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# INTELLECTUAL PROPERTY THEFT IN CHINA AND RUSSIA

## HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

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# CONTENTS

## HEARINGS


| | Page |
|---|---|
| Part I | |
| INTELLECTUAL PROPERTY THEFT IN CHINA | 1 |
| Part II | |
| INTELLECTUAL PROPERTY THEFT IN RUSSIA | 105 |


## OPENING STATEMENT

### PART I (CHINA)


| | |
|---|---|
| The Honorable Lamar Smith, a Representative in Congress from the State of Texas, and Chairman, Subcommittee on Courts, the Internet, and Intellectual Property | 1 |
| The Honorable Howard L. Berman, a Representative in Congress from the State of California, and Ranking Member, Subcommittee on Courts, the Internet, and Intellectual Property | 2 |


### PART II (RUSSIA)


| | |
|---|---|
| The Honorable Lamar Smith, a Representative in Congress from the State of Texas, and Chairman, Subcommittee on Courts, the Internet, and Intellectual Property | 105 |
| The Honorable Howard L. Berman, a Representative in Congress from the State of California, and Ranking Member, Subcommittee on Courts, the Internet, and Intellectual Property | 106 |


## WITNESSES

### PART I (CHINA)


| | |
|---|---|
| Ms. Victoria Espinel, Acting Assistant U.S. Trade Representative for Intellectual Property, Office of U.S. Trade Representative | |
| Oral Testimony | 4 |
| Prepared Statement | 7 |
| Mr. Ted C. Fishman, Author and Journalist, China, Inc. | |
| Oral Testimony | 8 |
| Prepared Statement | 10 |
| Mr. Myron Brilliant, Vice President, East Asia, U.S. Chamber of Commerce | |
| Oral Testimony | 13 |
| Prepared Statement | 15 |
| Mr. Eric H. Smith, President, International Intellectual Property Alliance (IIPA) | |
| Oral Testimony | 22 |
| Prepared Statement | 24 |


### PART II (RUSSIA)


| | |
|---|---|
| Ms. Victoria Espinel, Acting Assistant U.S. Trade Representative for Intellectual Property, Office of U.S. Trade Representative | |
| Oral Testimony | 108 |
| Prepared Statement | 111 |

Page

Mr. Eric J. Schwartz, Vice President and Special Counsel, International Intellectual Property Alliance (IIPA)
Oral Testimony ..... 113
Prepared Statement ..... 115
Ms. Bonnie J.K. Richardson, Senior Vice President, International Policy, Motion Picture Association of America
Oral Testimony ..... 139
Prepared Statement ..... 140
Mr. Matthew T. Gerson, Senior Vice President, Public Policy and Government Relations, Universal Music Group
Oral Testimony ..... 148
Prepared Statement ..... 150

## APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

PART I (CHINA)

Prepared Statement of the Honorable Howard L. Berman, a Representative in Congress from the State of California, and Ranking Member, Subcommittee on Courts, the Internet, and Intellectual Property ..... 163
Prepared Statement of the Honorable Bob Goodlatte, a Representative in Congress from the State of Virginia ..... 164
Prepared Statement of the Honorable Elton Gallegly, a Representative in Congress from the State of California ..... 165
Prepared Statement of the American Chamber of Commerce People's Republic of China ..... 166
Article from the New York Times entitled "The Pirate Kingdom" by Pat Choate ..... 176

PART II (RUSSIA)

Dear Colleague and Article entitled "In Russia, Politicians Protect Movie and Music Pirates" from the Honorable Lamar Smith, a Representative in Congress from the State of Texas, and Chairman, Subcommittee on Courts, the Internet, and Intellectual Property ..... 178
Prepared Statement of the Honorable Howard L. Berman, a Representative in Congress from the State of California, and Ranking Member, Subcommittee on Courts, the Internet, and Intellectual Property ..... 182
Prepared Statement of Tom Thomson, Vice President, Coalition for Intellectual Property Rights (CIPR) ..... 183
Letter from the Recording Industry Association of America (RIAA) to President George W. Bush ..... 188

# Part I

# INTELLECTUAL PROPERTY THEFT IN CHINA

**TUESDAY, MAY 17, 2005**

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS, THE INTERNET,
AND INTELLECTUAL PROPERTY,
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 10:08 a.m., in Room 2141, Rayburn House Office Building, the Honorable Lamar Smith (Chair of the Subcommittee) presiding.

Mr. SMITH. The Subcommittee on Courts, the Internet, and Intellectual Property will come to order.

I am going to recognize myself and the Ranking Member for opening statements, and then we will proceed quickly to hear from the witnesses. And we very much look forward to their testimony.

Today, in what may be a first for the Judiciary Committee, this Subcommittee will conduct two back-to-back oversight hearings on the subject of international intellectual property theft. The first will examine the massive piracy and counterfeiting that persists in China. The second will focus on the Russian Federation which, according to one of our witnesses today, "is the largest unregulated and unenforced producer of private optical discs in the world."

One of the purposes of these hearings is to begin an examination of the role of intellectual property rights in promoting international respect for the rule of law. In whatever form it takes, the theft of intellectual property inflicts substantial economic harm on our country, our entrepreneurs, our innovators and, ultimately, on the American consumers.

The losses incurred are not limited to those sustained by the traditional "core" copyright industries, but extend to virtually all manufacturers and industries throughout our economy.

The circumstances in China and Russia are unique, and clearly present separate challenges for U.S. policymakers. However, it is possible that the persistent failures of these two governments to adequately protect and enforce IP rights may be systemic and deliberate, rather than mere "growing pains" associated with the development of market economies.

We need to determine for ourselves whether it is credible to believe the Chinese government is serious about enforcing the legitimate IP rights of U.S. companies, when copyright piracy levels continue to average 90 percent, and the government refuses to even police their own computers by removing unlicensed software.

We need to assess whether the Chinese government has determined that they can continue to simply take without compensation the fruits of the investment, innovations, and industriousness of our most creative citizens.

We must begin to consider the true cost of IP theft; not by merely calculating the effects of lost revenues, but by assessing the competitive advantage that Chinese companies wrongfully acquire by paying pennies for the exact same tools and software that cost U.S. and other manufacturers thousands, and sometimes millions, of dollars.

Finally, we must ask whether we have done everything in our power to impress upon the Chinese government the seriousness we attach to respect for the rule of law and the protection of our most valuable commercial property.

Our witnesses today will present overwhelming evidence that the theft of intellectual property in China has increased exponentially. This is in spite of the fact that successive U.S. governments have sought to engage China in the international rules-based trading system, and despite our active support for their accession to the WTO. In return, China committed to adequately and effectively protect the rights of intellectual property owners, something that to date the Chinese government has failed or chosen not to do.

At the conclusion of these two hearings, I hope we will not simply be asking, "What is happening in China and Russia?", but will have begun to focus on the more difficult question of, "How do we solve this problem?"

That concludes my comments. And the gentleman from California, Mr. Berman, is recognized for his.

Mr. BERMAN. I thank you very much, Mr. Chairman, for scheduling these back-to-back hearings on this scourge of intellectual property piracy, with a focus on China and Russia. The problem we confront with both countries is the same: how to prevent billions of dollars in losses to the American economy as a result of an unfettered ability to pirate.

From almost the beginning of recorded history, China has served as a provider of desired goods. Marco Polo traveled the world to bring back goods made in the Orient. Today, China's economy has grown to include the manufacture of many different products, including clothing, purses, software, computers, and movies.

While just as desired as the goods of Marco Polo's day, these modern goods often are not the legitimate product of the original source. Instead, these are goods that are copied, reverse engineered and, with limited investment and no payment to the creator, sold for a negligible price for China's 1.3 billion citizens, and exported in massive quantities to other countries, including America.

The impact of counterfeiting and piracy on American innovators and the general public is impossible to quantify with precision, but it is enormous. The Chinese government, and some Chinese companies, appear to have an interesting philosophy about piracy. They point to their robust laws on intellectual property, show you attempts at enforcement with a televised raid of a market stall, and describe their involvement in the issue by lending you educational materials for high schools on the importance of respecting intellectual property.

Piracy, they claim, is not to be tolerated. Yet the reality is that not only is piracy tolerated, but the government typically turns a blind eye to allow the benefits of piracy to accrue to Chinese consumers.

These cheaper products, it is argued, provide the Chinese population with the luxury items they desire but may not be able to afford. I have heard some in the Chinese government assert that the pirates are merely providing cheaper products for those who cannot afford to buy bread, in essence, functioning as "Robin Hoods" for these goods. Yet this argument holds little credence when those goods are openly exported around the world, disrupting existing markets for legitimate products.

As noted by the Chamber of Commerce, in the year ending October 31, 2004, the value of Chinese counterfeits coming into U.S. markets seized by the U.S. increased 47 percent. This Saturday, the Washington Post reported that—well, no.

If the government in China sincerely wanted to stop piracy, it could; because they have. Clearly, when piracy hurts Chinese interests, the government has been motivated to step in. When teeshirt knockouts of the Beijing 2008 summer games were being sold, the government was quick to close down the shops and find the counterfeiters. In 2001, the government tore down 690 billboards that illegally associated products with the event, and ripped fake Olympic emblems off 67,000 taxis. When they want to, they can.

This Saturday, the Washington Post reported that the Administration will likely cap imports of clothing as a result of the glut of Chinese products entering the American market. There is a far more compelling case for the Administration to be forceful with China about its willingness to tolerate intellectual property violations.

A precondition to China entering the World Trade Organization was that it implement intellectual property protections. They have been given time to address this concern, and have failed. It is time for the Administration to bring a WTO case and confront China in a meaningful way. If we provide the will for them to put a stop to piracy, they'll find a way.

I look forward to hearing from our witnesses, Mr. Chairman, and especially from the U.S. Trade Representative's Office on what steps they are taking to protect America's most valuable treasure, our ideas and creations.

Mr. SMITH. Thank you, Mr. Berman. Without objection, other Members' opening statements will be made a part of the record.

And before I introduce the witnesses, I would like to ask you all to stand and be sworn in.

[Witnesses sworn.]

Mr. SMITH. Thank you. Please be seated.

Our first witness is Victoria Espinel, who is the Acting Assistant U.S. Trade Representative for Intellectual Property in the Office of the United States Trade Representative. In that capacity, Ms. Espinel serves as the principal U.S. trade negotiator on IP. Ms. Espinel's office chairs the intra-agency committee that conducts the annual Special 301 review of the international protection of intellectual property rights. The latest report was published on April 29, 2005. Ms. Espinel holds an LLM from the London School of Ec-

onomics, a JD from Georgetown University, and a BS in foreign service from Georgetown University School of Foreign Service.

I am told that this is Ms. Espinel's first time testifying before Congress. She'll be doing double-duty today, since she will also be testifying at our Russia hearing, as well. Now, we look forward to hearing her testimony, and welcome her to the Committee today.

Our second witness is Ted Fishman, the author of the best-selling book, "China, Inc.: How the Rise of the Next Superpower Challenges America and the World." Provocative, timely, and insightful, Mr. Fishman's book has been favorably reviewed by numerous business and general interest publications. In addition to his book, Mr. Fishman has written for The New York Times, the Times of London, Harper's, and USA Today. Mr. Fishman is a graduate of Princeton University.

Our next witness is Myron Brilliant. Mr. Brilliant serves as the Vice President for East Asia at the United States Chamber of Commerce. In that capacity, he is responsible for overseeing the U.S. Chamber's programs and policy in that region. His focus has been on strengthening and promoting the U.S.-China relationship. Towards that end, he formed the U.S. Chamber's China WTO Implementation Working Group in 2001; led efforts to secure congressional support for PNTR for China—we may ask you if you still are happy you did that—and currently heads the U.S. Chamber's international IPR initiative. Mr. Brilliant received his JD from American University's Washington College of Law; his BA in government and politics from the University of Maryland.

Our final witness is Eric Smith, who serves as the President of the International Intellectual Property Alliance, IIPA, which is based in Washington, D.C. IIPA is a private-sector coalition of six U.S. trade associations which represents over 1,300 companies that produce and distribute materials protected by copyright laws throughout the world. A co-founder of IIPA, Mr. Smith frequently serves as the principal representative of the copyright industries in WTO, TRIPS, and free trade agreement negotiations. Mr. Smith has a JD from the University of California at Berkeley, a BA from Stanford, and an MA from the School of Advanced International Studies at Johns Hopkins.

We welcome you all. Without objection, your entire statements will be made a part of the record. As you know, please try to limit your testimony to 5 minutes, both because that's the rules and because we're expecting votes in about 35 minutes.

Again, we appreciate you all being here. And Ms. Espinel, we'll begin with you.

## TESTIMONY OF VICTORIA ESPINEL, ACTING ASSISTANT U.S. TRADE REPRESENTATIVE FOR INTELLECTUAL PROPERTY, OFFICE OF U.S. TRADE REPRESENTATIVE

Ms. ESPINEL. Thank you very much. Chairman and Members of the Committee, thank you for the opportunity to address your concerns over ineffective protection of intellectual property in the People's Republic of China.

As Ambassador Portman stated in his confirmation hearing testimony, we face major challenges in China. Our trade deficit, as you well know, with China last year alone was $162 billion, and part

of that deficit is because the Chinese do not always play by the rules.

Estimates on copyright piracy, for example, from the copyright software and music industries are illustrative of the scope of the problem, with reports that 90 percent of all software installed on computers and over 90 percent of the market for sound recordings in China was pirated in 2003. These disconcerting statistics are emblematic of the problems that can be found in other industries.

After being sworn in just a couple of weeks ago, Ambassador Portman immediately reiterated his commitment to enforcing our trade agreements and the international obligations of our trading partners. He has ordered a top-to-bottom review of all trade issues with China, and plans to shift resources and people as appropriate to address these pressing concerns.

I am here today because Ambassador Portman and this Administration place the highest priority on stemming the tide of IPR infringement in China. Counterfeiting and piracy in China are at record levels, and are affecting a wide range of U.S. business interests.

Our companies report billions of dollars in lost revenue, irreparable harm to their brands and future sales, all of which ultimately affects U.S. workers who design and produce legitimate products forced to compete against Chinese fakes. We want and look forward to working closely with you and your staff in combatting the theft of American intellectual property in China.

On April 29, USTR reported the results of its Special 301 out-of-cycle review on China. In this report, we concluded that while China has undertaken a number of serious efforts at the national level to address its IPR theft epidemic, particularly by amending laws and increasing raids against those selling pirate and counterfeit goods and by operating illegal production facilities, China is still not deterring rampant piracy and counterfeiting.

Piracy and counterfeiting rates in fact continue to grow, a situation that is hitting our small- and medium-size business the hardest. As a consequence, in our April 29 report we outlined a series of actions to ratchet up the pressure on China.

These include working with U.S. industry and other stakeholders, with an eye toward utilizing WTO procedures to bring China into compliance with its WTO TRIPS obligations, including the possibility of WTO litigation;

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

Elevating China onto the Priority Watch List, on the basis of serious concerns about China's compliance with its TRIPS obligations and commitments that China has made at the JCCT;

Continuing to monitor China's commitments made under our 1992 and 1995 bilateral agreements;

And intensifying the JCCT process, including the Intellectual Property Working Group which is scheduled to meet next week to significantly improve IP protection and enforcement in China.

China must expend the political capital necessary to deliver on its promise to substantially reduce IP infringement. China's Vice

Premier Wu Yi recommitted to this at the April 2004 JCCT. We will work with our counterparts on the Chinese side, beginning with the upcoming meeting of the IPR Working Group, to impress upon China that patience within the Administration and on Capitol Hill has run and now is the time for results. We will also share our technical expertise with China, where possible, to overcome the many challenges that lie ahead.

Supplementing these bilateral IP efforts, we will continue outreach activities to U.S. stakeholders and our trading partners being harmed by the growth in counterfeit and pirate goods. One avenue through which we are seeking cooperation on this shared problem is the Administration's Strategy Targeting Organized Piracy, otherwise known as the STOP Initiative.

Since the announcement of STOP in October 2004, we have been working with the Departments of Commerce, including the U.S. Patent and Trademark Office, Homeland Security, including Customs and Immigration and Customs Enforcement, Justice, and State, to build international cooperation for a series of proposals that will stop the trade in fakes.

Last month, a delegation representing these seven Federal agencies visited Singapore, Hong Kong, Japan, and Korea, generating much interest and fruitful discussions. In the coming months, we will continue our outreach so as to determine the activities that provide opportunities for cooperation to demonstrate tangible results. We would very much like China to participate in STOP, if it is prepared to do so and its participation would be useful.

On the domestic front, we will continue to work with U.S. industry to identify problems and address trade complaints related to China, as we did during the out-of-cycle review. This includes cooperating with industry on China's WTO TRIPS implementation and on the use of WTO procedures to address our serious concerns about China's compliance.

Industry's daily operations throughout the country provide us insight into China's IP regime at the local and provincial levels. We hope Congress will join us in encouraging industry's robust participation on this front, including those companies and associations representing the recording industry, motion pictures, software, chemicals, pharmaceuticals, and information technology. Their engagement and support on IP issues this year is key to our efforts to improve IP protection in China.

Lastly, we appreciate and will continue to work closely with Congress on these matters. We will press forward with the bilateral and multilateral strategy laid out before you, with the goal of improving the situation for American owners of intellectual property in China and worldwide.

We will continue to reach out to our trading partners to develop mechanisms to comprehensively combat IPR theft through multilateral fora such as APEC, the OECD, and the WTO. And we will continue to conclude agreements such as our free trade agreements that reflect the level of protection and enforcement of intellectual property in the United States.

Mr. Chairman and Members of the Committee, thank you for providing me with the opportunity to testify. I look forward to your questions.

[The prepared statement of Ms. Espinel follows:]

PREPARED STATEMENT OF VICTORIA ESPINEL

Chairman Smith and members of the Committee, thank you for the opportunity to address your concerns over ineffective protection of intellectual property rights (IPR) in the People's Republic of China.

As Ambassador Portman stated in his confirmation hearing testimony, we face major challenges with China. Our trade deficit, as you well know, with China last year alone was $162 billion. And part of that deficit is because the Chinese do not always play by the rules. Estimates on copyright piracy, for example, from the computer software and music industries are illustrative of the scope of the problem, with reports that 90 percent of all software installed on computers and over 90 percent of the market for sound recordings in China was pirated in 2003. These disconcerting statistics are emblematic of the problems that can be found in other industries.

After being sworn in just a couple of weeks ago, Ambassador Portman immediately reiterated his commitment to enforcing our trade agreements and the international obligations of our trading partners. He has ordered a top-to-bottom review of all of our trade issues with China, and plans to shift resources and people as appropriate to address these pressing concerns.

I am here today because Ambassador Portman and this Administration place the highest priority on stemming the tide of IPR infringement in China. Counterfeiting and piracy in China are at record levels and are affecting a wide range of U.S. business interests. Our companies report billions of dollars in lost revenue, irreparable harm to their brands and future sales, all of which ultimately affects U.S. workers who design and produce legitimate products forced to compete against Chinese fakes. We want and look forward to working closely with you and your staff in combating the theft of American IP in China.

On April 29, USTR reported the results of its Special 301 Out-of-Cycle Review on the IPR situation in China. In this report, we concluded that while China has undertaken a number of serious efforts at the national level to address its IPR theft epidemic, particularly by amending laws and increasing raids against those selling pirated and counterfeit goods and operating illegal production facilities, China is still not deterring rampant piracy and counterfeiting. Piracy and counterfeiting rates continue to grow, a situation that is hitting our small and medium size businesses the hardest. As a consequence, we outlined a series of actions to address our concerns:

1) Working with U.S. industry and other stakeholders with an eye toward utilizing WTO procedures to bring China into compliance with its WTO TRIPS obligations.

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

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

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

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

China must expend the political capital necessary to deliver on its promise to "substantially reduce IPR infringement." China's Vice Premier Wu Yi committed to this at the April 2004 JCCT and in our 1995 bilateral Memorandum of Understanding on IPR. We will work with our counterparts on the Chinese side, beginning with the upcoming meeting of the JCCT IPR Working Group scheduled for the week of May 22nd, to impress upon China that patience within the Administration and on Capital Hill has run and that now is the time for results. We will also share our technical expertise with China where possible to overcome the many challenges that lie ahead.

Recently, the Chinese Government has increased its efforts to promote better IPR protection in China. We expect China to demonstrate these efforts will yield tangible

results on IPR. In our OCR Report, we identified for China six specific results that in our view would be evidence that these efforts are succeeding, and have provided suggestions on how to achieve them. China must now take ownership of the problem and exercise the political leadership needed to show improvements in these areas, particularly at enhancing criminal enforcement, providing for a deterrent administrative enforcement system, allowing for fair market access for legitimate products, securing China's borders against exports of pirated and counterfeit products, protecting copyrights in the context of the Internet, and increasing the transparency of its legal system.

Supplementing these bilateral IPR efforts, we will continue outreach activities to U.S. stakeholders and our trade partners being harmed by the growth in trade of counterfeit and pirated goods originating from countries such as China. One avenue through which we are seeking cooperation on this shared problem is the Administration's Strategy Targeting Organized Piracy, or STOP!.

Since the announcement of STOP! in October 2004, we have been working with the Departments of Commerce,(including the U.S. Patent and Trademark Office), Homeland Security (including both Customs and Border Protection, and Immigration and Customs Enforcement), Justice, and State to build international cooperation for a series of proposals to that will stop the trade in fakes. Last month, a delegation representing these seven federal agencies visited Singapore, Hong Kong, Japan and Korea generating much interest and fruitful discussions. In the coming months, we will continue our outreach so as to determine the activities that provide opportunities for cooperation to demonstrate tangible results. We would very much like China to participate in STOP! if it is prepared to do so and its participation would be useful.

On the domestic front, we will continue working with U.S. industry to identify problems and address trade complaints related to China, as we did during the Out-of-Cycle Review. This includes cooperating with industry on China's WTO TRIPS implementation and on the use of WTO procedures to address our serious concerns about China's compliance. Industry's daily operations throughout that country provide us insight into China's IPR regime at the local and provincial levels. We hope Congress will join us in encouraging industry's robust participation on this front, particularly those companies and associations representing the recording industry, motion pictures, software, chemicals, pharmaceuticals and information technology. Their engagement and support on IPR issues this year is key to our efforts to improve IPR protection in China.

Lastly, we appreciate and will continue to work closely with Congress on these matters. We will press forward with the bilateral and multilateral strategy laid out before you with the goal of improving the situation for American owners of IPRs in China and world-wide. We will continue to reach out to our trade partners to develop mechanisms to comprehensively combat IPR theft through multilateral fora such as the APEC, OECD, and the WTO and will continue to conclude agreements such as our free trade agreements that reflect the level of protection and enforcement of IPRs in the United States.

Mr. Chairman and members of the Committee, thank you for providing me with the opportunity to testify. I look forward to your questions.

Mr. SMITH. Thank you, Ms. Espinel.

Mr. Fishman.

## TESTIMONY OF TED C. FISHMAN, AUTHOR AND JOURNALIST, CHINA, INC.

Mr. FISHMAN. Thank you so much. I'm honored to be here. My written statement, and my book, China, Inc., and the attached New York Times articles that I provided offer a comprehensive view of why I think the Chinese intellectual property regime is so difficult to tackle.

In my spoken remarks, I'm going to focus on why I think the problem is going to grow, and just what kind of force I think this Committee will need to encourage the United States to exert in order to overcome it. And the underlying issue there is China's growth.

The more China grows, the richer its people get, the more global its industries grow, the more difficult it is going to be to enforce

intellectual property; because there'll be more people willing to pay for pirated goods, more businesses in demand of pirated goods. This is part of China's low-cost manufacturing machine and part of its industrial growth.

Over the last 20 years, there has been no enforcement of intellectual property rights in China, virtually none. And yet, China has still attracted about a trillion dollars in foreign direct investment. It has not been a disincentive for foreign investment to date. In fact, if anything, it's been an incentive; because when the world's manufacturers move to China, they also take advantage of factories that work on machines that are created on pirated platforms, on computer-aided design work stations that run on pirated platforms, on virtually everything inside a factory that is protected by some intellectual property somewhere else. Those move to China at no cost, and are an essential part to how China produces goods for the world at low prices.

If you want to assert an intellectual property protection regime in China, you're going to have to drive a wedge in between the interest in keeping China the world's low-cost manufacturing center, and the interest in keeping the United States a vital knowledge economy in which innovation is primary.

Look at China's growth. It is impressive by any measure. It is urbanizing and industrializing at a pace faster than any country in the history of the world. Within a generation, 300 million people will move off the farm, in which there is no technology virtually and it is the most basic of economies, into a rapid urban industrializing future. Every aspect of that urban industrialized future relies in some essential way on pirated technology—every aspect of it.

And, you know, we shouldn't overlook how China's industrialization is also benefitting America's consumers. The China price, which is the lowest price available for goods in the world, has saved American consumers, on average, about $600 each a year over the last year and a half. Those numbers come from economist Gary Hufbauer at the Institute for International Economics.

And when you assert an intellectual property regime in China, you're going to see prices go up, and it's going to be the consumer that pays the price. But you're also going to have a conflict of interest among those who buy those goods in the United States. Any time you walk into a big-box store, say a large discounter, what you are seeing is seven out of ten of the goods on those shelves coming from China. Often, those goods are made on entire production lines that are created with pirated intellectual property. It is simply a fact. It is a component of the Chinese economy.

And China has very strong interests in not strengthening its IP. Do a thought experiment. If you were the leader of 1.3 to 1.6 billion people who were mostly desperately poor, in need of the world's best educational resources, in need of the world's best technology, and you could grant them this technology virtually for free, without consequence, and borrow the jewels from the rest of the world's economies and deliver them to your people, and put them on an equal plane with the world's most advanced industrial economies, would you make that choice?

That is the choice that the Chinese regime has made. And reversing that choice, or stopping that choice, requires an extreme willingness on the part of the United States to form a consensus on China, to drive a wedge between those strong interests which deliver wealth to the Chinese people, in the area of pharmaceuticals it delivers better health to the Chinese people, and in the area of education it delivers the most advanced technological products available in the world. That is a strong interest to overcome.

And yet, right now we are at a juncture. In order to save our economy and the innovative nature of our economy, we have to make that choice. Thank you.

[The prepared statement of Mr. Fishman follows:]

PREPARED STATEMENT OF TED C. FISHMAN

Let me start with two bold statements. Intellectual property is now the most important issue in the economic relations between the United and China. Convincing the Chinese to consistently enforce laws that protect intellectual property, especially intellectual property held by foreigners, will impossible without a powerful assertion of American interests. My hopes for my testimony are to explain why China's current, exceedingly loose intellectual property regime is one of the engines of the country's amazing economic growth and thoroughly in that nation's interest. I will offer what I think are the essential choices we Americans must make in addressing China's intellectual property regime, choices that often pit one strong interest—such as our interests as consumers in search of low prices—against others—such as our need to protect America's knowledge economy.

Let me describe briefly the Chinese economic miracle that must be the backdrop for this discussion. Ever since the Chinese economic reforms began in earnest a little more than two decades ago, China has been growing faster than any large economy in the history of the world. China's actual growth statistics are a source of considerable controversy, but even conservative estimates are impressive. As a nation, China has almost certainly enjoyed an average growth rate above 8 percent for two decades running. China has lifted 400 million people out of the lowest depths of poverty, and in twenty years has seen the incomes of the average household climb fourfold. In a country where recently private enterprise was strictly forbidden, and where the government owned every business, the land under every home, and even the pots, pans forks and knives in the kitchen, there are today 85 million private businesses. The United States, in contrast, has around 25 million private businesses. In other words, the Chinese Communist Party has overseen the one of the greatest capitalist flowerings the world has ever seen. It is hard for Americans to imagine leaders who proudly call themselves Communists allowing such rampant and successful commercialization, and harder still to see how communism has nevertheless informed China's transformation. Yet, when looking at how China's government will act in the future, it pays to see how the country's communist leaders act for their country's welfare, rather than to take to usual tact, which is to demonize the Communists and to see them at odds with the best interests of the Chinese people. Make no mistake: I have strong reservations about China's government and sincere hope that China will look more like our democracy over time. Even so, in the context you are addressing today, we must acknowledge, and grudgingly admire how the Chinese have improved their lot and moved to the forefront of the world's economic powers.

China's loose intellectual property regime allows the government to pass on to its citizens goods that make the Chinese people richer, smarter and healthier. They have solid reasons for doing business the way they do, and many of us would act in much the same way were we in the position the Chinese now find themselves in. Here's a simple thought experiment. Imagine you were the leader of between 1.3 and 1.6 billion people, most of them desperately poor and modestly educated. Suppose you could transfer to your people the jewels of the world's advanced industrialized nations, paying nothing for much of it and pennies on the dollar for some more. Suppose, in other words, you could steal the best technology, copyrighted materials, brand names and top entertainment for your wanting people. And imagine further that you had little expectation of being held to account for that theft. To the contrary, you would be rewarded for it. In fact, that theft would make your country an ever-more desirable home for the very international fashion, technology and knowledge enterprises you were so liberally borrowing from. Anyone here would

make that choice—the choice which the Chinese government and people made and still do make every day. One of the precepts of good leadership is to make one's people prosperous and capable, and the Chinese practices have followed that hands down. The Chinese are indisputably richer today than ever before, the use of personal computers is widespread and expert and Chinese factories routinely run on the very same software that their competitors in America use. In all, China's creation of an extremely loose intellectual property regime has paid off handsomely. It is now time we exercise what means we have to enforce global rules that will also serve the American economy.

All of Hollywood, Bollywood and even French, Italian and Russian cinema is available for a pittance in the streets of China. Everyone on this committee knows about DVD pirating, but how many have seen how the markets work in the streets of China. One soon sees why there are only a handful of movie theaters in China. Travel up a crowded escalator at the entrance to a Shanghai subway stop on a Friday evening after work, and there at the top is a woman with a medium-sized duffle bag. She steps to the side, opens the bag and with great speed lays out hundreds of DVDs of the latest American movie hits. Immediately, she is rushed by commuters who snap up the disks at $.70 a piece. There are few movie theaters in China because women with gym bags, and men with crates of DVDs on their bicycles and stores in alleys, and sometimes on busy business streets are, in essence, China's movie theaters. The trade is so open that Chinese policeman can regularly be seen rifling through the bins of DVDs shops, not shutting them down, but shopping for a weekend's entertainment.

China's lax policies on copyright protection offer the country the advantages of both bread and circuses. One expert I interviewed for my book, China, Inc. is Andrew Mertha, a political scientist at Washington University. Mertha, who has worked with Chinese and American officials on Chinese intellectual-property law, summarizes the circus side of things: "If you're the Chinese leadership, do you want people idling around in the street, complaining about how unhappy they are, or do you want them home watching Hollywood movies?" In other words, the government is slow to crack down on the piracy of entertainment products because these serve its social agenda. But is there any doubt that if vendors suddenly found a brisk market for DVD's promoting Tibetan independence or the virtues of Falun Gong, the outlawed religious sect, the DVD business would shrivel up overnight and all those anticounterfeiting laws on the books would find ready application? Indeed, when Sega's new online fantasy sports game "Football Manager 2005" had the gall to suggest that imaginary soccer leagues in Hong Kong, Taiwan and Tibet could be governed locally, rather than by the central government, China's Ministry of Culture banned the game on the grounds that it posed "harm to the country's sovereignty and territorial integrity." Fines reached $3,600.

The two most cited examples of China's disregard for intellectual property are movies sold on pirated DVDs and software copied and sold at low cost in Chinese shops. Nearly every movie, and every piece of software in China (except those used by multinational companies operating in China) is somehow stolen. It seems right to criticize these practices, but Americans must also acknowledge how we are complicit in them. Anyone who has shopped for a DVD player in an American store in the last two years knows that prices have dropped dramatically. During their first few years on the market, DVD players were manufactured by a handful of large global consumer electronics companies, and the technology that went into them was protected by patents held by a few of the companies. Any company that wanted to make a DVD player had to pay the consortium that held the patent rights a license fee. Then, about four years ago, Chinese manufacturers began to make players without paying the license fees. They simply copied the technology and assembled the machines. In fact, they added functions to the players that made them better then any others on the market. One of those function was the ability to read poor quality DVD disks, the kinds that sell out of gym bags. The original intent of the Chinese makers was to sell to Chinese consumers, who make up the largest group of consumers of recorded entertainment in the world. Soon, instead of 5 or 6 foreign companies making and licensing DVD players, their were hundreds of Chinese manufacturers turning them out. Prices dropped from nearly $1,000 to around $50. Of course, the players did not stay in China. Today, there are $26 players for sale at America's big box stores and chain pharmacies and grocers. That is roughly the price of two movies. The chipset and license fee for a DVD player costs about $11. When one sees a $26 Chinese-made player on the selves of a discount store or drugstore, it is worth wondering how it could get there unless there were winks and nudges from American retailers who insist on ever-lower prices from their Chinese suppliers, but do not always insist that the goods they buy have the proper IP bona fides.

The motion picture industry and the American software industry suffer in China. I have noticed, however, that when I bring up the issue of counterfeiting and piracy in China it is almost impossible to get the average American to feel pity for Hollywood or for software giants like Microsoft. Or even for big pharmaceutical companies that face their own China challenges. There is group for whom there is lots of sympathy, however. It is American manufacturers who face intense competition from China's low-cost manufacturing machine. And it is this group that may suffer the most from China's lax intellectual property regime.

American companies are not just creators of intellectual property, they are buyers of it. It can cost millions, or tens of millions or dollars to purchase and service the software to run an American company. Yet, Chinese competitors often pay nothing for the same technology, because it is simply stolen. Walk into the vast majority of Chinese firms that run computers and one will see one work station after another stuffed with $2 version of software that costs Western competitors hundreds of dollars to run. Or walk into any company that designs and manufactures highly engineered parts. A metal caster that has built a reputation for making precision parts—the kind that American companies excel at—typically designs its parts at engineering work stations manned by highly trained engineers who run proprietary software that can cost $50,000 to $60,000 a year to run. It is likely to have several such workstations, perhaps dozens or hundreds. Chinese competitors run the same software, but they are unlikely to have paid anything for it. It is easy to understand how low-cost labor contributes to China's low-cost manufacturing. So far, the low-cost of technology has been entirely overlooked. I cannot offer numbers of the total cost of this mismatch, but it is an essential part of the dynamic that drives manufacturing to China. The cost would almost certainly dwarf the losses in sales suffered by Hollywood or the software industry. As China moves up the economic feeding chain, this level of piracy will play against American companies more and more. Our economic health demands that we address this. One place to look is toward American companies that bring in Chinese-made goods that are made on pirated platforms. That's a daunting task, because nearly everything America buys from China achieves some of its cost competitiveness from China's loose intellectual property regime.

