is so critical to accomplish a coordinated policy.

We set up a number of years ago a group called NIPLECC, the National Intellectual Property Law Enforcement Coordinating Council. I am anxious to hear how that council is doing. I did ask one day how that council was doing of an individual who, it turned out, was serving on the council and didn't know that they were. I am not sure that that council, which is set up basically to get everybody in an operating pattern that was coordinated, has had the impact it was supposed to have.

So what we are basically interested in in these hearings is hearing about some of the specifics of how the theft is occurring, obviously, especially relative to the international part, but more importantly, hearing about how our Federal agencies which come under the jurisdiction of this committee—the Justice Department, the Commerce Department, State Department, USTR, PTO—are doing as agencies in responding to the theft and the piracy and whether they are adequately coordinated, and if there is a problem here, what suggestions does the industry have for how we can improve the effort. If they are legislative, we can address those, and if they are appropriations, we can address those. As for management, we can also address those.

So this is a hearing to get hopefully action, move from not just making a record but to actually use the capacity of this committee to help across jurisdictions within the Federal Government to accomplish something, which is hopefully a more coordinated and aggressive approach towards protecting intellectual property.

So I appreciate this panel coming forward. We had had a second panel scheduled for today, but because there are going to be three votes and the rest of the day is going to be disjointed, I would just try this presentation. Actually, it is not a bad idea to have this panel come forward, give us some thoughts, and then we can digest them a little bit, and then next week or the following we can have the agencies come forward and we will discuss with them the ideas that you volunteered on how we can better execute in this area.

So I very much appreciate this very distinguished panel and appreciate your participation. Obviously, it is led by the dean of the Washington community, Mr. Valenti. We are very honored to have him here today as he is winding down his relationship with the Motion Picture Association he has been involved with for eons. His history in this city is epic, so it is a pleasure to have him testify before us today.

Also, Doug Lowenstein, President of the Entertainment Software Association. We appreciate Doug coming.

Robert Holleyman, head of the Business Software Alliance, which is clearly the future industry in this area, especially as an engine for our economy.

And Mitch Bainwol of the Recording Industry Association of America, which has been fighting this issue aggressively domestically, especially, so we very much appreciate your participation.

We would like to hear from you and why don't we start with, if you are ready, Mr. Valenti, we will start with you and get your thoughts, then move down the line.

STATEMENT OF JACK VALENTI, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MOTION PICTURE ASSOCIATION OF AMERICA

Mr. VALENTI. Thank you, Mr. Chairman. In my 5 minutes, I am not going to take——

Senator GREGG. Take as much time as you feel you need to make your presentation.

Mr. VALENTI. I will try to be brief because I think that is probably more salutary from your standpoint.

I think it is fair to say that the American movie industry faces parallel challenges, both here and abroad, in the kind of thievery that is going on, and it has been relentless and consistent.

Right now, about—I would say that one of our problems abroad is the intrusion by organized crime into the theft of movies. We find that the theft of movies in foreign countries right now is high reward and low risk. Indeed, our investigators tell us that drug dealers are finding they can make a larger profit without the bleak prospect of being shot in gang wars or going to long terms in prison by giving up the drug business and going to the stealing of movies.

Also, our investigators tell us that they believe that immense sums are being funded to terrorists. Now, they don't have specific evidence of it, but so far, they think that is pretty clear.

If you add to that a rapidly growing thievery that is going on in the Internet, and Mr. Bainwol will tell you about the devastation reaped on the music industry, but it is beginning to happen with us. This thievery is going to grow more malignant in the future with this rapid avalanche and this increased velocity of take-down times. Cal Tech has had an experiment called FAST when I visited with their labs in October. Last summer, they brought down a DVD-quality movie in 5 seconds.

Internet II, which is a consortium of scientists headed by Dr. Molly Broad, President of the University of North Carolina, also conducted experiments. They sent 6.7 gigabytes, 6.7 billion bytes of graphics and text, which is about one-third longer than the average movie. They sent it halfway around the world, 12,500 miles, in 1 minute.

So you take these unbelievable and bewildering speeds that can be in the marketplace in 18 months to 2 years, you can see why it gives us in the media industry more than a few Maalox moments.

This a really dark and menacing threat for this economy. You might ask, why? Because intellectual property composes about 5-plus percent of the gross domestic product of this country. We bring in more international revenues than agriculture, than aircraft, than automobiles and parts. Most people don't know that. We are

creating new jobs at three times the rate of the rest of the economy, Mr. Chairman. These are not minimum-wage jobs.

The movie industry alone has a surplus balance of trade with every single country in the world with whom we do business. I don't believe that any other American enterprise can make that statement, and I don't have to tell you that this is a time when we are suffering of over $400 billion in deficit balance of trade.

So we are an awesome engine of economic growth, no question about it. No one can again say that. So I think what would be more interesting to you on trade would be what are our recommendations? What do we think ought to be done? In my written testimony, I give, I think, some vivid detail on that, but let me just sketch out for you some of the things we ought to do.

One, increase funding to the FBI and earmark that for properly equipped and trained agents for work in the field. Just developing a small group of agents, and I know the FBI has got tremendous, formidable problems out there, but just a tiny group of agents dedicated to this would make a significant difference. I want to pay tribute to the Federal Bureau of Investigation and to the U.S. Attorneys around this country and to the Justice Department. They have been magnificent in trying to help, but they are, I don't have to tell you, overwhelmed themselves.

Number two, raise the profile of intellectual property enforcement among the international agencies. Now, the United States Trade Representative and his merry band of warriors do a tremendous job. They have been very effective and relentless in their energetic approach to this, but that is only with the trade tools at their disposal. They need beefing up. They really do, and especially in the Intellectual Property Division. Their resources are stretched to the stretching point, snapping point.

So we suggest creating a new Office of Intellectual Property Protection within the USTR and headed by a new Assistant USTR with a suitable staff. If they want to go higher than that, that is fine. Right now, this IP function is being handled by a group that is responsible not only for intellectual property, but for investments and service. That is a huge undertaking. It is too much to handle. The portfolio is too large.

And given the State Department's important role, we recommend a larger profile for the State Department's Intellectual Property Division. I think that is necessary. We think you have to lift it, giving it, in the jargon of the State Department, an officer director level, to allow them to recruit more experienced Foreign Service officers to be involved in the situation.

And three, I think you need to revitalize the 301s to help, Special 301s to help on international lobbying efforts. We need to use, and again using jargon of the USTR, out-cycle reviews to make sure that these nations sustain the commitments they have made and the pledges they have offered. But this takes time. There needs to be staffing for that. And therefore, we hope the administration also is going to act quickly on our GSP, Generalized System of Preferences Petitions, such as the ones confronting Russia and Lebanon and Brazil at this time.

And number four, we need to explore innovative approaches to our Embassies abroad. The Patent and Trademark Office has done

something I think quite inventive. They have assigned one of their most experienced international intellectual property lawyers to the U.S. Embassy in Beijing, working very closely with similarly put people in China. That is a terrific thing. I applaud that. A Federal prosecutor is now finishing up an assignment with the Beijing Embassy, working with prosecutors in China and helping them understand how best to do prosecution of this time. Our Ambassadors have just got to lift the level of the intensity of intellectual property protection.

Thank you, Mr. Chairman of the Appropriations Committee, for coming here.

Our Ambassador to Russia, I might point out, has been wonderful, has been splendidly effective in working this. He has really gone above and beyond the call of duty of a U.S. Ambassador in this area, and well he might because Russia is one of the most troubled arenas in the world so far as piracy is concerned.

There are a lot of other things that I think could be done, but I will stop here now and let my colleagues inform you further. Thank you, Mr. Chairman, for letting me speak to you.

Senator GREGG. Thank you. That is important. We appreciate it.

[The statement follows:]

PREPARED STATEMENT OF JACK VALENTI

The challenges of ensuring effective protection of intellectual property have skyrocketed in recent years. The large-scale involvement of organized crime in the international replication and export of pirated DVDs, and the large and rapidly growing threat of Internet piracy represent major challenges for the filmed entertainment industry and other copyright industries to overcome.

Motion picture production and services employment growth has been more than double the rate for all Non-Farm jobs since 1972: 4.8 percent for motion picture production and service jobs, compared with 1.9 percent for all non-farm jobs.

The cumulative effect over the past 30 years is even more striking. Motion picture production and services jobs grew 292 percent, while all non-farm jobs grew 78 percent over that period. Ensuring the continued health of the filmed entertainment industries, and the U.S. copyright industry as a whole, is in the national interest.

I welcome your interest, Mr. Chairman, in ensuring that the Federal Government is organized and equipped to confront the growing challenges of protecting intellectual property, both at home and abroad. And increasingly, piracy knows no boundaries. The line between domestic and international piracy is becoming increasingly blurred.

DOMESTIC ENFORCEMENT

Over the last several years, the Department of Justice, and the various federal law enforcement investigative agencies, have devoted increased attention to enforcing the laws prohibiting copyright and other intellectual property crimes. We greatly appreciate these efforts. Stepped-up prosecution not only addresses the serious matter of intellectual property crimes committed in the United States, but also serves as a positive example for our trading partners, who understand that our country not only exhorts other nations to protect intellectual property, but also exerts substantial efforts itself.

Much of the augmented resources devoted to domestic intellectual property enforcement has gone toward establishing prosecutorial interest and expertise. For instance, the Computer Crime and Intellectual Property Section of the Justice Department's Criminal Division has significantly increased its staffing. Over a dozen U.S. Attorney's Offices around the nation have established "CHIP" (Computer Hacking and Intellectual Property) Units to ensure that prosecutors are trained to investigate online criminal activity, including intellectual property crimes. Indeed, through the "CTC" (Computer and Telecommunications Coordinator) program, there are prosecutors in every jurisdiction in the country prepared to address this important crime problem. These efforts are vital to sustain and grow: as the key evidence necessary to convict is increasingly found in computer hard drives and ISP records,

we need prosecutors adept at understanding these crime scenes and at explaining them to judges and juries.

Unfortunately, the investigative resources devoted to this issue have not kept pace with this welcome expansion of prosecutorial attention. In fact, with the migration to the Department of Homeland Security of agencies that had previously been able to devote more attention to criminal intellectual property enforcement, such as the Bureau of Immigration and Customs Enforcement and the U.S. Secret Service, the FBI is increasingly the only choice for investigating intellectual property crime. Yet, we are receiving a consistent message that promising leads in intellectual property cases are not being pursued because of a lack of trained tech-savvy investigators who are familiar with how to conduct intellectual property investigations.

We do, of course, understand that the war on terror and the imperative to keep our people safe properly consume the lion's share of investigative attention at the FBI and other investigative agencies. But this is not an "either/or" proposition: we have the resources and we have the need to stop terrorism and combat intellectual property crime.

FIGHTING INTERNATIONAL PIRACY

Trade Tools

Effective use of trade tools has been, and remains, an essential part of our strategy to protect American intellectual property abroad. Over the past two decades during which global piracy emerged as a major concern for the U.S. creative industries, trade tools have played a critical role in establishing legal norms of effective copyright protection and in providing the impetus for foreign countries to take these legal obligations seriously.

Special 301 remains a key tool for industry to communicate its priorities for combating intellectual property problems with the U.S. Government, for the U.S. Government to set its own priorities for tackling these problems, and for the U.S. Government to communicate and influence foreign government responses to international piracy. For example, last year USTR's effective use of Special 301 helped prompt Taiwan to monitor more closely its optical disc factories and to launch effective raids against the night markets, which had teemed with pirate products. However, for the past two years, one key tool that evolved informally under the Special 301 program—the so-called "Out-of-Cycle Review"—has been used with decreasing frequency. These "Out-of-Cycle Reviews" are a mechanism for reviewing progress in addressing piracy in key countries at an appropriate internal partway through the annual Special 301 cycle. We believe that resource constraints may have led to the decision to decrease the number of countries with which the U.S. Government holds these interim reviews of progress under Special 301.

The Generalized System of Preferences (GSP) represents another trade tool provided by Congress that has proven to be an effective point of leverage in motivating countries to take their intellectual property obligations seriously. Unfortunately, a combination of factors, including several temporary lapses in the GSP program, helped weaken the effective use of this leverage. However, the GSP program is currently authorized and a major review under the GSP program is scheduled for July 1. It is time to reinvigorate this unilateral trade benefits program to help encourage countries to find the political will to enforce effectively their intellectual property laws.

The conclusion of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights in May of 1994 established enforceable global standards for copyright protection. USTR immediately tested those standards in a series of dispute settlement cases in the mid-90s, leading to improvements in copyright laws and standards of protection in a number of countries in Western Europe. Now that inadequate enforcement has replaced statutory deficiencies as the key TRIPS-related problem, the copyright industries are working with USTR to find a good case to test the fairly broad enforcement standards of TRIPS.

Over the past two years, the U.S. Trade Representative's Office has negotiated a network of Free Trade Agreements that lift the international copyright standards to a whole new level, helping to ensure that our trading partners have the tools to help us confront the new piracy challenges that color our international working environment. MPAA is a big fan of these Free Trade Agreements. While individually, several of the countries are small, collectively, the FTAs negotiated to date cover export markets worth at more than $742 million to the filmed entertainment industries. Taken together, our FTA partners provide the eighth largest market for American filmed entertainment.

Traditional Diplomacy

The threat of trade sanctions is a useful weapon, but not sufficient to arm the United States for an effective fight against piracy. Not every problem is covered by trade agreements or best addressed by threats of sanctions. Good old-fashioned high-level advocacy can solve a lot of problems.

The U.S. Commerce Department has demonstrated effective and impressive leadership in ensuring that piracy remains at the top of our bilateral commercial agenda with key countries. Assistant Secretary William Lash, in particular, deserves commendation, and certainly has my personal respect, for his tireless advocacy efforts on behalf of the copyright industries. His pressure on the Philippines may not have won him friends in some Philippine circles, but it certainly helped move forward a long delayed optical disc law.

The U.S. State Department, both through headquarters and the U.S. Embassies, also brings the weight of U.S. diplomacy to bear on international piracy problems. Several U.S. Ambassadors have shown exceptional leadership in the fight against piracy. Ambassador Alexander Vershbow in Russia has been particularly active in the fight against piracy. His hard-hitting speeches and editorials keep a beam of light focused on the unpleasant truth of Russia's endemic piracy. He and his staff have tirelessly pressed for key legislative and policy reforms. The fight against piracy in Russia is far from over; however, the pieces of a solution may finally be coming together. In addition to the Embassy's diplomatic efforts, other key pieces are the threat of trade sanctions, the carrot of WTO accession, and the realization by President Putin that Russian economic interests are best served by protecting intellectual property.