China's loose intellectual property rules also transfer to Chinese industry valuable intellectual assets that can take American companies years and cost significant sums to develop. American automobile makers can spend half a billion dollars developing and building anew car, and take two years to do it. As soon as the car hits the market, Chinese manufacturers study it and look at how to copy it. Chery Motors, the company which will soon introduce Chinese built cars into the U.S. market has been accused by General Motors of pirating an entire GM car and beating GM to market with the Chery copy. It is not unusual for whole assembly lines to get duplicated in China, where the copiers need not worry about the cost of developing and designing the lines. Big business in the U.S. is vulnerable, but so are smaller firms where often one good idea, patented or kept proprietary in some other fashion, is the only truly valuable asset the firm has.

China's failure to police its intellectual property rules often looks less like ineffective government than a conscious policy to shift the highest value goods from other economies into the country. It is, in essence, the largest industrial subsidy in the world, and brilliantly, it costs the Chinese nothing. In 2005, China will most likely be the world's third-largest trading nation, and counterfeiters give the country's increasing number of globally competitive companies the means to compete against powerful foreign rivals that pay for their use of proprietary technologies. In a broader geopolitical context, China's counterfeiters deny the world's advanced economies, especially in the U.S. and Japan, the opportunity to sell to China the valuable designs, trademarked goods, advanced technology and popular entertainment that the Chinese urgently desire but cannot yet produce on their own. For the U.S., this mismatch is particularly punishing. Japan and Germany, which also suffer from China's policies, do not have the huge trade deficits with China that the U.S. does. One reason is because our export economy is far more dependent on the sale highly valuable, intangible and easily copied goods. Japan and Germany make the machines China needs to run. America makes the software that runs those machines. It is far more difficult for us to paid by Chinese users for what we make, though most of the rest of the world pays handsomely for it. Until we can get paid for what we make and the Chinese use, our deficits will worsen, not improve. Say, for example, that the value of the dollar drops against the Chinese yuan. Economists predict our trade situation will level out, but do not take into account that no matter what our goods cost, the Chinese will most likely continue to pay nothing for some of the most useful goods we make. And, as a result, their factories will continue to be able to beat even the most efficient American factories on price.

We now have a golden moment in which we can still use our power as China's most important customer to enforce a change in its intellectual property regime. Action ought to be forceful and unequivocal. Our trade deficit with China alone—not counting the rest of our trade with the country—is more than ten percent of the entire Chinese economy. That is an astonishing figure, and in it we can find strength to exert rules over our trade with China. That may require a radical rethinking of past agreements, some brinksmanship with quotas and tariffs and other remedies. Without action, however, the U.S. is likely to find our entire economy copied in China and Americans paid little for the brainwork imported to make it run.

Mr. SMITH. Thank you, Mr. Fishman.

Mr. Brilliant.

**TESTIMONY OF MYRON BRILLIANT, VICE PRESIDENT, EAST ASIA, U.S. CHAMBER OF COMMERCE**

Mr. BRILLIANT. Mr. Chairman, Members of the House Judiciary Subcommittee, good morning. The U.S. Chamber appreciates your invitation today to appear at this important hearing on China's intellectual property record.

As the world's largest business federation, representing more than three million businesses, the U.S. Chamber of Commerce is keenly aware of the global threat of counterfeiting and piracy to American firms and workers. Counterfeiting and piracy is not a victimless crime. Counterfeiting and piracy are costing the U.S. consumers and American companies billions of dollars every year, and those numbers are going up.

It damages investment and innovation, has devastating economic consequences for small businesses, puts a severe strain on law enforcement agencies, nearly always escapes taxation, threatens public and health safety, diverts government resources from other priorities, and has links to terrorism and organized crime.

IP theft will continue to be rampant without a concerted effort on the part of business and government. The U.S. Chamber has launched a three-part strategy aimed at mobilizing business and government to fight against counterfeiting and piracy. As part of our efforts, we have launched country-specific IPR initiatives in China, Brazil, Russia, India, and Korea, where the problems are particularly acute for American companies.

Let me now turn to offer specific views on China, the subject of today's hearing. The U.S. Chamber fully recognizes the importance of China's successful integration into the world economy. U.S.-China trade has boomed in recent years since China's accession into the World Trade Organization. U.S. exports to China have grown by 114 percent since 2000, five times faster than exports to any other country.

While the U.S.-China commercial relationship is of immense and growing importance to our membership, the U.S. Chamber feels strongly that China must do significantly more to comply fully and on time with its WTO, World Trade Organization, commitments; and in particular, in critical areas such as intellectual property rights.

And we are communicating our views directly to the Chinese. This week, U.S. Chamber President and CEO, Tom Donohue is visiting Beijing with a business delegation for high-level delegation discussions with the Chinese government, including Premier Wen Jiabao and Minister Bo Xi Lai, and talking to the Chinese about

the need for more tangible immediate steps to crack down on counterfeiting and piracy.

Next week, we will play host to a senior Chinese IPR delegation led by Vice Minister Ma Xiuhong, and we will again use the opportunity to seek clarification and assurances about their enforcement efforts.

Where do we stand? It is clear that the protection which China is actually providing fails to meet the standards of effectiveness and deterrence set out in the WTO TRIPS Agreement. IPR violations in China now severely affect all American industries, from consumer industrial goods, including medicine; to autos and auto parts, food and beverages and cosmetics; to copyright works, including entertainment and business software, movies, music, and books.

China is the single largest source of counterfeit and pirated products worldwide, and we believe that the scope of counterfeiting and copyright piracy in China worsened for most of our member countries in 2004. Infringement levels are at 60 to 90 percent, or even higher, for virtually every form of intellectual property in China. In the copyright industry alone, for instance, USTR estimates U.S. losses are between 2.5 billion and 3.8 billion annually.

The U.S. Chamber was heartened by the promises of Vice Premier Wu Yi at the April 20, 2004 Joint Commission on Commerce and Trade meetings, on the intention of the Chinese government to significantly reduce IPR violations. We acknowledge that the PRC government is taking important and constructive steps to improve coordination.

In a further positive development, we acknowledge that they have issued a long awaited judicial interpretation that covers frankly criminal prosecutions—could cover—and could strengthen, deter, and impact China's criminal enforcement efforts in the IP field.

In 2004, China's government modestly improved its regulatory environment for IPR protection, and carried out raids and other enforcement actions at the central, local, and provincial levels.

Administrative penalties, however, mainly limited to fines and confiscation of fake products, remain too small to create deterrence. And despite some signs that new efforts are underway in 2005, China has not significantly reduced IPR infringement levels as Vice Premier Wu Yi promised at last year's JCCT meeting.

The U.S. Chamber remains concerned that the limited legal reforms and enforcement campaigns which commenced in China in 2004 are insufficiently bold. If tangible progress is not made in the months ahead, we believe that USTR should conduct a second Special 301 out-of-cycle review of China later this year, to assess China's implementation of the judicial interpretation and other enforcement efforts.

We would encourage the U.S. Government to continue to work through the JCCT and through other appropriate forums in the months ahead to identify specific action items for China to undertake. Those are outlined in our written testimony, but in the interest of time, I would note that we will be looking in particular to see if the Chinese take steps to add police resources in critical regions; criminalize export-related cases; introduce new enforcement

guidelines that will significantly boost fines and other penalties imposed by administrative enforcement agencies. We want to see significant increases in the number of criminal IPR investigations, prosecutions, convictions, and deterrent sentencing.

Let me just briefly touch upon Russia, the subject of the second hearing, as I was asked to do by the Committee. Russia's efforts to join the World Trade Organization in 2005 gives the U.S. Government a critical window of opportunity to seek from that country important commitments and progress on IPR enforcement. There is no question Russia's IPR problems, like China, are growing, and this is of concern to our membership.

We fully support USTR's decision to keep Russia on the Priority Watch List and to conduct an out-of-cycle review to monitor Russia on IPR in 2005, but—but—the U.S. Chamber also encourages our government to make it a priority to engage Russia on how that country will improve its IPR enforcement efforts in the context of its WTO accession talks. We must not lose that opportunity.

Thank you, Mr. Chairman, Members of the Committee. The U.S. Chamber and our members appreciate the opportunity to participate in today's House Judiciary Subcommittee hearing on intellectual property rights. Given the importance of this matter to the American business community, we look forward to staying engaged with this Committee. Thank you.

[The prepared statement of Mr. Brilliant follows:]

PREPARED STATEMENT OF MYRON BRILLIANT

Mr. Chairman, members of the House Judiciary Subcommittee, good morning. The U.S. Chamber appreciates your invitation to appear at this important hearing today on the importance of intellectual property rights to American companies.

As the world's largest business federation representing more than 3 million members, the U.S. Chamber of Commerce is keenly aware of the global threat of counterfeiting and piracy to American firms and workers. In the Information Age, intellectual property (IP) is the "gold standard." It must be protected as it is the cornerstone for economic prosperity in this new era. Yet, IP is under attack here in the United States and globally.

The problem goes by many names—counterfeiting, piracy, or knockoffs. The fact is the problem is getting worse worldwide. IP theft will not go away without a concerted effort on the part of business and government.

BREADTH OF THE PROBLEM

Counterfeiting and piracy are costing the U.S. consumers and American companies billions of dollars every year. But the problem is more insidious than that. It damages investment and innovation; has potentially devastating economic consequences for small businesses; puts a severe strain on law enforcement agencies; nearly always escapes taxation; threatens public and health safety; diverts government resources from other priorities; and has links to terrorism and organized crime.

Counterfeiting and piracy, once viewed, as "victimless" crimes mainly consisting of selling cheap products such as sunglasses and watches, have mushroomed in recent years to endanger every product. From dangerous substandard replacement parts for airplane engines, to ineffective pharmaceuticals, to illegally copied compact discs manufactured in clandestine factories around the world, sales of counterfeit and pirated products are skyrocketing. Profits from these illicit sales are being funneled worldwide into the pockets of everyone, from groups associated with known terrorists to organized crime elements.

The problem of counterfeiting and piracy goes beyond the manufacture, distribution, and sale of cheap, unauthorized goods. It threatens our national security, lessens the value of legitimate brand names, and erodes the profits of nearly every business in America.

Some statistics might be helpful to illustrate the magnitude of the problem we face today. Approximately 5% to 7% of world trade is in counterfeit goods, according

to the FBI, Interpol, and the World Customs Organization. That's the equivalent of as much as $512 billion in global sales. Of that amount, U.S. companies lose between $200 billion and $250 billion in global sales. U.S. Customs and Border Protection estimates that counterfeit merchandise is responsible for the loss of more than 750,000 American jobs. Finally, we would note that the World Health Organization (WHO) has estimated that counterfeit drugs account for 10% of all pharmaceuticals. Incredibly, in some developing countries, WHO suggests that this number is as high as 60%.

These statistics exemplify the U.S. Chamber's concerns about the growing epidemic of IP theft globally. It is time to act, to take real measures to thwart the growing threat of counterfeiting and piracy.

THE U.S. CHAMBER: MAKING A DIFFERENCE

The U.S. Chamber has launched a three-part strategy aimed at mobilizing business and governments to fight against counterfeiting and piracy.

Part one is education. We are working in the United States to educate businesses, the media, and lawmakers about the growing threat of this issue.

Part two is enforcement. The U.S. Chamber is committed to bringing these criminals to justice. We are working with manufacturers, retailers, and law enforcement to disrupt the ability of counterfeiting networks to use legitimate distribution channels.

As part of our efforts, the U.S. Chamber established the Coalition Against Counterfeiting and Piracy (CACP) with the National Association of Manufacturers (NAM) to coordinate the efforts of the business community to stop counterfeiting and piracy. CACP is committed to increasing the understanding of the negative impact of counterfeiting and piracy by working with Congress and the administration to drive government-wide efforts to address this threat.

Part three is international. The roots of counterfeiting and piracy extend far beyond U.S. borders. The U.S. Chamber therefore recognizes the importance of tackling this issue in foreign markets. We have launched country-specific initiatives in priority countries, where the problems are particularly acute for American companies. Our initial efforts have focused on China, Brazil, Russia, India and Korea. But we will also be working with our members in other countries where the problem is also prevalent.

The remainder of my testimony will focus on our efforts in the international arena, in particular, on China and Russia which is the focus of today's hearing.

CHINA

The U.S. Chamber fully recognizes the importance of China's successful integration into the world economy. It is perhaps the greatest foreign policy challenge facing our country today.

*China as an Opportunity and a Challenge*

As we noted previously during a recent Congressional hearing on U.S.-China economic relations, it is now trite to say that the U.S.-China commercial relationship is of immense and increasing importance to both the U.S. and Chinese business communities. U.S.-China trade has boomed in recent years. The United States ranked second among China's global trading partners in 2004, and China was once again the 3rd largest trading partner for the United States. U.S. exports to China have grown by 114% since 2000—five times faster than exports to any other country.

Year-on-year increases of U.S.-manufactured exports from 2003 to 2004 reveal positive trends: exports of U.S. power generation equipment increased by 34%; exports of electrical machinery and equipment increased by 27%; and exports of optics and medical equipment jumped by more than 30%. These statistics underscore the opportunities that China offers to U.S. exporters, to investors, and, more broadly, to U.S. economic development.

Yet, we also recognize that concerns are rising in many quarters over the U.S. trade deficit with China, rising competition from Chinese imports, and concerns about China's currency policy. The U.S. Chamber feels strongly that China must do significantly more to comply fully and on time with its World Trade Organization (WTO) commitments and, in particular, in critical areas such as intellectual property rights (IPR).

In our view, China has failed to adequately enforce its own laws and regulations when it comes to piracy and counterfeiting violations. This is an endemic problem with immense consequences for the U.S. economy, our companies, particularly for small and medium-size businesses, and public safety. We are committed to construc-

tive engagement with the Chinese government on this and other issues; however, we want to see China move beyond words to actions that crack down on IPR infringements.

This week, U.S. Chamber President and CEO Thomas Donohue is visiting Beijing with a business delegation for high-level discussions with China's government and business community. In particular, Mr. Donohue will be building upon recent discussions with Chinese officials in Washington, D.C. and China on the full range of issues in our commercial relationship, including the issue of IP protection and enforcement.

*China's WTO Implementation Efforts*

Briefly, let us turn to China's overall efforts to develop a market based on the rule of law and in accordance with WTO principles and disciplines.

Now in year four of China's WTO implementation, the U.S. Chamber believes that China's WTO implementation process is fostering positive changes in its trade and investment regimes.

We agree with the United States Trade Representative's (USTR's) December 2004 report to Congress, which stated that China "deserves due recognition for the tremendous efforts made to reform its economy to comply with the requirements of the WTO." Moreover, we continue to believe firmly that engaging China in the rules-based trading system has resulted in important progress in key areas, particularly in tariff reduction, revising existing laws and drafting and passing new ones as well as educating its officials and companies about its WTO obligations.

Positive steps by China to implement outstanding and new WTO commitments not only improve the Chinese business environment for the benefit of U.S. and Chinese companies alike, but also underscore China's broader credibility in the global trading system. If China falters in meeting its commitments and its adherence to WTO disciplines, such as in the areas of intellectual property (IP) and transparency, there will be ramifications that will constrain the full potential of this relationship to the detriment of both countries as well as companies from both countries.

*Intellectual Property Rights*

Upon its accession to the WTO over three years ago, China agreed to fully comply with Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement obligations. Yet, it is clear that the protection which China is actually providing fails to meet the standards of "effectiveness" and "deterrence" set out in TRIPS. IPR violations now severely affect virtually all industries, from consumer and industrial goods—including medicines, autos and auto parts, food and beverages, and cosmetics—to copyright works, including entertainment and business software, movies, music, and books. The scope of counterfeiting and copyright piracy in China worsened for most of our member companies in 2004, and we believe that this problem has reached epidemic proportions.

China is the single largest source of counterfeit and pirated products worldwide. Failure to control exports of these products is eroding our companies' profit margins, diminishing brand value, and, in many cases, endangering public safety. U.S. Customs statistics showed an increase of 47% in the market value of counterfeit goods seized in the year ending October 31, 2004. Statistics compiled for 2004 by other governments are expected to reflect a similar trend.

Increasingly, counterfeiting in China is harming small and medium-size U.S. enterprises. Many of these SME's do not have operations on the Mainland and confront a flood of Chinese knockoffs in the U.S. market or in third-country markets where they export. Smaller companies clearly have fewer resources to deal with investigations and legal action against pirates in China and their middlemen in other countries. Thus the need for more convincing and proactive government intervention is becoming increasingly apparent.

The U.S. Chamber was heartened by the promises of Vice Premier Wu Yi at the April 2004 Joint Commission on Commerce and Trade (JCCT) meetings on the intention of the Chinese government to significantly reduce IPR violations. We also acknowledge that the PRC government, at the central level and under the leadership of Vice Premier Wu Yi and the Market Order Rectification Office of the Ministry of Commerce, is taking important and constructive steps to improve coordination among relevant agencies responsible for IP protection and enforcement.

The U.S. Chamber also notes some recent progress in the Chinese government's willingness to engage directly with companies and industry associations in addressing problem cases and cooperating on capacity-building.

In a further positive development, China's Supreme People's Court and Supreme People's Procuratorate issued a long-awaited Judicial Interpretation on December 21, 2004. This interpretation included a number of important changes that can

strengthen the deterrent impact of China's criminal enforcement efforts in the IP field.

Regrettably, though, the Judicial Interpretation contains a number of problems that leave potentially gaping loopholes for infringers, and industry is closely monitoring their impact. Key examples include the following:

- Unclear methods for calculating case values, including the lack of standards for valuing semifinished products and raw materials.
- Lack of clarity whether trading companies caught dealing in fakes can be held criminally liable for counterfeiting and piracy.
- Lack of provisions to clarify the conditions under which vendors and accessories meet the requisite knowledge requirements to be held criminally liable.
- Lack of provisions to criminalize repeat offenses by smaller-scale infringers.
- Whether sound recordings are even covered by the Judicial Interpretation.
- Significantly higher monetary thresholds for enterprises than for individual persons.

As the U.S. Chamber stated in its fall 2004 report on China's WTO implementation record, enforcement of IPR will not be effective until civil, administrative, and criminal penalties are routinely applied to IPR infringers. China's government modestly improved its regulatory environment for IPR protection and carried out raids and other enforcement actions at the central, local, and provincial levels in 2004. Administrative penalties, however, mainly limited to fines and confiscation of fake products—remain too small to create deterrence. Despite some signs that new efforts are under way (and there is an increased level of arrests and raids), China has not "significantly reduced IPR infringement levels" as Vice Premier Wu Yi promised at last year's JCCT meetings.

The U.S. Chamber remains concerned that the limited legal reforms and enforcement campaigns, which commenced in China in 2004, are insufficiently bold. More focused action plans are needed at both the national and local levels in order to bring counterfeiting and copyright piracy under control. While it will take time to design and implement such plans, we do not yet see a commitment on the part of the Chinese to developing them.

Based on inadequate levels of IPR protection and enforcement in China, causing adverse impact on U.S. economic interests, the U.S. Chamber recommended earlier this year that USTR request consultations with China through the WTO and place China on the Priority Watch List in its 2005 Special 301 Report.

USTR elected a slightly different approach. As noted in its Special 301 Report released in April, USTR elevated China to the Priority Watch List for "failure to effectively protect IP rights and to meet its commitment to significantly reduce infringement levels." While USTR did not act to immediately take China to the WTO for consultations, it did clearly note that it will work with American business to establish the basis for utilizing WTO procedures to bring China into compliance if infringement levels remain unacceptably high and if China fails to take robust enforcement actions.

The U.S. Chamber welcomes working with USTR and other government agencies further on this important issue. We believe that USTR should conduct a second Special 301 Out-of-Cycle Review of China later this year to assess China's implementation of the Judicial Interpretation and other enforcement efforts. Particular focus should be on reviewing the value of adding police resources in critical regions, criminalizing export-related cases, and introducing new enforcement guidelines that will significantly boost fines and other penalties imposed by administrative enforcement authorities.

In reporting its findings, USTR noted that overall counterfeiting and piracy rates are not declining since China's WTO accession. Some alarming statistics underscore our need to see more immediate robust actions in China.

According to submissions made to USTR, infringement levels are at 90 percent or above for virtually every form of intellectual property in China. In the copyright industry alone, USTR estimates U.S. losses are between $2.5 billion and $3.8 billion annually. U.S. Chamber members in this area also note that internet piracy is quickly becoming an immense threat and serves to remind us that the lost sales could be even higher in years to come if the problem is not addressed.

The problem is not unique to industries impacted by piracy. USTR observed that in 2004 the "value of Chinese counterfeits coming into U.S. markets seized by the United States increased 47 percent from US$94 million to US$134 million." Seizures from China accounted for 67 percent of all U.S. Customs' IPR seizures in 2004.

Given the facts noted above, the U.S. Chamber and its members seek convincing evidence from Chinese authorities that the IPR climate is improving and creating

a climate of deterrence. This should include data that confirms a much more substantial increase in proactive government investigations into cases, and substantial increases in prosecutions, convictions, and incarcerations of counterfeiters and copyright pirates.

Aside from liaising with China in the WTO context, the U.S. Chamber strongly supports continuing efforts by the U.S. government to address China's failure to comply with its IPR commitments through the JCCT, other bilateral forums, and multilateral policy mechanisms. The U.S. government should continue to work through the JCCT and through other appropriate forums in the months ahead to identify specific action items for China to undertake that:

(a) Demonstrate a significant increase in the number of criminal IPR investigations, prosecutions, convictions and deterrent sentencing;

(b) Implement administrative IPR enforcement actions that are deterrent;

(c) Demonstrate specific steps to combat copyright and trade infringing activities, including internet piracy;

(d) Make public available case rulings and IPR-related statistical data;

(e) Demonstrate steps Chinese customs authorities are undertaking that are leading to significant declines of exports of infringing products;

(f) Ensure that China removes administrative and other market access impediments that support illegal infringing activities and prevent the sales of legitimate foreign products; and

(g) Resolve high profile cases involving infringements of foreign IP owners thus establishing the primacy of the rule of law.

If China were to take such actions, tangible results could be achieved.

*U.S. Chamber Action Plan*

The U.S. Chamber is prepared to support the Chinese and U.S. governments in its efforts to extend greater protection to foreign and Chinese IP owners. We have embarked on a targeted program offering on the ground capacity—building efforts in the provinces, fostering public awareness of the importance of IPR protection among the Chinese public, and advising on policy changes to better strengthen the legal framework.

The four main components of the U.S. Chamber action plan include:

(1) Spearheading high level dialogues with Chinese business and government leaders including here in Washington DC in late May with the Vice Minister of MOCOM and other ministries on IPR;

(2) Engaging local and provincial Chinese leaders on best practices, judicial and administrative training or related educational programs;

(3) Benchmarking progress with our American Chamber of Commerce in Beijing;

(4) Promoting public awareness in China by implementing a media strategy for re-branding IPR as not a "victimless crime."

To achieve these goals, the U.S. Chamber is also working closely with U.S. and Chinese governments, our corporate members, and counterpart associations, including with the AmCham network in China.

As noted above, we want to benchmark China's progress in implementing the new Judicial Interpretation through monitoring the number of judicial prosecutions, convictions, and jail sentences for IP crimes in 2005. In addition to monitoring the criminal enforcement, we want to collaborate with these partners to track enforcement by administrative authorities, including administrative fines, confiscations of production equipment, export enforcement, and the success of the government in transferring cases from administrative enforcers to the police for criminal prosecution.

*Looking Ahead*

In our view, the burden of ensuring a reduction in China's piracy and counterfeiting levels in 2005 will ultimately hinge on the political will of local Chinese authorities as much as the national government. Police investigations into new cases need to be proactive and adequately resourced in order to send a proper message to criminal networks that are increasingly behind the problem.

The sincerity of China's pronouncements that it is serious about protecting and enforcing IP rights will further be tested by its willingness to eliminate loopholes for infringers in existing and new regulations and to resolve high-profile cases, such as the Pfizer patent case on Viagra and the General Motors auto case, that impact domestic and foreign IP owners.

Full protection under PRC law and enforcement of IPR in China as set forth in China's TRIPS obligations are critical to the interests of foreign and PRC companies

in China, as well as to China's public health and safety, the integrity and attractiveness of China's investment regime, and its broader economic development goals. We hope that the PRC government will accelerate IP enforcement in 2005 by further enhancing national leadership and dedicating additional capital and resources. Only through aggressive measures will China's IPR protection enforcement regime be effective and respected.

China's accession to the WTO afforded it an opportunity to sell increasing quantities of products where it has a comparative advantage to the United States. But by tolerating massive counterfeiting and piracy, China is denying U.S. companies the chance to do the same in China. Moreover, by tolerating the export of such counterfeits, China strips our companies of the opportunity to use their comparative advantage—and thus WTO benefits—in third countries as well.

Ultimately, it is essential that China purchase the foreign IP-based products it is illegally using. That would translate into billions of dollars in sales and exports by U.S. and other foreign companies and more accurately reflect the balance of trade between the U.S. and China.

RUSSIA

In addition to China, the U.S. Chamber has great interest in seeing significant progress in Russia's intellectual property enforcement efforts. This is made all the more pressing as Russia proceeds toward entry into the World Trade Organization (WTO) in 2005. This process gives the U.S. government a critical window of opportunity to require that, as part of its WTO accession, Russia make considerable efforts on its IPR-related commitments and their implementation.

Unfortunately, the sense of urgency that we all feel here today does not appear to fully register in the upper echelons of the Russian government. The Russian government has acknowledged that there is an intellectual property problem in Russia, and it has created government commissions and introduced meaningful legislation. However, new laws are not enough. The governmental commissions have so far achieved little and there is no consistent political will to address the real fundamental issues such as:

1) Better enforcement at all levels (e.g., customs, police, etc.);
2) Educating the public; and
3) Making IPR a priority public policy issue that needs to be addressed immediately.

In short, the IP problem in Russia is not the law, except for geographical indications and a few other issues, it is enforcement.

The U.S. Chamber believes that Russia is at a critical crossroads, where it can turn from the significant source of IPR violations it is today, to becoming a key partner in the ongoing global efforts to safeguard IPR as the foundation of innovation. At the eve of its accession to the WTO, Russia faces a critical choice, where it can choose to invest in research and development and expand its intellectual assets, or go the other direction. The U.S. Chamber is committed to a constructive engagement with the Russian Federation to help it make the right choice and reform before it is too late.

The U.S. Chamber is therefore actively supporting and engaging with companies, government agencies, officials, business associations, especially the American Chamber of Commerce in Russia, and other groups dedicated to IPR protection and enforcement in Russia, especially the Coalition for Intellectual Property Rights (CIPR). The goal is to encourage the Russian government to take steps that will achieve tangible results in the fight against this economic plague.

*Dimensions of the IP problem in Russia:*

Although there is much need for better and more comprehensive statistical information on IP issues in Russia, the following trends should be highlighted.

Clearly, there is a sense in the American business community that the Russian government has recognized that it has an IP problem. However, we feel that there is no consistent will to address the real fundamental issues such as better enforcement, educating the public, and making IPR a priority policy issue that needs to be addressed immediately.

As part of its 2004 reorganization, the Russian government restructured the regulatory structure for IP regulation and enforcement. Many Russian government officials who were IP experts and dealt with IP issues were removed from their positions. In their place appeared new officials with less knowledge and experience on major issues affecting industrial property and copyright protection. Other administrative changes resulted in decreased enforcement. There is also a latent lack of co-

ordination between government agencies, which further worsens the problem. In addition, there is no strong political will to address IP issues from the top down in the Russian government.

IP rights-holders and consumers take very little action to defend their rights and resolve their problems. The Russian government clearly needs to focus on educating the public, and the business community needs to motivate its customers and its companies to become more involved in this issue.

The U.S. Chamber believes that IP violations are truly a global crime issue, and that no country can solve the problem alone, especially due to widespread border control issues. Russian IP problems are having a direct impact on other former Soviet republics, notably in Ukraine, in Eastern and Western Europe (countries now part of the European Union), and in the Middle East. Fake goods are produced in Russia, but Russia is also a transit point for fake goods made in Asia, notably China.

Russia's exports of counterfeited and pirated product to the United States and other markets have a significant effect on the U.S and our businesses.

*Statistics on IP in Russia:*

USTR noted in its 2005 301 Report that:

"Certain aspects of Russia's IPR regime, including enforcement and data protection, appear to be inconsistent with Russia's obligations under the 1992 U.S.-Russian Federation Trade Agreement and thus would not conform to obligations which Russia needs to fulfill in order to join the WTO."

USTR 301 Report points to staggering figures concerning piracy, which corroborate the urgency of the actions mentioned above. "Piracy in all copyright sectors continues unabated, and the U.S. copyright industry estimated losses of $1.7 billion in 2004." "The U.S. copyright industry reports the following levels of piracy: 66% in the recording industry, 80% in the motion picture industry, 87% for business software, and 73% for entertainment software."

USTR 301 Report does not emphasize trademarks as an IP problem in Russia; however, industry associations, like the Moscow-based Coalition for Intellectual Property Rights (CIPR), have reported that trademarks violations (particularly counterfeits) are today no less important.

Russian government officials acknowledge that there is an IP problem, while also acknowledging that they have no good data to detail the scope of the problem. According to the Russian Agency for Patents and Trademarks (Rospatent) official 2004 data, the turnover of counterfeit goods on the Russian market is 80 to 100 billion rubles (US$2.89 to $3.61 billion), and the government's budget loses up to 30 billion rubles (US$1.08 billion) in tax revenue. Russian Federation Deputy Head of the Federal Service for Consumer Rights Protection, Nadyezhda Nazina, spoke at an IP related Parliamentary hearing to the Russian Federation State Duma in November 2004. She stated that counterfeit and false products on the market are likely between 30% and 40%. Some Russian experts have speculated that counterfeit and pirated products make up at least 60% of the retail "grey" market in Russia.

We believe that Russian officials do not yet really have a full picture of the scope of the problem in their market. This is supported by statements made in March 2005 by Russian Federation Deputy of Culture and Mass Media, Leonid Nadirov, to the press when summarizing the results of a meeting of the governmental commission to fight IP violations. He stated "we ourselves can't imagine how much counterfeit products are produced in Russia, in what geographic regions the production is occurring in, how much money is being stolen and how much taxes have not been paid." However, Mr. Nadirov said that by October 2005, the government "should receive a real picture of the market situation, so that we can, in an understandable language, communicate with partners both inside the country and internationally."

The U.S. Chamber encourages our government to make it a priority to engage Russia on how that country will improve its IPR enforcement efforts and data protection. We also fully support USTR's decision to keep Russia on the Priority Watch List and to conduct an "out-of-cycle" review to monitor Russia on IPR in 2005.

## CONCLUSION

The U.S. Chamber and our members appreciate the opportunity to participate in today's House Judiciary Subcommittee hearing on intellectual property rights.

As noted at the outset, IP theft is a global problem. Business and governments need to continue to work together to address the growing proliferation of intellectual property theft in the United States and globally. Once seen as a threat mainly to a few select industries, today, the theft of intellectual property is now so widespread

that it touches nearly every industry and every country, including China and Russia.

It is not a victimless crime. It hurts legitimate established businesses, innovators, consumers, and governments that lose tax revenues.

With particular regard to China, we note that while China is now the fastest-growing trading partner of the United States, it also the single largest source of counterfeit and pirated products worldwide. Rapidly expanding bilateral economic and commercial ties underscore the market opportunities that China potentially offers to U.S. exporters and investors, which support the creation of high value-added jobs at home. Yet, the failure of Chinese authorities to date to crack down effectively on the manufacture, distribution and export of counterfeited and pirated products is eroding legitimate Chinese and foreign companies' profit margins, diminishing brand value, and, in many cases, endangering public safety.

China can and must do more to stop IP theft. The U.S. business community and others that vigorously advocated China's WTO membership premised their support on expectations that China is evolving into a more open and transparent market based on the rule of law. China's unsuccessful efforts to consistently enforce its IPR laws and to vigorously deter IP theft represent the most visible examples of these expectations remaining unfulfilled.

Similarly, we believe that Russia should take aggressive steps to stem its counterfeiting and piracy problem. Our government should require Russia to show demonstrable evidence of efforts to crackdown on counterfeiting and piracy before it formally supports that country's accession into the WTO. This is an important opportunity to encourage more tangible actions on the part of Russia.

The U.S. Chamber, the world's largest business organization, will remain fully engaged on doing our part in waging a campaign against counterfeiting and piracy on behalf of American business. We will continue to lend our strong voice to ensure that China, Russia, and other countries take even more robust measures in this critical area.

Thank you, Mr. Chairman and members of the committee, for the opportunity to express the views of the U.S. Chamber and our members on this important topic. Be assured the protection of IP is a top priority of our organization and we look forward to working with the members of this Committee and Congress in finding constructive solutions.

Mr. JENKINS. [Presiding.] Thank you, Mr. Brilliant.

We'll now hear from Mr. Eric Smith.

## TESTIMONY OF ERIC H. SMITH, PRESIDENT, INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE

Mr. SMITH. Chairman Smith, Ranking Member Berman, Members of the Subcommittee, it's an honor to appear before you at this very timely moment, shortly after USTR elevated China to the Priority Watch List, and just a few days before the Chinese IPR working group arrives in Washington to continue a dialogue with the U.S. Government on China's enforcement of IP rights and its failure to accord broader market access to U.S. copyright industries. We know that they will be listening to what this Subcommittee says about the current situation in China.

Mr. Chairman, the copyright industries—business and entertainment software, filmed entertainment, recordings, and books and journals—are in dire straits in China. Piracy rates have hovered at over 90 percent in the more than 15 years that IIPA has been engaged with the U.S. and the Chinese governments.

Indeed, with new digital copying technologies and the Internet, the situation has even worsened. Every year, industries have lost conservatively between one and a half and two and a half billion dollars; in 2004, it was over two and a half billion dollars. These losses will grow unless this unacceptable situation is quickly reversed.

Before I elaborate on the difficult situation our industries face in China, let me note again what we have said before. The copyright industries now represent over 6 percent of U.S. GDP, and that number increases every year. We employ 4 percent of the U.S. workforce, and generated in 2002 over $89 billion in revenue in export—from exports and foreign sales.

This growth is fueled by the huge global demand for U.S. creative and high-tech products, with 50 percent of our revenue generated coming from international trade. It is the ability to enter and prosper in foreign markets that will allow us to continue this growth and employ new highly-paid workers at a rate that is double the economy as a whole.

In trade jargon, the U.S. has a huge comparative advantage in trade and copyrighted products. But as we know, in China, potentially the largest market in the world, that advantage hasn't even begun to be realized; while, as we know, China is continually taking advantage of their comparative advantage in so many areas, with a trade surplus of $162 billion.

Of all the industry sectors represented in the U.S. economy, the copyright industries face a market more closed to them than to any other. Not only are nine-tenths of the Chinese market closed through piracy, but our industries suffer under onerous and sometimes discriminatory market access barriers. China's denial of effective market access prevents us from getting to know the market and establishing a presence that would enhance our ability to fight piracy.

Even if we were to reduce piracy by half in China, under the present circumstances, most of our industries could not satisfy the huge local demand, because of these barriers to effective market entry. In short, these two problems are indelibly interlocked.