Intelligence gathering and analysis

Fighting the organized crime groups, and perhaps even the terrorist organizations that currently profit from piracy requires intelligence gathering tools that are far beyond what private industry can employ. There may be a larger role for the Government agencies, whether it is Treasury, Justice, State Department's Intelligence and Research Bureau, or the CIA, to help track the money flows and uncover possible links between piracy, organized criminal rings and terrorism.

Training and Capacity Building

Many agencies of the U.S. government play important roles in training and building the capacity of foreign governments to address intellectual property challenges. The Copyright Office of the Library of Congress, the Patent and Trade Office, USAID, Justice Department's Overseas Prosecutorial Development Assistance and Training Office, and State Department's International Narcotics and Law Enforcement Affairs are all involved in training and capacity building in the area of intellectual property law and enforcement. In one of the more commendable efforts in good government, the Intellectual Property Division in State Department's Economic Bureau took the lead in organizing a regular, informal series of meetings aimed at ensuring that those agencies that choose to participate are aware of the training programs others have organized. This effort has helped ensure a minimum of duplication and the maximization of taxpayer dollars. To our delight, the State Department also actively seeks participation of U.S. industries and trade associations, which are also deeply involved in anti-piracy training efforts.

The U.S. State Department has two new, innovative programs for capacity building that deserve close inspection. Utilizing $2.5 million allocated by Congress for this fiscal year, the State Department is in the process of identifying recipients among foreign law enforcement agencies that could use start-up funds to build out their enforcement capacities in order to better meet their obligations under international copyright and intellectual property treaties. Helping foreign governments build effective copyright enforcement capabilities helps them and helps us. We are hopeful that this program will prove its worth and merit ongoing Congressional funding.

The U.S. State Department is to be commended for experimenting with a new, cultural outreach tool to get the message out regarding the importance of protecting intellectual property. Just last Friday, U.S. State Department's Bureau of Educational and Cultural Affairs published a request for grant proposals entitled "Intellectual Property Rights For Artists" soliciting project proposals to increase awareness among filmmakers, writers, composers, musicians, and other experts of the need to protect against unauthorized replication and distribution of their cultural works to protect each nation's cultural heritage as well as safeguard the individual property rights of its artists. Using hands-on workshops, the project aims to assist artists in Brazil, China, Egypt, Israel, Lebanon, Morocco and/or Russia to navigate the legislative systems in their countries in order to influence their governments to

adopt and/or enforce good copyright laws. If this project yields innovative responses and proves itself to be effective, this may be a type of capacity building that could provide a useful supplement to other sorts of more technical training.

MPAA RECOMMENDATIONS FOR STRENGTHENING THE ABILITY OF THE U.S. GOVERNMENT TO FIGHT PIRACY

Increase funding to the FBI and earmark it for properly equipped and trained agents to work cases in the field

Even devoting a relatively small number of agents to investigating domestic piracy can make a significant difference. It will deliver the crucial message, necessary for deterrence, that the U.S. government recognizes the importance of intellectual property, and will treat theft of intellectual property with the same attention as other types of serious economic crime.

Raise the profile for intellectual property enforcement among the international agencies

There is no denying that USTR's resources have been stretched to the breaking point. This subcommittee could significantly enhance USTR's ability to meet its enforcement mandate by raising the profile of the intellectual property function at USTR, increasing its staffing levels and resources, and dedicating some staff specifically to the enforcement function. There are several options for raising the intellectual property profile at USTR. These include creating a new Ambassadorial position that would be subject to advice and consent of the Senate; and/or creating a new Office of Intellectual Property Protection to be headed by a new Assistant U.S. Trade Representative for Intellectual Property. Currently the intellectual property function is headed by a Deputy Assistant U.S. Trade Representative, who is part of an office that is also responsible for services and investment—an enormous portfolio of issues. Whether an Ambassador or an AUSTR heads the intellectual property efforts, either option, to be effective, will require an additional Senior Executive Service slot, additional staff, at least one of whom should be solely dedicated to enforcement of existing agreements, and the associated financial resources.

Similarly, a heightened profile for the U.S. State Department's Intellectual Property Division might be beneficial. Heading this office at the Office-Director level could help them recruit even more experienced Foreign Service Officers and lend greater weight to their voice in intra-agency and inter-agency debates.

Reinvigorate key trade tools

Given the central importance of Special 301 to our international lobbying efforts, the subcommittee may wish to assure itself that the key Special 301 agencies have adequate resources to support "Out-of-Cycle Reviews" to ensure that countries sustain their efforts to improve the protection throughout the year.

Petitions are pending to suspend GSP benefits for Russia, Lebanon, Brazil, and other countries. An important Presidential review under the GSP program is due for completion on July 1. We hope the Administration will act upon our petitions, unless of course these countries make meaningful and sustained progress prior to this date.

Explore Innovative Approaches to Staffing at U.S. Embassies

Two interesting experiments in melding legal expertise and strong language skills may also prove to be interesting precedents to be considered for other countries. The Patent and Trademark Office will be assigning one of its experienced international intellectual property lawyers to the U.S. Embassy in China later this summer to bolster the Embassy's expertise and ability to work directly with Chinese intellectual property experts. Similarly, a federal prosecutor is currently finishing up an assignment to Beijing where he worked directly with Chinese prosecutors and judges on a range of legal reform issues, including intellectual property. Both of these assignments seem to us to be quite innovative. These experiences may provide some insights into how to move beyond putting trade pressure on the executive branches of foreign governments to find effective ways to help strengthen and motivate prosecutors and judges, who play a critical role in effective intellectual property enforcement.

Hone USG efforts at international intellectual property training and capacity building

We encourage Congress to fund a significant expansion of the $2.5 million capacity-building program for State Department for fiscal year 2004, so that resources continue to be available to aid foreign law enforcement efforts.

We also encourage continued efforts at coordination among all the training agencies. With the growing importance of trade-related capacity building as well as the law reform projects funded by the Agency for International Development, strengthening the information sharing among AID and the rest of the federal agencies and involved U.S. industries would be particularly worthwhile.

MPAA/MPA'S EFFORTS

Lest I leave you with the impression that we expect our government to do all the heavy lifting, I want to remind you that MPAA and its sister organization outside the United States, the Motion Picture Association (MPA), operate anti-piracy programs in over 60 countries. These anti-piracy programs help investigate and cooperate with local authorities in raiding pirate replication and distribution sites. In 2003 MPA in cooperation with local law enforcement initiated almost 66,000 investigations and inspections, participated in 32,000 raids, and seized over 16 million DVDs and 28 million VCDs. We also oversaw civil litigation, especially against commercial sellers of DVDs decryption software and websites selling pirated DVDs. In appropriate circumstances, MPA also brings civil cases, whether against Internet up and downloading, or in some cases against cable operators, hotels or other legitimate companies that are simply cutting corners. Our anti-piracy experts present expert testimony in criminal prosecutions. We also help organize educational and public relations campaigns to inform the public about the evils of piracy, as well as lobby for appropriate copyright reform and other legal tools, such as ensuring that organized crime statutes include copyright as an actionable offense.

CONCLUSION

Your leadership, Mr. Chairman, in reviewing whether all these agencies have enough resources at an appropriate level to ensure effective response is key to ensuring that the U.S. Government remains adequately equipped to aid us in our fight against worldwide piracy.

Senator GREGG. Mr. Bainwol.

STATEMENT OF MITCH BAINWOL, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, RECORDING INDUSTRY ASSOCIATION OF AMERICA

Mr. BAINWOL. Mr. Chairman, Mr. Chairman, thank you both for focusing Congress' attention on the devastating impact of piracy, and more important, on the steps Government can take to address this enormous problem.

I am the CEO of the Recording Industry Association of America. Our members create and distribute 90 percent of the recorded works in the United States. The United States represents about 40 percent of a 32.7 billion unit global market.

The 1980s and the 1990s were terrific decades for music sales. Domestic shipments soared from about $4 billion in 1980 to about $15 billion in 1999. The pattern globally was similar, soaring from $11 billion in 1980 to about $39 billion in 1999. And then things went south.

Part of the explanation is the pervasiveness of international piracy professionally, the old fashioned way, factory produced cassettes and CDs. But there are two new and more salient triggers. First, the enormous wave of illegal file sharing that began with the centralized Napster was followed by a surge of decentralized P2P networks. And second, the widespread proliferation of CD marketing that made it so very easy to reproduce high-quality sound recordings.

We found ourselves in a rapidly evolving market defined by, one, widespread ambiguity about what you can and can't do to share music, and two, a dramatic decline in the barriers to piracy with either a CD burner or physical piracy or a home computer hooked

up to the Internet for a P2P piracy and recently for broadband. It became easier than ever to get music without paying for it.

In rough terms, the combination of global physical piracy, user Internet piracy, and illegal CD burning generated a 20 percent decline in shipments since 1999. The impact of the revenue crash has been profound, both in human and in creative terms. A thousand jobs lost at Warner in March. Several weeks ago at EMI, 1,500 jobs lost. Last year at Sony, another 1,000. Over the last 2 years at Universal, 1,500. There were major losses at BMG, as well. And none of this takes into account the impact of the thousands of closures of regional outlets. Lots of jobs have been lost there, as well.

Yet the creative loss is even more troubling. Artists' rosters have been slashed dramatically as companies no longer can afford to carry as many dreams. Piracy robs industry of the capital it needs to invest. As a result, fewer artists are finding the financial support they need to put food on the table. The path to artistic success in music has never been linear, speedy, or terribly predictable. A performer can break with his first album, his second album, or never at all. In today's world, however, smaller rosters accommodate fewer starting performers. The price? Perhaps the next Norah Jones or Willie Nelson or the next Beyonce.

We have talked about the online problem. The most important thing this Congress can do is recognize the true nature of the technological challenge. It isn't a case of digital versus plastic. It is not content versus technology or old versus new. It is legitimate versus illegitimate. Shine the spotlight and here is what you will find.

The legitimate industry: We pay taxes, we provide jobs. We contribute positively to the trade balance. We label our content and we compensate songwriters and artists unfailingly who bring to the market great new products that fans everywhere enjoy.

The illegitimate industry: They have hijacked the neutral technology P2P. They don't pay taxes. They don't provide jobs. They don't impact trade. They don't label. They don't even effectively shield kids from pornography. And they certainly don't pay songwriters or artists. Moreover, these networks do compromise user privacy. They do jeopardize computer security. And they do induce illegal behavior without anything remotely close to adequate disclosure. New product? They don't do that.

Shine the spotlight through the fog and demand accountability and help us educate parents, teenagers, and pre-teens how to enjoy music in ways that preserve the future of the creative enterprise. There will always be ways to steal music technically. There will always be ways to do that. So what we have got to do is jointly spread the message that IP matters, that the future of music for the creators and fans alike is predicated on the simple principle that you pay for what you get.

While nothing is more vital than sending the right message that IP matters, enforcement would be a close second, so we were very heartened last week with Operation Fastlink, the announcement by Attorney General Ashcroft. They deserve enormous credit for the 11-nation coordinated strike on the pre-release groups that make it sport to put content on the Internet before it is even released commercially.

We think there is a real promise in the new task force that the AG has announced under the capable leadership of David Israelite, and of course we are delighted with the recent announcement of the United States-China Joint Commission on Commerce and Trade. USTR and the Commerce Department deserve great praise for achieving tangible specific commitments from the Chinese. Moving forward, we think it wise that Congress seek to elevate the status of international IP protection and we offer these specific suggestions that parallel much of what Mr. Valenti had to say.

One, elevate the status of trade-related IP at USTR by creating a special Ambassador for Intellectual Property.

Two, consider separating out from the USTR Office that manages service and investment a stand-alone IP Office with sufficient staffing to ensure the obligations made by our trading partners are honored.

Three, ensure that Commerce, PTO, and State have adequate resources to assist USTR on these issues. USTR is obviously tiny and needs the help.

Four, as Jack suggested, consider elevating the State Department Intellectual Property Division to office-level status, and the $2.5 million investment made last year for IP capacity building may be maintained and extended.

On behalf of the music community, we thank you for your focus and attention on this issue and look forward to working with you.

Senator GREGG. Thank you very much.

[The statement follows:]

PREPARED STATEMENT OF MITCH BAINWOL

The Recording Industry Association of America (RIAA) is the trade group that represents the U.S. recording industry. Our mission is to foster a business and legal climate that supports and promotes our members' creative and financial vitality. Our members are the record companies that comprise the most vibrant national music industry in the world. RIAA members create, manufacture and/or distribute approximately 90 percent of all legitimate sound recordings produced and sold in the United States.

Music is the world's universal form of communication. It touches every person of every culture on the globe to the tune of $32 billion annually, and the U.S. recording industry accounts for more than one-third of that world market. Our members create employment for thousands of people, including singers, musicians, producers, sound engineers, record promoters and retail salespersons, to name only a few.

The importance of the U.S. recording industry, and intellectual property protection, to the U.S. economy

International markets are vital to our companies and our creative talent. Exports and other foreign sales account for over fifty percent of the revenues of the U.S. record industry. This strong export base sustains American jobs.

In this respect, the protection of our intellectual property rights abroad is vital to promoting America's competitive advantages in world commerce. As our trade deficit has soared, we call upon Congress to consider more closely the relationship between our widening trade and current account deficits and copyright piracy and to take steps to enable us to more effectively protect our intellectual property rights at home and abroad.

An important part of our nation's competitive strength lies in the creation of knowledge-intensive intellectual property-based goods and services. This is one of those economic activities that Americans do better than the people of any other nation. The "core" U.S. copyright industries account for more than five percent of U.S. GDP. Employment in our industries has doubled over the past 20 years, growing three times as fast as the annual growth rate of the U.S. economy as whole. The foreign sales and exports of U.S. copyright industries were nearly $90 billion in 2001, an amount greater than almost any other industry sector, including automobiles and auto parts, agriculture and aircraft.

In a sense, the intellectual property of the United States is like a warehouse of ideas and creativity. For people to walk in and steal them is no more tolerable than theft of physical goods. And the sale of our recordings abroad makes a major contribution to America's current account balances. Each and every sale of a pirated product abroad that substitutes for the sale of a legitimate American product increases our current account deficit. As a result, Americans employed in competitive industries like ours are denied financial benefits that should have occurred but did not.

The Effect of Music Piracy

The piracy of music is almost as old as the music industry itself, but historically it was difficult for the criminal to reproduce copies as good as the real thing. Now with the advent of digital recordings criminals can reproduce near perfect copies of any recording. There is massive manufacture and traffic of illegal CDs, both in the form of molded CDs that are produced in large plants, and CD-R's produced with blank optical discs and readily available computer CD-R burners.

Annual world-wide pirate sales approach 2 billion units; worth an estimated $4 to $5 billion. Globally, 2 in 5 recordings are pirate copies. Total optical disc manufacturing capacity (video/audio CDs, CD–ROMs and DVD)—stands at well over 40 billion units, having quadrupled in the past five years and greatly exceeds legitimate demand. This creates a business environment ripe for exploitation by criminal syndicates and even international terrorist groups, at times shielded by governments hostile to our interests. Given that the pirate producer has few or none of the overheads associated with genuine production, the profit margin is substantial.

The battle against intellectual property theft must be unrelenting. Digital technology and internet piracy have greatly exacerbated our problems. Our country must employ every tool at its disposal, including the critically important leverage provided by international trade agreements.

Recording Industry Actions to address Piracy

Through our international affiliate, the International Federation of Phonographic Industries, or "IFPI", the recording industry maintains a global anti-piracy team of investigators and analysts, made up largely of ex-law enforcement personnel who develop civil litigation and work with law enforcement personnel in pursuit of criminal prosecutions. We also have an active online anti-piracy program. We work in close collaboration with governments, police forces and customs departments worldwide.

We also 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.

We work closely with national and international bodies to encourage adoption of laws that strengthen copyright protection and promote an environment in which our industry can continue to innovate.

Forensic analysis

We maintain a unique forensics laboratory at the IFPI headquarters in London that traces the manufacturing source of pirate CDs through microscopic examination and measurement. This has helped link infringing discs to source factories and resulted in many raids on suspect plants worldwide. This in turn encouraged several governments including Malaysia, Poland, Bulgaria and Russia to establish their own forensic programs.

International co-operation

Primarily through the IFPI we work with government enforcement agencies and international crime investigation organizations on a global basis. Interpol has recently created the Intellectual Property Crime Action Group (IIPCAG) in response to the growing incidence of counterfeit or copyright infringing goods. We are very active within this group, and also maintain an important partnership with the World Customs Organization's intellectual property strategic group to make IP protection a priority for customs authorities worldwide.

Tackling piracy at source

Increasingly, enforcement actions are being concentrated at the source of pirate operations, where raids and seizures can result in the confiscation of manufacturing or copying equipment. In 2002, 71 CD manufacturing lines were de-commissioned, 49 of them in Asia, up from 42 the year before. This represents a production capacity of over 300 million units, bigger than any legitimate music CD market except the United States.

Nearly 7,000 CD copying machines were seized, with a production capacity of 250 million pirate discs per annum—up from 4,500 seized in 2001.

Seizures of blank discs and artwork inlays also rose sharply. In 2002 just over 90 million blank discs were seized with nearly 80 percent of these found in Latin America. They included huge one-off seizures of 13 million discs in Paraguay, 12.5 million in Mexico, 3 million in Colombia and 1.2 million in Argentina.

As you can see from the above, the recording industry is not sitting back and waiting for others to act. We are investing millions of dollars around the world to protect our products, but we are battling forces far beyond our ability, acting alone, to solve. First, government corruption in many other countries denies us any possibility of criminal or civil justice. In addition, and perhaps as part of this, there is a well-established link between piracy, organized crime, and even international terrorism which uses music piracy to divert huge sums of money to other criminal enterprises. Recent testimony by a Mafia boss from Forcella, Naples (February, 2003), clearly illustrated that the Mafia are directly involved in the production and distribution of pirate music, carving up the territory between various gangs and paying a share of profits to godfathers'.

The Importance of the U.S. Government to our industry

America's music composers, performers and producers could not survive in the battle against piracy, domestic and international, but for the absolutely critical and splendid assistance that we have received over the past 15 years from the United States Government, Executive and Legislative branches—Republican and Democrat.

We rely heavily upon our government for our very survival in combating the plague of music piracy. The U.S. Government does more than any other government in protecting its nation's intellectual property, and does so with vigor and determination, albeit with limited resources.

Since the passage of the 1988 Omnibus Trade and Competitiveness Act, intellectual property issues have been an integral part of our country's international trade agenda. When it comes to U.S. Government efforts in this regard, it all starts at the Office of the U.S. Trade Representative. USTR develops, coordinates and implements our nation's trade policy. With its small but highly dedicated staff of only 200 individuals, USTR provides leadership and negotiating expertise in nearly all trade policy areas.

It is in the context of the massive size and scope of our nation's international trade activity that we look for so much help in protecting our nation's creative wealth. Of course, USTR is not tasked with doing all these things alone. Its mission is to develop, coordinate and implement our nation's trade policy in conjunction with other relevant and highly interested agencies, including the Departments of State and Commerce and, within Commerce, the U.S. Patent and Trademark Office, as well as the Copyright Office in the Library of Congress. Ultimately, helping us battle piracy abroad requires the involvement of these and other agencies of the U.S. Government, including the Ambassadors and officers in many of our embassies abroad.

Existing Tools for Addressing International Piracy Problems

Congress has already provided several "tools" for our government to use in helping us better protect our intellectual property abroad.

Special 301.—The first and most important tool for doing this, and one that is extremely important to us, is the annual "Special 301" review and report issued in just a few days. This annual review and report, mandated by the 1988 amendments to the Trade Act of 1974, requires USTR, with the active assistance of these other agencies, to identify foreign countries that deny adequate and effective protection of intellectual property rights or fair and equitable market access for U.S. persons that rely on intellectual property protection.

Once this pool of countries has been determined, the USTR, again with the active involvement of other agencies, is required to decide which, if any, of these countries should be designated "Priority Foreign Countries." Priority Foreign Countries are those countries that: (1) have the most onerous and egregious acts, policies and practices which have the greatest adverse impact (actual or potential) on the relevant U.S. products; and (2) are not engaged in good faith negotiations or making significant progress in negotiations to address these problems. If a trading partner is identified as a Priority Foreign Country, USTR must decide within 30 days whether to initiate an investigation of those acts, policies, and practices that were the basis for identifying the country as a Priority Foreign Country. A Special 301 investigation is similar to an investigation initiated in response to an industry Section 301 petition, except that the maximum time for an investigation under Special 301 is shorter in some circumstances.

This annual review is an outstanding tool for leveraging other countries into making needed improvements to their intellectual property laws and/or enforcement. It also serves as the mechanism for the executive branch to set its annual agenda for how it will address intellectual property matters in our bilateral, regional and multilateral trade relationships, and how it will allocate its resources in combating intellectual property problems globally.

USTR and the other agencies do a tremendous job with the limited resources available to them, but there is little doubt that this program could be more effective if there were additional resources. For example, an extremely effective aspect of Special 301 is conducting "out-of-cycle" reviews of selected countries over the course of the year, and other less structured but intensive bilateral engagement. Otherwise, some countries conduct a flurry of activity prior to April 30 in order to avoid an undesirable designation in the report, then turn a blind eye to piracy once the report is issued. This can be remedied by re-visiting the most problematic countries over the course of the year by announcing that they will be reviewed again after a certain number of months. However, limited resources at several agencies, including at USTR, in recent years have limited the utilization of the very effective tool of out-of-cycle reviews.

"GSP" Trade Benefits.—Another important tool in our trade policy arsenal is the conditioning of the grant of duty-free importation to developing countries under the Generalized System of Preferences (GSP) on adequate and effective intellectual property protection in such countries. The law authorizes the President to suspend or revoke all or part of a country's GSP benefits if he determines that it denies adequate and effective intellectual property protection to U.S. right-holders. In the past, suspension of such benefits has been an extremely effective tool in achieving meaningful IPR improvements in these countries. We have pending petitions to suspend GSP benefits for Russia, Brazil, and other countries. An important Presidential review is due for completion on July 1. We hope the Administration will act upon our petitions, unless of course these countries make meaningful and sustained progress prior to this date.

The TRIPS Agreement in the WTO.—An important multilateral tool is active U.S. Government participation in the World Trade Organization's Agreement on Trade-Related Intellectual Property Rights, or the "TRIPS Agreement. All 146 members of the WTO are obligated to provide and enforce minimum standards of intellectual property protection to all the other members. If they fail to do so, the WTO provides an effective dispute resolution process that provides with imposition of trade sanctions against countries that fail to comply with TRIPS obligations. The TRIPS Agreement, which came into effect in 1995, ensured that scores of countries adopted and committed to enforce fairly modern, substantive copyright laws. This was a tremendous achievement. Monitoring full implementation of the TRIPS Agreement, and aggressive use of WTO dispute settlement against non-compliance, remains a top priority for our association and our members.

The WIPO Digital Treaties.—Digital technology, much of which came onto the market after the TRIPS Agreement came into effect, has brought many changes and challenges to international trade and perhaps none more so than with respect to the protection of intellectual property rights. In this new digital environment, entertainment products, legitimate and pirated, can be transmitted across the internet in perfect digital form from one corner of the globe to another in a matter of seconds. Revolutionary new technologies of this nature sometimes demand that revolutionary new rules be included in the agreements that govern trade between nations.

Two significant treaties to this effect were concluded at the World Intellectual Property Organization in 1996. Ratification and implementation of these treaties is a high priority for our organization. We are pleased that our government has made achieving ratification of these treaties an important element of its bilateral intellectual property agenda.

Bilateral Trade Agreements.—The Administration's ambitious agenda to negotiate bilateral free trade agreements has proven to be an excellent mechanism for achieving legally-binding bilateral obligations from certain trading partners to ensure that digitized content and transmissions are correctly and adequately provided full copyright protection. The FTAs negotiated thus far with Jordan, Singapore, Chile, Australia, Morocco, and the five Central American countries under the CAFTA address this urgent need. We look forward to significant improvements in addressing rampant copyright piracy in such countries as Thailand, Colombia, Bolivia and Peru, where FTA negotiations begin this summer. The FTA negotiating process is the best avenue currently available to us for ensuring that these important digital copyright issues are adequately addressed. We praise USTR, Commerce, PTO, the U.S. Copyright Office and other agencies for doing so and congratulate them for achieving significant results in these negotiations.

At present, it is the view of RIAA that the global political environment will not, at the multilateral level, accommodate the significant revision of laws and practices necessitated by changes in technology, and it is therefore necessary to address these on a bilateral, and occasionally regional, basis. This is extremely time and resource consuming—but absolutely necessary if we are to preserve the U.S. economic competitiveness created by American ingenuity, know how, and creativity. We thus strongly support the negotiation of free trade agreements to introduce laws and practices consistent with the needs of today's business world.

In addition, we have major music piracy problems in countries with which the U.S. Government is not negotiating free trade agreements. China, Russia, Taiwan and Pakistan are particularly egregious examples, but there are many others. It thus is critically important that the U.S. Government have adequate resources to actively press these countries using, when appropriate, the tools already granted by Congress to do much more to significantly reduce music piracy in these countries. The recently concluded U.S.-China Joint Commission on Commerce and Trade included potentially significant new commitments by China in this regard. But significant follow-up efforts will be required to ensure that they live up to these new commitments.

Other Activities.—Traditional diplomacy is also very important, bringing the weight to USG power to play quickly when we encounter foreign governments unwilling to enforce their laws against those pirating our products.

Cultural outreach is useful to help empower local cultural communities to lobby for IP protection. Education/technical assistance are also important. Beyond the simple transfer of information and enforcement methods, such training can reinforce links among IPR officials within a region and build working relations between U.S. and foreign law enforcement.

Intelligence gathering/analysis is also increasingly important to deal with the organized criminal element or terrorist financing links associated with international piracy.

Proposals for Reform—International

First, given the critical nexus between intellectual property piracy and international trade, we propose that Congress elevate the status of international intellectual property protection on our nation's trade policy agenda. Here are our suggestions:

USTR.—Given their central role in the trade-policy making process, I suggest elevating the status of trade-related intellectual property policy at USTR. This could be accomplished by creating a special Ambassador for intellectual property. Such a person would be able to advocate strongly on behalf of U.S. trade-related intellectual property interests internationally and inside the U.S. Government. A similar position already exists at USTR with respect to agricultural issues and has existed in the past with respect to textiles and apparel that could serve as useful models. The copyright industries alone account for over 5 percent of U.S. GDP. While I have not seen the precise figures, IP industries writ large must account for well over 10 percent of U.S. GDP. Protection of the leading edge of the U.S. economy demands no less.

The creation within USTR of a stand-alone intellectual property office with adequate staff to conduct multilateral and bilateral negotiations and to ensure that our trading partners honor their IPR obligations to the United States would also be useful. IPR issues are presently included in an office within USTR that also covers services and investment issues. Services and investment account for two-thirds of the U.S. economy. The incumbent Assistant USTR is thus responsible for trade and investment issues covering an enormous swath of the U.S. economy in addition to intellectual property issues.

So it might be time to separate intellectual property from services and investment. With adequate staff, an IPR office would be able to ensure that the Special 301 program is used to its potential, as described earlier in my testimony, including through the more aggressive use of out-of-cycle reviews. Similarly, this expanded office could help ensure that the GSP program is used more aggressively to leverage countries to better protect American intellectual property rights.

Separately, we note and are pleased that USTR is creating a separate and expanded Office of China Affairs to accommodate an increase in staff dedicated to the many China trade issues confronting our country. In the Consolidated Appropriations Act, 2004, Congress, through the leadership of Chairmen Gregg and Congressman Frank Wolf, provided additional funds to USTR for this purpose. Just as the magnitude of our trade relations with China necessitates a separate China office, the enormous effect of foreign piracy of American intellectual property argues for establishing a separate, high profile intellectual property office at USTR. .

Department of Commerce.—We are very grateful for the role that Under Secretary Grant Aldonas and Assistant Secretary for Market Access and Compliance William Lash have played in helping us address music piracy issues in various countries. Under Secretary Aldonas played a critical role in IPR negotiations with China as part of the preparations for last week's meeting of the Joint Commission on Commerce and Trade. Assistant Secretary Lash has been outstanding in actively confronting many countries with significant piracy problems. We are most grateful for their personal involvement, and for the hard work of numerous other Commerce Department officials in helping us address piracy around the globe.