About a year ago, Vice Premier Wu Yi was here with the U.S. in the JCCT process. The government committed at that time to "significantly reduce IPR infringements," by taking a number of tough enforcement and regulatory measures. The bottom line is that 1 year later, even though more raids were run and products seized and the criminal thresholds, as was mentioned, reduced somewhat, there has been little effect on the market, and piracy rates have not come down.

Why? The answer is not new. There is still no deterrence in the Chinese enforcement system, no disincentive to continue to engage in piracy. Even exports of pirate product which slowed to a trickle after the 1996 section 301 action against China, have resumed, and are growing again.

China relies on an ineffective and uncoordinated administrative enforcement system which has not succeeded in all these years in reducing the rate of piracy. The system is characterized by woefully low fines. A study done by one of our members in raids they were involved in revealed that the average fine per unit of product seized exceeded only marginally the cost of a blank CD. To expect such a system to deter one of the most lucrative economic crimes is a flight of fancy. But China has to date simply refused to do what all other countries in the world do; namely, bring criminal actions with deterrent fines and jail terms.

While it is difficult to be certain on these matters, our industries know of only a handful of cases involving criminal piracy prosecutions involving U.S. works in the last 10 years. Countries like South Korea, Singapore, and even Taiwan, have been able in the late '90's to reduce audio and video piracy, for example, from over 90 percent to less than 20 percent of the market, with aggressive and deterrent criminal enforcement. The Chinese can do the same.

We believe that the failure to use the criminal law to fight piracy is a violation of China's TRIPS obligations. We believe that the Chinese criminal law, because it does not encompass all acts of copyright piracy on a commercial scale, which is the TRIPS standard, also violates that agreement.

Because of the failure, despite repeated bilateral engagements, of the Chinese government to show the political will to lower these staggering piracy rates, IIPA urged USTR to engage in a new multilateral dialogue with China. Following USTR's announcements of the results of their out-of-cycle review, we are working closely now to develop the elements of a possible WTO case against China; unless China takes immediate action, making such a course unnecessary.

In my written testimony, Mr. Chairman, we have tried to give this Subcommittee a flavor of how hard it is to do business under these circumstances. Copyright theft in China is hurting America, and hurting China. Since I do not have time to detail these specific problems, I hope our written statement will cover those issues.

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

Thank you, Mr. Chairman, and I look forward to a lively and productive dialogue.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF ERIC H. SMITH

Mr. Chairman, Ranking Member Berman and other distinguished Committee members, IIPA and its members thank you for the opportunity to appear today to review China's record on enforcement of its copyright law against widespread piracy including China's compliance with its WTO-TRIPS obligations. This oversight hearing is extremely timely. Madam Ma, head of China's delegation to the IPR Working Group of the Joint Commission on Commerce and Trade (JCCT), will be in Washington next week, discussing these issues with the United States Government. Your interest in China's record is certain to illuminate those talks.

IIPA represents the U.S. copyright industries. Its six member trade associations consist of over 1,300 U.S. companies, accounting for millions of U.S. jobs. The copyright industries, in 2002, contributed over $625 billion to the GDP, or 6% of the U.S. economy and almost 5.5 million jobs or 4% of U.S. employment. These companies and the individual creators that work with them are critically dependent on having strong copyright laws in place around the world and having those laws effectively enforced. On average, the copyright industries generate over 50% of their revenue from outside the U.S., contributing over $89 billion in exports and foreign sales to the U.S. economy. Given the overwhelming global demand for the products of America's creative industries, all these numbers would be significantly higher if our trading partners, including China, that continue to allow piracy to flourish in their own economies were to significantly reduce piracy rates by enforcing their copyright law vigorously.

IIPA'S SPECIAL 301 REPORT ON PIRACY IN CHINA

I have appended to our written testimony a copy of IIPA's comprehensive February 2005 Special 301 submission on China to the U.S. Trade Representative. In that submission we called for entering into a new, multilateral dialogue in the WTO with the Chinese government as a way to persuade it to take aggressive action—as promised in the Joint Commission on Commerce and Trade (JCCT) meetings over one year ago—to significantly reduce the rate of piracy in all IPR sectors including the copyright sector. We then provided a summary review of what had happened in China over the last year to redeem that commitment. Our conclusion: China has failed to comply with its commitment made over one year ago in the JCCT to significantly reduce piracy rates. While some modest reductions have occurred in some sectors, by no measure have piracy rates been significantly reduced. In fact little has changed in the marketplace for our members and their companies, despite reports of increased raiding activity and seizures of many pirate products. In my testimony today, I would like, for the record, to update that report and in the process to summarize it where appropriate. Our report tells the sad, frustrating story of the failure of an enforcement system to deter rampant piracy in the potentially largest market in the world.

RECENT ACTIONS BY THE U.S. GOVERNMENT ON CHINA

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

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

THE CHINESE MARKETPLACE FOR COPYRIGHT PRODUCTS: A RECORD OF FRUSTRATION AND FAILURE

Mr. Chairman, our industries are deeply frustrated by the lack of real progress by China in taking effective action to deter piracy and to open up its market to legitimate cultural and high technology copyright products. China remains one of the most closed markets in the world for the U.S. copyright industries. Onerous market access restrictions affect all our industries. Notwithstanding Premier Wen's pledge to address the $162 billion trade imbalance between the U.S. and China by increasing China's imports from the U.S., China is retaining—and, in some sectors, augmenting—market access restrictions for creative and high-tech products that represent America's comparative advantage.

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

THE PLIGHT OF THE COPYRIGHT INDUSTRIES DUE TO PIRACY IN CHINA

*The Business Software Industry*

Taking the business software industry first—one of our nation's most productive and important creative sectors: The software industry faces piracy rates in China of 90%, one of the highest in the world for that industry. China leads the world in the production and export of counterfeit software—software packages that are purposely designed to replicate the original legitimate product. Losses to U.S. software publishers were estimated by IIPA member, the Business Software Alliance (BSA), at $1.47 billion in 2004. China was the 6th largest market in the world for personal

computers and ranked 26th in legitimate software sales. This increasing disparity not only damages the U.S. industry but hurts Chinese software developers as well.

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

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

*The Motion Picture Industry*

The U.S. motion picture industry is facing a 95% piracy rate in China (the highest in the Asia Pacific region, and among the highest in the world) which represents a worsening of the situation from the previous year. Losses to just the motion picture industry, from 1998 through 2004, are estimated at over $1 billion (not including losses from Internet piracy, which are growing alarmingly). While raids and seizures have increased somewhat following Vice Premier Wu Yi's 2004 enforcement campaign, administrative fines remain far too low to deter pirate activity and, as I will describe later, criminal cases have been extremely rare despite Chinese promises to use this TRIPS-required remedy. According to a recent newspaper report, the legitimate home video market in China represents about 5% of the estimated total market of $1.3 billion (which is itself a very conservative estimate). Of the 83 optical disc factories licensed by the government (and an unknown number of "underground" unlicensed plants), many continue to churn out pirate DVDs. The export of pirated home video product, which had slowed to a trickle after the U.S. Section 301 action (and threatened retaliation) in 1995–96, has resumed and is growing. The total optical disk plant production capacity, a significant amount of which is devoted to producing pirate product, is now close to 2.7 billion units annually. Optical disks sourced in China and containing pirated films have been seized in over 25 countries around the world. The massive quantity of pirated movie product available in China is evidenced by the fact that pirate prices start around $0.60 per unit, the lowest price in Asia. As with the other copyright industries, any enforcement that occurs is conducted by administrative agencies, with overlapping jurisdiction and often little coordination, and fines imposed are a mere "cost of doing business." A recent anecdotal study, conducted by IIPA member, the Motion Picture Association (MPA) revealed that the average fine imposed per pirate home video product (DVD, VCD) seized in raids resulting from MPA complaints is only slightly higher than the cost of purchasing a blank disk—clearly of no deterrent value. The lack of deterrent administrative penalties is a key reason, in addition to the almost complete lack of criminal enforcement that piracy rates persist at 90% of the market and above.

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

*The Entertainment Software Industry*

The entertainment software industry, one of the fastest growing copyright-based industries, faces similar high piracy rates and estimates the value of pirated videogames in the market at $510 million in 2004. Demand for entertainment software products is growing rapidly but is being soaked up primarily by the pirates. This demand is exemplified by the exploding popularity of "massively multiplayer online role-playing games" (MMORPGs) where literally thousands of players can compete against one another simultaneously. Demand for MMORPGs in China grew at 40–45% over expectations in 2004. This increasing demand has fueled, in part, the growth of Internet cafés in China. (It is estimated that there are close to

200,000 Internet cafés in the country, with a seating capacity of between 100–300 seats, of which 60% are involved in game play.) While U.S. game publishers, represented by IIPA member, the Entertainment Software Association (ESA), have engaged in some licensing of the cafés, the vast majority of the product used is pirated, either available at the café or downloadable from the Internet. This dire situation has been all the more exasperating since the Chinese government extensively regulates the activities of these Internet cafés and often and vigorously revokes licenses for actions the government deems inappropriate. However, as far as we know, the government has *never* sought to include in this extensive regulatory scheme prohibitions against the widespread and blatant piracy at these cafés in its business licenses (which are otherwise very thorough). Moreover, no copyright enforcement of any kind has occurred. The legal infrastructure governing the Internet still is not helpful to copyright enforcement. Takedown of pirate sites is negligible; penalties non-existent.

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

*The Book Publishing Industry*

The U.S. book publishing industry, represented by IIPA member, the Association of American Publishers (AAP), faces both significant offset printing of pirated books, primarily in translated editions, and massive commercial photocopying of textbooks and reference books on and near University campuses. There are 580 licensed state-owned publishers in China, 50 of which are considered major. There are only a few privately owned publishers but they must buy publishing rights from the state-owned publishers. U.S. publishers issued 4500 translation licenses in 2004, a significant number but far below China's potential. All the best selling books are then virtually immediately pirated by outlaw "printers" and made available through independent bookstores, stalls and street vendors. To give an example, the famous self-help bestseller "Who Moved My Cheese" sold over 3 million copies in China. It is estimated, however, that the pirates sold another *6 million* copies. The Harry Potter books, and other best sellers like Hilary and Bill Clinton's books "Living History" and "My Life," John Grisham's books and others all face a similar fate from the pirates. Former General Electric President, Jack Welch's biography, "Winning," has sold over 800,000 copies but with an equal number of pirate copies available in the market. English language textbooks are also heavily photocopied in their entirety and there are six known websites which make available entire copies of textbooks that are downloaded and then photocopied. Enforcement against this vast piracy is spotty and all done administratively through the local and national copyright bureaus. Any resulting administrative fines are non-deterrent. We know of no criminal enforcement. The book publishing industry also faces market access barriers—U.S. publishers are not permitted to publish, sign authors, or print their books in China.

*The Recording Industry*

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

Internet piracy in China, as in other countries in the world, has become a huge problem for the recording industry. Thousands of active websites such as www.9sky.com and www.chinaMP3.com are giving away, or offering links to, thou-

sands of pirated songs. (These not-for-profit acts of piracy are not criminalized in China, as they are, for example, in the U.S.). International criminal syndicates are apparently using Chinese servers to hide their illicit activity (www.boxup.com) and many Asian pirate sites are doing a thriving business in China, such as www.kuro.com from Taiwan.

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

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All in all, the copyright industries estimate their total losses in excess of $2.5 billion in 2004 due to piracy in China. The simple fact remains that these losses and the 90% piracy rates will NOT be significantly reduced without subjecting major piracy to criminal enforcement accompanied by deterrent penalties and substantially increasing the administrative fines specified in the copyright law and imposing them in practice. To date, even after the JCCT commitments, this has NOT happened and there is a real question whether the Chinese government as a whole (Vice Premier Wu Yi has been a staunch defender of better enforcement) can muster the political will to take these absolutely necessary actions—actions that have been key to significant reductions in piracy levels in other countries in which our companies operate. China cannot exempt itself from the rules—that enforcement against piracy requires deterrence and criminal remedies. The global community recognized this when it fashioned the Article 61 criminal obligation in TRIPS and it has proven to be the case in practice.

ACTIONS TO BE TAKEN BY THE CHINESE GOVERNMENT

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

- China should significantly liberalize and implement its market access and investment rules, including and in addition to those already made in the WTO, and improve the overall business climate in China to permit effective operations by all copyright industries. This should be a major objective in the JCCT.
- Immediately commence criminal prosecutions using both the monetary and new copy thresholds and carry these forward promptly to impose deterrent penalties. The Economic Crime Division of the Public Security Bureau should be made responsible for all criminal copyright enforcement and be provided sufficient resources and training to very substantially increase criminal enforcement under the new Judicial Interpretations. Further amendments should be made to those Interpretations, particularly to include sound recordings.
- Under the leadership of Vice Premier Wu Yi, constitute a single interagency authority at the national and provincial/local levels to undertake administrative enforcement against piracy of all works. This authority would have the would have the full authority to administer fines and to refer cases to the Ministry of Public Security and the Supreme People's Procuratorate for criminal prosecution, under referral guidelines that are equal to or better than the Judicial Interpretations. Such authority must have the full backing of the Party Central Committee and the State Council. Far greater resources must be provided to this enforcement authority. All administrative enforcement, and enforcement by Customs at the border, must be significantly strengthened.[1]
- Adopt, in a transparent manner with the opportunity of public comment, a full and comprehensive set of regulations governing protection and enforcement on the Internet, including the liability of Internet Service Providers, which follow the recommendations made in IIPA's Special 301 submission, in-

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

cluding effective "notice and takedown" mechanisms and without unreasonable administrative evidentiary burdens. Establish within this single interagency authority described above special units (at the national, provincial and local levels), whose purpose is to enforce the law and these new regulations against piracy on the Internet.

- Amend the Criminal Law to comply with the TRIPS Article 61 requirement to make criminal all acts of "copyright piracy on a commercial scale." These must include infringing acts not currently covered, such as end user software piracy and Internet offenses conducted without a profit motive. Also amend the Criminal Code provisions requiring proof of a sale, to require instead proof of commercial intent, such as possession with the intent to distribute.
- Significantly increase administrative penalties/remedies, including shop closures, and monetary fines and impose them at deterrent levels.
- Permit private companies and trade associations to undertake anti-piracy investigations on the same basis as local companies and trade associations.
- Through amended copyright legislation or regulations, correct the deficiencies in China's implementation of the WCT and WPPT, and ratify the two treaties.
- Significantly ease evidentiary burdens in civil cases, including establishing a presumption with respect to subsistence and ownership of copyright and, ideally, permitting use of a U.S. copyright certificate, and ensure that evidentiary requirements are consistently applied by judges and are available in a transparent manner to litigants.

The copyright industries will be working closely with USTR to prepare the necessary elements of a WTO case should the TRIPS obligations of China described above and in our submission not be fully implemented. This work is now ongoing. We are grateful for the support of the Chairman and members of this Subcommittee in working with us to monitor China's progress and to ensure that it takes these actions and avoids further confrontation with its trading partners on the issue of copyright piracy.

Thank you.

**ATTACHMENT**

# INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE
## 2005 SPECIAL 301 REPORT
# PEOPLE'S REPUBLIC OF CHINA (PRC)

## EXECUTIVE SUMMARY

**Special 301 Recommendation:** IIPA recommends that USTR immediately request consultations with China in the World Trade Organization, and that it place China on the Priority Watch List pending an out-of-cycle review to be concluded by July 31, at which time further appropriate multilateral and bilateral action, including the possible establishment of a dispute settlement panel in the WTO, will be determined.

On February 9, 2005, IIPA submitted its comments[1] to USTR on China's progress in implementing the commitments it undertook under the Joint Commission on Commerce and Trade (JCCT), its WTO commitments and its 1995 and 1996 bilateral agreements and action plans to provide adequate and effective protection and enforcement for U.S. copyrighted products. These comments were part of the out-of-cycle (OCR) review process announced by USTR on May 3, 2004[2] and for which industry comments were sought by Federal Register Notice on December 14, 2004.[3] In that OCR submission, IIPA summarized the views of the copyright industries on what progress had been made since the JCCT meetings concluded. Below, we summarize IIPA and its members' findings and our conclusions:

- **Piracy levels have not been "significantly reduced" — they still are around 90% in all sectors.** China's actions in 2004 (and to date in 2005) have not produced substantial progress toward a significant reduction in copyright infringement levels, as promised by Vice Premier Wu Yi at the JCCT. China has not met its WTO TRIPS commitment to provide effective enforcement, and particularly criminal enforcement against piracy "on a commercial scale," nor its continuing bilateral obligations reflected in the 1995-1996 bilateral agreements and action plans. On October 12, 2004, IIPA submitted its comments in connection with the TPSC's request for industry views on China's compliance with its WTO commitments and concluded that China is not living up to its international obligations, in particular by failing to amend its criminal law to bring it into compliance with Article 61 of the TRIPS Agreement, and by its failure to translate those commitments into effective, deterrent enforcement in practice.[4]
- **The recently-amended Supreme People's Court's "Judicial Interpretations" (hereinafter "JIs") leave unanswered questions about China's political will to bring criminal prosecutions and impose deterrent penalties.** The new JIs make only minimal decreases in the monetary thresholds and continue to be calculated at pirate prices, but the new 1000/3000/5000 copy threshold may be helpful if implemented to

[1] See http://www.iipa.com/rbc/2005/CHINA%202005_Feb9_PRC_OCR_Submission.pdf.
[2] See http://www.ustr.gov/Document_Library/Press_Releases/2004/May/Special_301_Report_Finds_Continued_Progress_But_Significant_Improvements_Needed.html.
[3] See http://a257.g.akamaitech.net/7/257/2422/06jun20041800/edocket.access.gpo.gov/2004/pdf/04-27373.pdf.
[4] See http://www.iipa.com/rbi/2004_Oct12_IIPA_CHINA_WTO_TPSC_Submission-rev.pdf.

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bring more criminal cases against manufacturers and distributors. Online infringements that meet the thresholds are criminalized but the ability to use the new rule in practice has yet to be tested. Importing and exporting of pirate products are criminal, but not directly; liability is only under the rule governing "accomplices" — at significantly lower criminal penalties. End user software piracy appears not to have been criminalized. The rules were weakened with respect to repeat offenders. Industry is very concerned that the apparently grudging minor changes will not result in significantly more criminal cases with deterrent penalties and thus piracy levels will not be markedly affected. To the best of our knowledge, no criminal cases have yet been brought under the new JIs, so it is premature to assess whether they will make a real difference in practice in reducing piracy levels. In addition, the first line of implementation of this new interpretation will be the police (the Ministry of Public Security/Public Security Bureau or PSB). Effective enforcement will not become a reality if there is inadequate attention, investment and training by the PSB. However, police resources for this purpose have not been increased nor, to the best of our knowledge, were they involved in drafting the JIs. More importantly, that part of the PSB reportedly directly responsible for copyright enforcement has been uninterested in bringing criminal cases against copyright piracy and has so informed the U.S. Government. There needs to be a mandate for the PSB to treat criminal investigation and enforcement of IPR offenses as a top priority. Finally, criminal enforcement of copyright piracy continues to be burdened by the fact that Articles 217 and 218 of China's criminal code requires a demonstration that piracy is occurring for the purpose of making a profit, something very difficult to demonstrate, particularly in the online environment. TRIPS requires criminalization of "copyright piracy on a commercial scale" — not just piracy for the purpose of making a profit.

- **However, raiding activity has increased for most sectors.** As a result of Vice Premier Wu Yi's leadership at the JCCT and, in August 2004, in forming the National IPR Protection Working Group (which she heads as Group Leader) and the National IPR Protection Office (NIPO), a one year national anti-piracy campaign was kicked off in September 2004. These actions, and prior actions taken immediately following the JCCT meeting, have given rise to increased raiding activity (though almost entirely at the administrative level), to higher seizures of pirate product, and what would appear, at this early stage, to be better coordination of administrative enforcement in the regions. Nevertheless, despite Wu Yi's singular efforts, IIPA members report no meaningful decrease in the national piracy rates, which still are estimated to be around 90% in all copyright sectors.

## Actions to be Taken by the Chinese Government

To redeem its JCCT commitments and to meet its TRIPS obligations, the Chinese authorities must take the following further steps immediately and through July 31, 2005:

- Commence criminal prosecutions using both the monetary and new copy thresholds and carry these forward promptly to impose deterrent penalties. The Economic Crime Division of the PSB should be made responsible for all criminal copyright enforcement and be provided sufficient resources and training to very substantially increase criminal enforcement under the new JIs.
- Under the leadership of Vice Premier Wu Yi, constitute a single interagency authority at the national and provincial/local levels to undertake administrative enforcement against piracy of <u>all</u> works. This authority would have the responsibilities similar to those formerly exercised by the National Anti-Pornography and Piracy Working Group

(NAPPWC)[5] for audiovisual works and would have the full authority to administer fines and to refer cases to the Ministry of Public Security and the Supreme People's Procuratorate for criminal prosecution, under referral guidelines that are equal to or better than the JIs. Such authority must have the full backing of the Party Central Committee and the State Council. Far greater resources must be provided to this enforcement authority. All administrative enforcement, and enforcement by Customs at the border, must be significantly strengthened.[6]

- Issue a final set of comprehensive and transparent regulations governing enforcement on the Internet, including the liability of Internet Service Providers, which follow the recommendations made in this submission, and including effective "notice and takedown" mechanisms and without unreasonable administrative evidentiary burdens. Establish within this single interagency authority described above special units (at the national, provincial and local levels), whose purpose is to enforce the law and these new regulations against piracy on the Internet.
- Amend the Criminal Law to comply with the TRIPS Article 61 requirement to make criminal all acts of "copyright piracy on a commercial scale." These must include infringing acts not currently covered, such as end user software piracy and Internet offenses conducted without a profit motive.
- Amend the new JIs to ensure that sound recordings are fully covered.
- Significantly increase administrative penalties/remedies, including shop closures, and monetary fines and impose them at deterrent levels.
- Fully implement China's WTO market access commitments and begin now to liberalize its market access rules and overall business climate to permit effective operations by all copyright industries.
- Permit private companies and trade associations to undertake anti-piracy investigations on the same basis as local companies and trade associations.

## By the end of 2005, China must

- Through amended copyright legislation or regulations, correct the deficiencies in China's implementation of the WCT and WPPT, and ratify the two treaties.
- Significantly ease evidentiary burdens in civil cases, including establishing a presumption with respect to subsistence and ownership of copyright and, ideally, permitting use of a U.S. copyright certificate, and ensure that evidentiary requirements are consistently applied by judges and are available in a transparent manner to litigants.

Each of the measures noted above is necessary to strengthen China's intellectual property enforcement regime. The true test, however, is the impact of China's actions and policies on U.S. sales and exports of copyrighted works. A piracy rate hovering around 90 percent has denied the U.S. copyright industries and our national economy what should have been a long-standing trade surplus in American music, movies, books and software. It is essential that China rectify this imbalance between its widespread use of U.S. copyrighted works and its negligible trade in legitimate products. It is not enough for China to introduce new copyright laws or to temporarily escalate enforcement activity, if such actions do nothing to increase sales of

[5] Due to the re-organization of the functions of the NAPPWC in 2005, that body will now only focus on major pornography/piracy cases. NAPPWC's coordination function has been withdrawn and provincial offices are to be closed down early in 2005.

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

legitimate U.S. products or halt the production and use of illegal copies. Similarly, intellectual property reforms are of little value to U.S. right holders if China persists in maintaining and erecting other trade barriers that limit or foreclose access to the Chinese market. If markets for U.S copyrighted products are closed or market access severely restricted, intellectual property rights are of limited value. IIPA thus recommends that USTR also measure China's progress according to additional benchmarks that signify meaningful gains and opportunities for U.S. copyright owners. IIPA looks forward to working with USTR on developing these additional benchmarks.

PEOPLE'S REPUBLIC OF CHINA
Estimated Trade Losses Due to Copyright Piracy
*(in millions of U.S. dollars)*
and Levels of Piracy: 2000-2004[7]

| INDUSTRY | 2004 | | 2003 | | 2002 | | 2001 | | 2000 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Loss | Level | Loss | Level | Loss | Level | Loss | Level | Loss | Level |
| **Motion Pictures** | 280.0 | 95% | 178.0 | 95% | 168.0 | 91% | 160.0 | 88% | 120.0 | 90% |
| **Records & Music**[8] | 202.9 | 85% | 286.0 | 90% | 48.0 | 90% | 47.0 | 90% | 70.0 | 93% |
| **Business Software**[9] | 1465.0 | 90% | 1787.0 | 92% | 1637.3 | 92% | 1140.2 | 92% | 765.1 | 94% |
| **Entertainment Software**[10] | 510.0 | NA | 568.2 | 96% | NA | 96% | 455.0 | 92% | NA | 99% |
| **Books** | 50.0 | NA | 40.0 | NA | 40.0 | NA | 130.0 | NA | 130.0 | NA |
| **TOTALS** | 2507.9 | | 2859.2 | | 1893.3 | | 1932.5 | | 1085.1 | |

## THE STATE OF COPYRIGHT PIRACY AND ENFORCEMENT IN CHINA

### Piracy Continues at Unacceptably High Levels Despite China's JCCT and Other International and Bilateral Commitments

Several of IIPA's members have undertaken surveys of the market since the summer of 2004 in an effort to measure progress in reducing piracy levels. These surveys, which were provided to USTR on a business confidential basis, provided a detailed review of piracy at the retail level and provided data on seizures from destination countries of pirate DVDs. Other data provided to USTR covered enforcement actions in which either those industries were involved or for which the data was provided by the Chinese government. Because of the lack of transparency in the administrative and criminal enforcement system and the inability to compile meaningful statistics directly, as opposed to relying on Chinese government information (which

[7] The methodology used by IIPA member associations to calculate these estimated piracy levels and losses is described in IIPA's 2005 Special 301 submission at www.iipa.com/pdf/2005spec301methodology.pdf.
[8] The estimated losses to the sound recording/music industry due to domestic piracy are US$202.9 million for 2004, and exclude any losses on sales of exported discs. This number is also based on a "displaced sales" methodology.
[9] BSA's final 2003 figures represent the U.S. software publisher's share of software piracy losses in China, as compiled in October 2004 (based on a BSA/IDC July 2004 worldwide study, found at http://www.bsa.org/globalstudy/). In prior years, the "global" figures did not include certain computer applications such as operating systems, or consumer applications such as PC gaming, personal finance, and reference software. These software applications are now included in the estimated 2003 losses resulting in a significantly higher loss estimate ($3.62 billion) than was reported in prior years. The preliminary 2003 losses which had appeared in previously released IIPA charts were based on the older methodology, which is why they differ from the 2003 numbers in this report.
[10] ESA's reported dollar figures are preliminary and reflect the value of pirate product present in the marketplace as distinguished from definitive industry "losses." The methodology used by the ESA is further described in Appendix B of this report.

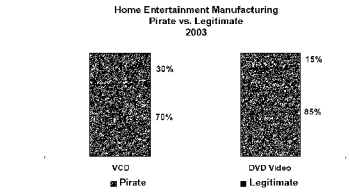
is rarely sufficiently granular to draw meaningful conclusions), the data presented in these surveys and in this submission are incomplete at best. While certain selected information is available, like, in some cases, what shops, distribution centers or factories were raided (and such data was provided, where available, to USTR), a meaningful picture of the scope of the piracy problem must be drawn from the gross statistics available primarily from the Chinese government, supplemented by industry-generated statistics. What follows, first, is a description of the current, updated, piracy situation facing the copyright industries in China and, second, 2004 enforcement information that is available to those industries.

**Piracy in the home video and the audiovisual market generally:** MPA reports that, in 2004, China Customs claimed to have seized approximately 79.6 million optical discs which were intended to be smuggled into China. At the same time, the NAPPWC reported seizing a staggering 165 million discs during this same period in the domestic market. These numbers (a total of over 244 million pirate discs in 2004) exceed any data that IIPA has seen from prior years and is indicative of the continuing vast scope of the piracy problem.[11] In 2003, NAPPWC seizures were down to 64 million disks (reportedly due primarily to complications of the SARS epidemic), compared to the 78.8 million discs seized in all of 2002. This also serves as evidence of stepped up enforcement which most IIPA members have reported following the JCCT announcements. However, based on these new market surveys (which are only a partial look at best), the percentage of pirate product available in the marketplace continues to support the piracy level estimates we provide in this submission.

In 2004 there were reportedly 83 licensed plants in China, with 765 operating production lines. This is up from 71 plants and 569 lines reported for 2003. 152 of these lines are dedicated to producing DVDs. Total capacity, excluding the production of blank CD-Rs, is now 2.67 billion units annually — a staggering figure when viewed in conjunction with the prevailing 90% piracy rates. These above numbers do not count underground plants, whose locations have increasingly been dispersed to more rural areas in China. Reports emanate from China regularly about raids on such plants, but we are unable to ascertain, in almost all cases, the disposition of any enforcement actions against their owners. Because industry is forbidden from conducting investigations, only Chinese authorities have any ability to identify and raid these underground factories.

[11] In evaluating these seizure statistics provided by Chinese authorities, it must be kept in mind that (a) seizures of pirate product involving U.S. copyrighted material is not broken out, (b) it is not known how many of the discs seized contained pornographic or otherwise politically unacceptable material or involved legal violations other than copyright piracy. The lack of transparency makes it difficult therefore to ascertain a true picture of the anti-piracy enforcement situation in China.

China is one of the leading global manufacturers of pirate product. *Understanding and Solutions* estimates that in 2003, 69% of the VCD and 85% of the DVD discs manufactured in China were pirate product.




Source: *Understanding & Solutions*

The impact of piracy on the film market is pronounced. *Informa Media* reports that admissions and national box office takings have suffered as a direct result of piracy. Part of the problem is that pirate product is priced much lower than cinema tickets. According to market experts, the average cost of a pirate VCD is $0.60 to $1.20 and $2.00 to $2.50 for a pirate DVD,[12] compared to $4.00 to $5.00, the average cost of a movie ticket in Beijing.[13] Further, optical disc versions of recent foreign hits often are available in the pirate market long before theatrical, let alone home video, release in China. Pirate videos of *Harry Potter and the Prisoner of Azkaban, Van Helsing and The Day After Tomorrow* — with Chinese subtitles — were on sale within one week of their U.S. and UK releas for $1.00 per copy.

Another measure of the level of piracy is VCD and DVD players. The VCD and DVD player dominate the Chinese home nt market. In 2003, *Screen Digest* estimated that 84.4 million, or 24% of television households had a VCD player, whereas 26.4 million, or 8% of television households had a DVD player. The DVD player has recently seen explosive growth in China. Between 2000 and 2002, the number of DVD households grew by 23.4 million, or 867%.

At the same time the number of legitimate DVD discs sold to consumers in China grew at a much slower pace. In fact, in 2003 the number of DVD discs sold to consumers was a mere 0.3 per DVD household. This is inconsistent with the trends seen in Hong Kong, a similar market, which is dominated by the VCD player. In 2003, the average DVD household in Hong Kong made 4.3 DVD disc purchases. Clearly, economic circumstances influence buying patterns of consumers, but the discrepancy between these two markets is in large part due to the piracy epidemic within China. It is unlikely that Chinese consumers are investing in DVD players only to leave them gathering dust in their living rooms; more likely is that consumers are investing in pirate film collections.

**Export piracy:** MPA has also been experiencing a marked increase in exports of DVDs from China to the U.S., the UK and other countries and has provided USTR with charts

[12] Motion Picture Association, April 2004.
[13] *Informa Media Group*, "Global Film: Exhibition & Distribution", 2003.

showing destination countries and some information on the Customs seizures themselves.[14] Exports have been steadily increasing over the last three years and show no signs of abating. In addition, exports of pirated music sound recordings have been found in several Southeast Asian countries. It is the hope that the new anti-piracy campaign announced in August 2004 will reduce this problem, which, as we know, slowed to a mere trickle in 1996-97 following the Chinese government's decision to avoid U.S. government trade retaliation by shutting down the export trade in pirate video and audio product. (Exports of very high quality counterfeit software continued throughout this period, however.)

**Internet piracy:** With respect to Internet piracy generally, it continues to grow rapidly in China and the problem is discussed in the sections devoted to each industry sector. In 2003, we reported that 78 million people were then on line (up from 58 million users in 2002 and 33.7 million in 2001). In 2004, that number has jumped to 94 million, making China the largest user of Internet facilities in the world.

Specifically, for audiovisual works, this piracy, which is also increasing, involves the sale of "hard goods" (VCDs and DVDs—all formats) as well as the illegal streaming of films. As discussed below, MPA's attempts to enforce against piracy have significantly increased but with only some success. As detailed in the enforcement section, in 2004, MPA sent out 3,905 cease and desist letters. As the majority of these were sent to P2P targets it is not possible to determine the compliance rate. Where cease and desist letters were sent to other than P2P targets (mostly streaming sites), the compliance rate was a very disappointing 17%.

**Broadcast, Cable and Public Performance Piracy:** Other types of audiovisual piracy also continue in China, including the unauthorized public performance of U.S. motion picture product, which continues mostly unchecked in hotels, clubs, mini-theaters and even government facilities; television piracy, particularly at the provincial and local level; and cable piracy (over 1,500 registered systems) which routinely pirate U.S. product.

**Piracy in the Market for Sound Recordings**: As IIPA reported last year and as is reflected in the submissions made by RIAA during the OCR pendency, the crisis in the local and international music industry continues for a fifth year in a row. Losses, under the new methodology begun in last year's submission which counts displaced sales are estimated at $202.9, a decrease from an estimated $289 million in 2003. The estimated national piracy rate is 85%, down from 90% in 2003. OD piracy continues at a high level and cassette piracy remains a significant factor in the marketplace. The recording industry is looking to the new enforcement campaign to deal with piracy by factories, both licensed and underground, and piracy at the retail level which remains at massive levels, though the increased raiding in 2004 has had some impact on losses and the piracy rate.

**Internet Piracy:** Internet piracy was a significant concern for the recording industry in 2003, and, as predicted in last year's submission, the situation has worsened in 2004. Websites in China such as www.9sky.com and www.chinaMP3.com are giving away or offering links to thousands of pirated songs. (The new JIs do not criminalize non-profit, free Internet transmission, and it is unclear if the inclusion of advertising as indicative of "for-profit" activity will cover music files on a multi-content Internet site). RIAA estimates there are thousands of active websites hosting infringing MP3 files, and that some of these have thousands of infringing files. The industry is also concerned that international online pirate syndicates are using China-

[14] MPA reports that there is evidence of Chinese DVD exports to Australia, Belgium, Hong Kong, Japan, Sweden, the U.K. (185,000 disks seized from January-September 2004), UAE and the U.S.

based servers to hide their infringing files. One such example is www.boxup.com, which offers songs to paying members (and therefore, if the thresholds are met, should be subject to criminal prosecution under the new JIs). Also overseas pirate sites have been offering their services in China. Taiwan's Kuro is one such example. We understand that Kuro now has a server in China.

The record industry has approached NCAC and the Beijing Copyright Bureau to assist with administrative enforcement. They were told that they must await formal issuance of the new NCAC regulations.[15] While enforcement assistance is welcome, low administrative penalties issued in other piracy cases do not bode well for deterrent enforcement against Internet piracy. It is unclear whether the new regulations will cover P2P services, like Kuro, now under indictment in Taiwan.