Department of State.—The State Department's Ambassadors, embassy staff and officials here in Washington have been consistently extremely helpful in addressing our problems abroad. The State Department has consistently instructed its embassies to help us wherever problems arise. They have worked closely with us to ensure that their officers in the field are adequately trained to be able to advocate to their foreign counterparts about our concerns.

State has a broad range of foreign policy issues to resolve and balance. Within the context of foreign policy problems competing for resolution, copyright piracy issues must be given the prominence they deserve. To better ensure this outcome, one possible improvement might be to elevate the State Department's Intellectual Property Division to "Office-level" status, thereby granting this unit greater authority to carry arguments with other offices within the State Department.

In addition, during this fiscal year, the State Department began playing a critical role in providing funding for helping other countries improve their law enforcement against copyright piracy. Specifically, Congress directed that State should provide $2.5 million on building the capacity of foreign law enforcement officials to better enable these countries to comply with their obligations under international copyright and intellectual property treaties. This was a one-year allocation. However, we strongly urge the Congress to continue and significantly expand this allocation in subsequent years so that this $2.5 million for fiscal year 2004 becomes the seed money for what will ultimately be a truly effective, ongoing program. At the same time that we are demanding that foreign countries prepare themselves for the protection of IP in the 21st century, we need to recognize that many of them have 19th century technology and know how. Arming them so that they can establish effective IPR protection helps them and helps us.

The Patent and Trademark Office.—PTO does an excellent job in reaching out and promoting effective intellectual property protection and enforcement internationally. We appreciate its efforts in providing technical assistance and training to foreign IP officials and helping USTR negotiate strong IP provisions in the FTAs. We hope that the Congress will provide full funding for PTO and enact PTO's fee modernization bill.

Proposals for Reform—Domestic

Here in the United the low-cost, low-risk, high-return nature of intellectual property theft like music piracy, when compared to other criminal endeavors, is attracting more criminals. Increased law enforcement resources to the Department of Justice Computer Crime and Intellectual Property (CCIPs) investigative units and Computer Hacking and Intellectual Property (CHIPs) prosecutorial units ensure more vigorous enforcement of existing laws. We applaud the Justice Department's recent formation of an Intellectual Property Task Force designed to look at ways the Department can strengthen and improve its efforts to combat theft of intellectual property. Because of the expanding geographical scope and sophistication of the organized criminal enterprises behind the piracy problem, cooperation among local, state, federal and international law enforcement entities will continue to be important.

There clearly is no silver bullet answer to solving the problem of physical piracy. However, there are several things that can be done that would help change the risk/reward calculation for pirates. These include, among other things, increased asset forfeiture, lower criminal thresholds, increased sentencing guidelines, as well as easier and more definite loss calculations. In other contexts, these tools have provided law enforcement with greater flexibility and authority to crack down on the epicenter of criminal enterprises as opposed to continually dealing with the problem further downstream. It will come as no surprise that attacking these criminal enterprises higher "up the ladder" (i.e. acting against manufacturers and distributors as opposed to low-level street vendors) not only increases our deterrent impact, but is also a much more efficient use of our limited resources.

Senator GREGG. Mr. Lowenstein.

STATEMENT OF DOUGLAS LOWENSTEIN, PRESIDENT, ENTERTAINMENT SOFTWARE ASSOCIATION

Mr. LOWENSTEIN. Thank you, Mr. Chairman. I would like to start, I think I have testified over the years about 10 or 15 times on a panel with Jack Valenti and I am fearful that this may be the last time, so I just want to say what a privilege it has been to follow you all the time. And the problem with following Jack is one tends to simply want to say, I agree with what he said, and move on, and he usually says it better, so indulge me if I say some of the same things but perhaps not as articulately.

I do appreciate the opportunity to share the views of the American video game industry on the U.S. Government's efforts to control intellectual property piracy. Worldwide video game revenues now exceed $25 billion and the industry has been the fastest growing of all entertainment sectors since the late 1990s. With the average age of game players now 29, the industry is poised to sustain double-digit growth in the next 5 years, and the growth potential is even greater if we can begin to open up the vast expanses of markets currently closed due to rapid piracy.

The typical video game now costs between $5 and $10 million to make, often double that, and 2 or 3 years of development time. But the opportunity to recover this investment through sales in Asia, Eastern Europe, the Middle East, and Central and South America is virtually nonexistent. Piracy rates in these regions are at 80 percent and sometimes 90 percent or even higher, and they serve as an effective barrier to entry, let alone to the establishment of a viable, legitimate market.

The value of pirated products circulating in these markets is easily in the billions. Piracy in these regions includes illegal optical disk and video game cartridge replication and manufacturing facilities, the mass exporting of pirated games, Internet piracy, and so-called burn-to-order operations. In many cases, organized criminal enterprises are at the center of the global piracy and counterfeit rings.

Our members are aggressive and proactive on the anti-piracy front, but unfortunately, our efforts alone are not enough. For this reason, we have been grateful for the engagement of the Congress and in particular this subcommittee and several executive branch agencies, including the State Department, the Commerce Department, the U.S. Trade Representative, and the Department of Justice in the global anti-piracy campaign.

But I submit to you that the investment our Government makes in protecting the intellectual property assets of America's creative industries ultimately enhances this Nation's economic growth and vitality. For every dollar invested to protect entertainment software or movies or music or business software, every dollar invested to protect those products from piracy promotes export sales, contributes to a positive balance of trade, and the continued creation by our industry of highly skilled, well-paying jobs right here in the United States. In fact, about 40 to 50 percent of the revenue of a typical game company comes from overseas sales.

Let me briefly highlight some recommendations that we think would build on the good work done to date by this committee, the

subcommittee, and the Government agencies engaged in the fight to protect U.S. intellectual property.

First, we recommend that the subcommittee provide additional resources for USTR to hire personnel dedicated to monitoring and enforcing compliance by signatory countries with the multilateral agreements and recent bilateral agreements, such as the new FTAs with Australia, Singapore, Morocco, and so forth. It is critical to recognize—critical—that negotiating agreements is only the beginning of the process, not the end.

Second, we recommend that the subcommittee provide additional resources dedicated to intellectual property investigations by the Department of Justice, including the Computer Fraud and Intellectual Property Section and the various CHIPs units in several U.S. Attorneys' offices. DOJ's announcement last week, as we have said, Operation Fastlink, offers impressive evidence of the value of this kind of investment. Fastlink was an investigation whose roots actually involved game piracy and it resulted in the take-down of more than 200 computers in the United States and 10 other countries.

Third, we recommend additional resources for the FBI to train more agents to pursue intellectual property investigations into the larger-scale Internet and hard goods piracy operations. Such investigations are the key to smashing the global piracy syndicates.

Finally, we recommend that the subcommittee provide resources for U.S. law enforcement agencies to coordinate investigative operations against criminal organizations involved in large-scale factory-level manufacturing of pirated game product in Asia and Eastern Europe.

Given America's leadership in the field of law enforcement in this area and the inadequate capabilities in many countries where piracy flourishes, the simple fact is that if the United States does not lead this enforcement effort against the organized criminal syndicates that are at the root of the global piracy problem, genuine long-term progress will be difficult to achieve.

Mr. Chairman, the U.S. Government has been a strong and effective partner in the battle against global entertainment software piracy, but it is equally clear that the global piracy problem remains deeply entrenched and that it directly endangers America's economic security, as U.S. companies' survival in potential markets close off due to the proliferated of pirated and counterfeit goods. We need your continued help. We thank you for your continued interest and support.

Senator GREGG. Thank you.

[The statement follows:]

PREPARED STATEMENT OF DOUGLAS LOWENSTEIN

INTRODUCTION

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to discuss international and domestic intellectual property enforcement as it relates to the entertainment software industry. Our industry values its working relationship with Congress, the Office of the United States Trade Representative, and the Departments of Commerce, Justice, State, and Homeland Security, as we work cooperatively to ensure that one of America's greatest assets—its intellectual property—receives adequate protection, domestically and abroad.

I appear on behalf of the members of the Entertainment Software Association (ESA). The ESA serves the business and public affairs interests of companies that publish video and computer games, including games for video game consoles, per-

sonal computers, handheld devices, and the Internet. ESA members produced more that 90 percent of the $7 billion in entertainment software sold in the United States in 2003. In addition, ESA's member companies produced billions more in exports of American-made entertainment software, helping to power the $20 billion global game software market. The entertainment software industry is one of the nation's fastest growing economic sectors, more than doubling in size since the mid-1990s and in so doing, has generated thousands of highly skilled jobs in the creative and technology fields.

Our industry makes a tremendous investment in its intellectual property. For an ESA member company to bring a top game to market, it often requires a team of 20 to 30 professionals—sometimes twice that number—working for two or three years to fuse together the work of writers, animators, musicians, sound engineers, software engineers, and programmers into an end product which, unlike any other form of entertainment, is interactive, allowing the user to direct and control the outcome of the experience. On top of these research and development costs, publishers will invest at least $5 to $10 million to market and distribute the game. The reality is that only a small percentage of these titles actually achieve profitability, and many more never recover their front-end R&D costs. In this type of market, it is easy to understand how devastating piracy can be as it siphons the revenue required to sustain the enormously high creative costs necessary to produce successful products.

In this testimony, I would like to focus on a number of domestic and international intellectual property challenges we face today, including, most formidably, from large-scale, for-profit piracy of industry products. I will share with you what ESA and its member companies are doing to combat these problems, how government has responded, and what we all must do protect our industry and the nation.

THE PIRACY PROBLEM

Entertainment software piracy is an international problem occurring both in the United States and abroad. It takes many forms, which fall into two basic types: hard goods piracy and Internet piracy. Billions of dollars worth of pirated entertainment software products—including some produced by organized criminal syndicates—are present in worldwide markets today.

Hard Goods Piracy

Entertainment software programs are produced for a variety of platforms, including video game consoles, personal computers, handheld devices, and the Internet. Hard goods piracy involves the illegal manufacturing of counterfeit optical discs for use in personal computers (PCs) and consoles for the home, such as Microsoft Xbox, the Sony PlayStation2, as well as counterfeit cartridge manufacturing for handheld devices such as the Nintendo Game Boy.

Optical media piracy is a growing problem for the industry. In many parts of the world, especially Malaysia, China, Thailand, and Russia, pirate optical disc factories produce huge numbers of illegal copies of popular games. In its Special 301 report to the United States Trade Representative this February, the International Intellectual Property Alliance (IIPA) (of which ESA is a member) reported a "staggering" growth in the number and capacity of these optical disc factories across the globe. The "burning" or copying of compact discs and DVDs is also a global problem, not only in Asia, but in Europe and Central and South America as well. In addition, console game publishers are victimized by the growing prevalence of so-called "mod chips"[1] and other devices designed to circumvent technological protection measures built into entertainment software products.

As with optical discs and mod chips, there is large-scale piracy of game cartridges used for handheld units. This piracy is committed in factories as well as smaller workshops which produce huge numbers of illegal products.

The extent of this problem cannot be overemphasized. In some nations, these large pirate enterprises operate in the open, raking in millions in illegal profits. For example, Professor Daniel Chow of Ohio State University said in recent congressional testimony that the intellectual property piracy problem in China has reached a crisis level, with virtually the entire economy of the Chinese city of Yiwu in Zhejiang Province now based on the trade of pirated products. The problem is widespread in China. As I testified before a House Subcommittee last month, enforcement undertaken by just one ESA member, Nintendo, resulted in the seizure of 4.7 million counterfeit items in China during 2003.

[1] "Mod chips" are a particular type of circumvention device that are installed into video game consoles chiefly for the purpose of rendering the console capable of playing pirated games.

Internet Piracy

While pirate factories tend to be an offshore problem, Internet piracy is a problem both domestically and internationally. Internet piracy has been a problem for several years, but is becoming an ever more serious threat due to advancing technology. While broadband Internet communication has created tremendous opportunities for consumers to enjoy high-speed communication and entertainment, it has also been a boon to pirates. High-speed Internet has given pirates the ability to readily distribute entertainment software around the globe. Some of the main Internet piracy problems include so-called "warez" sites, "cracker" groups, and peer-to-peer (P2P) distribution.

There are a number of ways in which the Internet is used to facilitate piracy of entertainment software products. It is a highly efficient distribution tool for the software and video games themselves. Each day, our investigators uncover hundreds of instances in which unauthorized copies of our members' products are made available through the use of virtually all popular Internet protocols, including through websites, FTP sites, chat sessions and, increasingly, through a growing number of peer-to-peer protocols. The Internet is also used as an advertising vehicle for services that offer pirated hard copies of disc and cartridge-based games, circumvention devices, and circumvention services.

"Warez" is a name given to sites where software and other content is distributed illegally. Often, these warez sites are operated by teams of software "crackers," individuals and groups skilled in "cracking" technological protection measures, thus allowing infringers to distribute unlimited copies of the games around the world. These sites represent a major threat to our industry. We have been extremely gratified with the Justice Department's aggressive enforcement actions against these warez groups, including last week's announcement of Operation Fastlink, an internationally coordinated investigation which resulted in the closing of warez servers and the seizure of pirated products. The Department of Justice reported that Operation Fastlink resulted in the seizure of more than 200 computers in the United States and 10 other countries. We are most appreciative for these actions that have effectively shut off illegal access to approximately $50 million of pirated works.

Internet piracy also fuels hard goods piracy by serving as an early source of the "cracked" version of game titles. Internet pirates generally obtain legitimate copies of games on the day of release or, in some cases, even prior to the commercial release of a game title. These copies are then farmed out to crackers, who, within 12 to 24 hours are often able to bypass the access and copy protection technologies included in the game software and produce a "cracked" version of the game, i.e., one stripped of these protection technologies. These cracked versions are immediately made available throughout the Internet and often are sold directly to different criminal organizations, which dominate the global trade in pirated entertainment software through a network of replication facilities in Southeast Asia and Eastern Europe. These organized crime syndicates are able to use these "cracked" versions of game software obtained illegally from the Internet to manufacture and sell pirated games on the streets, either in competition with legitimate versions or, as in most countries around the world, two to three weeks in advance of the time that legitimate goods are available.

Internet cafes offering computers for temporary use have become ubiquitous fixtures around the world. They provide a quick and easy way for people to check e-mail or use the web. Unfortunately, they also provide a quick and easy vehicle for piracy. For example, in countries throughout Asia, many Internet cafes buy only one licensed copy for use by hundreds of users in the cafe, while the cafe owner is making a profit from each and every user. In addition, many cafe operators turn a blind eye to customers who use their facilities to commit further infringements, such as burning software and other copyrighted works onto CDs.