**Piracy in the market for entertainment software products**: The market for PC games, console games, and games played on handheld devices is continuing to grow in China. It is the market for online gaming, however, where the growth has been significant in the last few years. Piracy rates are still extremely high for the industry. A number of entertainment software publishers have entered the market and Sony and Nintendo entered the market in 2003 and 2004, respectively. Given these levels of piracy, they do so at considerable risk.

Internet piracy has also become a significant problem, more so than illegal factory OD production. In 2004, there were an estimated 200,000 Internet cafés in China with 100-300 computers at each location with about 60% of the patrons playing games. Typically, these cafés purchase one legitimate copy, or use a pirated copy and load it on each computer. Customers are also generally permitted to download games from *warez* sites and even to burn their own CD-Rs on the premises. The industry is seeking to license these cafes but this process, given the nature of the marketplace, is inevitably slow, absent real enforcement. Although the government has taken actions against several Internet cafes, such actions have been focused on ensuring that the cafés do not allow "unhealthy information to be spread through the Internet" and requiring that cafés install blocking software for pornographic sites and materials, and other similar sites. There are also other significant restrictions on Internet cafés such as keeping them a specific distance from schools[16] and these regulations are vigorously enforced. However, the government regulations do not address piracy specifically and no enforcement actions have been taken to ensure that the cafes use only legitimate or licensed entertainment software products. China must include copyright provisions in the business licenses it issues to Internet cafes for as Internet and online gaming continues to grow, the cafés are likely to be the primary means for Internet access for much of the Chinese population.

Furthermore, as the market for entertainment software (particularly online gaming) continues to grow, the Chinese government must also ensure that the law and regulations are adequate to take aggressive action against all types of online piracy. The Chinese video game market is likely to be dominated by online gaming; it is essential that the appropriate legal framework be in place to provide copyright owners as well as law enforcement agencies with the necessary tools to protect copyrighted works in the online environment. A particular problem for entertainment software publishers is the existence of offline or pirate servers in

[15] The latest draft of the NCAC Internet regulations appears to require notices "in writing" and would not permit email notifications. If this pertains in the final regulations, the compliance rate of ISPs is likely to drop markedly. The draft regulations are discussed in detail below.

[16] Some news reports noted that the government would also begin imposing restrictions against the use of entertainment software products in Internet cafés. However, the restrictions do not appear to have been imposed though news accounts have been scarce.

China. These unauthorized servers operate sites which emulate a publisher's online game and thereby divert traffic and potential subscribers from the legitimate site. ESA member companies have attempted to contact Chinese ISPs to request that access to such sites be disabled, but to no avail. Unfortunately, existing Chinese law and regulations has not yet clearly addressed this problem.[17] Neither do there yet seem to be any legal incentives to encourage ISPs to cooperate with right holders in expeditiously disabling these unauthorized or pirate servers.

The manufacturing and assembly of cartridge-based handheld games also continues to be a massive problem in China. Counterfeit Nintendo products continue to be produced in mass quantities in China, and exported throughout Asia, Latin America, the Middle East and Europe. Until the factories engaged in assembling counterfeit cartridge-based products are closed permanently, and significant fines and jail sentences imposed, it will remain difficult to stem the massive production of counterfeit video games in the country. The new JIs now set copy thresholds for initiating criminal actions in the area of trademarks, but they do not appear to address the situation involving a seizure of vast quantities of component parts, which is the prevailing scenario in actions involving cartridge-based games. During a raid, administrative authorities may seize hundreds of the component parts waiting to be assembled into the final counterfeit cartridge game in a factory — that is, the printer circuit boards (PCB) which contain the video game software, the plastic cartridges which will house the PCBs, as well as the labels and instruction manuals to accompany the final pirated product. It seems the case that notwithstanding the seizure of hundreds of these component parts, as they have not yet been assembled into the final product, i.e., what may constitute a "copy," the JI thresholds may be interpreted as not applying. This would present a serious impediment to pursuing criminal actions against pirates engaged in the manufacture of thousands of counterfeit cartridge games. It is unclear how law enforcement authorities will thus treat instances where they find hundreds of these component parts during a raid, but which have not yet been assembled into the finished counterfeit video game cartridge. Nintendo is concerned that this seeming gap may actually make it easier for pirates to elude seizures and arrest, as fully assembled products will be immediately removed from the factories and transported (under cover of night) to various locations, thus leaving no finished product on the premises.

**Piracy in the market for business software:** Unauthorized use of software in enterprises in China causes the vast majority of piracy losses faced by the business software industry. Losses also occur in the retail market, including the loading of pirate software on the hard disks of computers as part of the sale of computers. The market is also characterized by huge exports, on a global basis, of high-quality counterfeit software packages. The software industry has struggled for years to persuade NCAC to devote sufficient resources to raiding/auditing enterprises that use unauthorized software. There have been some recently successful administrative actions against end-users (see enforcement discussion) and, as part of the new anti-piracy campaign following the JCCT, the authorities in many of the major cities have announced plans to increase enforcement against software piracy and some have even referenced end-user piracy. However, enforcement remains spotty and resources are still woefully inadequate at the national and local copyright administrations and bureaus. The new JIs did clarify that fake (end-user) licenses fall within the scope of "without permission of the copyright owner." However, the industry's most important priority — to persuade the SPC to amend its JIs to make end-user piracy a criminal offense under TRIPS — was apparently not met.

[17] The draft Internet regulations, discussed below, do not address the problem of pirate servers located outside China.

To significantly reduce the piracy levels for business software, the government, through the existing authorities — the new National IPR Protection Working Group, the State Council, the NCAC and the Ministry of Information Industry — should issue a policy statement or order, accompanied by a national public education campaign, requiring enforcement authorities to enforce the law more vigorously against enterprise end-user piracy. Actual enforcement should be placed under the authority of the new interagency mechanism described above, and enforcement actions should be followed up by the allocation of sufficient resources and their employment in the vastly increased administrative raiding of enterprises using unauthorized software. Without these actions, there is no possibility, in the view of the software industry, of significantly reducing the world's highest piracy rate — 92% of the market!

Unauthorized use of software in government ministries remains a problem, even though in February 1999, the State Council reissued a "Notice" originally released by the National Copyright Administration of China in August 1995 ordering all government ministries at all levels to use only legal software (the so-called "Red Top Decree"). A number of other decrees requiring the legal use of software were issued after this, including a joint decree by four ministries. The most recent was a circular issued by the State Council on the use of legal software by local governments. In the circular, government agencies at the provincial level are requested to legalize their software by the end of 2004, and government at lower levels are to accomplish software legalization by the end of 2005. Some progress has been made but the problem persists, causing large losses for the industry. The value of these decrees is in showing transparent implementation not only to the software industry but also, more important, to the private sector. The government should issue a public report on the status of its internal legalization, including the agencies that have legalized their software use and the amount of public procurements of software resulting from such legalization efforts. Following government legalization, the Chinese government should also issue a decree for the use of legal software in state-owned enterprises since there is no practical way to carry out enforcement and deterrence.

As part of the government legalization effort as well as to implement the 2002 Government Procurement Law, MOF and MII drafted Implementing Methods for Governmental Procurement of Software. The Methods describe new government procurement practices in software that are unique to China and that bear little relation to the principles of the WTO Government Procurement Agreement (GPA), whose goal is to ensure non-discriminatory, pro-competitive, merit-based and technology-neutral procurement of goods and services so that governments can acquire the best goods to meet their needs for the best value. The regulation would effectively prevent U.S. software companies from selling software products and services to the Chinese government. When viewed in the context of China's 92% software piracy rate, this discriminatory measure would effectively close China's largest software market to U.S. competition. The U.S. software industry has already lost billions of dollars in export revenue due to rampant piracy and counterfeiting in China; a ban against government procurement of U.S. software would eliminate the industry's best opportunity to expand exports to China and set a dangerous precedent for China's procurement policies in other major economic sectors. Addressing this problem is a very high priority for the U.S. software industry.

While enterprise end-user piracy is the most pressing problem for the business software industry in China, counterfeiting and hard disk loading are also major problems. Indeed, China is the source of some of the most sophisticated counterfeit software anywhere in the world. Industry representatives report that high quality counterfeits are produced in large quantities both for the domestic Chinese market and for worldwide distribution, with software available in multiple languages. However, this problem is unlikely to be brought under any semblance of control without aggressive criminal enforcement.

**Piracy of books and journals:** Previous IIPA Special 301 submissions detailed the successful effort of the Chinese government, in cooperation with the publishing industry, in dealing with the formerly rampant problem of print journals piracy.[18] While these significant improvements are for the most part continuing in 2004, publishers are starting to see increased photocopying of print journals, in part as a result of the lack of sufficient government funding for legitimate journals purchasing by universities. The Chinese government should monitor use of print journals closely to ensure that its successes of prior years are not eroded.

Problems abound for other published materials as well. Illegal commercial photocopying has, for the first time, become the chosen mode of book piracy in China, at least with respect to academic materials. While photocopying had previously taken second place to print piracy in China, decreasing costs of photocopy paper and other necessary materials have resulted in a sharp increase in photocopying in 2004. This photocopying takes place primarily on university campuses, as well as secondary schools and English language teaching programs. Many of these programs draw students by advertising their use of full color, high quality books, and then provide photocopies of books to students upon enrollment.

Despite the rise in photocopying, traditional reprint piracy continues to remain a major problem in China, particularly of higher education textbooks and trade bestsellers. Popular books such as Bill Clinton's *My Life* and J.K. Rowling's latest Harry Potter® book, *Harry Potter and the Order of the Phoenix*, were heavily pirated. The Chinese government needs to take action against hard goods piracy of books with the same vigor with which it tackled journals piracy in 2001.

Counterfeiting problems also abound. IIPA has previously reported the publication of totally bogus books purportedly written by a famous author. This happened most recently with the Harry Potter® series, with Chinese publishers producing at least three additional books about Harry under Rowling's name. One of the publishers was caught and subjected to a $2,500 fine.[19] Furthermore, well known business and academic trademarks, such as those of the Harvard Business School, are used illicitly to promote sales of books by implying a nonexistent affiliation or endorsement.

Translation piracy also remains a problem for foreign publishers. Publishers continue to report production of illegal translations, of both textbooks and bestsellers, largely by second-channel distributors. The scope of this problem grows larger in smaller cities and provinces.

**Internet piracy:** Publishers have noticed alarming increases in electronic journals piracy over the past year. University gateways are routinely left open for illegal access by unauthorized users, and file-sharing among users is on the rise. In fact, publishers now report more illegal downloads of online journals as well as digital license violations in China than anywhere else in the world. This problem extends to databases containing other types of published data as well. The Chinese government should take steps to ensure that commercial or institutional users are abiding by their license agreements.

Furthermore, piracy over the Internet is increasingly affecting not only journals, but also academic textbooks and bestsellers, with several websites offering hundreds of scanned published titles for download. Bestsellers are, of course, distributed over peer to peer networks

[18] See IIPA's 2003 Special 301 country report on the People's Republic of China, pages 25-26, available at http://www.iipa.com/rbc/2003/2003SPEC301PRC.pdf.
[19] Id.

with impunity. This phenomenon is likely to grow during 2005 unless the government is able to take steps to ensure effective measures are available to rights holders to defend their materials.

**Enforcement: Raiding and seizures have increased for most copyright sectors; administrative penalties remain too low to provide a deterrent; criminal enforcement under Articles 217 and 218 has not yet begun; and, consequently, piracy levels have not yet declined.**

Vice-Premier Wu Yi's commitment to "significantly reduce piracy levels" will not be met by the time of this submission. Indeed, overall piracy rates have remained virtually constant from 2003 to 2004.

China does not presently meet its WTO/TRIPS commitments on enforcement and particularly TRIPS Articles 41, 50 and 61 (provide enforcement which "on the ground" deters further infringements, provide effective *ex parte* civil search orders, and provide specific deterrent criminal remedies). To meet this obligation, IIPA recommends that China implement a system in which the Party Central Committee and the State Council ensure that the enforcement authorities (a) cooperate more closely with affected industries (including permitting U.S. associations to undertake investigations in China); (b) significantly increase transparency (c) give Vice Premier Wu Yi even greater and "publicly announced" authority to intervene at all levels, to organize an effective interagency enforcement authority throughout the country, and to coordinate the nationwide enforcement effort; (d) significantly increase administrative penalties and actually impose them at deterrent levels, including closing retail stores that deal in pirated goods; (e) amend the Criminal Law to increase criminal penalties and cover all types of "commercial-scale" infringements; and (f) use the new Judicial Interpretations to their fullest to prosecute — publicly — significantly more infringers under Article 217 and 218, not just for pornography, "illegal business operations" or smuggling. None of these objectives has as yet been met.

In the following sections, we report on what we know about the level of enforcement in the administrative, criminal and civil enforcement system in China in 2004.

**Administrative enforcement**

As noted above, NAPPWC appears to have been the most effective administrative enforcement mechanism in China, with a continued large number of raids, seizures and detentions.[20] With the change of the functions of NAPPWC in 2005, it is essential that a similar authority be created to take over the responsibilities of nation-wide coordination of anti-piracy operations and that its jurisdiction be extended to cover enforcement in all copyright sectors, including computer software. It is also critical that this new authority NOT be charged with dealing with pornography, but only piracy, and that it be mandated to have an effective and transparent reporting system. If pornography is included, it will never be known whether the authorities are enforcing for that crime or for IPR violations.

With respect to existing administrative enforcement, NCAC's title verification program continues to work well for only one industry—the motion picture industry—with, in the year 2004,

[20] It must be noted, however, that the primary mandate of the NAPPWC is to rid the market of pornography or other material deemed by the government to be politically or socially unhealthy.

a total of 2,881 title verification requests submitted by MPA, and 146 titles challenged by MPA and I.F.T.A. found to have been unauthorized.

Even with the myriad cases handled by NAPPWC,[21] the lack of transparency in the enforcement system, particularly the lack of industry access to levels of fines and other penalties for infringement, makes it almost impossible to judge whether there have been advances in deterrent enforcement. We do know, however, that the piracy rates remain universally high and thus we have no alternative but to conclude that the administrative enforcement system is not having any serious impact in the marketplace. This is not to say that industry does not welcome or does not fully support these efforts, simply that the Chinese government must focus on vastly increased deterrence as the key to reducing piracy rates. To date it has not done so. The following summarizes the deficiencies in the administrative enforcement system:

- Fines are too low, both as written and as imposed;[22] these need to be increased significantly, imposed in practice and widely publicized throughout China, and the results provided to the U.S.G. as promised in the bilateral IPR agreement.
- The system is almost entirely nontransparent; it is, with some recent exceptions, impossible to ascertain what penalties are imposed in particular cases. This extends to the Chinese public as well as to foreign right holders. Right holders cannot, for example, obtain documents from the government on the activities of CD plants (even though every order the plant accepts must be recorded and reported to the authorities). Foreign right holders are usually told that these are "national confidential documents." IIPA members have no evidence that these practices will change.
- There is a lack of time limits for investigations, leading to long delays and a resulting failure to deter pirates.
- There is still "local protectionism" by administrative agencies involving politically or financially powerful people engaged in pirate activities.
- NCAC continues to fail to use its authority effectively to deal with the all-important problem of corporate end-user software piracy.

**The software industry:** As a result of the increased attention to enforcement in the second half of 2004, BSA reports an end-user raid on a design and engineering company which resulted in the detention of four persons and the seizure of 24 computers. This is among the first such actions that has resulted in the detention of an employee from a company engaged in unauthorized use of business software. In October 2004 in Shenzhen in Guangdong Province, six shops engaged in selling pirated software were raided and the software confiscated. In Shangxi Province, two design companies using unauthorized copies of AutoCAD and 3DMAX were raided in October by the Xi'an AIC, the Xi'an Press and Publications Bureau and the Xi'an PSB. Twenty-four copies were seized and the offenders were fined a paltry RMB 2000 (US$242). BSA also notes that the NCAC took very seriously the administrative enforcement of two major CD-replicators (Beijing, Tianjin), and pro-actively did PR to generate awareness and

[21] MPA does confirm, however, that most of these cases involved pornographic material with only a small number limited to purely pirate product. Nevertheless, the interagency body reported the "arrest" of 6,912 offenders and the seizure of 11 illegal production lines (5 DVD lines and six VCD lines). Two OD factories were also penalized. In one of these cases where MPA has information (reported in the text below), the licensed factory was in Hunan and, in July 2004, was fined RMB80,000 (US$9,660) by GAPP related to copyright infringement. This fine, for an OD factory, is clearly not a deterrent.

[22] Fines can be up to three times the value of the pirated goods measured at pirate prices, but fines as actually imposed are woefully low.

deterrence. These two cases were included among the top ten 2004 IPR infringement cases published by the State Council Office of Intellectual Property Protection.

**The entertainment software industry:** A number of ESA member companies are active in the Chinese market, with a few engaged in domestic enforcement either through local counsel or its own in-country anti-piracy program. In particular, Nintendo has undertaken a significant number of administrative actions in Guangdong Province, though these actions have been taken largely under the trademark law to protect the globally famous "Game Boy" brand. While trademark actions have generally proven easier to prosecute than copyright cases for Nintendo, available penalties are as low, or lower, than those imposed for copyright infringement. The efforts of the Chinese administrative authorities (specifically in Guangdong Province), in cooperation with Nintendo representatives, have resulted in raids against a number of retail shops and factories. Raids against the factories have also revealed that they are (directly or indirectly) connected with Hong Kong and Taiwanese factories (for instance, funding was often supplied by a Taiwanese national, or a Hong Kong "affiliate" office often served as a conduit for transmitting orders to the factory on the Chinese mainland.

**The motion picture industry:** MPA's separate submission reports in detail on the joint administrative raids in which it was involved in 2004. These joint raids represent only a fraction of the total raids conducted by NAPPWC and by local authorities without notice to the affected association or company. In 2004, 573 joint raids against retail shops were conducted in Shanghai, Beijing, Shenzhen and Guangzhou. MPA is encouraged to report that 145 of these shops, principally in Beijing, were closed after the raids — 510 shops were fined; the average range was from RMB1,000-RMB5000 (US$121-US$604). A very few fines exceed this and it is encouraging that one shop named "The 74th Store of Yongshengshiji AV Center," located in Congwen District of Beijing, was fined RMB50,000 (US$6,041). The average fines remain notoriously low, however, and are hardly a deterrent.

Other information on the level of administrative fines is spotty. The General Administration of Press and Publications (GAPP) ran a raid against a licensed VCD factory on July 27, 2004. The factory had seven lines and reportedly produced very significant quantities of pirate product from 1998 to 2004. The factory was ordered to cease operation from July to September 2004 and was fined only RMB80,000 (US$9,666). Temporary closures and fines of this level will not deter factory-level piracy. However, MPA was pleased to have at least received notification of the action. We hope this bodes well for greater transparency in the future.

The statistics reported below by MPA for administrative cases come from the Chinese authorities. It cannot be confirmed as covering only U.S. pirate movies but may involve other product. It also cannot be confirmed that the fines levied were just for copyright piracy; they could cover pornography or other legal violations beyond copyright piracy.

**The recording industry**: In its business confidential submission to USTR, RIAA/IFPI noted the lack of transparency that pervades China's administrative enforcement system and reported on isolated actions taken by local and provincial enforcement authorities against factories, distribution centers, retail establishments and street vendors. The recording industry rarely receives information on the level of penalties imposed following those raids, and where information is made available, it is generally distressing. In one raid in Shenyang conducted by the local AIC for example, where over 3000 pirate music CDs were seized, the industry learned that the fine imposed was only RMB30,000 (US$3,625) or a little over US$1.00 per pirate CD!

Better information is available from the authorities in Shanghai (the Shanghai Culture Inspection Team), where transparency is somewhat improved. After looking at the data put together from Shanghai, RIAA estimates that the fines ran from about RMB500 to RMB5000 per incident (US$60-US$604). However, of the total number of cases, 90% resulted in warnings; only 10% in fines. The authorities also closed approximately 19 warehouses in 2004, but these were only facilities where more than 10,000 copies of pirate product were found. This is a clear example of the non-deterrent nature of the administrative process and Shanghai is far better than other provinces/cities.

**The book publishing industry**: U.S. book publishers have heard of isolated instances of action taken by enforcement authorities against book pirates, but almost entirely on behalf of Chinese companies. Publishers are working with local authorities to increase government administrative activity on behalf of U.S. companies and will be monitoring the degree of cooperation more closely during 2005, though the lack of transparency in the system is a major hurdle.

| ADMINISTRATIVE COPYRIGHT ENFORCEMENT STATISTICS FOR 2004<br>PEOPLE'S REPUBLIC OF CHINA | | | |
|---|---|---|---|
| ACTIONS | MOTION PICTURES | BUSINESS SOFTWARE | TOTALS |
| NUMBER OF RAIDS/SEARCHES CONDUCTED | 1,153 | 12 | 1,165 |
| NUMBER OF ADMINISTRATIVE CASES BROUGHT BY AGENCY | 914 | 12 | 926 |
| NUMBER OF DEFENDANTS FOUND LIABLE (INCLUDING ADMISSIONS/PLEAS OF GUILT) | 894 (20 cases pending) | 9 (2 cases pending) | 903 |
| RATIO OF CONVICTIONS TO THE NUMBER OF RAIDS CONDUCTED | 77.5% (894/1,153) | 75% (9/12) | 78% (903/1,165 ) |
| RATIO OF CONVICTIONS TO THE NUMBER OF CASES BROUGHT | 100% | 75% | |
| NUMBER OF CASES RESULTING IN ADMINISTRATIVE FINES | 798 | 0 | 798 |
| TOTAL AMOUNT OF FINES LEVIED | | | |
| RMB$0-1,000 (UP TO US$120) | 209 | 0 | 209 |
| RMB1,001-5,000 (UP TO US$604) | 264 | 0 | 264 |
| RMB5,001-10,000 (UP TO US$1208) | 188 | 0 | 188 |
| RMB10,000 AND ABOVE (ABOVE US$1208) | 137 | 0 | 137 |
| TOTAL AMOUNT OF FINES ORDERED IN HOW MANY CASES (E.G., $XXX IN Y CASES) | RMB$4 million (US$483,284) in 798 cases | US$174,735 in 9 cases | |

## Criminal enforcement

IIPA and its members (and the USG) have pressed China for years to use its criminal law to prosecute pirates, since it is the only viable means effectively to reduce piracy levels in China. While criminal enforcement does occur periodically under other laws such as those dealing with pornography, smuggling or running an illegal business (Article 225 of the Criminal Code), it will be difficult for China to convince its people that piracy is an economic crime that damages the Chinese economy and Chinese culture until there is a publicly announced commitment from the State Council/Vice-Premier level and an ample record of convictions for "piracy" with deterrent penalties.

IIPA and its members hope that that process begun last April with Vice Premier Wu Yi's announcements, and, in particular, the recent amendment to the SPC Judicial Interpretations will mark the beginning of an initiative and not its highpoint. Further discussion on the new JIs is set out below.

IIPA members have consistently had difficulty in gathering information on the use of the criminal law against acts of piracy. When we hear of convictions, we discover that they are usually under other laws, like pornography or "illegal business," not piracy. China publicly announces the seizure and destruction of pirate product on a regular basis, but seems rarely to publicly announce a jail term or deterrent fine for piracy per se. This must change.

**The recording and motion picture industry**: RIAA has reported in their business confidential submission to USTR that it has no knowledge of any criminal "piracy" prosecution involving its product. MPA, on the other hand, last year reported some statistics it was able to unearth. It reported last year that in 2002, 19 criminal cases had been brought and concluded (with reported sentences of six months to 6 years) in Beijing involving that industry's products—apparently none in any other city. It reported that, in 2003, 30 cases were filed in Beijing and Shanghai, with again, 80% in Beijing. However, it also reported that, to the best of its knowledge, only three of these cases were brought under the criminal "piracy" provisions, Article 218, the high threshold having been met in those 3 out of 49 total cases over 2 years. The rest of the cases were basically censorship/pornography cases brought under Article 225 of the Criminal Law. Jail terms were, however, significant in most of these cases (though the Chinese have traditionally treated pornography very seriously) indicative of the fact that a criminal prosecution, as contrasted with an administrative proceeding, is likely to result in some deterrence—if properly and widely publicized and directly identified with piracy.

In July 2004, the Chinese government announced a major raid conducted by the Economic Crime Investigation Division (criminal copyright enforcement, as noted earlier, is normally undertaken by the less-efficient Social Order Division)[23] of the MPS, assisted by the Shanghai PSB and the U.S. Department of Justice and U.S. Customs. Over 210,000 DVDs were seized in the raid and six people were arrested, including two U.S. citizens. 20,000 of the DVDs were to be sold in the U.S. and the rest were to be transmitted via the Internet to 25 countries. These six defendants were prosecuted under the "operating without a license" provisions in Article 225 of the Criminal Code.

We have also heard from Chinese representatives that there have been other criminal convictions specifically prosecuted under the criminal piracy provisions, though the ones cited have involved Chinese origin works and all have admitted that these cases are very, very few. We have inquired on many occasions about the existence of criminal convictions purely for piracy offenses and we have received no confirmations.[24]

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[23] In fact, a senior official in the Social Order Division of the PSB told a visiting US Government delegation during 2004 that copyright piracy was an offense generally committed in the rural regions of China and not warranting criminal prosecutions.

[24] 2002 may have marked the year of the first pure piracy case ever, involving a factory in Guangdong Province, where two defendants were sentenced in March 2002 to two years' imprisonment for copyright piracy only. This case involved the Foshan Jinzhu Laser Digital Chip Co. Ltd., which had accepted a phony order for 920,000 DVDs from a Taiwan defendant [who was fined RMB 400,000 ($48,329)]. In addition to the prison terms, three lines were removed, and the GAPP revoked the plant's license. There were other rumors of criminal piracy convictions in Anhui Province but no confirmation was obtained. Another case in Shanghai involved the *Dictionary of Cihai*, but again it appears that this was not a pure copyright case. IIPA has received informal reports of two book-piracy cases which were decided purely under Article 217 and 218, but these may be the Anhui cases for which we have no confirmation.

Bringing criminal cases was not only an obligation in the U.S.-China 1995 Memorandum of Understanding and [Enforcement and Market Access] Action Plan, but is a clear TRIPS requirement. China's JCCT obligations include a commitment that China will "subject a greater range of IPR violations to criminal investigation and criminal penalties," and that criminal sanctions will be applied "to the import, export, storage and distribution of pirated and counterfeit products" and that criminal sanctions will also apply to on-line piracy. China is not now in compliance with either that bilateral agreement, TRIPS or its JCCT commitments. As discussed below, industry is skeptical whether the lowered thresholds and other amendments to the JIs will be implemented in such a way to result in the commencement of many significant criminal prosecutions, though we fervently hope that we are wrong. This is the only way, in industry's view, that "piracy levels can be significantly reduced" in China, as promised by the Vice Premier.

**Other copyright industries:** Except for the statistics cited above, no other industry reports having a criminal case—for piracy—brought or concluded with respect to their products. Indeed, the recording industry, which has brought myriad civil cases against licensed OD factories, continues to voice its frustration that the criminal authorities (the Public Security Bureau) are not taking actions against underground plants where civil actions are not possible.

While the copyright industries welcome actions under Article 225 of the Criminal Law, real deterrence won't be brought to the criminal system until a significant number of widely publicized cases are brought under Articles 217 and 218. For this to happen, there must be political will to bring those cases. Below MPA and BSA report the criminal cases they have been told about, but again, it is likely that, in the case of audiovisual product, few or no such cases were prosecuted for "piracy," but under other provisions, such as operating an unlicensed business under Article 225 or for pornography. Until the authorities commence accurate and granular reporting of these statistics, it will be very difficult to evaluate progress in the enforcement system.

| CRIMINAL COPYRIGHT ENFORCEMENT STATISTICS FOR 2004<br>PEOPLE'S REPUBLIC OF CHINA | | |
|---|---|---|
| **ACTIONS** | **MOTION PICTURES** | **BUSINESS SOFTWARE** |
| NUMBER OF RAIDS CONDUCTED | 42 | 2 |
| NUMBER OF VCDS SEIZED | 15,172,549 | 2500 |
| NUMBER OF DVDS SEIZED | 22,221,488 | |
| NUMBER OF CD-RS/DVD-RS SEIZED | 27,157 | |
| NUMBER OF INVESTIGATIONS | 50 | 2 |
| NUMBER OF VCD LAB/FACTORY RAIDS | 8 | |
| NUMBER OF CASES COMMENCED | 34 | 1 |
| NUMBER OF INDICTMENTS | 30 | 1 |
| NUMBER OF DEFENDANTS CONVICTED (INCLUDING GUILTY PLEAS) | 48 | 1 |
| ACQUITTALS AND DISMISSALS | 2 | |
| NUMBER OF CASES PENDING | 13 | 1 |
| NUMBER OF FACTORY CASES PENDING | 0 | |
| TOTAL NUMBER OF CASES RESULTING IN JAIL TIME | 21 | |
| SUSPENDED PRISON TERMS | | |
| MAXIMUM 6 MONTHS | 5 | |
| OVER 6 MONTHS | 1 | |
| OVER 1 YEAR | 6 | |
| TOTAL SUSPENDED PRISON TERMS | 101 MONTHS | |
| PRISON TERMS SERVED (NOT SUSPENDED) | | |

| CRIMINAL COPYRIGHT ENFORCEMENT STATISTICS FOR 2004<br>PEOPLE'S REPUBLIC OF CHINA | | |
|---|---|---|
| ACTIONS | MOTION PICTURES | BUSINESS SOFTWARE |
| MAXIMUM 6 MONTHS | 3 | 1 |
| OVER 6 MONTHS | 14 | |
| OVER 1 YEAR | 25 | |
| TOTAL PRISON TERMS SERVED (NOT SUSPENDED) | 42 | |
| NUMBER OF CASES RESULTING IN CRIMINAL FINES | | |
| UP TO $1,000 | 2 | 1 |
| $1,000 TO $5,000 | 6 | |
| OVER $5,000 | 10 | |
| TOTAL AMOUNT OF FINES LEVIED (IN US$) | 313,020 | 362 |

## Civil enforcement

As noted above, one positive development is the increasing sophistication and effectiveness of the IPR courts throughout China. For this reason, Chinese right holders and, increasingly, U.S. right holders have used the civil system as a means to bring some deterrence to the enforcement system in China, given the demonstrated failures of the criminal and administrative enforcement systems.

**The recording industry:** The recording industry has brought over 235 cases against factories since 2002 and many others (through 2004, 202 cases) against retailers and Internet pirates. Ninety-one of the factory cases remain pending. Total damages/settlement amounts in all these civil cases brought by the recording industry amounted to US$1.9 million. While there may be some limited deterrence associated with these amounts, it is clear that China can not rely upon civil actions to significantly improve the business climate, and that criminal actions are sorely needed. It must also be noted that the industry rarely is made whole for the damages they sustain in these civil cases. In only a few cases do the record companies even recoup their litigation costs (awards average 30% of actual litigation costs). The largest award/settlement in this range of cases was RMB600,000-800,000 (US$72,493-US$96,657). These judgments/settlements were against factories suspected of producing millions of units of pirate music CDs at profits which far exceed these meager damages—-thus demonstrating that engaging in large scale production of pirate materials, even when you get caught, is presently a rational business decision in China.

As noted above, the recording industry continues to face massive Internet piracy in China but has been required to fight this problem through cease and desist letters to ISPs and, where necessary, civil litigation. More than 2000 cease and desist letters were sent in 2004, with a compliance rate of 75%, a significant improvement over the 30% in 2003. The industry has now completed 17 civil Internet cases. A recent case was won against www.tyfo.com, one of China's most popular pirate websites. Damages awarded were RMB 370,000 ($45,000) which, while significant, is low given the damage done. In summary, while these cases have been successful, monetary damages have been very low and hardly a deterrent to further infringements. The maximum received in an Internet case was approximately RMB170,000 for 15 songs (US$1,370 per song) in the case against www.ti.cn, awarded by the Tianjin No. 1 Intermediate Court. Compliance has generally been good by the ISPs but litigation and *ex officio* action by Chinese enforcement authorities will be necessary to make a significant difference. Moreover, the industry is very concerned about the new draft Internet regulations, which if adopted, would severely threaten this compliance rate. RIAA/IFPI has brought a

number of civil suits against ISPs and websites, which have been reported, in earlier submissions. Some success has been achieved.

**The motion picture industry:** The motion picture industry also embarked on a civil litigation program in 2002, with a total of ten civil cases having been brought under the recent Copyright Act amendments, all of them successful. Four cases against factories were settled. Six cases against three retailers in Shanghai resulted in a damages in favor of the plaintiffs based on statutory damages of up to RMB500,000 (US$60,410) available under Article 48 of the 2001 amendments to the Copyright Act. However, evidentiary requirements remain burdensome and unnecessary. Further amendments to the Copyright Act should establish a presumption with respect to subsistence and ownership of copyright and permit, for example, a U.S. copyright certificate to be used.

In 2004, MPA has issued 4,055 cease and desist letters to ISPs in China, primarily for P2P piracy. This was an almost ninefold increase over 2003. However, the compliance rate was, as noted earlier, only 17%. The new "Interpretations" in combination with NCAC's soon-to-be completed Internet regulations, plus an easing of the burdens to followup with civil cases with significant, and deterrent, damages, must change this result. Any civil enforcement strategy must also be accompanied by aggressive use of China's administrative enforcement machinery, under the new JIs criminal enforcement.

As discussed in detail in prior submissions, the new copyright law amendments have made certain positive changes that should assist in bringing successful civil cases against infringers.

- Provisional remedies were added in Articles 49 and 50 and, as we understand it, it is intended that these operate on an *ex parte* basis.
- Court-determined "pre-established" damages can now be awarded under Article 48 up to a maximum of RMB500,000 (US$60,410) where the "actual losses suffered by the holder of the right or the profit earned by the infringing party cannot be determined."

**The software industry:** These changes are significant improvements, though U.S. right holders have continued to have some problems in successfully bringing civil cases in China, particularly the business software industry. Until this year, very few cases have been brought and concluded. However, the trend has been encouraging with respect to the Chinese civil court system's willingness to take on and decide end-user cases. There have been, as of this date however, only six such cases. The first two, involving AutoDesk and Adobe, were decided in favor of the copyright owner but evidence of actual damages (which were substantial—in one case over US$250,000) ended up being rejected and the cases were decided under the new statutory damages provisions of the copyright law amendments. In one case the damages were RMB500,000 (US$60,410) and in the other RMB115,000 (US$13,894 including court costs). A third case was settled under pressure from the judge for only RMB50,000 (US$6,041). In the fourth case, against a large interior design company in Beijing with 15 operations, NCAC finally agreed to raid two locations. After about eight months, NCAC awarded only RMB270,000 (US$32,621) in fines and the copyright owner then sought to bring civil actions in the courts against four other branches of the enterprise. In October 2003, the Beijing High Court, for the first time ever, awarded damages based upon the number of copies times the retail price—a total in damages of RMB1.49 million (US$180,023). In the two recent cases, the courts supported almost all the claims made by right holders. In one case the damages were RMB378,200 (US$45,695) — the decision is on appeal — and in the other

RMB290,900 (US$35,147). While this is a major victory for the software industry, any significant dent in the rate of software piracy in China will need the widespread application of administrative enforcement by NCA and the criminalization of enterprise end-user piracy. BSA also remains concerned that evidence preservation orders are still coming too slowly and are too difficult to obtain, in view of China's TRIPS obligations in this important area.

Also of significance is a decision in the summer of 2004 in the Shenyang Intermediate People's Court which ruled against end users of unauthorized software. The case involved Chinese software (RIP2.1). The court made use of the presumption in the 2001 copyright amendments to require the defendants to show that their use was legal. The eight defendants were unable to do so and damages of RMB100,000 ($12,082) were imposed.

**The book and journal publishing industry:** In the area of piracy of literary works—in a major salutary development—a Beijing Intermediate Court rendered a judgment in September 2003 (in a case commenced in 2000) which sought damages against the Beijing New Oriental School. This school had for years administered the TOEFL and GRE tests to Chinese students seeking entrance into U.S. universities. ETS alleged that the school has been stealing ETS's highly secure test questions and test forms and selling them to its students at a significant profit. The school also distributed these highly secret test questions widely in China. ETS claimed that the security and integrity of the tests have been compromised to the extent that it has led some U.S. universities to doubt the authenticity of all test scores from China, harming the entrance prospects of Chinese students. (Over 10% of the 800,000 students taking the TOEFL test worldwide come from China). New Oriental had been unsuccessfully sued before and the size of the infringement was staggering, with New Oriental adding an average of 10,000 students per month and with a nine-month waiting list. The court finally concluded a case that had been rife with procedural hurdles, and awarded damages of US$1.2 million to both ETS and GMAT.

U.S. publishers have brought a number of civil cases in the past year, but have been hampered in some important cases by non-transparent and onerous evidentiary burdens. The industry has a number of civil cases pending and will be monitoring the progress of these in the coming months.

| CIVIL COPYRIGHT ENFORCEMENT STATISTICS FOR 2004<br>PEOPLE'S REPUBLIC OF CHINA | | | | |
|---|---|---|---|---|
| **ACTIONS** | MOTION PICTURES | BUSINESS SOFTWARE | BOOK PUBLISHING | TOTALS |
| NUMBER OF CIVIL RAIDS CONDUCTED | 0 | 0 | 0 | 0 |
| POST-SEARCH ACTION | 0 | 0 | 0 | 0 |
| CASES PENDING | 0 | 0 | 0 | 0 |
| CASES DROPPED | 0 | 0 | 0 | 0 |
| CASES SETTLED OR ADJUDICATED | 2 | 2 | 0 | 4 |
| VALUE OF LOSS AS DETERMINED BY RIGHT HOLDER ($USD) | 0 | 0 | 0 | 0 |
| SETTLEMENT/JUDGMENT AMOUNT ($USD) | US$30,000 | US$82,860 | 0 | US$112,860 |

## Statutory Law and Regulations: The New Judicial Interpretations, the Criminal Law, the 2001 Copyright Amendments, and the Draft Internet Regulations

### The new Supreme People's Court judicial interpretations

On December 21, the Supreme People's Court issued its long-awaited, and promised, amendment to its Judicial Interpretations of the Chinese Criminal Law. IIPA has reviewed these amendments and comments on them as follow:

- As a fundamental matter, whether the new Judicial Interpretations are positive or not will depend entirely on the **political will** of the Chinese authorities to use them aggressively to bring criminal cases and to impose deterrent penalties on pirates. In IIPA's view, this is a necessary condition for China to redeem its JCCT commitment to "significantly reduce piracy levels."
- Even though some of the thresholds were reduced, and some significantly, it remains to be seen whether, given that the Chinese, for inexplicable and unjustifiable reasons, chose to retain measuring the thresholds at pirate prices, there will be any difference in the number of cases **in practice**.
- If the JIs, as they came out in the end, are any measure of the government's ultimate political will to use the criminal process to reduce piracy, then we cannot be very optimistic since the improvements were so minimal.
- The new "copy" thresholds do hold some promise, particularly if requirements to prove sales are unnecessary. However, 1,000/3,000 copies (individuals/units for the lower penalties where jail time is not mandatory and fines are set by the judge and not in the JIs) and 5,000/15,000 copies (individuals/units for the mandatory three year minimum jail term) still place a heavy burden on enforcement authorities and will only result, it would seem, in the possibility of prosecuting the very biggest pirates — not much different than under the previous JIs. We note that the 1000 copy threshold (for individuals, not units) is <u>double</u> the threshold for prosecuting for illegal business operations under Article 225. We also note that in an apparent inadvertent drafting error, sound recordings are not covered in the copy threshold provisions. Finally, the copy thresholds apparently do not apply to Article 218 offenses involving only "sales." We understand that the SPC has taken the position that "sales" is not the equivalent of "distribution" and that the latter implies some connection with the entire supply chain, beginning with manufacture. This must be clarified since it may result in excluding from possible criminal prosecution owners of warehouses where large seizures have been made, where there is no evidence of the owner being involved in production and where the monetary thresholds have not been met.
- The Chinese government took the exact opposite approach from that suggested by the copyright industries and the U.S. government: they kept "profits" as the main test, with "business volume" as a secondary test at a higher threshold. Only when the pirate price is "unknown" can we apparently measure the threshold by the legitimate price. China is still the only country in the world that uses pirate "profits" as a criterion for what is criminal and what is not. Some benefit may come from the new ability to aggregate income amounts over multiple raids, however.
- They also inexplicably failed to abolish the individual/unit distinction; most sophisticated pirates will now have an even greater incentive to operate only as a "unit" to avoid the lowered "individual" thresholds.

- It is positive that the act of importing and exporting has been added to the JIs, but, again, importers and exporters will not be held liable for direct infringement under Article 217 or 218 but only be held liable as "accomplices" under Article 27 of the Criminal Law. This Article is written in such a manner as seemingly to "encourage" judges to impose the most minimal penalties.
- Specific reference to Internet offenses is also good but it will be even more difficult to provide proof that the thresholds have been met than would be the case with physical piracy. Again, in what is likely an inadvertent drafting error, sound recordings are not covered!
- End-user software piracy "could" be covered as a crime, but BSA reports that all indications are that the intention is NOT to cover it — a huge deficiency. It is also unclear how hard-disk loading piracy of software in the wholesale and retail channels can be adequately covered by the new JIs, given the excessively high copy thresholds.
- It is unclear why the provisions on repeat infringers was removed entirely, rather than strengthened by applying the higher, rather than the lower, tier of statutory penalties.

As noted earlier, it is critical that the PSB be given the resources necessary to implement the new JIs and that the Economic Crimes Division be put fully in charge of criminal copyright enforcement.

**Section 217 and 218 of the Criminal Code criminalizing copyright piracy must be amended to comply with TRIPS.**

The JIs, as proposed by IIPA, were not amended to rectify the critical TRIPS incompatibilities in Article 217 and 218 of the Criminal Code. IIPA has noted in prior submissions that the criminal piracy articles of Chinese law are deficient on their face, and thus violate TRIPS Article 61, which requires the criminalization of all "copyright piracy on a commercial scale." These articles must be amended, inter alia, (1) to criminalize end-user piracy; (2) add reference to all the exclusive rights now provided in the law (including the new WIPO treaties rights and unauthorized importation; (3) add criminalization of violations of the anti-circumvention provisions and rights management information; (4) criminalize Internet and other offenses that are without "profit motive" but that have impact on right holders "on a commercial scale"; (5) eliminate distinctions between crimes of entities and individuals; and (6) increase the level of penalties overall.

**The 2001 Copyright Amendments must be further amended to bring the law into compliance with TRIPS and the WIPO "Internet" treaties.**

The amendments to China's 1990 copyright law were adopted on October 27, 2001, and IIPA's 2002 and 2003 submissions provide great detail on both the positive changes, as well as the deficiencies, in these amendments.[25] The amendments sought to bring China into compliance with its WTO obligations and added many provisions that sought to implement the requirements of the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT). The deficiencies detailed in these prior submissions were not

[25] See IIPA's 2003 Special 301 country report on the People's Republic of China, pages 33-36, available at http://www.iipa.com/rbc/2003/2003SPEC301PRC.pdf. Copyright Law of the People's Republic of China, Adopted at the Fifteenth Session of the Standing Committee of the Seventh National People's Congress on September 7, 1990, Amended in Accordance with "Decision to Amend Copyright Law of the People's Republic of China," Adopted at the Twenty-Fourth Session of the Standing Committee of the Ninth National People's Congress on October 27, 2001 (translation on file at IIPA).

fixed by the December 2001 regulations governing computer software or the regulations to the Copyright Law, which became effective on September 15, 2002. The following are the key deficiencies in the 2001 amendments that still need to be corrected:

- The most glaring deficiency is that criminal liability is not affected and there are apparently no plans to amend the Criminal Code. As noted, the current Criminal Code articles on copyright violate the TRIPS Agreement.
- While the Law [Article 47(6)] provides anti-circumvention protection, it does not fully implement the WIPO treaties obligation, in that it: (1) does not expressly prohibit the manufacture or trade in circumvention devices, components, services, etc.; (2) does not define "technical protection measures" to clearly cover both "copy-controls" and "access controls"; (3) does not make clear that copyright exceptions are not available as defenses to circumvention violations; (4) does not expressly include component parts of circumvention technologies (assuming devices are covered); (5) imposes an "intent" requirement as to acts (and business/trade if such activities are covered), which might make proving a violation difficult; and (6) does not provide for criminal penalties for circumvention violations (since the copyright law only deals with civil and administrative remedies).
- While the law protects against "intentionally deleting or altering the electronic rights management system of the rights to a work, sound recording or video recording" without consent of the right holder [Article 47(7)], this protection may not fully satisfy WIPO treaties requirements and requires further elaboration. For example, the law does not expressly cover "distribution, importation for distribution, broadcast or communication to the public" of works or other subject matter knowing that RMI has been removed or altered without authority, as required by the WIPO treaties, nor does it define "electronic rights management system" in a broad, technology-neutral manner.
- Temporary copies are not expressly protected as required by Berne, TRIPS and the WIPO treaties. As with the copyright law prior to amendment, protection of temporary copies of works and other subject matter under the 2001 copyright law remains unclear. According to an earlier (February 2001) draft amendment of Article 10, "reproduction" as applied to works was to include copying "by digital or non-digital means." The phrase "by digital or non-digital means" was removed from the final version of Article 10(5) prior to passage. Article 10(5) also fails (as did the definition of "reproduction" in Article 52 of the old law, which was deleted, and Article 5(1) of the 1991 Implementing Regulations) to specify that reproductions of works "in any manner or form" are protected. Addition of either of these phrases might have indicated China's intent to broadly cover all reproductions, including temporary reproductions, in line with the Berne Convention, TRIPS and the Agreed Statement of the WIPO Copyright Treaty.[26] As it stands, the

[26] The agreed statement to Article 1 of the WIPO Copyright Treaty provides,

> [t]he reproduction right, as set out in Article 9 of the Berne Convention, and the exceptions permitted thereunder, fully apply in the digital environment, in particular to the use of works in digital form. It is understood that the storage of a protected work in digital form in an electronic medium constitutes a reproduction within the meaning of Article 9 of the Berne Convention.

Dr. Mihály Ficsor, who was Secretary of the WIPO Diplomatic Conference in December 1996, has stated that the term "storage" naturally encompasses temporary and transient reproductions. Ficsor notes that "the concept of reproduction under Article 9(1) of the Convention, which extends to reproduction 'in any manner or form,' must not be restricted just because a reproduction is in digital form, through storage in electronic memory, and just because a reproduction is of a temporary nature." Mihály Ficsor, Copyright for the Digital Era: The WIPO "Internet" Treaties, Colum.-VLA J.L. & Arts (1998), at 8. See also, Mihály Ficsor, The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation (2002).

current Article 10(5) description of the reproduction right includes "one or more copies of a work by printing, photocopying, copying, lithographing, sound recording, video recording with or without sound, duplicating a photographic work, etc." Objects of neighboring rights (Articles 37, 41 and 44) mention "reproduction" (e.g., Article 41 provides sound recording and video recording producers a "reproduction" right), but the Article 10(5) description is not expressly applied *mutatis mutandis*. It should also be noted that the Article 41 reproduction right for sound recording producers does not expressly extend to indirect reproductions, as required by TRIPS (Article 14.2) and the WPPT (Article 11). China has apparently conceded in the TRM process in Geneva that its law does not encompass temporary copies.

- A new compulsory license (Article 23) permits the compilation of "[p]ortions of a published work, a short work in words or music, or a single piece of artwork or photographic work" into elementary and high school (so-called "el-hi") textbooks, and "State Plan" textbooks (which we are still trying to determine would not include university textbooks, which would cause even greater concern for U.S. publishers); in addition, sound recordings, video recordings, performances, and broadcasts apparently are subject to this compulsory license. IIPA hopes that the Chinese government will confirm that this compulsory license provision will not be read to apply to foreign works and other subject matter since it would violate the Berne Convention and TRIPS if it did. It would also violate the International Treaty regulations referenced above (which implemented the 1992 U.S.-China Memorandum of Understanding [MOU]), even if it were further confirmed that it only applies to foreign printed materials used in elementary or high school "textbooks" (hard copies). The significant damage to publishers would be further exacerbated if "State Plan" were to encompass university textbooks and/or if "textbook" includes forms other than "printed" forms (e.g., digital forms or multimedia). The regulations must be framed to exclude foreign works or to limit their scope in a manner consistent with the Berne Appendix.
- The provisions on collecting societies leave unclear whether this provision extends to the creation of anti-piracy organizations which can "enforce" the rights of their members in the association's name. This change is sorely needed in China, particularly for the benefit of foreign right holders, and other laws or regulations which inhibit the formation of such organizations should also be amended or repealed. Regulations did not clarify this point.
- The treatment of works and sound recordings used in broadcasting continues to remain woefully deficient and out of date. While Article 46 spells out that broadcasters must obtain permission to broadcast "unpublished" works (e.g., an exclusive right), Article 47 provides a mere "right of remuneration" for the broadcast of all other works, with the sole exception of cinematographic and "videographic" works. Such a broad compulsory license (not even limited to noncommercial broadcasting) is not found in any other law, to IIPA's knowledge. Furthermore, the broadcast of sound recordings is not even subject to a right of remuneration by virtue of Article 41 and Article 43. Record producers should not only enjoy full exclusive rights for both performances and broadcasts in line with modern trends, and this treatment appears to conflict with the "Regulations Relating to the Implementation of International Treaties" promulgated in 1992. Article 12 extends these rights to foreign cinematographic works and Article 18 applies that Article 12 applies to sound recordings. The authorities, though asked, did not clarify this contradiction in the Implementing Regulations to the Copyright Law discussed below. Provisions should be added to ensure that certain uses of sound recordings that are the equivalent of interactive transmissions in economic effect should be given an exclusive right. An exclusive importation right should also be added.

- The draft does not take advantage of the opportunity to extend terms of protection to life plus 70 years and 95 years from publication. This is the modern trend.
- A full right of importation applicable to both piratical and parallel imports should have been included.

Deficiencies also occur in the enforcement area:

- Administrative fines need to be substantially increased. The equivalent of injunctive relief must be provided and clarified.
- Again worthy of particular emphasis, however, is the failure of these amendments to address the lack of TRIPS-compatible criminal remedies, probably the single most important change that must be made to open up the Chinese market closed by staggering piracy rates around 90%. Criminal remedies must be extended to include violations of the TPMs and RMI provisions in order to comply with the WIPO treaties obligations.

IIPA also urges China to ratify the WIPO "Internet" treaties by the end of 2005.

**The Supreme People's Court's Internet Interpretations and the NCAC's Draft Internet Interpretations**

The Supreme People's Court issued its "Interpretations of Laws on Solving Online Copyright Disputes," with effect from December 20, 2000.[27] These were amended at the end of 2003.[28] As announced at the JCCT, NCAC and MII were to issue Internet-related regulations by the end of 2004. A draft was released in April 2004 and another in November 2004.[29] These regulations deal entirely with the liability of Internet Service Providers and with the details of "notice and takedown," and, we understand, are being issued pursuant to Article 58 of the 2001 copyright law amendments pursuant to which the State Council reserves to itself the task of issuing regulations on the "right to transmit via information networks."

Clarification is necessary on how these draft regulations interrelate with the current 2003 "Interpretations" of the Supreme People's Court.

With respect to the 2003 amended SPC "Interpretations," they are deficient or unclear in several respects:

- Article 3 remains problematic. It appears to provide a loophole for the reprinting, extracting or editing of works, once they have appeared on the Internet with permission and remuneration. While the copyright owner can give notice that it does not want its work used further, this "quasi compulsory license" is unworkable in practice. Copyright owners should not have to undertake these notification burdens when they are granted exclusive rights under the Conventions.

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[27] "Interpretations of the Supreme People's Court on Laws for Trying Cases Involving Internet Copyright Disputes" (Adopted at the 1144th session of the Judicial Committee of the Supreme People's Court on Nov. 22, 2000).
[28] Decision on Revising "Interpretation of the applicable law and some other matters for hearing computer network copyright-related disputes by the Supreme People's Court" by the Supreme People's Court (Adopted by the Trial Committee of the Supreme People's Court at No. 1302 meeting on Dec. 23, 2003).
[29] Administrative Measures on Copyright under the Environment of the Internet (Draft), April 2004. Administrative Protection Measures on the Right of Communication through the Information Network (Draft), National Copyright Administration of China; Ministry of Information Industry, November 2004. English translations on file at IIPA.

- Many of the provisions of the "Interpretations" overlap with the NCAC draft regulations discussed below but it is unclear, for example, whether the notice requirements set forth in the NCAC regulations would also apply in the context of a civil infringement case brought before the courts. There are also inconsistencies. Article 6 seems to imply that the ISP must provide the "author" with information identifying the infringer. This is not part of the NCAC regulations.
- Article 5 makes ISPs fully liable where they are "aware" of the infringement, either before notice from the right holder or after receiving notice and failing to take down the infringing site. Is this a more liberal test than in the NCAC draft regulations? The ISP must also have "adequate evidence" of infringement. What constitutes "adequate evidence" of infringement? Will it be the same as the onerous requirements for an administrative action? All this must be clarified. The "Interpretations" also do not apparently require an "immediate" takedown as provided in the draft NCAC regulations.

The NCAC draft regulations, revised and issued in November 2004, continue to be inadequate in dealing with the realities of infringement on the Internet and must be further redrafted. Below are a few of the deficiencies:

- It is important that ISPs that are in a position to control content not be subject to any limitations on liability. The current language in Article 2 should be clarified to this effect.

- The requirements in draft Article 8 on the content of the notice are unworkable. Articles 5, 7, 8 and 10 imply that only the "copyright owner" can supply the notice, and not an authorized representative of the owner, such as a trade association. This change must be made. Article 8 then continues to list the requirements for a valid notice. The Article requires that the "copyright owner" supply an "ownership certificate of copyright." This is followed by four other documentary requirements. These are unclear and far too onerous to be practical. All that should be required, as in the DMCA and the U.S. FTAs, is a statement that the copyright owner has a good faith belief that the material is infringing and that the statement in the notice is accurate. There is also no provision which allows the right holder to "substantially" comply with the notice requirement. Indeed, Article 10 permits the ISP to ignore the notice if it is literally "without any of the content prescribed in Article 8."

- A fundamental flaw in the draft regulations is the requirement in Article 10 that all notices be made "in written form." Virtually all notices globally are accomplished via *electronic* communications (e.g., email). This provision would seem not to permit this, making the provision wholly impractical and unworkable. It would severely reduce the already low compliance rates for takedowns in China.

- The prior draft was fortunately changed to require the ISP to "immediately" take down the infringing content upon receiving notice, but the complex notice requirements and the "writing" requirement may vitiate this positive feature.

- Article 7 allows the ISP to "put back" the alleged infringing materials upon receiving a counter-notification. However, no notice to the copyright owner of such action is required. Clearly the copyright owner needs to be advised of the putback notice and given time to take further action. This is in the DMCA and FTAs and an essential part of an effective notice and takedown system. Interestingly, Article 7 says "may" which

seems to indicate the "put back" is not mandatory. But this is still a poor substitute for notifying the copyright owner.

- The knowledge requirement in Article 11 is too strict. Under the DMCA and the FTAs, an ISP is liable if it "knows" or if it is "aware of facts or circumstances from which infringing activity is apparent" (DMCA, Article 512). That needs to be a feature of these regulations. It is very difficult to prove actual knowledge but easier to show facts from which the ISP should have known that the material being transmitted was infringing.

- There is no clear right in NCA to order the equivalent of injunctive relief, just the right to fine, and then only three times "income" (which as we know is virtually impossible to prove). Thus, the maximum fine will realistically be only "up to RMB100,000." This is hardly an effective deterrent to mass infringements. Also, administrative fines can only be imposed if the infringing conduct "impairs the social and public interest" as a condition. NCA has not done well by the software industry using this language. It should be eliminated. Finally, the right to seek injunctions from a civil court must be clarified and preserved. This raises again the critical question of the interrelationship of these regulations with the SPC "Interpretations."

- There is nothing in the revised draft regulations requiring the ISP to disclose the identity of the infringer, except to NCA directly. In turn, there is no requirement that NCA disclose that identity to the right holder enabling the bringing of a civil or criminal case. An effective and expeditious notification system is a critical element to effective Internet enforcement.

- Finally, Article 4 paragraph 2 defines where an infringement occurs as the place where the server is located. If this is literally the rule, then ISPs have no obligation to take down infringing material emanating from servers in Taiwan or the U.S. or any other country. Moreover, servers can be moved virtually instantaneously. Administrative agency jurisdiction should never depend on the location of the server. Again, such a system is simply unworkable.

## The Urgent Need for Improved Market Access

**China must eliminate its onerous market access restrictions and create a competitive marketplace that can meet domestic demand.**

Most of the copyright industries suffer from non-tariff and tariff trade barriers, which severely limit their ability to enter into business, or operate profitably, in China. These are only selected barriers that affect the named industries:

**Entertainment software:** Hard goods versions of entertainment software titles must go through an approval process at the GAPP. It is believed online versions of games will need to go through an approval process at the Chinese Ministry of Culture before distribution is allowed. The rules and regulations are not transparent at this time.

For hard goods, in many instances, the approval process takes several weeks to several months to complete. Given the prevalence of piracy, it is important that any content review process be undertaken in as expeditious a manner as possible. Protracted content reviews result in considerable delay before a newly released video game title is approved for release in

the Chinese market. In the meantime, pirated versions of these games are sold openly well before the legitimate versions have been approved for release to the retail market. Such a delay affords pirates with a virtually exclusive period of distribution for newly released titles. The Chinese government should enforce these regulations and clamp down on pirates who distribute games that are not approved by GAPP for sale in the country.

There is also concern that this review process may now be bifurcated between these two agencies. It would be extremely helpful to the industry for this review function to be lodged with only one agency. Already, there are video games, which though distributed through physical optical disc media, also have an online component. Having to undergo two separate content review processes before two different agencies would be burdensome to entertainment software publishers, adding not only additional costs but also further delay in releasing new product into the market. Further, transparency in the review process would help game companies in preparing games for the market.

In addition, there are other investment and ownership restrictions that must be abolished.

**Book and journal publishing:** In IIPA's 2004 submission, we detailed some of the existing barriers for the U.S. publishing industry. China was required to eliminate some of these barriers by December 11, 2004, in accordance with its WTO commitments. Under the agreement, publishers must be afforded full trading rights (the right to freely import directly into China), and be permitted to engage (with wholly owned companies) in wholesale and retail distribution activities. While it appears that China has fulfilled many of these commitments with its 2004 Foreign Trade Law, which went into effect on July 1, this law has produced as many questions as answers, and the U.S. publishing industry awaits clarification on a number of issues, including how the Foreign Trade Law provisions interact with other laws and regulations pertaining to the publishing industry as well as those restricting foreign investment generally.

In addition to the questions that remain regarding trading rights and distribution, other activities essential to effective publishing in China remain off limits to foreign publishing entities. These include the right to publish (including editorial and manufacturing work) and print books and journals in China without restrictions (except for a transparent, quick and non-discriminatory censorship regime) and the right to invest freely in all manner of publishing related activities without ownership restrictions. Restrictions on these activities result in greater expense to publishers and consumers alike, and discourage development of materials prepared specifically for the Chinese market. These restrictions also create delays in distribution of legitimate product in the Chinese market, opening the door for pirate supply of the market. China's WTO commitments as to these activities must be clarified, and existing regulations prohibiting these activities should be repealed.

Finally, restrictions and high fees related to access to foreign servers result in high costs to publishers of electronic materials (such as academic and professional journals) in making their products available in China, resulting in fewer, lower quality options available to Chinese scholars and students.

### Motion picture industry

*Import quotas:* Limits on the number of films imported into China continue. Under the terms of China's WTO commitment, China has agreed to allow 20 revenue-sharing films into the country each year, up from a previous limit of 10. The Chinese are insisting that the 20 are a

"maximum," not a "minimum." This interpretation is not in accordance with its WTO obligations and should be corrected. Moreover, the needs of the market far exceed the legal films now available as demonstrated by the huge market in pirated optical discs. The monopoly import structure is the main tool by which these quotas are imposed and enforced. China must begin immediately to dismantle all these archaic, protectionist and discriminatory restrictions. Note that SARFT has previously informally tied any increase in the number of foreign films imported into China to the expansion of the domestic industry.

*Monopoly on film imports and film distribution:* China Film continues to hold a state enforced monopoly on the import of foreign films. China Film also held the monopoly on the distribution of foreign films until Huaxia Distribution was authorized by SARFT to be the second distributor of imported films in August 2002. Huaxia is a stock corporation with investment from over 20 share holders, the largest of which is SARFT, with over 20%, then China Film, Shanghai Film Group and Changchun Film Group, each with about 10%. SARFT requires that the distribution of all foreign films brought into China that are revenue sharing be distributed equally by the Government's mandated foreign film distribution duopoly. Foreign studios or other distributors cannot directly distribute revenue sharing foreign films. This restriction of legal film supply leaves the market to the pirates and they are taking full advantage of this limitation. China should begin now to eliminate all barriers to the import and distribution of films, including all investment and ownership restrictions.

*Cinema ownership and operation:* "The Interim Regulations for Foreign Investment in Theaters" effective on Jan 1, 2004 restricts foreign ownership of cinemas to no more than 49% but provides for 75% in the "pilot cities" of Beijing, Shanghai, Guangzhou, Chengdu, Xi'an, Wuhan and Nanjing. Foreigners are not permitted to operate cinemas. For the growth and health of the industry, foreigners should be allowed to wholly own and independently operate cinemas.

*Broadcast quota:* Under SARFT's "Regulations on the Import and Broadcasting of Foreign TV Programming" effective on 23 October 2004, the broadcast of foreign film and television drama is restricted to no more than 25% of total air time each day and is not permitted to be broadcast during prime time between 7:00 PM and 10:00 PM on any forms of television broadcast other than pay television without SARFT approval. A channel's other foreign television programming (news, documentary, talk shows, travel etc.) is restricted to no more than 15% of total air time each day. Foreign animation programming must follow the same censorship procedure as general programming and cannot exceed 40% of total animation programming delivered by each station on a quarterly basis. Since new regulations on the animation industry became effective in April 2004, only producers of domestic animation programming can import foreign animation programming and can only import the same proportion of foreign animation programming as they produce domestically. The quota on air time should be raised to at least 50%, and the prime-time quotas should be eliminated altogether. China should begin now to eliminate all these discriminatory restrictions.

*Retransmission of foreign satellite signals:* Foreign satellite channels may only be shown in three-star hotels and above and in foreign institutions. Moreover, foreign satellite channels beaming into China are required to uplink from a government owned satellite for a fee of $100,000, placing a significant and unnecessary financial burden on satellite channel providers. The up-linking fee should be eliminated because it inhibits the development of the television market. Indeed, all these restrictions and barriers should be eliminated.

*Television regulations:* Under the 1997 Foreign Investment Guidelines, companies that are wholly or jointly owned by foreign entities are strictly prohibited from investing in the broadcast industry. MPA member companies are not allowed to invest in broadcast stations or pay television systems. China TV Program Agency under CCTV, the government acquisition arm, must approve all importation of foreign programming under the guidance of SARFT. The "Interim Management Regulations on Sino-Foreign Joint Ventures and Sino-Foreign Cooperative Television Program Production Enterprises" effective on 28 November 2004 sets out that:

- Foreign companies can hold up to 49% stakes in production ventures, which must have initial capital of at least US$2 million (or US$1 million in the case of animation companies). Local partners can be private, but must be existing holders of a production license.
- Foreign partners must be "specialized radio or TV ventures", a requirement aimed at ensuring the liberalization brings in expertise that will help the industry — although an indirect role for non-media investors may be possible.
- The joint ventures must also have a unique logo — a provision intended to ensure they are not used to promote the brand of foreign parents.
- Ventures must use "Chinese themes" in two-thirds of programs — the government will ensure that foreign-invested TV ventures produce original content rather than adapt their overseas programs for mainland audiences.

All such restrictions should be abolished along with other foreign investment restrictions embodied in the June 1995 foreign investment guidelines, which restrict investment, on a wholly owned basis, in other important segments of the film, video and television industries.

*Taxation:* The theatrical and home video industries have been subject to excessively high duties and taxes in China. These levels have a significant impact on revenues and continue to hinder market access. With its accession to the WTO, however, China committed to reducing import duties by approximately one third; duties on theatrical films were reduced (from 9% to 5%) and home video imports (reduced from 15% to 10%). These should be fully and fairly implemented.

*Internet regulation:* To monitor the Internet, economic and telecommunication-related ministries have staked out their turf on the web and have drafted competing regulations that are often vague and inconsistent. The State Council has been charged with creating a clear, effective and consistent Internet policy. Until the State Council completes its work, however, the landscape of existing regulations will remain confusing, with the Internet governed by regulations promulgated by a dizzying array of ministries and agencies. A stable, transparent and comprehensive set of regulations is necessary to guide the development of the Internet and e-commerce in China. China has also attempted to regulate and censor content on the Internet through regulation and technological controls. For example, the State Secrecy Bureau announced in January 2000 that all websites in China are to be strictly controlled and censored. In addition, the State Council set up the Internet Propaganda Administration Bureau to "guide and coordinate" website news content in April 2000. Jointly issued by the State Press Publication Administration and the Ministry of Information and Industry, the Provisional Regulation on Management and Control of Internet Publications became effective August 1, 2002, providing an additional mechanism for the government to intensify supervision of newspapers, periodicals, books and audio-visual content available online. The Ministry of Culture published "Interim Regulations on the Administration of Internet Culture," effective July 1, 2003. These regulations require that providers of Internet-based content (with any broadly defined "cultural" attributes) receive MOC approval prior to distribution in China. The National

Copyright Administration of China will publish regulations on the use of copyright material on the net in early 2005. SARFT also claim governance of certain censorship rights on the Internet.

From a technological standpoint, China maintains firewalls between China and foreign Internet sites to keep out foreign media sites, and regularly filters and closes down Chinese sites that are seen as potentially subversive. In September 2002, for example, both the Google and Alta Vista search engines were blocked without explanation or acknowledgement by the government. While the industry respects the rights of China to ensure that its population is not subject to content that may be questionable under Chinese values, the breadth of China's restrictions on the Internet are unprecedented. Such restrictions will likely limit the growth in the sector and severely restrict the ability of MPA member companies to distribute product via this nascent distribution medium.

**Recording industry:** The recording industry is also severely hampered both in the fight against piracy and in helping to develop a thriving music culture in China by the many and varied market access and investment restrictions that affect the entire entertainment industry, specifically:

*Censorship:* Only legitimate foreign-produced music must be approved by Chinese government censors. Domestically produced Chinese sound recordings are NOT censored. China should terminate this discriminatory process. Censorship offices are also woefully understaffed, causing long delays in approving new recordings. Censorship should be industry-administered, as in other countries. If not possible, steps must be taken to expedite the process so that legitimate music can be promptly marketed, preventing pirates from getting there first. For example, staff shortages must be filled. In the near-term, China should be pressed for a commitment to (1) end discrimination in censorship; and (2) complete the approval process within a reasonable period (e.g., a few days). In the long term, censorship should be abolished.

*Producing and publishing sound recordings in China:* U.S. record companies are skilled at and desirous of developing, creating, producing, distributing and promoting sound recordings by Chinese artists, for the Chinese market and for export from China. However, onerous Chinese restrictions prevent this from occurring. For example, for a sound recording to be brought to market, it must be released through an approved "publishing" company. Currently only state-owned firms are approved to publish sound recordings. China should end this discrimination and approve foreign-owned production companies.

Further, production companies (even wholly owned Chinese ones) may not engage in replicating, distributing or retailing sound recordings. This needlessly cripples the process of producing and marketing legitimate product in an integrated manner. China should permit the integrated production and marketing of sound recordings.

U.S. record companies may market non-Chinese sound recordings only by (1) licensing a Chinese company to produce the recordings in China or (2) importing finished sound recording carriers (CDs) through the China National Publications Import and Export Control (CNPIEC). China should permit U.S. companies to produce their own recordings in China and to import directly finished products.

*Distribution of sound recordings:* Foreign sound recording companies may own no more than 49% of a joint venture with a Chinese company. However, the recently concluded "Closer Economic Partnership Agreement" (CEPA) between China and Hong Kong permits Hong Kong companies to own up to 70% of joint ventures with Chinese companies engaged in distributing

audiovisual products. China should grant MFN status to U.S. record producers per the terms of the CEPA.

**Business software industry:** The software industry's ability to increase exports to China — and recoup billions of dollars in piracy-related losses — is severely limited by China's failure to take the steps necessary to create a fair and level playing field for U.S. software developers and other IT companies. As noted in USTR's 2004 Report to Congress on China's WTO Compliance, "China's implementation of its WTO commitments has lagged in many areas of U.S. competitive advantage, particularly where innovation or technology play a key role." Of particular concern to BSA is China's pending software procurement regulation (described above), which would effectively prevent U.S. software companies from selling software products and services to the Chinese government.

The Chinese government procurement market represents one of the most significant growth opportunities for the U.S. software industry, which derives more than half of its revenues from exports. The Chinese government sector is the primary purchaser of software in the world's largest emerging market for IT products. According to a recent study conducted by IDC, the Chinese market will continue to grow at a compound annual rate of 25.8 percent, making it a $5.1 billion market by 2007. This explosive demand for software and other IT products will be fueled in significant part by government IT procurements.

IIPA is thus deeply concerned about China's plan to close its government procurement market to U.S. software products and services. The U.S. software industry has already lost billions of dollars in export revenue due to China's ongoing failure to address rampant domestic piracy and massive counterfeiting; a ban against government procurement of U.S. software would eliminate the U.S. software industry's most meaningful opportunity to expand exports to China, and would set a dangerous precedent for China's procurement policies in other major economic sectors.