Piracy and Organized Criminal Syndicates

Many organizations, including law enforcement agencies such as Interpol, have concluded that organized criminal enterprises are involved in intellectual property piracy. In its February Special 301 report, the IIPA reported that because of the immense profits that pirates can make by stealing intellectual property, criminal organizations have taken over pirating operations in many countries. In addition, the relatively weak penalties for intellectual property crimes in many nations make it an attractive funding source for organized criminal enterprises. Noting that intellectual property piracy gives organized criminal enterprises far greater profits and much less risk than dealing narcotics, the IIPA report cited organized crime involvement in intellectual property piracy in numerous nations, including Malaysia, Taiwan, Russia, Mexico, and Spain. Indeed, the cross-border nature of organized crime's involvement in software piracy presents an additional challenge.

ESA AND MEMBER COMPANY RESPONSES TO THE PIRACY PROBLEM

The entertainment software industry has taken the initiative to protect its intellectual property with a variety of anti-piracy measures, including international enforcement programs, online monitoring efforts, civil litigation, support and assistance to law enforcement and border control agents, technological measures, policy interaction, training of law enforcement and intellectual property education programs.

International Enforcement

Internationally, ESA and its members companies have targeted game piracy through the establishment of local enforcement programs in countries across the world. For its foreign programs, ESA typically will engage local attorneys and investigators to work with and support local law enforcement and customs officials in pursuing enforcement actions against local individuals and entities engaged in game piracy. In Asia, ESA established programs in Hong Kong and Singapore several years ago to address burgeoning game piracy in those countries. These programs have successfully curtailed the spread of street-level and retail piracy, with the Hong Kong program now focused on addressing upstream targets which are involved in the import/export of pirated goods to other markets. In South America, ESA initiated an industry program in Brazil two years ago as a joint effort with a local software industry association. This program is quite active, with monthly actions against retail venues in Sao Paulo and other major Brazilian cities as well as actions against local labs that routinely burn copies of games for distribution in the local market place. More recently, ESA has begun work on launching new enforcement programs in Canada and Mexico to address growing piracy situations there.

ESA's programs complement local enforcement programs established by some of our larger members, including Electronic Arts, Microsoft, Nintendo, Sony Computer Entertainment, and Vivendi Universal Games. These member programs similarly involve the retention of local attorneys and investigators who focus on the pirate trade in that member's game products, and work with local police and customs officials to seize pirate game product and arrest and prosecute the responsible parties. Periodically, member companies will also undertake civil actions against pirate groups. Collectively, these member companies have programs operating in more than 30 countries.

Online Monitoring and Enforcement

ESA has implemented an online monitoring program to enforce its members' intellectual property rights against Internet piracy. Under the online monitoring program, ESA has tracked an average of 400,000 new incidents of infringements per month and, over the last year, issued more than 130,000 takedown notices to Internet service providers (ISPs) under the provisions of the Digital Millennium Copyright Act (DMCA) and related authorities. These notices were addressed to ISPs both in the United States and abroad regarding instances of infringing activity engaged in by their users.

In addition to its online monitoring activities, ESA and its members have availed themselves of civil remedies available under law—including cease and desist notices, and when necessary, civil litigation—in enforcing member company rights against individuals engaging in online piracy.

U.S. Law Enforcement Support and Assistance

ESA and its member companies cooperate with United States customs and law enforcement officials on a number of levels, including preliminary investigative work, examination of seized products, and the preparation and submission of relevant documentation and affidavits in support of criminal prosecutions. ESA also assists law enforcement by providing trial testimony, identifying infringing game material found on servers, and assisting in high-level investigations of criminal organizations involved in game piracy. The U.S. Attorney's Office for the Eastern District of Virginia cited the entertainment software industry's assistance in obtaining a conviction of a member of the highly organized "DrinkorDie" piracy group targeted in "Operation Buccaneer." Last week, Attorney General Ashcroft credited ESA and other associations with providing vital assistance in "Operation Fastlink," an investigation that resulted in the coordinated takedown of more than 200 computers, including more than 30 servers that acted as storage and distribution hubs for warez groups, including Fairlight, Kalisto, Echelon, Class, and Project X.

Technological Measures

The entertainment software industry uses an array of technological protection measures (TPMs) to protect its various products, including those for personal com-

puter, console, and handheld games. These self-help protection methods act as "digital locks," preventing unauthorized access to the game content. However, criminal enterprises manufacture, create, and distribute illegal circumvention devices to disable or bypass these games' TPMs, and use the Internet to advertise and distribute these tools as well as the "cracked" (unprotected) products.

However, it has become clear that technology is not enough. We must have laws that protect not only the intellectual property, but the technological protection measures that facilitate distribution while safeguarding industry products. Furthermore, we must have meaningful enforcement of these laws in order to deter the often highly organized criminal enterprises from engaging in the piracy.

Policy Engagement

The entertainment software industry is also engaged—at both the association and member company levels—in legal and policy reform. In this capacity, we work closely with U.S. and foreign government officials to help provide an effective legal and commercial framework for the healthy growth of the industry and to promote the increased availability of entertainment software products.

Training of Law Enforcement

The entertainment software industry has assisted government in the area of intellectual property enforcement by having ESA conduct training sessions across the nation and internationally to help educate law enforcement on intellectual property issues. Over the past year, in over 70 training sessions involving approximately 1,400 officials and agents in the United States and three foreign countries, ESA provided training on methods of detection and identification of pirated game products.

Intellectual Property Education

Recently, the ESA and its member companies have undertaken a number of different initiatives to educate different segments of the public, in particular, younger age groups, regarding the importance of intellectual property, the harm that game piracy and other forms of intellectual property infringement can cause, as well as the risks inherent in engaging in pirate activities. Most of these efforts have focused on providing children a deeper appreciation of the value and importance of intellectual property such as copyright and trademarks.

GOVERNMENT'S RESPONSE TO THE PIRACY PROBLEM

USTR and other key offices in the Departments of Commerce and State tasked with enforcing U.S. trade law and—as part of the trade agenda—intellectual property law, have consistently demonstrated their strong and continuing commitment to creators generally and the entertainment software industry specifically, pressing for the highest attainable standards of protection for intellectual property rights through the successful negotiation of multilateral and bilateral agreements with other nations. These agencies have also stood firm in monitoring, rewarding, and in notable instances, penalizing countries for failing to achieve compliance with U.S. trade law and international intellectual property norms.

One especially valuable tool has been the "Special 301" review process, which the U.S. government utilizes effectively to target countries that must improve their efforts to protect intellectual property. In addition to Special 301, by requiring countries in the Generalized System of Preferences (GSP) program to ensure adequate and effective protection of intellectual property rights as a condition of obtaining the program's tariff free status for their exports to the United States, the United States has also raised awareness of intellectual property rights as a national policy priority.

Several U.S. agencies also monitor and help to dismantle market access barriers that hinder the flow of U.S. products to overseas markets. The market access problems facing the entertainment software industry include compliance with legitimate product identification formalities (such as so-called "stickering" regimes), protracted content review periods, and other trade or import restrictions against U.S. computer and video game products. These regimes not only increase the cost incurred by U.S. publishers in getting legitimate product to market but also add considerable delay before products are actually made available for sale. This delay, in turn, works to the advantage of pirates who bypass processes required of legitimate publishers.

The Department of Commerce, through its International Trade Administration (ITA), has made it a priority to gather information from our industry on trade barriers and other impediments to commerce, chief among them being endemic piracy, and to bring these barriers to the attention of U.S. and foreign officials. We are similarly appreciative of the resources dedicated year-round by the Department in support of the government's international negotiations (such as the recently con-

cluded Joint Commission on Commerce and Trade with China), and steps taken by the Department's Trade Compliance Center to ensure that American exporters overcome foreign trade barriers.

The Commerce Department's Patent and Trademark Office also contributes immensely to the work of USTR, by providing, for instance, the necessary technical expertise and advice during free trade negotiations and discussions of intellectual property issues at the multilateral level. In addition, the PTO provides training and technical assistance programs, not only to promote intellectual property protection, but also to foreign governments to improve their intellectual property laws and to train their law enforcement agencies to better address intellectual property infringement.

With respect to domestic enforcement, intellectual property rightsholders have been increasingly better served by the efforts of the investigative arms of the Departments of Justice and Homeland Security and the prosecutorial capabilities of the Department of Justice. Investigative agencies contributing to this mission include the FBI and Customs' Bureau of Investigations and Criminal Enforcement (ICE), as well as its Bureau of Customs and Border Protection (CBP). The prosecutorial offices contributing to the success of this mission include the Computer Hacking and Intellectual Property (CHIPs) units within several key U.S. Attorneys' offices and the Computer Crime and Intellectual Property Section (CCIPS) of the Department of Justice.

The Department of Justice has recently taken two important actions in the fight against piracy. First, it has established the Intellectual Property Task Force to coordinate the department's intellectual property enforcement activities. Second, as mentioned earlier, the Attorney General last week announced Operation Fastlink, a coordinated effort with law enforcement agencies around the world to stop Internet piracy. Operation Fastlink is an important example of the positive results that can be achieved when our government works together with other governments to coordinate response to piracy problems. With the global nature of the Internet, this type of international cooperation is vital.

In sum, we are extremely grateful that so many U.S. government agencies have taken action in the fight against global piracy. We believe, overall, that existing roles and responsibilities are allocated appropriately to assure that agencies with the greatest subject-matter expertise are on the job. That said, we believe there are a few actions that this Subcommittee can take to strengthen the U.S. Government's ability to strike additional blows that weaken the global pirate trade.

RECOMMENDATIONS

The entertainment software industry will continue to use technological and legal measures to protect its intellectual property, but private efforts are not enough. It is imperative that the U.S. government remain firm in its commitment to fight the rampant international and domestic piracy of intellectual property. The various government agencies responsible for the protection of intellectual property are doing a remarkable job in many ways, but can be hindered in their efforts to focus on enforcing the intellectual property provisions of international treaties and domestic laws due to insufficient resources and personnel. Following are some concrete steps we believe will arm our government with additional tools and authorities to win the war on piracy.

Office of the U.S. Trade Representative

In recent years, the Office of the U.S. Trade Representative (USTR) has done a tremendous job of successfully negotiating free trade agreements that raise intellectual property protection standards to the highest levels. We thank the Subcommittee for the $5 million that Congress added to the fiscal year 2004 budget for USTR, and acknowledge USTR's efforts to reorganize its China office in order to make best use of these resources. However, with the increasing burden of broadening the free trade sphere, USTR has not had the resources or personnel to devote to its other mission: monitoring compliance with and enforcing U.S. trade law and bilateral trade agreements.

USTR, to its benefit, relies on personnel from other federal agencies to perform its monitoring duties. Moreover, intellectual property rights issues are currently included in an office within USTR that also covers services and investment issues. Given the enormous importance of intellectual property to our economy, ESA recommends that the Subcommittee create a stand-alone intellectual property office with dedicated and adequate staff to conduct multilateral and bilateral negotiations and also to ensure that our trading partners comply with their intellectual property-related obligations to the United States. Additionally, the Subcommittee could consider creating a special ambassador for intellectual property and provide that official

with adequate staff and resources dedicated to the enforcement of existing agreements.

Whatever approach is taken, the addition of new staff dedicated to enforcement of agreements will materially strengthen USTR's ability to monitor WTO/TRIPS compliance, and to fulfill the potential of the 301 program by more aggressive use of out-of-cycle reviews. Similarly, dedicated intellectual property staff could help ensure that the GSP program is used as effectively as possible to induce foreign nations to better protect American intellectual property rights. (A reinvigoration of the GSP review process would be much desired as the prospect of losing tariff-free trade benefits that reach into the billions for certain nations would certainly prove to be a great incentive to improving intellectual property protections.)

Department of State

The State Department is playing a critical role in providing funds to foreign countries to help improve their law enforcement against copyright piracy. During this fiscal year, Congress provided a one-year allocation of funds to the State Department and directed it to spend the $2.5 million on building the capacity of foreign law enforcement agencies to better enable certain countries to comply with their obligations under the international intellectual property treaties.

ESA believes it is critical to sustain and grow this funding in the new fiscal year to help ensure that foreign enforcement programs will become fully developed and effective. The United States can only do so much, and this program recognizes that an investment in enhancing the ability of other nations to assume a greater role in enforcement may reduce demands on our own government in future years.

Furthermore, as helpful as the State Department has been, the fact remains that it is responsible for a broad range of foreign policy issues. Understandably, intellectual property issues often do not take priority. We believe the Subcommittee should consider elevating the State Department's Intellectual Property Division to "Office-level" status, thereby granting this unit greater authority to advocate for enforcement of intellectual property protections with other offices within the State Department.

Department of Justice

As noted elsewhere, the Justice Department has been increasingly aggressive and effective in the fight against piracy. Therefore, we recommend strongly that the Subcommittee allocate sufficient funds for Justice to continue its recent efforts and undertake new initiatives, such as the Intellectual Property Task Force and Operation Fastlink. We believe that the investigative capabilities of the FBI and the prosecutorial resources of the Department of Justice, including the Computer Crime and Intellectual Property Section (CCIPS) and the Computer Hacking and Intellectual Property (CHIPs) sections of the U.S. Attorneys' Offices should be fully funded to accomplish their vital missions.

We thank the Subcommittee for the support it has already given to the Department by setting aside a portion of the DOJ's appropriation for cybercrime and intellectual property crime enforcement. However, we recommend that Congress provide additional resources to the Justice Department to expand these efforts. Specifically, we recommend additional funding for the investigation of intellectual property crimes by the FBI. We believe that additional agents specifically trained in online investigations are essential to fighting domestic intellectual property piracy. This will enhance and support the efforts of U.S. Attorneys engaged in prosecuting intellectual property offenses.

CONCLUSION

Mr. Chairman and members of the Subcommittee, it is clear from my testimony that our industry has in the U.S. Government a strong and effective partner in the battle against global entertainment software piracy. Your Subcommittee's commitment to fighting piracy is well-documented. We are grateful for your commitment, especially at a time when our nation faces so many other threats to our security. But it is equally clear that the global piracy problem remains deeply entrenched, and that it directly endangers America's economic security as U.S. companies see viable potential markets closed-off due to the proliferation of pirated and counterfeit products. We need your continued help, and we appreciate the opportunity to share some ideas on additional steps that can be taken to protect America's greatest export: our creative and intellectual property. Working together, I believe we can fight piracy to protect what is one of America's most dynamic and fastest growing creative industries.

Senator GREGG. Mr. Holleyman.

STATEMENT OF ROBERT W. HOLLEYMAN, II, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BUSINESS SOFTWARE ALLIANCE

Mr. HOLLEYMAN. Chairman Gregg, Chairman Stevens, thank you very much for the opportunity to talk with you this morning representing the Nation's business productivity software industry. Our members are the leading developers of productivity software and their partners, and collectively based here in Washington, we represent their efforts in more than 60 countries around the world engaged in support of strong intellectual property protection, technology innovation, and the day-to-day fight against piracy.

It is a pleasure for me to participate on this panel because we share broadly with the copyright community interest in promoting intellectual property protection and also in the fight that you care about, the fight against piracy.

I will be blunt in saying that piracy is in many ways too delicate a term for what we are dealing with. It is theft. It is pure and simple theft. For the business software industry, nearly 40 percent of the products in use today from our member companies are pirated around the world or stolen. It is hard to imagine any other industry that could sustain those losses and still make the types of investments for the future that our industry is committed to.

There are really two key aspects to this problem, the domestic aspect and the international aspect. Last week, the announcement by the Attorney General of Operation Fastlink, I would say is a major announcement with 120 searches, 27 States, 10 foreign countries. That came about through concerted efforts at DOJ, and that came about through the very deliberate efforts of this committee in ensuring through appropriations measures that money earmarked for DOJ went and created the type of enforcement units that allowed the operation to be successful.

It is also important to internationally prosecute, because the expertise that we have in this country is important to share, particularly in the Internet environment, where we depend on the assistance of our trading partners and try to prevent the widespread global piracy operations.

The software industry has been a huge engine of economic growth. One of the things that BSA released last year was a study by the research firm IDC of over 57 countries where they analyzed the size of IT markets. They also analyzed the impact of piracy on those markets to show what reductions in piracy could mean for job growth and for tax revenues, not only in the United States, but to show our partners in the software industry in other countries what this global fight can mean for them.

We use that as an important tool. In the United States alone, there are 2.6 million people working in the IT industry, paying $342 billion in taxes generated, and its impact on the U.S. economy is $405 billion.

To look at the theft problem, the piracy problem, over the past 3 years, global piracy for productivity software has, on average, generated losses of $12 billion each year. In the United States alone, because this is the single biggest pirated market in dollar losses of any country in the world, in that period of time, we have averaged $2 billion of losses due to piracy in the United States.

Software piracy takes many forms. Perhaps a good advantage of coming at the end of this panel is I can say I share many of the concerns with counterfeit products and Internet-based piracy that my colleagues have talked about. But in business software, the biggest single problem we face is from end user piracy, organizational end user piracy. It is when a business may have one or two legal copies of software and they load it all on computers in their office where they have many more employees accessing a corporate network than they have license. It can happen in otherwise legitimate businesses. It can happen in university environments. And indeed, we find that in many foreign countries, Governments themselves as software users are not complying with the copyright laws.

The counterfeit problem is one we see globally. It is particularly acute in a number of Asian countries, such as China, Thailand, Taiwan, and the Philippines, and it is something that we share a common interest in fighting with our brothers in the copyright community.

And Internet-based piracy is, while for us still the minority of our losses, of the $12 billion in losses each year, it is the fastest growing form of piracy. In February of this year, our office identified 174,000 infringing software programs of BSA members from 149 different countries, and that ranges from pirated websites, peer-to-peer networks, to distribution of pirated codes allowing people to break copy protection measures.

But we are quick to point out that the solution to this is not to ban the technology but to deal with the irresponsible, illegal behavior. Indeed, P2P technology is providing many positive benefits in the university research community. Our member companies are using it as a means of distributing legitimate software, including security software upgrades. So we need to address the problem of illegal behavior, not the technology.

There are a variety of ways of dealing with this, including education. We have launched a whole series of programs at BSA ranging from the school level students to university students to work with the corporate community, working with our international trade partners to copyright treaty adoption, WTO, our bilateral agreements. But we also think that in the United States, the investigation and prosecution of copyright piracy is a central part of the problem.

Again, the resources that your committee has for many years now successfully earmarked for DOJ has led to the establishment of the computer hacking and IP units, the CHIPs units, in 10 districts around the country, and that has led to the rapid increase in prosecutions that we are seeing that is now happening, in fact, and spilling over to our international partners.

We also believe that as we look at this internationally, there are a number of other key steps that we can take. We support very much the leadership that USTR has historically had in this area, working with Commerce Department and the State Department. We share the belief of other members of this panel that additional resources in USTR for an office devoted to intellectual property protection could be an important aspect of increasing their arsenal of what I think has been previously the single most effective agen-

cy in the U.S. Government in opening markets by reducing piracy, by reducing the theft of U.S. software.

We also support efforts to create a specialized office within the Department of State, reporting to the Assistant Secretary for Economic and Business Affairs, and we support the effort to ensure that there are dedicated resources within the FBI to supplement the existing CHIPs units, CCIPs, and U.S. Attorneys' organizations that you have dealt with in the past.

Collectively through our research with IDC, which works on a global basis studying the technology industry that has the most credibility, we were able to determine last year that a 10-point drop, 10 point decline in the level of software piracy in the United States alone could create 130,000 more high-tech jobs in America, generate $142 billion in additional U.S. GDP growth, and generate an additional $23 billion in tax revenues for the United States. That is magnified when we then take that to our trade partners and talk about what a 10-point drop in piracy in their countries could mean both for their employment, but also from the spillover to the United States.

Thank you and this committee for your continuing efforts in this area in fighting theft, for looking at new innovative means of doing it. It is important for not only our industry, for the U.S. economy, but to job growth and job creation and promotion of one of this country's premier export industries, the American software industry. Thank you.

Senator GREGG. Thank you.

[The statement follows:]

PREPARED STATEMENT OF ROBERT W. HOLLEYMAN, II

Good morning. 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. BSA's members create approximately 90 percent of the office productivity software in use in the United States 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 will 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. Finally, I will summarize the lessons that we have learned regarding how best to end piracy both here at home and abroad, including certain steps the government can take to more effectively stem the tide of piracy.

First, I want to thank the members of the subcommittee for holding 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.

[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, Cisco Systems, CNC Software/Mastercam, HP, IBM, Intel, Internet Security Systems, Intuit, Macromedia, Microsoft, Network Associates, PeopleSoft, RSA Security, SolidWorks, Sybase, Symantec, UGS PLM Solutions and VERITAS Software.

Software Industry Contributions and the Impact of Piracy

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 software industry has also proven to be a remarkable engine for global economic growth. A recent economic survey (attached) by IDC, a major IT research firm, reports that worldwide the IT sector employs more than nine million people 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 percent, 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 $180 billion to the global economy.

This sector has yet to reach its full economic potential. This is due, in large part, to piracy. Initial estimates for 2003 put the global piracy rate at 42 percent. In many countries the piracy rate exceeds 75 percent, reaching highs of over 90 percent in some markets. Although piracy levels in the United States historically have been low as compared to other countries, the figure is far from negligible. 2003 estimates put the U.S. piracy rate up 6 percent from 2002, to 29 percent. More than one in every four 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 United States alone cost the software industry almost $2 billion in 2002. Worldwide, piracy led to estimated losses of over $8 billion last year.

Of course, the impact of piracy extends beyond lost sales. Pirates steal jobs and tax revenues as well as intellectual property. The IDC 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 between 2002 and 2006 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. Piracy of software can take several forms:

Corporate 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 "corporate end-user piracy."

Corporate end-user piracy occurs in many different ways. In what is perhaps the most typical example, a corporate entity will purchase one licensed copy of software, but will install the program on multiple computers. Other forms of end-user piracy include copying disks for installation and distribution, in violation of license terms; taking advantage of upgrade offers without having a legal copy of the version to be upgraded; acquiring academic or other restricted or non-retail software without a license for commercial use; and swapping disks in or outside the workplace. Client-server overuse—when too many employees on a network have access to or are using a central copy of a program at the same time, whether over a local area network (LAN) or via the Internet—is another common form of end-user piracy.

Corporate end-user piracy goes on in enterprises large and small, public and private. While corporate end-user pirates do not generally make copies for resale or commercial distribution, they nonetheless receive an unfair commercial advantage

because the money that they save on legitimate software licenses reduces their operating costs and increases the profitability of their enterprise. In many cases, the piracy is attributable to negligence and poor asset management practices. Enterprises can also be victimized by unscrupulous computer manufacturers and dealers who install copies of software onto the internal hard drive of the personal computers they sell without authorization from the copyright holder. In some cases, however, corporate end-user piracy is undertaken willfully, with management fully aware and supportive of the conduct.

Counterfeiting

Counterfeit software continues to pose a serious problem for BSA's members. The most flagrant software counterfeiters produce CD–ROMs that look very similar to those of the software publisher. These counterfeit CD–ROMs often bear reproductions of the manufacturer's logo and other labeling, and are distributed with counterfeit packaging, manuals, security features and other documentation. Sophisticated counterfeiters often replicate these CD–ROMs at dedicated pirate facilities, using the same type of equipment and materials used by legitimate software manufacturers. A single CD–ROM replication facility can produce more than a million discs every day, at a per unit cost of less than two dollars. In other cases, counterfeit CD–ROMs have been traced to "legitimate" replicating plants that have contracted directly with counterfeiters.

Over the past several years, BSA has seen a dramatic increase in the amount of high quality counterfeit software imported into the United States from overseas, especially from Asia. International counterfeiting rings have become even more sophisticated in their methods of producing "look alike" software and components. For example, raids in Hong Kong uncovered evidence of advanced research and development laboratories where counterfeiters reverse-engineered the security features of at least one member company's software media. These activities are often connected with serious criminal organizations, as investigations in Asia, Europe, and Latin America have revealed. Indeed, evidence suggests that proceeds of counterfeiting have been used to fund terrorist groups. Compared to other similarly lucrative crimes like narcotics trafficking or arms dealing, software piracy is easy to pursue and low-risk; chances of getting caught are slim and, if caught, penalties are often light.

Compilation CD–ROMs also pose a problem. These CDs typically contain a large selection of software programs published by different software companies. Compilation CDs are typically sold for very little money (relative to the value of the legitimate software) at swap meets, flea markets, mail order houses, and over Internet auction and software web sites. Compilation software can be replicated using a relatively inexpensive (less than $1,000) CD recorder which, when connected to a personal computer, employs a laser to "burn" installed software programs onto a blank disc. Although compilation CDs do not exactly replicate the packaging and logos of genuine software, unsophisticated consumers are often led to believe that compilation CDs 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. As technology innovators, BSA's members are at the forefront of these developments. Software is not only sold and delivered over the Internet, but also comprises a key component of the Internet infrastructure and provides the basic tools used to offer virtually any good or service online.

Unfortunately, in addition to creating significant social and economic opportunities, the borderless and anonymous character of the Internet makes it an ideal forum to engage in criminal conduct. As we have seen, the emergence of the Internet has added a new dimension to software piracy by permitting electronic sales and transmission of illegal software on a global scale. Instead of pirated copies being sold one at a time, millions of pirated copies can be downloaded every day. Geography no longer matters. A pirate based in Washington, D.C. can sell to someone in Australia or Norway with ease. Internet users can readily employ a search engine to find both legitimate and illegitimate sellers of software and the resulting transaction can take place in the privacy of their home or office. The ability of Internet pirates to hide their identities or operate from remote jurisdictions often makes it difficult for right holders to find them and to hold them accountable.

Over the past two years, BSA's Internet investigators have witnessed the global spread and growth in the online piracy of software. Today, computer users can and do download infringing copies of BSA members' products from hundreds of thou-

sands of locations on the Internet—from websites in China to shared folders on peer-to-peer systems in France. Pirated software is available on auction sites in Brazil and is offered through spam email solicitations that originate in Russia. To cite but one figure, during the month of February, BSA's Internet crawler system identified 173,992 infringing software programs being offered in 149 different countries.

There are three primary forms of Internet piracy: (i) the transmission and downloading of digitized copies of pirated software, through web sites, IRC channels, newsgroups and peer-to-peer systems; (ii) the advertising and marketing of pirated software on auction and mail order sites and through e-mail spam, involving delivery on physical media through the mails or other traditional means; and (iii) the offering and transmission of codes or other technologies used to circumvent copy-protection security features. There are, of course, many variations on these general themes. All of these activities cause significant harm to our industry, as they do to other creative sectors.

Among these variants of Internet piracy, peer-to-peer piracy (P2P) has been the subject of significant public debate over the past two years. BSA takes P2P piracy very seriously. We are engaged in concerted action to address this threat. While BSA and its members deplore this activity, however, we believe it is essential to distinguish the illegal uses of the technology from the technology itself. There is no doubt that P2P technologies have been abused to spread illegal content including pirated software, pornography and personal information. At the same time, however, P2P technologies have also created exciting new opportunities for legitimate users. One of the earliest examples of P2P technology is the SETI@Home project, which uses over 4 million computers worldwide to search radio signals captured from space for signs of intelligent life. Stanford is using P2P technology to help find cures for diseases such as Alzheimer's, cystic fibrosis and BSE (mad cow disease). Software companies are also looking to P2P technologies to undertake routine tasks such as distributing updates for installed software including anti-virus and firewall software; in this way, software can be constantly updated in response to new Internet threats.

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 multifaceted.

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. For example, just last week BSA launched "Netrespect," a free educational resource to encourage responsible Internet behavior amongst young people. This initiative, first rolled out in Ireland, responds to a growing need to promote cyber education, beginning with encouraging teenagers to value creativity, respect intellectual property and practice responsible computer behavior. In addition to our broad-reach educational campaigns, BSA offers many tools to facilitate compliance. Among other resources, we provide 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. BSA has provided input into the most important international agreements protecting intellectual property, including the World Intellectual Property Organization's Copyright Treaty and the World Trade Organization's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). We are active at the national level as well, both in the area of law reform and through the provision of training and other assistance to public authorities including police, prosecutors and judges. And we have worked directly with governments worldwide, including the U.S. Government, to adopt and implement software asset management programs in order to prevent software piracy in the public sector and to set an example for the private sector to follow.