These are not theoretical concerns; U.S. software companies are already experiencing the harmful effects of China's restrictive procurement policy in the marketplace. According to media reports, U.S. companies are being excluded from government procurement deals in several provinces as a direct result of the government procurement law. Thus, China's decision to close or greatly restrict its government procurement market to much of the world's best software products is already translating into losses in export revenues.

China's proposed domestic software preference reflects a troubling trend toward protectionism in the technology sector, which has resulted in a number of industrial policies designed to promote the use of domestic content and/or extract technology and intellectual property from foreign rightholders. If left unchecked, these discriminatory industrial policies would significantly limit imports of U.S. software products into the Chinese market. China's JCCT commitments to legalize government software use and combat software piracy would therefore be of very limited value.

Mr. JENKINS. Thank you, Mr. Smith.

Since I have ascended to the Chair this morning, I'll recognize myself for the first questions.

Ms. Espinel, shortly after I started a law practice down in Tennessee, a really nice lady came into my office. A national company, a storage and moving company, had lost her Oriental rug. She had moved from Washington, D.C., to Rogersville, Tennessee. And previously, she had been represented in this loss by a big, 50-member law firm.

She came into my office, and I inquired about—but the negotiations had gone on for months and months and months, and nothing had happened. So I inquired about whether anybody had talked to her about filing a lawsuit. She said "No." And that very day, I filed a lawsuit. And within a very short period of time, there was a recovery.

Now, to bring that to this situation, I liked Mr. Berman's suggestion. I liked his question in his opening remarks. You know, why are we not in the WTO court? That's the only jurisdiction that's available to us; isn't it?

Ms. ESPINEL. Thank you. As outlined in my testimony, we have made clear in the OCR report that was issued about 2 weeks ago that we are prepared to fight aggressively to protect our intellectual property in China. We have—our overall goal, I think the goal that we all share, is to significantly reduce the rampant piracy and counterfeiting in China. That may be through an intensified JCCT process; that may be through WTO litigation. There may be other means. There will probably, likely, I think, be a combination of means. And we are actively considering all of those options.

But beyond mere consideration of those options, we are also actively engaged with our industry now, including the recording industry, the motion picture, IIPA; including specifically some of the people testifying for you here this morning. They have been working very hard with us to develop our options, including the option of WTO litigation. And we look forward to their continued cooperation and hard work with us.

We are—this is a top priority for the Administration. This is a top priority for Ambassador Portman, as he has made clear in his confirmation hearings and also to his staff. He is in the process of reassessing our strategy, to see if there are ways in which it can be improved. But I can assure you that we are looking for the most effective mechanism that we can use to address this very significant concern.

Mr. JENKINS. Well, I, personally, don't have as much confidence in the WTO as I have in the courts in east Tennessee. But I don't think this matter of inaction will lead us anywhere, and I think it's time that we took some action somewhere, based upon everything that we heard this morning.

And I would ask Mr. Fishman, Mr. Brilliant, Mr. Smith, if they would agree with that. Or what do you think the best strategy is? Mr. Fishman?

Mr. FISHMAN. Well, certainly, you shouldn't give up your WTO options. But there are other options. You know, one of the groups that's very complicit in China's intellectual property regime, loose

as it is, is our American buyers of Chinese products, big buyers of Chinese products.

If you look at a DVD player, before the Chinese entered the market, a DVD player made with a licensed chipset and licensed software cost about a thousand dollars. The Chinese decided to enter that market. In very short order, there are about 300 companies in China producing DVD players without any licensed technology below it. The price went down to about $30.

Those players are now in American stores. And if you don't think that there's a wink and a nudge on the part of American buyers of those DVD players, the big-box stores that line their shelves with them, for the Chinese manufacturers to drive prices down by not paying the intellectual property license fees that they owe them, then you have something else coming.

Maybe one course to consider is: How do you address the problem by looking at American companies, who feed our $170 billion trade deficit with China by bringing in goods that are made in virtually every Chinese factory which uses pirated technology?

Mr. JENKINS. Thank you, Mr. Fishman. Mr. Brilliant?

Mr. BRILLIANT. I'd make a couple of observations. First of all, I think the U.S. Government is prodding China along, and is continuing to put pressure on the Chinese government to act in this area—with mixed results to date, no question. But I think the Chinese government understands this is a top priority of the U.S. government.

I think the American business community has also over the last year and a half, 2 years, amplified its voices on this issue. I mentioned already in my oral remarks that our president/CEO, Tom Donohue, was in discussions this week with Premier Wen Jiabao and Minister Bo Xi Lai.

More importantly, though, I think there is a broad array of industry associations and companies that are engaged in this issue today, that perhaps were not engaged a couple of years ago. The issue is that important to CEOs of big and small companies.

In terms of next steps, we actually did encourage USTR to seek WTO consultations. In our submission to the USTR as part of the out-of-cycle review, we encouraged WTO consultations because we do believe that China is falling short of its obligations under the WTO, and that we do believe that they need to do more, specifically in the area of enforcement and police investigations. And so we did encourage China—sorry, USTR to take that next step, and proceed with WTO consultations. We continue to believe that may be a necessary step. And we would urge USTR to exhaust all options, including perhaps a second out-of-cycle review later in the year.

I think the JCCT is an important process, and I think we are looking to that as well, to see what assurances and what actions China is taking to really deal with this issue. But as others have testified, and as I have already indicated, what we need to see is Chinese political action. And we need to see it at the local as well as the provincial level.

What we need to see is prosecutions. And what we need to see is not just the street vendors put away but, frankly, the owners of these illegal operations. And until we see real evidence of that, then we don't have the deterrence in the marketplace that we need.

And then, finally, I would just say that we should test the market ourselves. U.S. companies should press in China for enforcement actions. If we press for enforcement actions in China, and China fails to follow through on those actions, that would be more evidence that their enforcement mechanisms are not working.

Mr. JENKINS. Thank you, Mr. Brilliant.

My time has expired. The Chair will now recognize the Ranking Member from California, Mr. Berman.

Mr. BERMAN. Thank you very much, Mr. Chairman. I have several questions. I'd appreciate it if the witnesses could respond rather quickly.

But the first one that just comes to mind, Mr. Brilliant, in your very forceful answer to the previous question, and your testimony, you seem to blithely ignore the suggestion of Mr. Fishman that one strategy for dealing with what's going on is to—is essentially to go after American companies selling products not because—cheaper not because of labor costs or other kinds of comparative advantage, but because they are built on pirated and counterfeited intellectual property; and holding the stores and the retailers and the distributors of those products in this country accountable, apart from what else we might do with China. What do you think of that suggestion?

Mr. BRILLIANT. Well, I mean, I think we looked at all options.

Mr. BERMAN. Well, what about that one?

Mr. BRILLIANT. I think the short answer would be that we have had discussions with our own industries about steps that they can undertake to ensure that we are not selling counterfeit and pirated products. That's not a simple process, but I think that is an important step that we can undertake here in the United States. And certainly, we welcome——

Mr. BERMAN. Well, if a Chinese DVD is using counterfeited chips in its product, and it's being sold in U.S. stores, should the companies that own those stores have any accountability for that?

Mr. BRILLIANT. Well, I think those stores that perhaps are selling those products should, first of all, be made aware of that. And second, they should take steps to make sure that those products are not being sold in their stores. That's accountability to begin with.

In terms of legal liability, I'm not in a position comment; except that I will say that U.S. companies need to clean their own house, as well.

Mr. BERMAN. Okay. Ms. Espinel, in a column a couple of days ago in the New York Times, Pat Choate, who I don't generally agree with on trade issues, writes a compelling couple of paragraphs, which I'd like to read to you. First of all, on the issue of the WTO and bringing actions, he points out that the Clinton Administration brought 17—13 intellectual property cases at the WTO against other nations. All of them were resolved to the U.S.'s satisfaction. We've seen not one in the past 4 years.

And essentially, he concludes that China hasn't met its intellectual property obligations, which you seem to agree with, and that the U.S. has failed to leverage the WTO mechanisms that might bring China into compliance.

Although China has passed laws that accord with WTO requirements, the Trade Representative has reported—and as you said

here—that enforcement of those laws was inconsistent, ineffective, and discriminatory against foreigners. It found intellectual property infringement in China to be rampant, with violations worsening. This is your agency.

China has created a Potemkin Village of intellectual property protections. The WTO provides a way to confront that problem. If the U.S. can prove to a three-judge WTO panel that China is out of compliance and is harming intellectual property owners, it can seek damages. If WTO grants such a judgment, the U.S. can impose tariffs on Chinese goods.

Understanding that there's more dialogue and more meetings and more rounds and more watch lists, in the end, aren't all of those avenues more effective if China thinks that such a decision is imminent? And to the extent that those things haven't produced success, isn't that the way to go? And what could we expect, in terms of that kind of action by the Administration?

Ms. ESPINEL. Thank you. I'd be happy to respond. And with your permission, I'd also like to respond briefly to the question that you put to Mr. Brilliant, or at least give you another aspect of it.

With respect, though, to the question that you just asked, I think it's important to remember that a WTO case against China would be a new area for WTO litigation, in the sense that this would be a case not necessarily just against deficiencies in the Chinese statutes, but also against their enforcement. And that is one of the reasons why——

Mr. BERMAN. We have never brought a case against a country with good statutes and no enforcement?

Ms. ESPINEL. The intellectual property cases that we have brought have hinged on facial deficiencies in statutes. And this is one of the reasons why our very close cooperation with industry is key to this. However, I can tell you that we are committed to ensure that China is compliant with its obligations. And we will take WTO action if, in consultation with you and with our industry, we determine that this is the most effective way to fix the problem that we are resolved to fix.

Mr. BERMAN. And what would—on the horizon, when would such a conclusion be reached?

Ms. ESPINEL. Well, we are actually at the moment involved in very intense discussions with certain sections of our industry; in particular, the copyright industry. They have been—as I noted, they have been working very hard with us to develop our WTO options, so——

Mr. BERMAN. Is 6 months a reasonable time frame?

Ms. ESPINEL. I think it might be. I think to some extent it will be—the time line will be guided by our consultations with our industry. But given the focus and the hard work that is going into this, both on the part of USTR and with our industry, I think that that could be a reasonable time line.

Mr. BERMAN. Thank you.

Mr. SMITH. [Presiding.] Thank you, Mr. Berman. Let me recognize myself for questions, and say I'm sorry for my brief absence, but I had to go to another Committee to vote on a markup of a piece of legislation. As a result, my questions may overlap some of

the questions that you've already been asked, and let me know if that's the case.

Ms. Espinel, let me begin with you. And it sounds like I'm following up on a couple of things that had been raised. I was going to page 2 of your written testimony, where you list a series of five actions that you think need to be taken to address our concerns; the concerns being, as you pointed out and as other witnesses have pointed out, that basically counterfeiting and piracy in China are at record levels. And I assume that that means unacceptable to everybody involved.

What I'm interested in, you list these as a series of actions. I'd like to know specifically what actions you intend to take, and when you intend to take them. And let me pick out four of these five. The first is utilizing WTO procedures to bring China into compliance with WTO TRIPS obligations. What—you say you have an eye toward using those procedures. I'm really more interested in not looking, but in acting. And what specific actions might you take?

Ms. ESPINEL. I think we are resolved to go to WTO litigation if we determine that that's the most effective strategy to accomplish what our overall goal is, which is reducing piracy and counterfeiting. And that goes to the answer to the question——

Mr. SMITH. Right.

Ms. ESPINEL.—I gave to Congressman Berman. We are working with our industry to develop these options, right now.

Mr. SMITH. When Mr. Berman asked you if 6 months was a reasonable time frame, you didn't really answer that question specifically. I hate to be too hard on you your first time to testify before Congress, but could you be explicit in the time frame?

Ms. ESPINEL. Well, I hate to make promises that I can't keep.

Mr. SMITH. You're learning fast. All right. [Laughter.]

Ms. ESPINEL. Because I think a lot of that will depend on our consultations with industry. But I certainly think that could be a reasonable time line.

Mr. SMITH. Okay. Let me go to a couple of other items here. You say you want to require China to produce detailed documentation on certain aspects of IPR enforcement. When will those requests and documentation be made?

Ms. ESPINEL. Very soon. There is no time line under the WTO procedures for us to make that request, but this is something that we have announced that we are going to do. We are in the process of preparing the request, and we are planning to file it very soon.

Mr. SMITH. Right. And also, of course, with the recent appointment of Rob Portman, you're, I'm sure, reviewing a lot of the policies and taking additional initiatives that you might not otherwise take as a result of Mr. Portman's personal interest. And I'm sure that's the case, too.

What about elevating China onto the Priority Watch List. You put China sort of in the middle position, but chose not to put China in a priority foreign country category. Why was that, when its violations are so egregious and it's so obvious?

Ms. ESPINEL. Well, as you probably know, China hasn't been on the watch list in any category for the last decade or so. And we thought, frankly, given the level of disappointment, and seriousness of the concerns that we had with China, it was important that

they be returned to the Priority Watch List. And we felt that that was a strong signal, frankly, of the level of unhappiness.

Mr. SMITH. Perhaps that's the first step. And maybe you'll get to the next-higher step, given the response by China, perhaps?

Ms. ESPINEL. Yes.

Mr. SMITH. Okay. Good. Thank you. Let me ask you a question that—or to respond to a recommendation made by Mr. Brilliant in his testimony. He said USTR should conduct a second Special 301 out-of-cycle review of China later this year, to assess China's implementation of the judicial interpretation and other enforcement efforts. You've talked about that a little bit, but what about that suggestion?

Ms. ESPINEL. Frankly, all options are on the table at this point. I think we're willing to consider any approach that we think would effectively address that, in consultation with our industry. So we will take, as we always do, any suggestions made by our industry quite seriously.

Mr. SMITH. I can't fault you for saying all options are on the table; since that's the phrase President Bush used with regard to Social Security reform. But can you tell us when you might take some of those options?

Ms. ESPINEL. Well, with respect—as I said, with respect to the request for additional information, the transparency procedures under the WTO, that's a request that we're planning to make very soon.

In terms of whether or not we decide to initiate a second out-of-cycle review, or decide to go to WTO litigation, I think the time lines that we've discussed earlier are probably reasonable ones——

Mr. SMITH. Realistic? Okay.

Ms. ESPINEL.—based on where we are with industry at this point.

Mr. SMITH. Okay. Very good. Thank you, Ms. Espinel.

Mr. Fishman, I wish we had more time to talk about your book. You've no doubt read Thomas Fishman's—Thomas Friedman's book, The World is Flat. And you saw the cover article—I think it was Newsweek—a couple of weeks ago on China, as well. We underestimate China at our peril, I think, in many, many ways.

In my time remaining—I don't know what happened to my 30-second warning yellow light, but we'll work on that. And if the Members will indulge me, what I'm going to ask the remaining three witnesses to do, very quickly—Mr. Smith, Mr. Brilliant, and Mr. Fishman, if you had one suggestion for what the U.S. should do to try to engage China in enforcing and respecting our intellectual property rights, what would be that suggestion for our Administration?

Mr. Smith, we'll start with you, and work down real quickly. And then, Ms. Espinel, we're not going to have time for you to respond, but perhaps you can in writing, to their three suggestions. And I also have two other questions to submit to you in writing, as well.

Mr. SMITH. I think we have to make clear to the Chinese government that they're in jeopardy. We can do that both bilaterally, and we need a credible—we need to take—the U.S. Government needs to take a credible position with respect to moving toward a WTO case in the next few months, as Ms. Espinel said.

I think that China needs to feel a lot of pressure, before they're going to move on this issue. There are a lot of domestic forces that are against it. And the more pressure we can bring to bear, and the more that this Congress can do to help in that effort, the closer we will come to that objective.

Mr. SMITH. Okay. Thank you, Mr. Smith.

Mr. Brilliant, go beyond, if you will, your four suggestions in your testimony. You talk about spearheading, engaging, benchmarking, and promoting. Specifically, what would you want the Administration to do?

Mr. BRILLIANT. Well, our testimony does cover both our actions as well as what we suggest that the USTR does. But what I would just say is follow up on previous comments, and just say we need to continue the pressure and we need the Administration to build toward a WTO case, if the facts warrant it. That means industry supporting it, but it also means that USTR needs to let the Chinese understand that these are challenging times, that we need tangible evidence of progress.

And that's the second point I'd make; which is we need to get out of the JCCT some sort of contract from the Chinese saying exactly what they're going to do in terms of dealing with the prosecution issue, dealing with police investigations, dealing with custom enforcements. We need some sort of litany—or really, a line-by-line contract from the Chinese to show that they're really serious about taking action.

Mr. SMITH. Thank you, Mr. Brilliant. And finally, Mr. Fishman.

Mr. FISHMAN. My one suggestion is a two-step process. The first is to form a domestic consensus on China. And part of that has to do with the future of our economy; stressing that the future of our economy is both industrial and innovative, and that needs to be protected. And that means asking consumers to make a sacrifice in order to maintain our standard of living.

And the second is to rethink all of the mechanisms that you've talked about today. There's a lot of dickering that can go on in the context of WTO, but the stakes are enormously huge. And there's billions and billions of dollars coming into this country based on counterfeit platforms. You might have to put a tax on all of that stuff, in order to force a change.

We have a small window when this can happen. The window is now. Our trade deficit with China right now—our deficit alone, not our total trade—is 14 percent of their economy. If we put a tax on that 14 percent of the economy, you will see rules change very, very quickly.

Mr. SMITH. Okay. Thank you, Mr. Fishman. I appreciate all your responses.

The gentleman from Virginia, Mr. Goodlatte, is recognized for his questions.

Mr. GOODLATTE. Mr. Chairman, thank you very much for holding this very important hearing. I have an opening statement that I didn't have an opportunity to give, and I'd ask that that be made a part of the record.

And I'd like to just point out a couple of figures that I have. It's estimated that in China 95 percent of motion pictures and 90 per-

cent of business software are pirated. And in Russia, 80 percent of all motion pictures and 87 percent of business software are pirated.

Considering that the core copyright industries account for 6 percent of the U.S. gross domestic product, and the total copyright industries account for approximately 12 percent of U.S. GDP, it's clear that America's businesses are facing a very serious problem.

Mr. Smith, what evidence have you found that piracy and counterfeiting are being used to fund organized crime in Russia and China? And why are piracy and counterfeiting such attractive funding mechanisms in those countries?

Mr. SMITH. Piracy has become one of the most lucrative businesses in Asia; indeed, throughout the world. By our best information, organized criminal syndicates, organized principally out of Taiwan, Hong Kong, and into the mainland, and in other countries in East Asia, have a solid lock on this business. And their lock is so solid that it is very difficult for governments to unlock it. And it's going to require major political will of those governments to break these syndicates.

Now, that process has started in many of the countries in Asia. I don't believe it's started in China. And we need to get about that business immediately. I know the STOP Initiative that the U.S. Government has initiated is an effort at least to get at international organized crime through international cooperation of justice departments in those regions.

But there is no question that organized crime and terrorism and gun running and money laundering are all part of a piece, and it's growing. And until we—this becomes an urgent matter and a zero-tolerance issue, it's going to continue to grow, because there's just too much money in this business.

Mr. GOODLATTE. Thank you. Mr. Brilliant, are you aware of instances where counterfeit goods have actually caused serious bodily injury or death?

Mr. BRILLIANT. I know in the case of China that has happened. There was the instance involving baby formula, but there are other examples. There have been examples regarding auto parts——

Mr. GOODLATTE. Brakes.

Mr. BRILLIANT. Brakes.

Mr. GOODLATTE. And airplane parts, too.

Mr. BRILLIANT. Right. So there are examples where faulty equipment has been cited as a cause for bodily harm. I think there is a real public health and safety component to this issue. We've all highlighted that. And certainly it's true, not just in the pharmaceutical area, but across a wide range of industries.

And that just adds to our concern that this be not just a priority of the U.S. private sector, but also the U.S. Government; which it is, I think, today.

Mr. GOODLATTE. Thank you. Ms. Espinel, we heard Mr. Fishman's very forceful arguments about some of the things that we could do. I wonder if you could tell us what remedies are available to better ensure that China and Russia live up to their domestic and international obligations to protect intellectual property rights. And what more can the U.S. do in this regard?

Ms. ESPINEL. Well, with China there are a number of steps that we outlined a couple of weeks ago in the OCR report that we re-

leased. And those include our elevation of China to the Priority Watch List; intensifying the JCCT process, in particular with respect to the Intellectual Property Working Group meeting that is going to be meeting next week; working with our industry in order to develop our WTO options; invoking the transparency procedures of the TRIPS Agreement, in order to require China to give us detailed information about its enforcement actions. I think we'll also require it to take a serious look at the deficiencies in its system.

These are a number of actions that we have already announced that we are going to take, but of course, we are also—and as Ambassador Portman has made clear, this is a top priority for him. And he made that clear at his confirmation hearing. He's made that quite clear to his staff. So we are also in the process, in consultation with our industry, of discussing what other options they might be. And of course, we would also be looking to this Committee for leadership and guidance in that process.

Mr. GOODLATTE. How close do you think we are to imposing tariff sanctions on China, along the lines of what Mr. Fishman suggested?

Ms. ESPINEL. With respect to intellectual property?

Mr. GOODLATTE. Yes.

Ms. ESPINEL. I think the range of options that we're looking at right now include the ones that I've just outlined. Of course, at the conclusion——

Mr. GOODLATTE. How long would it take? If we were to start that process today, how long would it take before we would see actual sanctions imposed on China?

Ms. ESPINEL. Well, WTO litigation generally takes somewhere between—I mean, it's a little hard to say, as in all litigation—but somewhere, I'd say, between a year and two. And partly, that depends on whether or not the trial court decision, so to speak, is appealed by China.

Of course, there may be progress made by China. And we will absolutely be pressing them to continue to make progress, if we go down the WTO road; that we not wait till the conclusion of a case and the imposition of sanctions to see progress from China.

Mr. GOODLATTE. Well, thank you. I know Mr. Portman is brand new to the job, but I hope the ambassador will take a close look at making some of those decisions very quickly in this regard.

Ms. ESPINEL. He absolutely will.

Mr. GOODLATTE. Thank you very much, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Goodlatte.

The gentleman from California, Mr. Schiff, is recognized for his questions.

Mr. SCHIFF. I thank the Chairman. And I just had the opportunity—one of the reasons I'm late this morning, I just had the opportunity to meet with the Chinese ambassador today, and to raise this issue personally.

I want to get your thoughts—and I apologize if we're covering ground we've covered already—but what is—what steps do you believe that China could effectively take to curtail this problem? My impression is that China is very capable of cracking down on dissenting viewpoints. They have the capability, certainly, of cracking down on illegal products.

What should China be doing that they're not doing? What evidence do we have that this is a conscious economic decision on China's part? And what are the constructive steps that we can take here in Congress to change China's behavior vis-a-vis pirated goods?

Mr. FISHMAN. I'd like to tackle that. I regard China's loose intellectual property regime as the largest industrial subsidy in the world. It transfers to China all of the gems of the world's advanced economies at no cost to the Chinese government. So it's a large subsidy that costs them nothing, and costs us everything.

If you want to know what the Chinese can do more of, it's virtually everything. But there's no will there to do it. And the will has to come from somewhere else. It has to come in the form of a cost. Because right now, their intellectual property regime enriches its people and benefits its people greatly. And we ought to have some grudging admiration for how they've run this so far, because it's gotten them to where they are and it's also created a country which we would love to do business with now because it's increasingly wealthy.

But right now, we're at an inflection point, where we have to act in order to preserve what we have. And you could get any action that you want. If pirated DVDs included something about Falun Gong or Tibetan independence, you would see enforcement happen on day two.

Mr. SCHIFF. Right.

Mr. FISHMAN. But it's a little bit more mysterious when you go into a manufacturing plant that's making "widgets," but they have 20 or 30 or 100 engineering stations, each of which in the United States would cost 50 or 60 thousand dollars a year to run, a proprietary piece of software; but they run for zero cost in China. Those factories are the kinds of factories that churn out goods to us. And unless you look to the world's customers of those goods, those Chinese factories have no incentive to spend extra millions on intellectual property license fees.

Mr. SCHIFF. And what's the most effective pressure point that the U.S. can bring to bear to get China convinced that it's in their economic interest?

Mr. FISHMAN. Well, there's been a lot of talk on this among the witnesses, about what individual companies can do to bring pressure. But individual companies have very few options, because there are so many ways to pressure them in China to transfer technology there.

You really need a public solution, and a widespread solution from the United States. And that has to be some kind of extreme brinksmanship or actual action that taxes everything in China that's made on a pirated platform that comes into the United States. And until you get that kind of broad-scale action, you will get no turn of sentiment in China on intellectual property.

Mr. SCHIFF. Can you address, any of you on the panel—I know this is a little bit off-topic—but the issue of Chinese restrictions, for example, on the type of software that their government agents—vendors purchase, that essentially excludes American exports in that area?

Mr. SMITH. Let me see if I can answer that. Right now, there's a pending regulation before the Chinese government to—for the Chinese ministries to procure only Chinese software. And there was a hearing last Friday before the Government Reform Committee, I believe, that dealt exactly with this problem, discrimination against American software publishers.

I mean, this is the kind of thing—following up on what Mr. Fishman said—that is exactly the wrong strategy. Maybe right, from a very narrow point of view; but it is our view that China's ultimate economic welfare does not lie in continuing to build a copying nation.

They are never going to go up the value chain, if they continue to do what they are now doing. They will continue to have trade friction with the rest of the world. We're trying to elicit the Japanese and the Europeans now to work with us to try to fight this problem.

And the mechanics of fighting it aren't that difficult. Other countries have done it. Other countries have reduced piracy rates. China can do it. I think Mr. Fishman is right: What are the incentives?

Part of those incentives are disincentives; and that includes the possibility of retaliation through a WTO case, and things like that. I believe——

Mr. SCHIFF. Is the WTO the most effective leverage that we have in dealing with—or are there interconnections between issues of the valuation of the Chinese currency or other economic issues that are a more powerful lever for us to use?

Mr. SMITH. I mean, I think there's a lot of pressure that can be brought to bear that's outside the IP area. I mean, everybody is now talking about the Chinese currency and all and—you know, and there's defense issues. There are a number of intersections. And the importance of China—or the interrelationship of China and the United States and that trade relationship is extremely important.

And China cannot continue to just thumb their nose at the United States on these issues, when our most productive industries can't even get into the market or, as Mr. Fishman said—and this is not so much true in the copyright area—product is coming out of—just flowing out of China that's counterfeit. There are remedies to that at the border of the United States. And I'm not speaking to what recommendations Mr. Fishman has made.

But there is no question that China must—it's not a question of whether; it's a question of when. They have to deal with this problem. We hope that the U.S. Government, and all of us, and the U.S. Congress, are in a position to convince the Chinese that it should be now, before this gets to the brink of disaster.

Mr. BRILLIANT. If I could just briefly comment, industrial policy is at the heart of some of this. I mean, government procurement issues, standards, intellectual property, that folds into an industrial targeting policy of the Chinese government. We have to not only deal with this issue bilaterally; we have to deal with it multilaterally.

The WTO is a multilateral system for dealing with it. But another component, we need to bring in the Europeans and Japanese

and others to increase the pressure on the Chinese to act. Because if we act just bilaterally—unilaterally—in our actions, that won't—the Chinese will go elsewhere. They'll deal with other markets. And that would cost American businesses, as well.

So we need to bring in the multilateral community into our fold. And I think the U.S. Government needs to do more on that front. I know there's actions underway, but that's an area where we need to progress further, is bringing in the Europeans and the Japanese and others who share our concerns about the policies in China.

Mr. SCHIFF. Thank you.

Mr. SMITH. Mr. Schiff, the gentleman's time has expired. Thank you for your questions.

Mr. Forbes and Mr. Issa, would you all be able to come back in 15 minutes, if we take a quick recess for these two votes? And then we'll finish up at that point. That'll be great. I hope the witnesses can stay, as well.

We'll recess for about 15 minutes, and then reconvene about 25 or 20 of 12:00, and finish up the questions then. Thank you.

[Recess.]

Mr. SMITH. The Subcommittee on Courts, the Internet, and Intellectual Property will reconvene, and we will resume our questions. And we will go to the gentleman from Virginia, Mr. Forbes, for his.

Mr. FORBES. Thank you, Mr. Chairman. And thank all of you for being here today. This is an important topic. Mr. Smith said earlier that he hoped we could have a lively and productive dialogue, and in the time periods we've got, it's very difficult to do that. But I just want to throw out a couple of things to you. And I'm going to ask you two questions at the end of that.

But I remember years ago going to a high school baseball game. And I got there a little bit late, and it was the fourth inning. And when I sat down on the bleachers, the team that was supposed to win, that was going to the State championship supposedly, was down eight-to-nothing, and it was the fourth inning. And this old man sitting beside me looked at me, and he said, "Don't worry. Don't worry. They're taking this very seriously." He said, "They're going to do everything it takes to win."

In the seventh inning, they were down 12-to-nothing. And he looked at me and said, "Don't worry. Don't worry. They're taking this very seriously. They're going to do everything it takes to win."

At the bottom of the ninth inning, it was 15-to-nothing. And he looked at me and he said, "They should have taken this more seriously." He said, "They didn't do what it took to win." And I don't want us to be in the ninth inning of this ball game, and be saying the same thing.

And some of the concepts are simple, and some are very complex. The simple ones are these. You know, we have ideas and creative talent that springs from the investment we put in a free society. China has cheap labor. You can steal ideas and creative thoughts. You cannot steal cheap labor.

My big concern is, when you look at this $162 billion trade deficit, it's more now than just dollars and cents in the economy. Just 5 years or so ago, when the Chinese went to the Soviets to buy weapons, they were using IOUs. Today, they're using our cash to

modernize their military. And their weapons are pointed at us. They don't have anybody else to point them to.

And my question is that the word games just don't seem to be working. I led a delegation to China in January. We'd just started a China Caucus. And you all know what happens is, when you meet with them to have a little chat, if you've got an hour, for the first 50 minutes, they talk; and then they give you 10 minutes, and you know they're not paying attention to anything you say in those 10 minutes.

Mr. Brilliant, you know, you raised some good ideas here. And you indicate if we enforce intellectual property rights, consumers will pay more. But that would be true here, too. If we didn't enforce intellectual property rights here, consumers wouldn't pay as much.

And when we talk about it being difficult to form a consensus because consumers would pay more, I have never had a consumer call me and say, "I want you to vote for a particular issue, because I'm going to get a DVD player $30 cheaper." It's the businesses that are selling the DVD players that are calling us and pushing some of these policies. So, you know, I feel that it's time for us to stop "going to be doing everything that's necessary to do this and win this." But it's important for us to actually take some steps to do something.

And my two questions to you are these. I measure a whole lot about what we're going to do in the future by what we've done in the past. When I was in China, I asked the embassy people, I asked everybody I met with, "What have we done right, and where are we winning?" And I didn't get many good answers.

And so the question that I would ask for you is—again, not putting a whole lot of stock in "going to study this," and "going to do something down the road"—when we're dealing with China, what have we specifically done right in this matter? And where are we winning?

And if each of you would give me—Mr. Brilliant, if you could give me—since you've got such a great name, we'll just—you have a brilliant name.

Mr. BRILLIANT. A brilliant name. First of all, what we've done right is getting China into the multilateral trading system. By getting them in the WTO, we do have opportunities to bring cases and——

Mr. FORBES. But help me with that, because when I talk to the average citizen—and you know, I supported—I mean, you know, so I'm not arguing—but I'll look at people, and they just laugh at me now and they say, "See, we told you. You were going to be able to get them in there and get them to enforcement." We haven't been able—we're not winning on that argument.

Mr. BRILLIANT. Well, I think, first of all, it's a lot better to have them in the camp than to have them out of the camp. Prior to 2000, we had less options in our arsenal than we do today. So I'm not arguing that we haven't—we need steps further to deal with this issue of intellectual property rights; but we have made progress by having them in the WTO. First of all, it binds them to rules that are internationally recognized.

Mr. FORBES. But that they're not abiding by.

Mr. BRILLIANT. Well, I think, first of all, they have made some important cuts in the area of tariffs. They've improved transparency. There are things they are doing. It's not a perfect situation. By no means are they complete in their WTO accession process. But there are things they are doing. They are making tariff cuts; they are improving transparency; they are implementing trading rights; they're dealing with distribution issues. But by no means does that mean we have complete market access. But it would have been a lot worse if they had stayed out of the world trade system.

The other thing is that China benefits, itself, from being part of a multilateral community. And that, I think, helps move them, and modernizes their economy. They see the benefit, as well. They're bringing cases, as well. And that means something. That means that they understand the value of playing by the same game.

Now, they're not abiding by all the rules that we want them to abide by. And certainly, in the topic of this hearing, they have fallen well short of our understanding and expectations in the area of intellectual property rights. But I think they have—I think it is to our benefit to have them in the trading system.

Mr. SMITH. In a few minutes, you're going to have a hearing on Russia, and Russia is not yet in the WTO. Hindsight is easy; but if we go back and look at what the situation was when China joined the WTO, for the IP industries we would probably want to do a lot more in that protocol than we did do.

And we hope to God that we do it in the Russia protocol, and we don't allow Russia to join with a totally ineffective enforcement system, and then drag this thing out. That's probably what we should have done back then.

I would only add that before China joined the WTO, we had the one example where I think there was a success with China. And China, faced with $2 billion worth of retaliation in 1995 and '96, closed their CD factories and stopped the export of pirate product. And that lasted five or 6 years. So that was a success.

And hopefully, we can not only convince the Chinese that it is in their interest to do this—and Mr. Fishman's rather bleak view is quite disturbing. We think we can convince them. We think it's the right answer. A lot of countries have also agreed that it's the right answer to protect intellectual property for the long-term growth of their country. But if we can't convince them, then we have the WTO.

Mr. FISHMAN. I think one thing we ought to look at is the trade deficit number. The trade deficit number is impressive for a lot of reasons; just impressive because it says how much more we spend on Chinese goods than they spend on us. But it's also the most direct measure we have of how much American companies are profiting in China.

It's American companies that bring in that $162 billion worth of extra goods. This year, the statistics might rise far beyond that. I've seen numbers running as high as $240 billion as a trade deficit with China in the next year.

That is the barrier that we face. There's a lot of profit being made by doing business with China. And they are growing richer from it, and American companies are growing richer from it. And

if we need to move in to protect American industry, we have to look at which industries you're going to protect.

Right now, it is the large companies in the United States which are moving as fast as they can to China, to change their supply chains and move them to China as fast as they can, and cut the rugs out from under medium- and small-sized businesses in this country.

Well, for most medium- and small-sized manufacturers in this country and many service businesses, the only valuable piece of property that they own is some core piece of intellectual property that they've developed in-house. And they are extremely vulnerable to that moving to China and feeding the large companies which are trying to move all their production over there.

Ms. ESPINEL. One of the things the Administration has done in the last year is intensify the JCCT process. And we have seen some real successes coming out of that. For example, the new judicial interpretations that were issued by the Chinese at the end of last year.