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. Operating on the basis of referrals from members, complaints from consumers and infringing activity identified through our own proactive searches, BSA's team of Internet investigators identifies infringing sites and takes action to have these sites removed or disabled. Last year alone, BSA sent over 170,000 notices to Internet service providers. 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. To this end, and consistent with the WTO TRIPs Agreement, we conduct civil "ex parte" (surprise) searches against corporate targets across the globe. We also work closely with local, national and international law enforcement bodies to protect the intellectual property rights of our members.

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.

The Role of Government

Of course, the government does have an essential role to play. Domestically, the investigation and prosecution of IPR-related offenses, using the legal tools provided by Congress, is a vital complement to our own enforcement efforts. We look to the government to continue to expand its IP law enforcement activities here at home. Internationally, the software industry looks to the U.S. government to persuade foreign governments to commit to protect and enforce intellectual property rights, and to ensure that these countries meet their commitments.

Domestic

Software piracy in the United States is a serious problem—make no mistake. Even though the piracy rate in the United States compares favorably with most other parts of the world, it still represents a loss of nearly two billion dollars annually for our industry.

Investigation and prosecution of copyright piracy is an essential part of the solution to this problem. We wish to thank you, Mr. Chairman, and the members of this subcommittee for the support you have given these efforts by setting aside of a portion of the Justice Department appropriation for cybercrime and intellectual property enforcement. These funds have permitted DOJ to form Computer Hacking and Intellectual Property (CHIP) units in 10 districts around the country. We urge the subcommittee to continue to dedicate substantial resources to these vital law enforcement efforts.

This investment is paying off. BSA congratulates the Justice Department and the FBI for the success last week of Operation Fastlink. This major enforcement action was coordinated by the Computer Crimes and Intellectual Property Section (CCIPS) of the Criminal Division of DOJ, and carried out in cooperation with right holder organizations, including BSA. It resulted in the execution of more than 120 searches in 27 states and 10 foreign countries, as well as the seizure of more than 200 computers that were allegedly used in the illegal dissemination of computer software and other copyrighted works on the Internet. It demonstrates in the most dramatic fashion our government's commitment to tackling the problem of internet piracy.

Last month's announcement of a new Intellectual Property Task Force under the leadership of David Israelite, Deputy Chief of Staff and Counselor to Attorney General Ashcroft, is another important affirmation of DOJ's commitment to fighting domestic and international piracy and counterfeiting. BSA commends the Department of Justice for its increased emphasis on IPR and cybercrime enforcement.

As I have already mentioned, Internet piracy is one of the major areas of concern for BSA's members. Congress has wisely enacted legislation that criminalizes online distribution of pirated software and increases penalties for Internet piracy. To ensure that these laws have real impact, U.S. law enforcement agencies have elevated the priority given copyright offenses including Internet piracy, resulting in important prosecutions against criminal pirates and counterfeiters. Following on these measures, the number of Americans on the Internet has nearly doubled, from 70 million people to 137 million. The copyright industry has expanded at a rate of 10 percent each year. And last year, copyright industries contributed $535 billion to the U.S. economy—more than 5 percent of the gross domestic product.

But, just as the Internet has evolved rapidly, so has Internet piracy. New methods of Internet piracy are constantly testing the limits of the legal tools that Congress has provided to right holders and prosecutors. BSA is eager to work with the Con-

gress and the Justice Department to ensure that legal tools such as the NET Act keep up with the challenges of the rapidly-changing Internet environment.

Legal tools are one part of the equation, but they must be complemented by adequate resources to investigate and prosecute IPR theft. Specifically, BSA urges this subcommittee to increase funding for the investigation of intellectual property crimes by the FBI. We believe that expanded investigatory assistance by the Bureau will support and enhance the efforts being made by U.S. Attorneys around the nation in prosecuting intellectual property offenses.

International

Intellectual property products, including computer software, have become a vital part of international trade. In 2001 the copyright industries generated more than $88 billion in foreign sales and exports. The nexus between IP and trade has also provided one of the principal levers for moving foreign governments into compliance with international norms for protection and enforcement of IP rights. The U.S. government has had great success in using a variety of tools at its disposal for achieving this goal—principally the negotiation of strong IP provisions in new trade agreements, enforcement of the TRIPs Agreement though WTO dispute settlement procedures, the Special 301 program, and administration of trade preference programs such as GSP.

These efforts have been led by a small but dedicated professional staff at USTR. USTR has been ably supported in this work by the State, Commerce and Justice Departments; and the USPTO and the Copyright Office have provided essential subject matter expertise. BSA commends the entire interagency team for their efforts to ensure foreign market access for goods and services with U.S. intellectual property and compliance with international agreements protecting intellectual property rights. In particular, we wish to recognize the efforts and leadership of Under Secretary Aldonas, Assistant Secretary Wayne, and Acting Under Secretary Dudas. Their hard work is paying off—not only for the United States, but for our foreign trading partners as well, since the ability of countries to reap high economic benefits from the software sector is highly dependent on their ability to promote protection and enforcement of intellectual property rights.

These efforts can and should be enhanced by providing USTR with additional resources for negotiating and enforcing strong norms and obligations for the protection of intellectual property rights. BSA would support the creation of a new and separate Intellectual Property Office within USTR, with increased staff, to enable USTR to continue to place a high priority on IPR negotiation and enforcement.

Similarly, BSA believes that an Intellectual Property Office should be created within the Department of State, under the Assistant Secretary for Economic and Business Affairs. This would assist the State Department in continuing to place a high priority on ensuring foreign market access for U.S. intellectual property products and services and compliance with international agreements protecting intellectual property rights.

PTO Funding and Patent Quality

BSA strongly supports the work that Acting Under Secretary of Commerce and Director of the USPTO Jon Dudas and his predecessors have done to seek to strengthen and modernize the U.S. patent system, to improve patent quality, and to reduce the increasingly lengthy time it takes to get a patent. Our members are among a large number of companies who support the framework contained in H.R. 1561, the Patent and Trademark Fee Modernization Act of 2004, and who are willing, collectively, to pay an additional $200 million per year to help the PTO achieve these objectives. The agreement reached in H.R. 1561 raises fees significantly, and, if enacted, would retain this subcommittee's oversight of the PTO, by continuing to require that funds for the PTO be appropriated by this subcommittee. H.R. 1561 would also provide for refunds to users of fees collected by the PTO, but not appropriated for its use. Under this scenario, the PTO would get only the funds it could reasonably and effectively use, and excess fees would be returned to the users who paid them. BSA encourages the members of this subcommittee, and the full Appropriations Committee to endorse this solution as an equitable approach to get the PTO the funds it needs to keep up with the increasing demands placed upon it, and to give us timely patents of good quality that reward inventors and do not impose unfair burdens upon the U.S. economy.

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.

Senator GREGG. You have given us a whole series of really excellent ideas. Let me turn to the chairman of the full committee for questions which he may have, then I will ask questions. It is nice to be joined by the Senator from Washington.

Senator STEVENS. Mr. Chairman, I want to request that you put my opening statement in the record as though I was here.

[The statement follows:]

PREPARED STATEMENT OF SENATOR TED STEVENS

I'd like to thank the Chair, my good friend from New Hampshire, for holding this hearing today.

The piracy of intellectual property is something that certainly harms those in the industry. And, it of course harms the consumers downstream as well.

Improved technology affects our lives in many positive ways—making our lives easier, more enjoyable and safer. But, one of the pitfalls of improved technology is that it can sometimes make the criminal's job easier. In this instance, it is used for the piracy of content—whether it is movies, songs or software.

It is good to learn that the Department of Justice has been able to use more resources to combat copyrighting and other piracy crimes.

I look forward to hearing from those on the industry panel—to not only learn about the effects that piracy has on their business but also to hear what they have been doing internally to combat this problem.

Senator Gregg has put together an interesting group of witnesses today and I look forward to hearing their testimony.

Senator STEVENS. I am sad I didn't get here quickly enough to hear my good friend Jack Valenti. I don't see Jack Valenti as leaving the scene. He just may not be at the table. He will be behind the table in the years to come.

I am reminded that some time ago, I assisted in setting up the National Intellectual Property Law Enforcement Coordination Council. I don't think any of you mentioned that, and I think there is some element missing from that. None of you are going to like what I am going to say, but you mentioned pure and simple theft and piracy. So is train robbery. It ended primarily when Government and the industry got together. The Pinkerton agency led the fight, but there were Government agents behind them.

I think we have to go back and crank up that council and get the ingredient that was missing, and that is a coordinated support from the industry itself to assist these agencies to do some of the basic investigation and some of the details that you are asking us to put up money to do, because I have got to tell you, there isn't much money here to add to the accounts that the chairman has already made available. As a matter of fact, I seriously wonder whether he is going to have the money to continue what he has done in the past in terms of the budget process we are going through right now with two major engagements going on, a war on terrorism and a war in Iraq. It is just not going to be increased in a substantial amount.

However, I do believe we can continue to fund the activities of the council and the activities of agencies, the Federal agencies involved in the council. But I would encourage you to get your legal departments working to see how we can authorize you to cooperate

and to really be part of the enforcement mechanisms and have people that are working for you share your information and to make it more readily available to the Federal agencies so it can be pursued and this piracy can be reduced, if not totally stopped.

It is, I think, one of the worst types of piracy because it is a disincentive to our further expansion of knowledge and our further development of new technology and our further implementation of that technology. I just was reading this morning about the basic area of communications and digital application is starting to expand again. Well, the losses that you are suffering now, I think, are one of the things that are a drawback as far as the investments your companies could be making in that new technology.

I urge, Mr. Chairman, we take a look at that council and work with the members of this group and the agencies that are involved to see if there is any way we can bring about greater coordination and eventually greater application of the legal processes so the departments can continue to pursue these people and stop this tremendous drain on our economy that is taking place because of this problem of piracy.

I would recommend that our staff get together with the staff of this panel and see if there is some way we can blend some money here. I think we can earmark some money, but we can't meet the needs that you outlined. You gave us four different areas for funding, for investigation, for training new agents to give us additional ability to coordinate the investigation and prosecution. I think those things can happen better if we have more coordination from the industry itself and more involvement from your people in terms of the basic investigation.

So I guess what I am really saying is we ought to create a new Pinkerton service for your industries and let them coordinate with the Federal agencies and bring about a more cohesive attack against these pirates.

It is something that bothers us considerably, I think all of us, and as I travel around the world and look at our military installations, I am impressed that you can't walk on a main street in any country in the world without seeing pirated copies on just little stands on the corner, of the intellectual property that has come from our country and been reproduced illegally and being sold to the world.

We ought to be more involved and we want to get more involved, but I am sorry to say that I think there is a limited amount of money we can pledge and I hope you would think about a partnership. Thank you very much.

Senator GREGG. Thank you, Mr. Chairman.

I would like to follow up on that point on a similar group which I mentioned in my opening, Mr. Chairman. I hadn't realized the chairman had created this entity. I have this chart which actually puts it right in the middle of everything. Theoretically on this organizational chart, Justice, State, USTR, Commerce, Homeland Security, all flow into NIPLECC which then flows out to the industry as a coordinating agency.

I guess my question would be to follow on the chairman. My first question would be to each of you to give me your reaction to what this NIPLECC group is doing, whether it is serving a function,

whether it—none of you mentioned it in your opening statements, so I am assuming it is not doing a heck of a lot. Is it a worthwhile approach to continue this type, and if it is, what should we do to energize it?

Mr. VALENTI. Mr. Chairman, we are aware of that agency and perhaps we have not made the best use out of it we should. I just talked to my colleague here from the manager's office and she is going to begin to confer with this committee.

But let me just say, in answer to Chairman Stevens' remarks, I think that he is right on about industry should be doing their own bit. I want to let you know that MPA has anti-piracy operations in 60 countries around the world. We have what we call pacts. We have federations with Japan, Great Britain, Spain, Portugal, Italy, Germany, Mexico, France, and other countries in the world where we join with them in a joint anti-piracy federation.

We have conducted over 66,000 investigations last year. We participate in 32,000 raids. We have confiscated 16 million counterfeit DVDs, 28 million counterfeit VCDs. We have been deeply involved with prosecutors and with police authorities in all these countries in the world. We spend a considerable amount of time doing investigation and surveillance and then turning over to the FBI and U.S. Attorneys information we have found, which saves them hundreds of thousands of man hours every year, for which they are grateful.

So we have spent a lot of money, a lot of time. Indeed, the prime priority of the MPA right now, my singular objective is to deal with thievery. We didn't mention too much about Internet, which has grown malignantly over the years.

And finally, I have before me a bulletin put out by the Department of the Army from their Network Computer Intelligence Section which says that the use of what we call peer-to-peer networks that presides in the Morpheuses and the iMesh and the eDonkeys and the Nutellas of the world, constitute, and I quote, "a threat to national security because"—I am not talking about secure networks now, where there is legitimate work being done. I am talking about the peer-to-peer, which is unsecure, insecure, and where a lot of this is going on now.

You get a movie—if I can go into a theater and camcord a movie—about 70 to 80 percent of the movies are pilfered that way—and then I upload it to the Internet, it can be taken down instantly, and because it is a digital movie, it is eminently watchable. And then unauthorized DVDs are stamped from that and flown around the world.

In 2002, we sent out to members of the Academy, screeners, 68 titles sent out so people in the industry could look at that for their awards ceremony, and about half of those were stolen, we found out, in 2002, and most of them wound up in Russia, where millions and millions of counterfeit DVDs were sent all over the world.

But I want to emphasize again that the growing malignancy is going to be stemming from these peer-to-peer services and I think the Government has got to deal with this. Government computers, corporate computers, are just as bad in their intrusions. And now the Army has said this is a threat to national security.

So we are doing everything we can, but we will get with this coordinating committee and see what more we can do, Mr. Chairman.

Senator GREGG. I am not sure—I guess my question is more generic than just how—my question is how are the Federal agencies doing in coordinating their efforts? Are they communicating with each other? Does USTR deal effectively with the FBI or it needs to improve? Does the State Department adequately deal with the Justice Department, Commerce with Justice? Is there a flow of information and a reasonably centralized strategic approach to fighting the theft of intellectual property, or is it just being done by agency, with each agency doing their own niche effort, and should there be a coordinating effort? I guess that is what this NIPLECC group was set up to do, was to do a coordinating effort. Does anybody have any thoughts on that?

Mr. LOWENSTEIN. What I would like to do is respond to you fully after we consult with some of our investigative people for the record. But I would say this.