However, I would say that we agree with you that we need to do more, and that we need to engage with China in a new way. I think it is fair to say that we are entering into a new phase of our relationship with China.

Ambassador Portman is well aware of the concern that you have, the criticalness of this issue to our economy, to our industry, to Congress. And we have—as I've mentioned before, we announced a couple of weeks ago a series of actions that we are taking to intensify the pressure on China.

But at the same time, Ambassador Portman is reexamining our strategy and our options, to find the most effective way we can to address this problem.

Mr. SMITH. Thank you, Mr. Forbes.

The gentleman from California is recognized. And I might say, to my knowledge, he's the only Member of the Judiciary Committee that actually holds patents, himself. And we look forward to his questions.

Mr. ISSA. Thank you, Mr. Chairman. And I got those patents by founding an electronics company 25 years ago. And I no longer own the company. I divested when I came to Congress. And I'm glad I did, because in preparation for this hearing I received from the general counsel of the company I founded, but do not own, something that's—and I would ask that this material be allowed to be inserted in the record.

Mr. SMITH. Without objection.

Mr. ISSA. Thank you. So ordered.

[The information referred to follows:]

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AMERICA'S LARGEST AUTO SECURITY COMPANY

May 10, 2005

The Honorable Darrell Issa
311 Cannon House Office Building
Independence & New Jersey Avenues, SE
Washington, DC 20515

Re: Chinese manufactured counterfeit a/d/s/ product

Dear Darrell:

I wanted to thank you for taking the time and interested in discussing our very serious problem with counterfeit manufacturing of a/d/s/ branded audio product in China.

As we discussed, this problem has had a devastating impact on our sales of a/d/s/ branded product throughout the Pacific Rim and continues to erode sales and profitability throughout the region.

Attached with this letter is a condensed summary of the history of events surrounding the development of the a/d/s/ brand and the discovery of the counterfeiting along with a description of the actions taken to date by Directed Electronics.

Also I am also forwarding a binder of material that clearly proves our long use of a/d/s/ along with catalogs and images of the products of the counterfeiters.

Any help you can provide to remedy this egregious situation would be truly appreciated.

Sincerely yours,

KC Bean
Vice President
& General Counsel

**SUMMARY BACKGROUND OF a/d/s/ CHINESE COUNTERFEIT ISSUE**

- Audio & Digital Systems Technology was established in 1974 in Boston by Godehard Gunther.

- The company sold advanced audio and sound equipment under the "ADS" brand and in 1984 established a branch in Germany and added the "a/d/s/" brand.

- The a/d/s/ brand became well know throughout the world and had broad distribution in many international jurisdictions including South Korea, Taiwan, Thailand, Japan, Singapore and throughout Europe.

- In November 2002 the a/d/s/ brand was purchased by Directed Electronics. Directed Electronics is a US manufacturer of a broad number of audio and other consumer electronics products sold under a variety of brands.

- The trademark a/d/s/ & ADS are registered by Directed Electronics in many countries throughout the world including;

| | | |
|---|---|---|
| USA | a/d/s/ | ADS |
| Australia | a/d/s/ | |
| Mexico | a/d/s/ | |
| Japan | a/d/s/ | |
| Singapore | a/d/s/ | |
| Taiwan | a/d/s/ | |
| Russia | a/d/s/ | |
| Europe | a/d/s/ | |

- Many trademark applications are also pending.

- In Mid 2004 it was discovered that a manufacturer based China and calling itself Guangzhou ADS was manufacturing and selling counterfeit a/d/s/ & ADS branded product in China and has been expanding its distribution throughout the Pacific Rim.

- The product manufactured by Guangzhou is <u>identical</u> in industrial design, packaging and marketing as the Directed Electronics' product. There is not differentiation.

- It was also discovered that Guangzhou ADS has registered the ADS and a/d/s/ marks in China and is attempting to register in Hong Kong.

- Directed Electronics has brought an action before the Chinese trademark office to cancel the Guangzhou ADS registrations on the grounds of bad faith adoption of the mark.

- Directed Electronics is also proceeding with and administrative action before the Provincial court in Guangzhou claiming unfair competition and trademark infringement.

AUTHENTIC
automotive loudspeaker system
a/d/s/
analog and digital systems
345is
346is

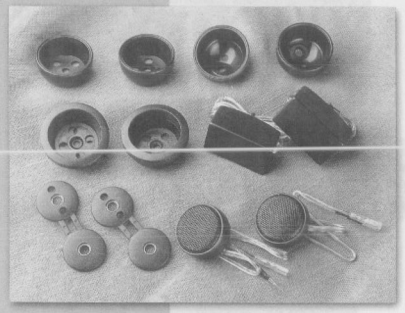
COUNTERFEIT
automotive loudspeaker system
a/d/s/
analog and digital systems
235is
230is

analog and digital systems

# Car speaker

汽车扬声器

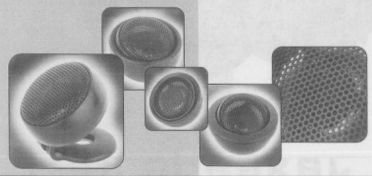
a/d/s/ analog and digital systems



#AC-18

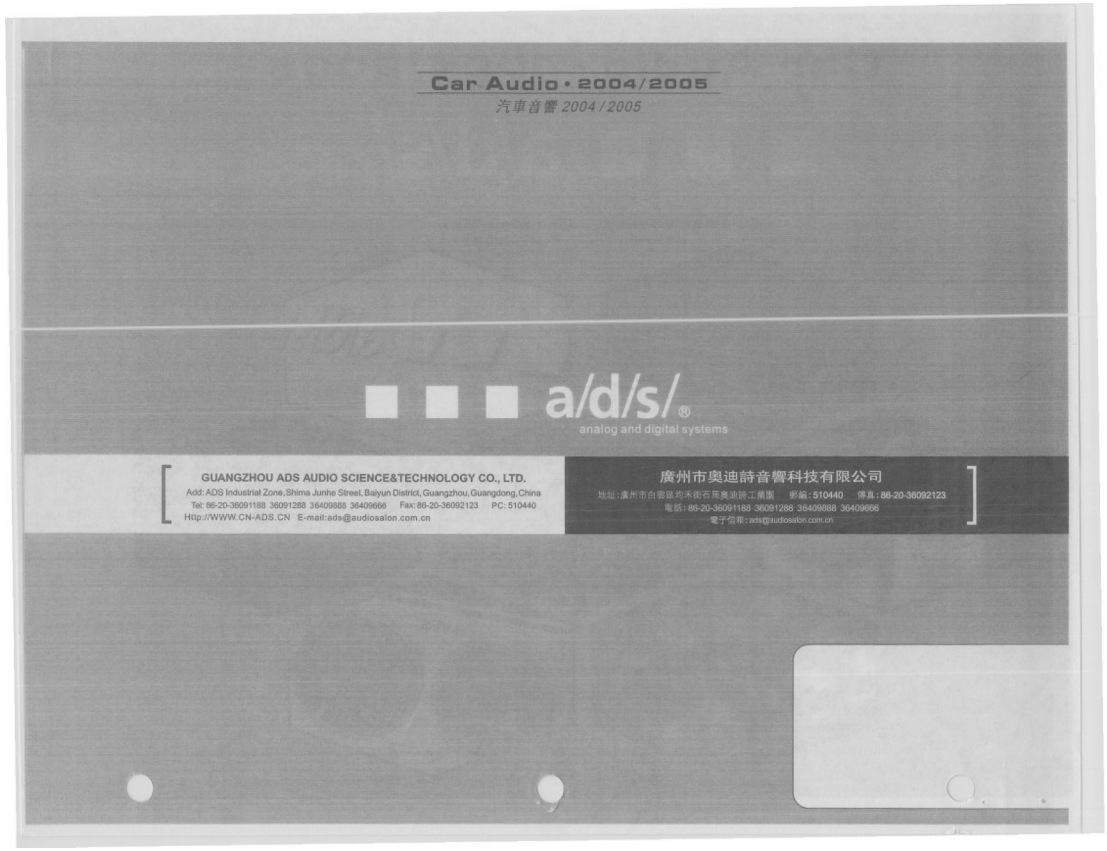
Model (型号): AB-2500
Nominal Impedance (额定阻抗) : 4 Ohm
Peak Power (峰值功率) : 250W
Rated Power(额定功率): 60W
Frequency Range (频响范围) :3K-26KHz
Sensitivity (灵敏度) : 89dB
Voice Diameter (音圈直径) : 14mm
Magnet (磁铁) : 50 X 22 X 8(mm)
Unit Dimension (产品尺寸): 86 X 34 X 86(mm)
Weight (重量):0.0 Kg
Box Dimension (彩盒尺寸): 360 X 165 X 50(mm)
PCS/20'Container (20尺柜): 8000
PCS/40'Container (40尺柜): 16560

AB-2500



## #AC-18 AB-2500

• Model (型号): #AC-18 • Nominal Impedance (额定阻抗) : 4 Ohm • Peak Power (峰值功率) : 150W • Rated Power(额定功率): 10W • Frequency Range (频响范围) :3K-20KHz
• Sensitivity (灵敏度) : 88db • Voice Diameter (音圈直径) : 13.5mm • Magnet (磁铁) : 27 X 16X 1.5(mm) • Unit Dimension (产品尺寸): 40 X 22 X 40(mm) • Weight (重量): 0.36Kg
• Box Dimension (彩盒尺寸):260 X 60 X31 (mm) • PCS/20'Container (20尺柜):16000 • PCS/40'Container (40尺柜):33120


Car Audio • 2004/2005
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a/d/s/®
analog and digital systems
GUANGZHOU ADS AUDIO SCIENCE&TECHNOLOGY CO., LTD.
Add: ADS Industrial Zone, Shima Junhe Street, Baiyun District, Guangzhou, Guangdong, China
Tel: 86-20-36091188 36091288 36409888 36409666 Fax: 86-20-36092123 PC: 510440
Http://WWW.CN-ADS.CN E-mail:ads@audiosalon.com.cn
廣州市奧迪詩音響科技有限公司
地址：廣州市白雲區均禾街石馬奧迪詩工業園 郵編：510440 傳真：86-20-36092123
電話：86-20-36091188 36091288 36409888 36409666
電子信箱：ads@audiosalon.com.cn

| | |
|---|---|
| Nature: | Limited Liability |
| Business Scope: | Audio equipments manufacture, process and its research & development and technology consultancy, research & development, retail and wholesale of computer communication equipments (except those commodities monopolized by the state) |
| Shareholder 1: | ZHAO Zhiwei (Male) |
| Invested Capital: | RMB 400,000 |
| Ratio: | 80% |
| Shareholder 2: | PENG Rujuan (Female) |
| Invested Capital: | RMB 100,000 |
| Ratio: | 20% |
| Executive members: | ZHAO Zhiwei, Chairman & General Manager; PENG Rujuan, Supervisor; CHEN Shuoji, Deputy Manager; ZHAO Zhihao, Deputy Manager; and ZHAO Zhijie, Deputy Manager |

3. After making the company search with the Guangzhou AIC, the investigator visited the Guangzhou ADS and found that the party used signs "[redacted]/A/s/ and Chinese characters" and "[redacted]/d/s/" on their two factory buildings.

4. The investigator was received by Mr. HUANG, who is in charge of Overseas Marketing Dept. and obtained the following information after talking with him:

   4.1. Guangzhou ADS mainly produces two kinds of products, family digital theater products, including audio amplifier, DVD, etc, and motor vehicle audio products, including audio amplifier, car equalizer, etc.

   4.2. Guangzhou ADS developed rapidly recent years and the total asset in 2003 is around RMB 60 million (about US$7,246,377).

   4.3. Guangzhou ADS now are using three trademarks that have been registered in China trademark Office, including "ADS & Chinese characters", "Yingzhiba & Chinese characters" and "BOSDN & Chinese characters". The trademarks "Yingzhiba & Chinese characters" and "BOSDN & Chinese characters" are only used for family digital theater products while "ADS & Chinese characters" is used for all products.

5. The investigator also had a talk with a male named ZHOU who works in Carpenter Dept. of Guangzhou ADS and got the following information:

   5.1. Guangzhou ADS has two factory buildings, with 1,000 meters away from each other. The older one was established in 1996, occupying an area of 5,000 square meters with 300 workers, and the new one was established in 2001,

occupying an area of 3,000 square meters with about 100 workers.

5.2. The Chairman & General Manager is ZHO Zhiwei and two of the three Deputy Manager, ZHAO Zhihao and ZHAO Zhijie are ZHAO Zhiwei's brothers.

6. After the talking with HUANG and ZHOU, the investigator visited factory and got the brochure and some promotion materials of Guangzhou ADS. One of the promotion materials shows that Guangzhou ADS also used /ɑ/ as the mark for their car audio products.

7. The investigator took some photos of the subject before leaving.

(End of the Report)

Appendix

| | |
|---|---|
| Appendix 1 | Company registration materials obtained from the Guangzhou AIC |
| Appendix 2 | Photos of the factory building |
| Appendix 3 | Name card of HUANG |
| Appendix 4 | Brochure and promotion materials |

Appendix I

Company registration materials
obtained from the Guangzhou AIC

2

## （一）企业法人（公司）申请变更登记事项

| 项目 | 原核准登记事项 | 申请变更登记事项 |
|---|---|---|
| 名称 | 杭州[illegible]信息科技有限公司 | 同左 |
| 住所（邮政编码） | 杭州市[illegible]村（[illegible]） | 同左 |
| 电话 | 0571-[illegible]666 | 同左 |
| 法定代表人 | 赵志伟 | 同左 |
| 经济性质或企业类型 | 有限责任 | 同左 |
| 注册资本（万元） | 任[illegible]元 | 同左 |
| 经营范围 | 软件的研究、开发、技术咨询、计算机通信设备的研究开发、批发和零售贸易（国家专营专控商品除外） | 加工、制造、软件的研究、开发、技术咨询、计算机通信设备的研究开发批发和零售贸易（国家专营专控商品除外） |
| 股东（发起人） | 董[illegible]<br>赵志伟 | 同左 |
| 经营场地（面积 m²） | 合计 / 其中生产占用 | 合计 / 其中生产占用 |
| 经营期限 | 自[illegible]年[illegible]月[illegible]日至[illegible]年[illegible]月[illegible]日 | 自 年 月 日至 年 月 日 |

注：1、原核准登记事项一栏应逐项填写。申请变更登记事项一栏，不变更的项目可不填写。
2、住所应填写所在区县。

3

(二) 申请变更理由

| | | | |
|---|---|---|---|
| 申请变更理由 | 同公司法定代表人申请变更 法定代表人签字 2002年3月23日 | | |
| 企业电话 | 3107188 | 联系人 | 赵伟 |
| 有关部门主管意见 | (公章) 年 月 日 | | |

[Translation]

Application Form for Changing the Registration Items

| Item | The previous registration | Changed to |
|---|---|---|
| Name | Guangzhou ADS | Same as before |
| Address | Shi Ma Village, Xin Shi Town, Bei Yun District, Guangzhou | Same as before |
| Telephone | 13609738656 | Same as before |
| Legal representative | ZHAO Zhiwei | Same as before |
| Nature | Limited liability | Same as before |
| Registered capital | RMB 500,000 | Same as before |
| Business scope | Audio equipments process and its research & development; technology consultancy; wholesale and retail (except those commodities monopolized by the state) | Audio equipments manufacture, process and its research & development; technology consultancy; research & development; computer communication equipments; retail and wholesale of (except those commodities monopolized by the state) |
| Shareholders | ZHAO Zhiwei<br>FENG Ruyuan | Same as before |
| Business validity | April 3, 2000 – Dec. 31, 2005 | |
| Reason of change | Broaden the scope of the business<br><br>Signature of ZHAO Zhiwei | |

# 法定代表人任职证明书

8

茲证明：

赵志伟 是依 [illegible] 公司

章程規定的程序，被任命（选举）为董事长（执行董事），任期 三 年。

全体董事签字：赵志伟、彭如明

股东签名（盖章）赵志伟 彭如明

一九九 年 3 月 [illegible] 日

注：如公司设董事会的，董事长由董事会选举产生，则全体董事在本表上签字；如公司不设董事会的，执行董事由股东的商产生，由股东在本表上签字。

—9—

Certification of Legal Representative

We hereby certified that

ZHAO Zhiwei is appointed as the chairman of Guangzhou ADS Science & Technology Ltd. and the tour of duty is 3 years.

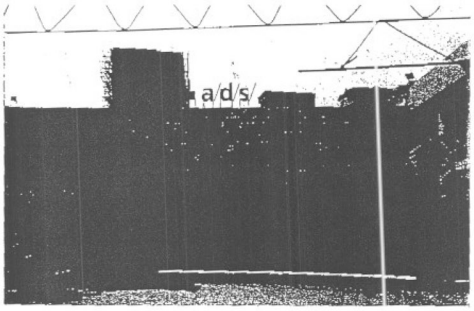
Signature of Directors: ZHAO Zhiwei; PENG Rujuan

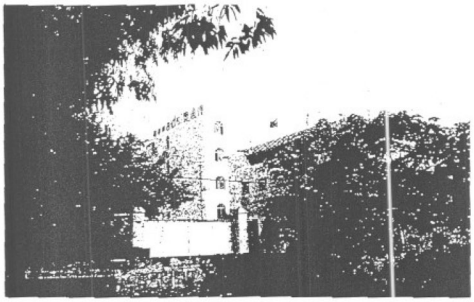
Signature of Shareholders: ZHAO Zhiwei, PENG Rujuan

March 23, 2000

Appendix 2

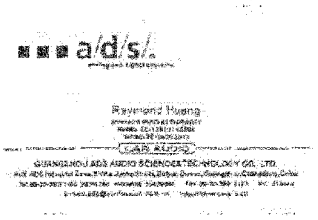
Photos of the factory building



Appendix 3

Name card of HUANG

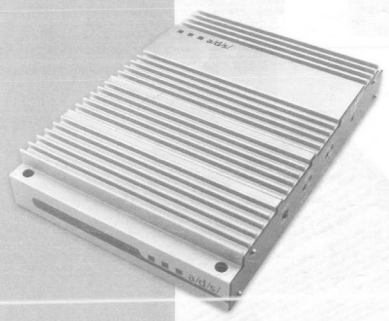

a/d/s/.
Raymond Huang

analog and digital systems

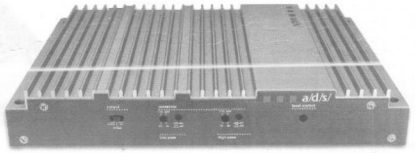
# Car amplifier

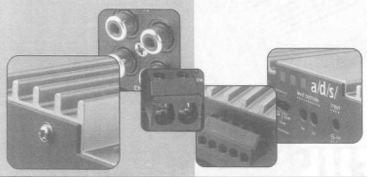
汽车声频功率放大器

a/d/s/®
analog and digital systems



- 2 channel with big power output
- Over-heated and over-loaded protection
- Mute circuit when switch on/off
- LED indicator
- Input volume control,full frequency,HP,LP choice, gain point converter
- Stereo,bridge,and mono mode output





## P450.2

• Model (型号): P450.2 • 4Ω Power (4Ω额定功率): 70W x 2 • 2Ω Power (2Ω额定功率): 90W x 2 • BTL Power (桥接额定功率): 160W x 1 • Fuse (保险丝): 15A x 2
• S/N Ratio (信噪比): >85dB • Weight (重量): 3.8Kg • Unit Dimension (产品尺寸): 240 x 330 x 50(mm) • Box Dimension (彩盒尺寸): 310 x 380 x 95(mm)
• PCS/20'Container (20尺柜): 2587 • PCS/40'Container (40尺柜): 4677

analog and digital systems

# Car speaker

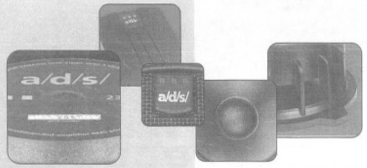
汽车扬声器

a/d/s/
analog and digital s

Model (型号): 235is
Nominal Impedance (额定阻抗) : 4 Ohm
Peak Power (峰值功率) : 250W
Rated Power(额定功率): 125W
Frequency Range (频响范围) :80-20KHz
Sensitivity (灵敏度) : 90dB
Voice Diameter (音圈直径) : 25mm
Magnet (磁铁) : 80 X 40 X 12(mm)
Unit Dimension (产品尺寸): 159 X 94 X 159(mm)
Weight (重量):3.8 Kg
Box Dimension (彩盒尺寸): 530 X 230 X 150(mm)
PCS/20'Container (20尺柜): 1400
PCS/40'Container (40尺柜): 2900

236is

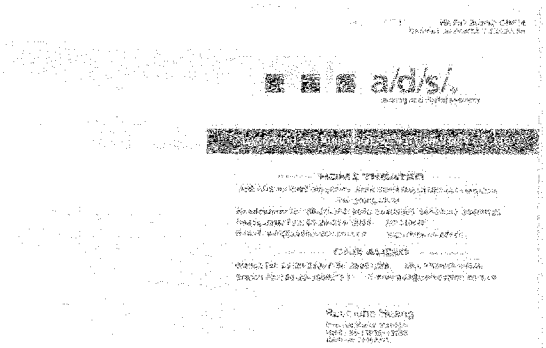
235is




## 235is 236is

• Model (型号): 236is • Nominal Impedance (额定阻抗) : 4 Ohm • Peak Power (峰值功率) : 250W • Rated Power(额定功率): 125W • Frequency Range (频响范围) :70-20KHz
• Sensitivity (灵敏度) : 89dB • Voice Diameter (音圈直径) : 25mm • Magnet (磁铁) : 156 X 75 X 20(mm) • Unit Dimension (产品尺寸): 220 X 110 X 220(mm) • Weight (重量): 4Kg
• Box Dimension (彩盒尺寸):530 X 230 X 150 (mm) • PCS/20'Container (20尺柜):1400 • PCS/40'Container (40尺柜): 2900

Car Audio • 2004/2005
a/d/s/®
analog and digital systems
Car Speaker
汽车扬声器
Car Amplifier
汽车声频功率放大器
level controls
input
TEMP METER
VOLT METER
DS-222
汽車音響2004/2005



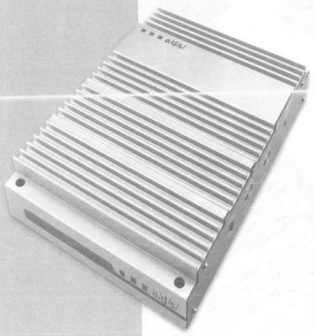
analog and digital systems

# Car amplifier

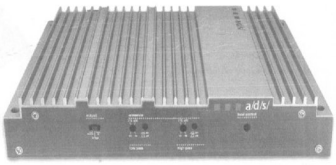
汽车声频功率放大器

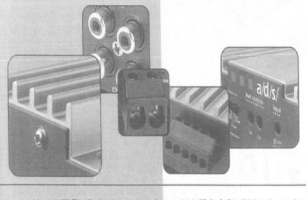
a/d/s/

analog and digital sy



- 2 channel with big power output
- Over-heated and over-loaded protection
- Mute circuit when switch on/off
- LED indicator
- Input volume control,full frequency,HP,LP choice, gain point converter
- Stereo,bridge,and mono mode output





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analog and digital systems

# Car speaker

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analog and digital s

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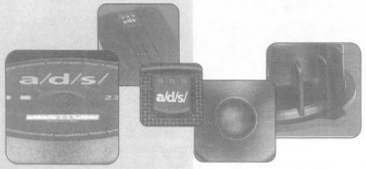
236is

235is



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Car Audio • 2004/2005
a/d/s/®
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Car Speaker
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汽车声频功率放大器
a/d/s/
level controls
input
TEMP METER
VOLT METER
DS-222
汽車音響2004/2005

Mr. ISSA. And what they did, which I think is noteworthy here, to show you just how bad—and particularly, for our Trade Representative—things are, after I left the company, Directed Electronics bought a company called ADS—famous speaker manufacturer, speaker and amplifier, very high-end. And they were already manufacturing some of their products—and had been for decades—in China; actually, for more than a decade, almost two decades. And so I have a picture of the authentic ADS product, and I'll send it down. This is going to be included in the record. And I have a picture of the counterfeit.

Now, the amazing thing is, it's less than 20 miles from the real factory to the fake factory. And when the company, according to the general counsel that sent me this, began the process of making them aware that a product that is trademarked all over the world was being counterfeited in China, sent into China, and that as a result the trademark, which had been acquired by the fake company, was invalid and fraudulently applied for, in every sense, they got a resounding "No Answer" from China. And that continues till today.

And there actually was—I only brought this part, but if you'd like, I do have that many inches that they've gone so far. And this was because I mentioned in a conversation that we were going to hold a hearing. China is not, in my opinion, going to do anything, unless we pull the trigger on some of those sanction capabilities.

And I would—I think I would be remiss if I didn't mention that the DVD example, from my standpoint, makes no sense. Those are patents, U.S. patents. You can get an injunction against Circuit City, Best Buy, or the person supplying them, in a matter of hours. Phillips and others could do that.

So I would hope that that not go in the record as the best example. Because I think that most of China's violations have more to do with when there is no patent, when the intellectual property is not easily seen. And certainly, when it comes to their domestic market—and much of this product is being sold to the domestic market—what they've decided to do is not let us into the domestic market at all; but rather, supply it themselves. And ignoring intellectual property gives them that ability.

And that market, as chairman Bill Gates and others have noted, is going to be huge. And that's why so many companies are putting an emphasis on getting access. And that, perhaps, is the story not told today.

I would have a specific question for Ms. Espinel. Isn't there a tendency—and if there absolutely isn't, please say it in those terms. Isn't there a tendency for our ongoing problems with North Korea to cause us to soft-pedal the trade portion, the valuation portion?

When I was there with Chairman Hyde in China, now over 2 years ago, that 1-hour discussion was 50 minutes on North Korea. And some note-taker, you know, put a check mark when we started talking about intellectual property.

Isn't that one of our challenges with China? That if this were the country of my grandparents, Lebanon, we'd demand that they change their rights and they enforce them and they do it, or we

sanction them. With China, isn't their size and their strength and their geopolitical influence part of our problem?

Ms. ESPINEL. I think the situation in China is very complex, for all of the reasons that you just mentioned. And I would add another one to that. I think, given the size of China, I think it is a difficult market even for the Chinese government to control the problem that they're facing.

That said, I agree with what other people have said here today, that this is a time for the Chinese government to demonstrate the political will that I think they can demonstrate to get a handle on the problem before it goes any further, and to correct the problem and reverse the situation that they've created.

In terms of USTR's relationship with China, Ambassador Portman has made quite clear, I think feels quite strongly, that IP protection is one of the top priorities that we have with China. And I think he is quite willing to press that issue with China as far as we need to, in order to effectively address this problem.

Mr. ISSA. And just one follow-up question. This problem—I know that just in one area, you cited 2.5 billion; but this problem represents a substantial portion of the trade deficit. How do we get whole, when we're talking about tens of billions of dollars of losses to our economy? And that's not to our economy in the abstract; that's to particular individuals, to particular companies, to particular workers, that are going on every day.

It has been more than—I mean, to be honest, Rob Portman's predecessor came in with exactly the same statements that you're giving us today about why this was important. And how many—how many hundreds of thousands of U.S. jobs and how much was lost as a result of saying we were going to act; but inaction?

Why is it that this Committee should believe that, until you actually show us action, that you're going to show us action? What's different now than it was 2 years ago?

Ms. ESPINEL. Well, one thing that I think is different, actually in the last couple of weeks, is the out-of-cycle review determination that we've made. As I've mentioned before, we have intensified pressure in the JCCT in the last twelve months.

We also conducted this extraordinary out-of-cycle review against China, and announced the results of that and the aggressive actions that we would take as a result of that, a couple of weeks ago. And those include things like elevating China to the Priority Watch List, which I think has sent a very clear signal to China; one that, I might add, they are quite unhappy about.

We have publicly announced that we are working with our industry to develop our WTO options, and we are actively engaged in that process. We have publicly announced that we will be invoking the WTO TRIPS Agreement procedures for transparency, in order to acquire information from China. So I think we have already outlined a fairly aggressive series of actions that we will be taking.

And in addition to that, I mean, we are looking very actively to see what our other options are. I think it seems to me that it's clear, given the scope of the problem in China, there is not going to be one single effective approach; but rather, a combination of approaches that we have already either started in train, or maybe, in

consultation with you and with our industry, able to develop over the next few months.

Mr. ISSA. Thank you, Mr. Chairman. This could go on, if only we had time.

Mr. SMITH. Thank you, Mr. Issa. That was a very good question, and a good response, as well.

Mr. Berman has one more quick question to ask, and as I do. And then we'll adjourn.

Mr. BERMAN. I think I'm not asking you to respond here, but if you could respond in writing, Mr. Smith in his testimony—he didn't really touch on it much in his testimony, but in his written testimony, talks about at least two different limitations on market access for films and music—one quotas; the other one, requirement of permission to retail music—and raises issues of discrimination, tests put on here that aren't put on Chinese produced music.

I'd like to know, number one, to your mind, do those violate China's international commitments? And secondly, what efforts are being made specifically on those market access limitations by the Trade Representative's Office? And if you would be willing to put that in writing, I'd be very grateful.

And I'd only say that, Mr. Issa, notwithstanding the problems, at least China is being very helpful with respect to North Korea.

Mr. SMITH. Thank you.

Mr. ISSA. You know, funny he should note that——

Mr. SMITH. Thank you, Mr. Issa. No response is necessary right now.

I do have a quick question to ask, myself, Ms. Espinel, and that is this. What can American industry do to help you make the case that you need to make in order to get the enforcement we need from China?

Ms. ESPINEL. As I mentioned, we have been working closely with some segments of the industry. And I would encourage them to continue to cooperate with us, as they have been doing, to continue the hard work that they have been doing, to help us build the factual record that we need in order to bring the best case possible.

Mr. SMITH. Okay. You need specific examples, specific figures, documentation, and so forth?

Ms. ESPINEL. Yes. Exactly.

Mr. SMITH. Okay. Thank you, Espinel [sic].

Ms. ESPINEL. Thank you.

Mr. SMITH. All right. Thank you all for being here. We appreciate your testimony. It's been very, very helpful. And I might add, I think this is the first such hearing that this Subcommittee has had on this important subject in probably many, many years. But we intend to go forward and work with—work with Ms. Espinel and our new ambassador to try to effectuate change of the kind that we want.

We are going to adjourn this hearing now, and then in about 5 minutes we will resume our hearing schedule and start the next hearing.

[Whereupon, at 12:15 p.m., the Subcommittee was adjourned.]

# Part II

# INTELLECTUAL PROPERTY THEFT IN RUSSIA

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**TUESDAY, MAY 17, 2005**

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS, THE INTERNET,
AND INTELLECTUAL PROPERTY,
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 12:26 p.m., in Room 2141, Rayburn House Office Building, the Honorable Lamar Smith (Chair of the Subcommittee) presiding.

Mr. SMITH. The Subcommittee on Courts, the Internet, and Intellectual Property will come to order. I will recognize myself and the Ranking Member for opening statements, and then we will get to the witness testimony.

This, the second of our two back-to-back oversight hearings on the subject of international intellectual property theft, will focus on the state of IP enforcement in the Russian Federation. In our first hearing, the Subcommittee received testimony that China, the single largest source of counterfeit and pirated products worldwide, has accelerated their theft of intellectual property and failed to adopt enforcement procedures that are designed to deter such actions.

The Russian Federation now seeks to become a member of the World Trade Organization, and is counting on the support of the United States Government and the American people for that privilege. Recently, Secretary of State Condoleezza Rice acknowledged the reality that Russia lacks "the legal framework to prosecute those who engage in piracy," and stated that this "really must be taken care of before WTO accession."

However, the adoption of a legal framework alone, which is not accompanied by a demonstrated and sustained commitment to criminal enforcement of large-scale commercial piracy and counterfeiting, is not enough to gain U.S. support for Russian accession. This commitment must be made at the highest levels, and it must be made before the American people endorse Russian accession to the WTO.

Russian President Putin stated last month "Our bureaucracy is still to a large extent isolated, and is undermined by corruption, irresponsibility, and incompetence." Anyone familiar with the Russian Federation track record for protecting and enforcing intellectual property would concur with President Putin's statement.

Last Thursday's Wall Street Journal contained a report entitled, "In Russia, Politicians Protect Movie and Music Pirates." It describes how certain Russian elected officials thwart police investigations of IP crimes, and in fact profit by doing so.

As our witnesses today will testify, the grim reality is that lawlessness, physical danger, and corruption are part of the daily challenges faced by businesses and individuals who seek to conduct business or protect their IP rights in Russia. They will provide compelling evidence that the situation has actually worsened, rather than improved, in recent years.

The Members of this Subcommittee will receive evidence that the Russian government is the landlord for as many as 18 optical disc plants that annually produce tens of millions of illicit copyrighted works for export to mature markets, and that the government has failed to even inspect the vast majority of these facilities, let alone investigate or prosecute any of the criminals. On the rare occasion when someone is investigated for IP theft in Russia, the most likely outcome is that no prosecution will occur and that any conviction will result in a suspended sentence.

If Russia is permitted to join the WTO without first demonstrating a sustained and serious commitment to the enforcement of IP rights, then the real winners will be the criminal syndicates. We owe it to the Russian people and to the American people to consider this record before the U.S. advocates that the Russian government be rewarded with accession to the WTO.

That concludes my statement, and the gentleman from California is recognized for his.

Mr. BERMAN. Thank you, Mr. Chairman. Russia is considered by the copyright industries as second only to China as an intellectual property pirate. In fact, that Wall Street Journal article that you sent around, Mr. Chairman, its paragraph says, "While China may be the world's top producer of illegal computer software, CDs, and DVDs, at least authorities there are getting serious about cracking down." Well, I'm not sure that's established. But then it points out, "In Russia, the Kremlin has been promising to deal with the problem for years, but industry officials say under President Vladimir Putin it's gotten worse, not better."

Almost 2 years ago, a number of Members of Congress sent a letter to President Bush to focus his attention on the escalating problem in Russia. Yet Russian plants are still producing tens of millions of pirated optical discs for export. U.S. copyright industries continue to lose billions of dollars, and the piracy rates are estimated at 70 percent for every copyright sector.

In February, the International Intellectual Property Alliance released its 2005 Special 301 Recommendations, a document that Mr. Schwartz will address in his testimony. The options laid out are time-sensitive. We must consider one or all of the following actions: Recommending the designation of Russia as a priority foreign country; or conditioning Russia's entry into WTO on meaningful copyright enforcement; or denying Russia its GSP benefits.

We must move quickly, because each day that goes by without a firm stance by the Administration on these possibilities lessens the importance of this issue in Russia's eyes.

When we had a hearing on international copyright piracy 2 years ago, a constituent of mine testified to her own personal experience of intellectual property theft by the Russian government. Before us today are representatives of the movie and music industry who will testify to the effect Russian piracy has had on that segment of the American economy.