I think that the coordinating role is a terribly important one, and I think NIPLECC is at least playing a positive role. I have no doubt that there can be improved coordination. We need to be careful not to confuse coordination and information exchange with creating some sort of grandiose centralized place that manages all of this effort, because the agencies involved do have their own functions. USTR negotiates and enforces trade agreements. The Justice Department does law enforcement investigations and criminal investigations. And it would be very difficult to sort of funnel all that into a single operation.

Yes, there needs to be coordination, and I think NIPLECC has a role to play there, and no doubt can play an improved role there, even though I think they are making the effort. But I think, as I said, we need to be careful not to sort of confuse coordination and information exchange with creating some sort of centralized czar that is managing the entire anti-piracy effort for the United States Government. But I would like an opportunity to give you a more thorough response on NIPLECC for the record.

Senator GREGG. Mr. Holleyman.

Mr. HOLLEYMAN. Mr. Chairman, I think that the goals by NIPLECC are certainly to be commended. All our organizations work closely with various—with the Justice Department, with State, USTR, with PTO and ITA-Commerce on these issues. I think in terms of general U.S. trade policy, there is a coordinated approach.

In terms of U.S enforcement, I think that one of the challenges of this is when you give a specific mandate to a specific group of people, then there is the greatest responsibility and the greatest connect. But when responsibility is diffused among a large number of people, in Government as in organizations, it is hard to have accountability.

So again, I come back to the very clear earmarks that this committee has made for the Justice Department, for the type of prosecutions and investigations in IP crime, and that has had a direct correlation to substantial increase in prosecutions within DOJ, coming out of DOJ in the last several years. So it is a very specific

request, very specific result, and we think that that is a good model going forward.

Senator GREGG. Now, I notice that there seems to be a consensus on at least three thoughts which were initiated, which were first mentioned by Mr. Valenti, that USTR set up a special office on intellectual property, that there be an Assistant USTR and is earmarked funding, that the State Department increase its office to the director level and that there be more clarity as to their responsibility and that the FBI have more of a specific funding stream directed at this issue for their efforts. There is consensus on those three, all of which this committee can do almost unilaterally, which are good recommendation and I suspect we will follow through on them, except for the FBI, which may follow through.

I have this question. The FBI's number one focus right now is counterterrorism. Their job is to find and protect those kind of people who want to harm us and stop them before they harm us, and we really have given them a huge new portfolio there and they are trying to work their way through it, and Justice is doing as best they can. This really has been a complete reorientation of the efforts of the FBI.

I am wondering if this responsibility for pursuing intellectual property theft, which is clearly a law enforcement role, there is a law enforcement role here, would be more effectively done in an agency other than the FBI that also has the international contacts and which has an overlapping role relative to organized crime, specifically the DEA. Has anybody given anything like that any thought, because to say to the FBI, we are saying do counterterrorism, and then we say, well, do intellectual property theft, too, may be a little bit of a mixed message coming from us as a society, as a Government, whereas an agency like DEA, which is picking up even more responsibility in the organized crime areas as it picks up part of the FBI role on drugs, might be a more logical agency and an agency which would have more capacity to focus on this than, say, the FBI. And it has the overseas agents, just like the FBI. In fact, it probably has more of them.

Mr. VALENTI. I will respond briefly. I don't know whether it should be the FBI, the DEA, or whomever, but I think there are some central facts that we can all agree on.

One, this problem is huge. It is mammoth and it is growing. That is the problem. And it has a direct effect on the decay of the U.S. economy. No one in this country would want to suggest that there be any less attention given to the war on terrorism. That is for our actual safety in this country. That should be number one.

But somewhere, somewhere in the wealth of things that we do, we have to attack this problem and we have to attend it with a great deal of intensity because it is a terrible, terrible peril for the future.

There are two ways. One, there has to be a USTR, a Department of Commerce where you have trade agreements with countries where the two essentials are a strong copyright law with stern penalties and the political will to enforce those laws. Without a lariat, we don't have anything. The USTR has done a great job in putting the diplomatic-economic coverlet over this platform from which springs the future.

But then there has to be the investigatory, prosecutory role, side of it, that people who break the law matter and they must be brought to justice. But in most of these countries of the world, it is a slap on the wrist.

So I think that the way to attack this thing is to have more people involved in the United States to deal with it. The State Department, for example, in their Economic Bureau, the Intellectual Property Division, recently started a series of meetings and bringing together all the agencies and departments of this Government to see what we could trade in the way of training and kind of initiatives which are taken, which I thought was quite commendable.

But to answer your question directly, it would be good if there was some central authority with enough trained people to deal with the investigations of these crimes that the FBI has been doing. If somebody else can do it, that is fine. But there has to be some, right now, funding, Mr. Chairman, trained agents and equipment to do the job or else we are just kidding ourselves.

Mr. LOWENSTEIN. Mr. Chairman, if I may briefly respond to that, I think there may well be a role for DEA and I think we need to look at this in a couple of ways. It is important to understand the FBI has, over their recent past, devoted a considerable amount of resources and energy to developing expertise in this particular field. So I think we don't want to lose that investment. So I think there is a continuing role for them.

I also think that you mentioned the role on counterterrorism, and as Jack said in his opening statement, there certainly is mounting evidence now that there is a nexus between piracy and terrorism. I read a recent report from Interpol in which they document some of those links. So I think there certainly is an appropriate ongoing role for the FBI just on that basis alone.

Certainly, the DEA, as Jack also said, there is increasing evidence that some of the drug syndicates are migrating from drugs over to piracy, so there may be a very natural flow for DEA. It is something I think that is well worth looking at, but not at the expense of removing that portfolio from the FBI.

Senator GREGG. Mr. Holleyman.

Mr. HOLLEYMAN. I will add one thing. There is important recognition of this for at least the domestic aspect. In most areas of crime in this country, the Federal Government acts as a safety net when State and local police and prosecutors either fail, need additional assistance, or there is some unique Federal interest. In intellectual property enforcement, whether for hard goods or particularly for Internet piracy, the only cop is the Federal Government.

And so one of the challenges here is that whether it is at FBI, which we support, at Justice, or your suggestion of DEA or some appropriate place both here and abroad, the Federal Government has a unique responsibility in this area which is very different from most areas of law enforcement that we deal with at the Federal level. So we urge you to continue to make that a priority.

Senator GREGG. I am not questioning the need for priority or the point that Mr. Valenti makes, which is that it needs focused resources as versus just cursory sources. I am just throwing out for a point of discussion as to what is the right place. We are going to significantly increase the stand-up and more aggressive effort in

law enforcement. If we continue with the FBI, which is right now totally involved in reorganizing its efforts, we consider maybe creating another entity. Logically, it would go to be under the DEA or maybe under the Criminal Division of the Attorney General's office that would be just intellectual property oriented. But it was just for discussion and I appreciate the initial reaction.

Senator Murray.

Senator MURRAY. Mr. Chairman, thank you very much for this hearing, and to all of our witnesses, certainly, this is an incredibly important issue. I listened to the full chairman of the Appropriations Committee and his cautioning all of us that we have no money whatsoever to deal with and even less than we probably think we do. That deeply concerns me.

I know that everybody wants to move to private companies to deal with this, but I just caution this committee that a small entertainment software company can't take on a country's enforcement or investigation. We need to tackle this as a country because we do need to protect our economy and this is having an incredible impact on our economy with the draining of dollars that all of you talked about in your testimony today from our country. The real fear is that it will take away our willingness to be creative and create new companies, because if you can't make profits on your company because you lose your intellectual property, it will discourage a lot of good start-up companies out there from even getting started.

And so I think it is an issue that we do need to invest in from our end, whether it is more prosecution and investigation, as Mr. Valenti talked about, but I also think we need enforcement in our country to combat it. I would like to ask the witnesses today, on the international level, are we using the tools that we have effectively, whether it is bilateral trade agreements or the Special 301 process at WTO or treaties? Is anything being used effectively to negotiate with other countries and enforce the laws that we have?

Mr. VALENTI. Senator Murray, I think the USTR has done an extraordinary job with a small, small group of people. They have concluded free trade agreements now, particularly in Singapore and Chile and others, and now the Congress is going to have to approve Morocco and, what's the other one? Australia. So they just need more staffing in order to do this, because their job is enlarged with such rapidity that they can't deal with it.

I think the State Department has done a great deal in trying to alleviate this, and particularly by instilling a new intensity of efforts in the Embassies, and I think that is good. Certainly, we have had good cooperation from the Justice Department and getting information that we need, and particularly here at prosecution.

But we have a problem abroad. The Special 301, I think has been good, and I think that your trips, for example, with Senator Stevens and Senator Inouye to Taiwan had a beneficent effect on changing their attitude about dealing with this. I think CODELs have been a big, big help. We inform the Senators and Congress, but meet with the presidents and prime ministers of these countries and lay it out very simply, instructing, here, we will not tolerate this.

Senator MURRAY. So diplomacy is important?

Mr. VALENTI. Yes, ma'am.

Mr. BAINWOL. And I would just concur. The tools are there. They need to be backed with diplomacy and backup, where possible, with money. It all comes down to enforcement.

I think the structural questions you asked earlier are highly relevant. And then today, though, I think you have to ask the question, what is the best way to enforce? That ought to drive the structural questions.

I have one other point that is a bit unrelated. That is, I understand this is the Appropriations Committee, but there are things that you can do that do not require money. This is—the nature of the piracy problem really is that there is this whole side, there is the Internet side. We have to recognize there are bad actors out there. It is not that, oh, gee, it has been hijacked. The bad actors need to be focused on. Shine a spotlight on them. We need to send a message. This is as much about teaching kids right and wrong and sending the right signals as it is about enforcement.

Mr. LOWENSTEIN. Senator Murray, I think you heard the comment about a single company about a single company can't take on a government, let alone organized criminal enterprises that are basically at the root of this. Even the local governments in those countries often don't have the will to take on these very large criminal syndicates, and that is one of the things that is terribly critical here and which I think we can do more in the United States.

We have tremendous expertise in this country at investigating organized criminal syndicates. We need to press some of these foreign countries to adopt laws like our RICO statutes. They have been in Hong Kong, for example. We need to press other governments to create more tools so they have indigenous ability to pursue organized syndicates.

And we need to take our expertise and coordinate and share with these foreign governments in terms of getting them the tools, the know-how, the ability to conduct these investigations. That doesn't necessarily mean money. That is knowledge. That is something we know a lot about in this country and we need to do a better job focusing on this.

If we don't nail these criminal organizations, we will be here year after year after year after year. That is the root of the problem and it is going to take a very focused effort not only in this Government but in cooperation with foreign governments in solving the problem.

Senator MURRAY. But I would assume that most of these countries would want that kind of control in their countries, too, because piracy is as much a problem for people who develop software in China as it is for people here when they lose their economic value.

Mr. LOWENSTEIN. It is absolutely true, and in the Fastline Operation, which we all referred to and the Justice Department announced last week, they did coordinate it with 10 other countries and they made a huge impact. So I think they understand the problem. I think it just needs to be sustained, and yes, ideally, additional resources, but I understand that may not be possible. But if not, it needs to be a continuing priority focus of this Government

and the FBI, the Justice Department, U.S. Department of Commerce has less of a law enforcement function than some of these other agencies.

Senator MURRAY. Mr. Holleyman.

Mr. HOLLEYMAN. Over the past decade, we have seen software piracy rates come down from about 60-something percent of all business software being pirated to about 40 percent today. Forty percent is still a huge loss. Of course, the dollar losses haven't gone down much because the market has grown. But the bulk of that success in reducing rates of piracy has been attributable to U.S. trade policy consistently over the years in efforts, both bilaterally and multilaterally. So everything you can do to reinforce that, we believe can make progress in reducing the unacceptable 40 percent rate that we currently face.

Senator MURRAY. Thank you. Thank you, Mr. Chairman. I do have another hearing I want to go to, but I really appreciate your having this hearing and I want to work with all of you. I think we can't lose sight of this issue and we need to keep it a priority both domestic and internationally and want to work with you to do that.

Senator GREGG. Thank you, Senator Murray.

It would be helpful to our staff if each of you could designate in your organization somebody who will work with our staff. There have been some very specific recommendations that have been made today which there appears to be consensus on. We are going to want to try to execute on those, if possible, certainly the USTR issue, the State Department issue. I want to figure out where we should put this—if we can find some money to put into this effort for enforcement, how we structure that. Maybe we set up a joint effort under the Criminal Division in the Justice Department with both DEA and FBI.

In any event, we want to get your expertise as we go down this road to try to support you in and your staff in protecting intellectual property.

I guess my last question would be, next week, we are going to have all the agencies here that our Government—the Government agencies that have jurisdiction in this issue. Is there anything specific that you think we should be asking these folks, USTR, Commerce, Justice, PTO, or have we already gone through that? I know you have made specific suggestions urging——

Mr. VALENTI. You know, I think that in the testimony we presented here, there were specific suggestions as to what could be done. I think some of these agencies are already coming to you for help in expanding their own operations. I realize that there are budgetary restraints, but I think if you take the war on terror and the war in Iraq and put that aside, those are the two top priorities.

I really don't know of anything that affects the future of this country more than what we have been trying to explain here today and to eliminate it. I think it is a distressing and troubling thing. It has to do, as Doug Lowenstein said, with behavior. I have spoken at nine campuses over the last year and I am just stunned by what I find. You people don't believe that stealing music or software or movies, there is anything wrong with that. There is a terrible contradiction, a great grand omission in the kind of values these young kids have.

And then number two, these P2P services out there, they even have the chutzpa to have an association formed in this city trying to tell how great P2P is. I am going to say, I congratulate them on their gall for this because it stuns me.

But this is a threat to national security, the Army has found out. This is something I think that we as a Government have got to deal with. You can't sit inert and mute. I don't mean you, I am talking about the editorial "you" here. As a people, we can't sit by inert and not do anything about this.

Senator GREGG. Well, I certainly agree that this is a core issue for the vitality of our economy and our competitiveness as a Nation, protection of intellectual property which energizes the creation of intellectual property, which is where we as a Nation must go if we are going to remain competitive in the environment. That goes to good jobs and it goes to good lifestyles. So this is at the essence of us as a culture.

So this committee is going to try to do our little part, and we certainly appreciate your participation today. You have some really good, significant ideas and I intend to follow up on them. Thank you very much.

CONCLUSION OF HEARING

We will have a hearing with the departments and agencies within the next week or two.

Thank you. We are recessed.

[Whereupon, at 11:14 a.m., Thursday, April 29, the hearing was concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

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