Whether one pirates from an individual or from a corporation, the act of piracy must be stopped. The same holds true whether the piracy is sponsored by the government itself, or funded by individual citizens. While the concept of private ownership of property is relatively new in many of the formerly communist countries, the value has not been lost on them.

Any government that wants the benefits of trade with America and who is currently benefitting from trade preferences, like Russia, has a responsibility to respect American innovation. Any citizen of a state must recognize basic rules of law, such as a prohibition on theft.

The Russian government has pointed to the high price of legitimate products coming from the U.S. as a justification for piracy. This is tantamount to blaming the victim for the crime. It is clear that price is not the cause of piracy. The pirated goods contain language tracks that include languages that are not Russian. The goal, therefore, is not simply to help Russians afford DVDs of movies; piracy is providing a business opportunity to services—to service those that live outside of Russia.

We have an opportunity now, in trying to address the piracy situations in Russia, to learn from our failures with intellectual property enforcement in China. This came up at the last hearing. Before permitting Russia's accession to the WTO, we must require stricter enforcement of intellectual property rights.

I look forward to hearing the witnesses describe the extent of piracy in Russia, and any suggestions they have to curtail the problem. And I look forward to working with you, Mr. Chairman, to address the importance of achieving significant reform of Russian intellectual property enforcement before admitting Russia into the WTO. Thank you, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Berman. And may I ask the witnesses to stand and be sworn in, if you will.

[Witnesses sworn.]

Mr. SMITH. Thank you. Please be seated.

Our first witness is Victoria Espinel, who is the Acting Assistant U.S. Trade Representative for Intellectual Property in the Office of the United States Trade Representative. In that capacity, Ms. Espinel serves as the principal U.S. trade negotiator on IP. Ms. Espinel's office chairs the interagency committee that conducts the annual Special 301 Review of international protection of intellectual property rights. The latest report was published on April 29, 2005.

She holds an LLM from the London School of Economics, a JD from Georgetown University, and a BS in foreign service from Georgetown University School of Foreign Service. After serving as the government witness in our China hearing earlier this morning—or this morning—Ms. Espinel is now a veteran who is sea-

soned in delivering testimony to Congress. We look forward to her return testimony, as well.

Our second witness is Eric Schwartz, Vice President and Special Counsel to the International Intellectual Property Alliance, IIPA, a private-sector coalition of six U.S. trade associations which represents over 1,300 companies that produce, and distribute materials protected by copyright laws throughout the world.

Mr. Schwartz is a partner at Smith and Metalitz, where he specializes in copyright, entertainment, and information law. Mr. Schwartz was the principal negotiator of the copyright provisions in the U.S.-USSR trade agreement of 1990, and he is the subject matter expert for IIPA on copyright matters that involve the Russian Federation and Eastern and Central Europe. A graduate of Johns Hopkins University, Mr. Schwartz obtained a JD from the American University's Washington College of Law.

Our next witness is Mrs. Bonnie Richardson, who serves as the Senior Vice President for International Policy at the Motion Picture Association of America, where she is responsible for international policies affecting the production and distribution of filmed entertainment in worldwide markets.

Before joining MPAA, she served as the director for services negotiations for USTR, and as a foreign service officer at the Department of State. Mrs. Richardson earned her master's degree at Johns Hopkins School of Advanced International Studies, and her undergraduate degree from the University of Delaware.

Our final witness is Matthew T. Gerson, the Vice President for Public Policy and Government Relations at the world's largest music company, the Universal Music Company. Mr. Gerson has been with Universal for 10 years. Prior to that, he worked at the MPAA. He is a graduate of Georgetown University Law Center, and Tufts University.

We welcome you all, and look forward to your very expert testimony. And as before, Ms. Espinel, we'll begin with you.

**TESTIMONY OF VICTORIA ESPINEL, ACTING ASSISTANT U.S. TRADE REPRESENTATIVE FOR INTELLECTUAL PROPERTY, OFFICE OF U.S. TRADE REPRESENTATIVE**

Ms. ESPINEL. Thank you. Chairman Smith and Members of the Committee, thank you for the opportunity to address your concerns over inadequate protection and enforcement of intellectual property rights in Russia.

Protection and enforcement of America's IP rights in Russia is an issue that is of the utmost concern to USTR and to the Administration, and is one that we take very seriously. Due to the importance of this issue and the prevalence of piracy in Russia, Presidents Bush and Putin have discussed improving protection of intellectual property in Russia at several recent summits, including most recently at their meeting earlier this month in Moscow. Successfully combatting the rampant piracy and counterfeiting that currently exists in Russia is a top priority.

The level of copyright piracy in Russia has increased dramatically, and the adverse effects on American owners of copyrights are compounded by the fact that Russia has become a major exporter of pirated materials. In addition to sales in Russia of illegal music,

movies, and computer software, Russia's pirates are exporting large volumes of illegal products to other markets. As a result, Russia is on the 2005 Special 301 Priority Watch List announced on April 29.

In addition, due to the severity of the problem in Russia, USTR announced that the Administration will conduct an out-of-cycle review this year to monitor progress by Russia on a number of IP issues. We are also continuing interagency review of a petition filed by the U.S. copyright industries to withdraw some or all of Russia's benefits under the U.S. Generalized System of Preferences program.

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

Through these and other ongoing efforts, we have seen an improvement in cooperation at the working level on IP issues, especially from Rospatent and the Ministry of the Interior. Based upon case information provided by our industry, embassy officials meet regularly with senior representatives of the Ministry of Interior, the prosecutors, Rospatent, and the Supreme Court, to track and press for enforcement in major criminal cases involving optical disc manufacturing facilities and Internet piracy.

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

Supplementing these efforts directly with Russia, the Administration is taking comprehensive action to block trade around the world in counterfeit and pirated goods through the Strategy Targeting Organized Piracy, or STOP, initiative. STOP is a U.S. government-wide initiative begun in October 2004 to empower U.S. businesses to secure and enforce their rights overseas, to stop fakes at our borders, to expose international counterfeiters and pirates, to keep global supply chains free of infringing goods, to dismantle criminal enterprises that steal U.S. intellectual property, and to reach out to like-minded U.S. trading partners that are facing similar problems in order to build an international coalition to stop counterfeiting and piracy worldwide. Addressing Russia's growing exports of pirate and counterfeit products is part of this initiative.

Our work has brought about some improvements, particularly with respect to the content of Russia's laws; but much more will need to be done in order to reduce the level of piracy and counterfeiting. As part of its effort to bring Russia's IP regime into compli-

ance with the TRIPS Agreement, Russia amended its copyright law in 2004 to provide protection for preexisting works and for sound recordings. Russia has amended a number of other laws as well, including its law on patents and protection of computer software and databases. Although these amendments demonstrate some commitment to strengthening its intellectual property laws, further improvements in Russia's laws are necessary.

On the enforcement side, we have seen far less progress. While Russian law enforcement agencies have taken some actions, including an increased number of raids by police, these actions have not resulted in the kind of robust prosecution and meaningful penalties that would deter the significant increase in piracy that our industry has observed in Russia.

Enforcement efforts in Russia must increase dramatically in order to combat the rising piracy and counterfeiting levels. We need to see improvements in enforcement of Russia's criminal law against piracy; improved enforcement at the border; and better administrative and civil procedures, such as providing for ex parte procedures in civil cases.

We are very concerned with the amount of excess optical media capacity in Russia and with Russia's lack of a comprehensive regulatory regime to control illegal optical media operations. Although Russian authorities have recently taken some positive steps to strengthen optical disc licensing procedures, Russia must establish an effective system for inspecting the optical media plants, to ensure that only authorized product is being made.

On the criminal enforcement side, we see frequent delays in prosecutions and then imposition of minimal penalties, including many suspended sentences. Frequently, pirated goods that have been seized are not destroyed, but are returned to the market. We have raised these issues with Russia, and are seeking decisive actions to address these growing problems, such as inspecting optical media plants, permanently shutting down illegal production, and taking down Internet sites that are spreading pirated material.

We share in our industries' frustration—and your frustration, I would imagine—over the lack of significant progress on the part of Russia's authorities. USTR is committed to utilizing effectively the tools currently available to us to press Russia to implement immediate concrete measures to combat piracy and counterfeiting and reduce the losses to our industry.

Despite our close engagement and continued work with the Russian government, Russia has made little progress in permanently closing down illegal production plants and bringing offenders to justice. Political will at the highest levels will be needed in order to see a reduction in piracy levels in the near term.

USTR will continue to monitor Russia's progress in bringing its IP regime in line with international standards through the Special 301 out-of-cycle review that we have just announced, the ongoing GSP review, and the WTO accession discussions.

Progress will be critical for our bilateral relationship with Russia, and will have implications for Russia's accession to the WTO. Ultimately, success will depend on the political will of Russia's leaders to tackle the underlying problems of corruption and orga-

nized crime. The STOP initiative will also be employed to address the significant intellectual property problem.

We remain committed to working with Congress, and this Committee in particular, in pressing Russia to effectively combat and reduce the unacceptable levels of piracy and counterfeiting which plague our industry.

Mr. Chairman and Members of the Committee, thank you for providing me with the opportunity to testify. And I look forward to your questions.

[The prepared statement of Ms. Espinel follows:]

PREPARED STATEMENT OF VICTORIA ESPINEL

Chairman Smith and members of the Committee, thank you for the opportunity to address your concerns over ineffective protection and enforcement of intellectual property rights in Russia.

Protection and enforcement of American's intellectual property rights (IPRs) in Russia is an issue that is of utmost concern to USTR and the Administration and is one that we take very seriously. Due to the importance of this issue and the prevalence of piracy in Russia, Presidents Bush and Putin have discussed improving protection of IPRs in Russia at several recent summits, including at their meeting earlier this month in Moscow. Successfully combating the rampant piracy and counterfeiting that currently exists in Russia is a top priority.

As you have heard from other witnesses here today, U.S. copyright, trademark, and patent-based industries are experiencing huge losses resulting from ineffective or, in some cases, non-existent enforcement—losses that, in some cases, are continuing to increase over the past year.

The level of copyright piracy in Russia has increased dramatically and the adverse effects on American owners of copyrights are compounded by the fact that Russia has become a major exporter of pirated materials. In addition to sales in Russia of illegal music, movies and computer software, Russia's pirates are exporting large volumes of illegal products to other markets. As a result, Russia is on the 2005 Special 301 Priority Watch List announced on April 29. In addition, due to the severity of the problem in Russia, USTR announced that the Administration will conduct an out-of-cycle review this year to monitor progress by Russia on numerous IPR issues. We are also continuing interagency review of a petition filed by the U.S. copyright industries to withdraw some or all of Russia's benefits under the U.S. Generalized System of Preferences (GSP) program.

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

We are working with other U.S. Government agencies and our Embassy in Moscow to more actively engage senior Russian officials and law enforcement representatives. Our Embassy has increased efforts on the ground, such as conducting a series of regional workshops on IPR enforcement. We will have held a workshop in every Russian region by the end of 2005. These conferences are designed to more actively engage Russian officials from the Ministry of the Interior's economics crimes unit, Russian customs, local prosecutors' offices and the judiciary at the regional level. Through these and our other ongoing efforts, we have seen an improvement in cooperation at the working-level on IPR issues, especially from Rospatent and the Ministry of Interior. Based upon case information provided by U.S. industry, Embassy officials meet regularly with senior representatives of the Ministry of Interior, the Procuracy (prosecutors), Rospatent, and the Supreme Court to track and press for enforcement in major criminal cases involving optical disk manufacturing facilities, as well as in Internet piracy cases.

We are also working on IPR issues in the context of Russia's WTO accession negotiations. We have continuing concerns that Russia's current IPR regime does not meet WTO requirements related to protection of undisclosed information, geographic indications and enforcement. We are raising these and other concerns in the acces-

sion negotiations and have made it clear to the Russian Government that progress on IPR will be necessary to complete the accession process.

Supplementing these efforts directly with Russia, the Administration is taking comprehensive action to block trade around the world in counterfeit and pirated goods through the Strategy Targeting Organized Piracy (STOP!). STOP! is a U.S. government-wide initiative begun in October 2004 to empower U.S. businesses to secure and enforce their intellectual property rights in overseas markets, to stop fakes at U.S. borders, to expose international counterfeiters and pirates, to keep global supply chains free of infringing goods, to dismantle criminal enterprises that steal U.S. intellectual property and to reach out to like-minded U.S. trading partners in order to build an international coalition to stop counterfeiting and piracy worldwide. Addressing Russia's growing exports of pirated and counterfeit products is part of this initiative, and Russian officials have repeatedly express interest in cooperating with us on the initiative.

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

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

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

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

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

USTR will continue to monitor Russia's progress in bringing its IPR regime in line with international standards through the Special 301 out-of-cycle review, the ongoing GSP review, and WTO accession discussions. Progress will be critical for our bilateral relationship with Russia and will have implications for Russia's accession to the WTO. Ultimately, success will depend on the political will of Russia's leaders to tackle the underlying problems of corruption and organized crime. The STOP! initiative will also be employed to address this significant IPR problem. We remain

committed to working with the Congress and this committee in particular in pressing Russia to effectively combat and reduce the unacceptable levels of piracy and counterfeiting which plague our industry.

Mr. Chairman and members of the Committee, thank you for providing me with the opportunity to testify. I look forward to your questions.

Mr. SMITH. Thank you, Ms. Espinel.

Mr. Schwartz.

**TESTIMONY OF ERIC SCHWARTZ, VICE PRESIDENT AND SPECIAL COUNSEL, INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE (IIPA)**

Mr. SCHWARTZ. Thank you, Chairman Smith, Mr. Berman, and Members of the Subcommittee, for giving IIPA the opportunity to testify on the copyright problems we're confronting in Russia.

I've provided a detailed report on some of the problems, and will use my time to just give you a brief overview across all the copyright sectors of the problems our industries are facing in Russia, as well as some suggestions that we think the U.S. Government could take to improve the situation there.

We've provided a lot of statistics, and the statistics only tell a part of the story. What they do not show is the poor reaction over the past 10 years of the Russian government to the piracy problem. The optical disc production and distribution problem, which is our most serious problem—that is, the making of CDs and DVDs at the 34 plants—did not spring up overnight. And this problem is not unique to Russia. It has been successfully addressed in other countries. So we know that it can be fixed.

IIPA first raised this problem with the Russian government in 1996, when there were two plants. The reason the problem has been allowed to escalate to the 34 current plants—that is, 34 known plants—eight of which are dedicated to making DVDs, and with a total plant capacity over 400 million discs a year, has been because the Russian government has failed to properly act. In short, what we have is a legacy of failed commitments.

On a personal note, I can tell you the piracy situation in Russia is the worst it has been in the 16 years I've been working on Russian and, before that, Soviet copyright issues. Let me show you a few of the statistics that we're confronting.

First, we estimate that the copyright industries lost over $1.7 billion last year alone to copyright piracy in Russia; over $6 billion in the last 5 years. At the same time that we're losing $1.7 billion last year, Russia enjoyed over $515 million in GSP benefits, $430 million in 2003. In short, Russia has not earned the right to enjoy these benefits. They are neither in compliance with the GSP requirements for enjoyment of the benefits, and they are not taking the necessary actions to reduce piracy.

Our rate, as noted in the opening statements, hover around 70 percent at the low end, and 87 percent on the high end. We know from forensic evidence that at least 24 of the 34 plants are known to be producing some pirate product. We don't know how much, because there is not proper plant inspections ongoing. We also know that Russian-produced optical discs have been positively identified in 27—at least 27—countries.

Let me give you an example of some of the actions that were undertaken last year, and the results. In 2004, the Russian govern-

ment and our industry agreed that there were eight actions taken against the Russian plants. But they were unsuccessful, for three reasons: One, most of the seized material ends back in the marketplace—by some industry experts, as much as 70 percent. Two, every single plant that was raided remained in operation throughout the year; they have never closed a plant. And third, there were few, if any, criminal prosecutions; almost all end in suspended sentences. I was looking back at my notes, and I believe it may be the case that in the last 10 years there have only ever been two criminal convictions that ended in served sentences.

We've suggested six steps to the Russian government on how to improve the optical disc problem. Step number one is easy. All they have to do is conduct surprise raids at 34 plants. This could be done in a matter of weeks.

As for new legislation, which Ms. Espinel has mentioned, we can't wait for new legislation. Yes, there are deficiencies in their optical disc regulatory scheme, but it took them 12 years to fix the deficiencies in their copyright law, and all the while the U.S. Government was pressing them, as well as the IIPA, on these shortages.

The legacy of failed commitments, though, is very serious. At all levels of the Russian government—as you've heard, even at the presidential level—these issues have been discussed without success. Beginning in 1999, when the Russian government first acknowledged that it had an optical disc problem—and remember, we raised it with them in 1996, so three years before—they acknowledged a problem; they acknowledged they would take care of the problem.

In 2002, they agreed in negotiation with the U.S. Government to create an action plan, something comprehensive to fix the optical disc problem. They never provided the action plan, and we never heard about the plan ever again after those rounds of negotiations. Instead, they created an inter-ministerial commission, which meets quarterly and issues reports on the "progress" that they're making on optical disc piracy problems.

As one example of the shortcomings of the government. This last October, we spent a considerable amount of time in discussions with them. And the Russian government officials told us that they would convene a meeting in December with the 18 plants known to be on leased or limited-access government property.

The meeting never took place. And the reason the meeting never took place: The government later acknowledged they couldn't identify who the owners of the plants are. Because they have no effective plant licensing system, they don't even know how to identify who they should be meeting with to stop these actions.

So we've suggested three things to the U.S. Government. For the past 9 years, Russia has been on the priority watch list, and it's time to take some different course of action. The first is to condition Russia's entry into the World Trade Organization on meaningful copyright enforcement.

The second is, when the out-of-cycle review is over, to designate Russia as a priority foreign country, and to get to the business of forcing them with deadlines, to either fix the problem or to face trade sanctions.

And the third, and probably simplest for the U.S. Government, would be to suspend or deny their eligibility for GSP benefits; which could be done immediately. We filed the petition in 2000 with the U.S. Government. It was accepted in 2001. I've testified twice on the issue, and regularly file updates on the shortcomings of the Russian government. And we think they could just suspend the GSP benefits.

In short, we think that the time for the Russian government is up. And looking at the clock, my time is up, as well. So I will thank you, and be happy to answer any questions.

[The prepared statement of Mr. Schwartz follows:]

PREPARED STATEMENT OF ERIC J. SCHWARTZ

Mr. Chairman, Ranking Member, and Members of the Subcommittee, the International Intellectual Property Alliance (IIPA) and our members thank you for the opportunity to testify today on the piracy problems we are confronting in Russia.

The IIPA is a private sector coalition representing the U.S. copyright-based industries in bilateral and multilateral efforts to improve protection and enforcement of copyrighted materials worldwide. The IIPA is comprised of six trade associations representing over 1,300 U.S. companies who produce and distribute materials throughout the world. The copyright industries contributed over $625 billion to the U.S. GDP, or 6% of the U.S. economy, and almost 5.5 million jobs or 4% of U.S. employment, in 2002.

The copyright businesses and the individual creators that work with them are critically dependent on having strong copyright laws in place in foreign countries and having those laws effectively enforced. In fact, most of the copyright sectors generate over 50% of their revenue from outside the U.S. This is why we are so concerned with the problems of weak legal regimes and poor enforcement in China, Russia, and the many other countries detailed in our annual Special 301 Report to the U.S. government.

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

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

SCOPE AND NATURE OF THE PIRACY PROBLEM IN RUSSIA

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

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

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

identified in at least 27 countries. So, the harm illegal Russian plants are doing far exceeds the Russian marketplace.

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

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

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

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

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

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

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

Most of our testimony today is limited to problems pertaining to hard-copy piracy, but there are growing problems related to digital piracy as well. In fact, the world's largest server-based pirate music website—allofmp3.com—remains in operation after a criminal prosecutor in early 2005 reviewed the case and determined (wrongly) that current Russian copyright law could not prosecute or prevent this type of activity. In fact, this interpretation of the Russian law is contrary to all the assurances the Russian government gave the U.S. government and private sector during the years-long adoption of amendments to the 1993 Copyright Law; those amendments were finally adopted in July 2004.

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

The book industry, the Association of American Publishers (AAP) reports widespread piracy of an array of reference works and textbooks, increasingly a large market in Russia as the penetration of English-language materials in the market

grows. Lax enforcement, including poor border enforcement—endemic to all copyright sectors—results in the import (and export) of illegal materials. In the book industry this includes unlicensed imports of pirated reprints from neighboring countries, and pirated reference books and medical texts; there is also widespread illegal commercial photocopying, especially in the academic sector.

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

THE RUSSIAN GOVERNMENT'S LEGACY OF FAILED COMMITMENTS

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

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

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

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

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

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

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

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

In 1995, Russia acceded to the Berne Convention but failed to comply with Article 18 to provide protection for pre-existing works. That same year, Russia acceded to the Geneva Phonograms Convention but provided no protection for pre-existing foreign sound recordings prior to the accession date of March 13, 1995. These were commitments Russia made to the U.S. government in the 1992 Bilateral NTR Trade Agreement—Russia agreed to have these commitments in place by the end of 1992. Finally, in July 2004, Russia adopted provisions to its law to provide protection for foreign pre-existing works and sound recordings—however, the 12 year delay in

adopting these provisions has resulted in flooding the marketplace with illegal product that will take years to enforce, even if Russian enforcement were effective (which it is not).

In the 1992 Bilateral NTR Trade Agreement, the Russian government committed to provide effective criminal penalties and enforcement. In 1996, Criminal Code amendments were adopted (after a 1995 veto) but a deficient provision (a "grave harm" threshold) prevented effective enforcement. In 2003 an amendment to "fix" the grave harm provision was finally adopted, but implementation of these criminal provisions remains a matter of concern, and there is no initiative to use these tools, if they even work properly, as part of effective enforcement.

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

STEPS THE RUSSIAN GOVERNMENT CAN TAKE TO PROPERLY ENFORCE IPR CRIMES—FOCUSING ON OPTICAL DISC PIRACY

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

1. Inspect, on a regular, unannounced and continuous basis, each of the 34 known OD plants, and immediate close and seize the machinery of any found to be used to produce pirate product (some of these steps require additional legislative or regulatory measures);
2. Announce, from the office of the President, that fighting copyright piracy is a priority for the country and law enforcement authorities, and instruct the Inter-Ministerial Commission, headed by the Prime Minister, to deliver reports every three months to the President on what steps have been taken to address the problem;
3. Adopt in the Supreme Court a decree setting forth sentencing guidelines for judges—advising the courts to impose deterrent penal sanctions as provided under the penal code as amended (Article 146);
4. Immediately take down websites offering infringing copyright materials, such as allofmp3.com, and criminally prosecute those responsible;
5. Initiate investigations into and criminal prosecutions of organized criminal syndicates that control piracy operations in Russia (including operations that export pirate material to markets outside Russia); and
6. Introduce either via executive order or legislation, the necessary modifications of the optical disc licensing regime so that it clearly provides more effective control over the operations of the plants, including the granting of licenses to legal plants and withdrawing and sanctioning of illegal plants; stricter controls on the importation of polycarbonate and machinery; mandatory seizure and destruction of machinery used to produce pirate materials; and the introduction of criminal penalties for the owners of such plants.

There are, obviously, may other steps the Russian government could take to combat commercial piracy in Russia, including, but not only related to, optical disc piracy. These steps, including other enforcement and legal reforms necessary in Russia, are detailed in our Special 301 Report of February 2005 (attached).

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

In addition, existing efforts by certain industries to offer low cost Russian editions have not had the effect of reducing local piracy rates. The record industry, for example, is already manufacturing locally, and sells legitimate copies for an average price of $6.00 to $8.00 U.S. dollars—a price that is extremely low not just in relation to

prices for music elsewhere, but also with respect to other consumer goods sold in Russia. It is not the price of legitimate product that is creating opportunities for piracy—it is the opportunity for easy profits that has brought criminal enterprises into this business, and Russia should stop offering such excuses for its continuing inaction.

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

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

WHAT CAN THE U.S. GOVERNMENT DO?

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

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

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

The Russian IPR regime is not in compliance with the WTO TRIPs obligations, especially pertaining to enforcement. As a consequence, the U.S. government should not assent to Russia's accession into the World Trade Organization until its copyright regime, both legislative and enforcement, is brought into compliance with the WTO TRIPS obligations.

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

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

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

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

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

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

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

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

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

CONCLUSIONS

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

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

In sum, Russia's commercial piracy problem must be addressed immediately by the Russian authorities. IIPA recommends that the U.S. government take the necessary trade steps to deny Russia trade benefits (such as GSP) and entry into the World Trade Organization until Russia takes clear and effective steps to bring this illegal activity under control. This country can no longer afford inaction.

**ATTACHMENT**

# INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE
# 2005 SPECIAL 301 REPORT
# RUSSIAN FEDERATION

## EXECUTIVE SUMMARY

**Special 301 Recommendation:** IIPA recommends that the Russian Federation should be designated a Special 301 Priority Foreign Country in 2005[1] and that the United States government should immediately suspend Russia's eligibility for any duty-free trade benefits that it enjoys under the Generalized System of Preferences (GSP) program.[2]

Russia's copyright piracy problem remains one of the most serious of any country in the world—over $1.7 billion in losses in 2004. Five years ago, the IIPA filed a petition with the U.S. government for the removal or suspension of Russia's GSP trade preferences, worth hundreds of millions of dollars per year, until the Russian government addressed enforcement deficiencies in a straightforward and effective manner. The copyright industries have lost over $7 billion in the past eight years in Russia as a result of poor enforcement so it is reasonable to link U.S. trade losses with Russia's trade benefits. We continue to press the U.S. government to use the GSP and other trade measures to get the Russian government to make progress on a piracy problem that has significantly deteriorated during the past few years. In large measure, the explosive growth in piracy is a result of the Russian government's legacy of failing to meet its commitments to improve IPR enforcement.

The Russian government has taken some IPR action during the past five years, mostly focusing on legal reforms, such as passage in 2004 of much-needed improvements in the copyright law. But these steps are meaningless without actual enforcement of old and new laws. The piracy problem has gotten worse and our losses have increased as Russia has become one of the world's largest producers and distributors of illegal optical media material. The production has devastated the domestic market, and exported Russian pirated optical discs have been forensically identified in over 25 countries. This activity must be addressed immediately by the Russian authorities with effective criminal enforcement to stem persistent commercial piracy.

**IPR Enforcement Priorities:** Russia must make enforcement its highest IPR priority to (1) stem the explosive growth of illegal optical media plants run by organized crime syndicates with widespread distribution networks; and (2) improve overall enforcement, in particular, focusing on deterrent criminal penalties addressing the problem of persistent commercial piracy. It is also important for Russia to make necessary enforcement-targeted legal reforms, including

[1] As detailed below, the Business Software Alliance (BSA) joins this recommendation solely as a result of the Russian government's failure to take effective action against the broad distribution of counterfeit software over the Internet, primarily through unsolicited e-mails (spam) originating from groups operating in Russia. BSA notes the adoption in July 2004 of positive improvements to the Copyright Law, and recognizes the willingness of Russian law enforcement agencies to take action against channel piracy (i.e., illegal software preloaded on computers sold in the marketplace), not only in the Moscow area, but also in other Russian regions. In addition, BSA is appreciative of progress made in software legalization in the public sector.

[2] For more details on Russia's Special 301 history, see IIPA's "History" appendix to filing at http://www.iipa.com/pdf/2005SPECIAL301HISTORICALSUMMARY.pdf. Please also see previous years' reports at http://www.iipa.com/countryreports.html.

further updating the criminal code, the criminal procedure code, and administrative code (as detailed in this and prior reports).

There are seven critical steps that the Russian government must undertake in the next few months to begin to effectively confront optical disc ("OD") piracy:

7. Announcing, from the office of the President, that fighting copyright piracy is a priority for the country and law enforcement authorities, and instructing the Inter-Ministerial Commission, headed by the Prime Minister, to deliver reports every three months to the President on what steps have been taken to address the problem;
8. Inspecting, on a regular, unannounced and continuous basis, each of the 34 known OD plants, and immediate closing and seizing the machinery of any found to be used to produce pirate product (some of these steps require additional legislative or regulatory measures);
9. Adopting by the Supreme Court a decree setting forth sentencing guidelines for judges—advising the courts to impose deterrent penal sanctions as provided under the penal code as amended (Article 146);
10. Immediately taking down websites offering infringing copyright materials, such as allofmp3.com, and the criminally prosecuting of those responsible;
11. Pledging to investigate all complaints from copyright owners with respect to the commercial replication, distribution or export of pirate optical discs;
12. Initiating investigations into and prosecutions of organized criminal syndicates that control piracy operations in Russia (including operations that export pirate material to markets outside Russia); and
13. Introducing, either via executive order or legislation, the necessary modifications of the optical disc licensing regime so that it clearly provides more effective control over the operations of the plants, including the granting of licenses to legal plants and withdrawing and sanctioning of illegal plants; stricter controls on the importation of polycarbonate and machinery; mandatory seizure and destruction of machinery used to produce pirate materials; and the introduction of criminal penalties for the owners of such plants.

These steps will not by themselves resolve the situation, but they would represent significant progress toward more completely addressing the range of continuing problems, both legal and enforcement related. Along with these steps, the Russian police and prosecutors must show significant improvement in the number and disposition of criminal cases brought against commercial pirates (especially the organized criminal enterprises). Separately, the Russian government must ensure that the Supreme Court will notify the judiciary that judges are to impose deterrent criminal penalties.

Russia did make important law reforms in 2004, to bring its laws into compliance with the 1992 Bilateral NTR Trade Agreement and the Berne Convention by, among other things, providing protection of pre-existing works and sound recordings. Now it needs to focus all its energies on enforcement, addressing the problem of piracy in Russia, and the pirated material (especially optical discs) which is made in Russia and exported around the world.

Russia also needs to seriously address the problem of optical disc piracy that has been "discussed" for far too long without meaning action. Nearly ten years ago, IIPA and the U.S. government first identified optical disc plant production as an important emerging problem in

Russia, and suggested the need for an enforcement "action plan" to address it, including legislative reforms. Two optical disc plants were identified in the IIPA's 1996 Special 301 Report. There are now 34 optical disc plants with a total plant capacity of 390 million discs per year of all types of optical discs. The local legitimate market is significantly less than this figure. At all levels of the Russian government there have been promises to address this problem (starting in 1999), including a 2002 pledge, never fulfilled to issue an "action plan"—but to date, there has been no effective action taken against the plants, no comprehensive plan of action issued by the Russian government, and no legislative reforms that have even been introduced to tackle optical disc plants' unauthorized activities.

The Russian government has an unfortunate history of failing to meet its commitments to the U.S. government with regard to copyright protection and enforcement. A history of the most significant failures, and the dates upon which these (mostly unfulfilled) commitments were first made, was included in IIPA's 2003 filing and is available at: http://www.iipa.com/rbc/2003/2003SPEC301RUSSIA.pdf

**RUSSIAN FEDERATION**
**Estimated Trade Losses Due to Copyright Piracy**
***(in millions of U.S. dollars)***
**and Levels of Piracy: 2000-2004[3]**

| INDUSTRY | 2004 | | 2003 | | 2002 | | 2001 | | 2000 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Loss | Level | Loss | Level | Loss | Level | Loss | Level | Loss | Level |
| **Motion Pictures** | 275.0 | 80% | 275.0 | 75% | 250.0 | 80% | 250.0 | 80% | 250.0 | 90% |
| **Records & Music** | 411.9 | 66% | 405.0 | 64% | 371.9 | 66% | 285.0 | 64% | 250.0 | 70% |
| **Business Software[4]** | 751.0 | 87% | 704.0 | 87% | 370.0 | 89% | 90.6 | 87% | 89.0 | 88% |
| **Entertainment Software[5]** | 255.8 | 73% | NA | 80% | NA | 90% | 173.6 | 90% | NA | 94% |
| **Books** | 42.0 | NA | 40.0 | NA | 40.0 | NA | 48.0 | NA | 48.0 | NA |
| **TOTALS** | 1735.7 | | 1424.0 | | 1031.9 | | 847.2 | | 637.0 | |

## COPYRIGHT ENFORCEMENT

### Illegal Optical Media Production and Distribution

The number of optical disc plants (of music CDs, DVDs, videogames, and VCDs) in Russia manufacturing and distributing products has more than doubled in the last three years; at present, there are at least 34 optical disc plants in operation in Russia and at least 24 of them are known to be producing pirate product. Production capacity has nearly tripled in the past four

[3] The methodology used by IIPA member associations to calculate these estimated piracy levels and losses is described in IIPA's 2005 Special 301 submission, and is available on the IIPA website at www.iipa.com/pdf/2005spec301methodology.pdf.

[4] BSA's final 2003 figures represent the U.S. software publisher's share of software piracy losses in Russia, as compiled in October 2004 (based on a BSA/IDC July 2004 worldwide study, found at http://www.bsa.org/globalstudy/). In prior years, the "global" figures did not include certain computer applications such as operating systems, or consumer applications such as PC gaming, personal finance, and reference software. These software applications are now included in the estimated 2003 losses resulting in a significantly higher loss estimate ($1.104 billion) than was reported in prior years. The preliminary 2003 losses which had appeared in previously released IIPA charts were based on the older methodology, which is why they differ from the 2003 numbers in this report.

[5] ESA's reported dollar figures reflect the value of pirate product present in the marketplace as distinguished from definitive industry "losses." The methodology used by the ESA is further described in Appendix B of this report.

years as criminal operations have encountered little hindrance in expanding their activities. The Russian government has acknowledged that as many as 18 plants are located on facilities of Russian military-industrial enterprises. As noted, it is estimated that Russia's annual manufacturing capacity now stands at 390 million CDs, despite the fact that the demand for legitimate discs is significantly lower.

Organized criminal enterprises are involved in many aspects of optical disc piracy in Russia, and they run operations in other countries as well. In late 2004, the Russian government announced that 18 plants, including those on military-industrial properties, would report on their activities to the government by the end of 2004. To the best of our knowledge, that meeting was postponed because, IIPA was informed, the government was having a hard time determining the owners of each of the plants. This is precisely why optical disc regulation is needed: to properly license and hold accountable the (licensed) owner of each plant for that plant's activities. The planned (and subsequently postponed) meeting with the government is simply, in our view, a measure of "self-policing" as an information gathering tool, and a dubious one at that. But it is not an enforcement tool. What is needed is government-directed criminal enforcement, not private party action, with actions undertaken by law enforcement authorities. With piracy profits rivaling or exceeding those made through the distribution of illegal drugs, the government must commit itself to cleaning up the criminal syndicates running piracy operations.

It appears that these enterprises are using the Internet as one means of distributing their counterfeit products. The business software industry reports that there is a persistent problem of counterfeit software promoted and sold all over the world using unsolicited e-mail advertisements (spam) and via mail-order. These spam e-mails originate from an organization operating under various names: CD Cheap, OEM CD Shop, OEM Software, and other aliases. Most of the counterfeit products are mailed to consumers from Yekaterinburg and other cities in the Sverdlovsk region. The spam and scam operation is apparently run by a well-connected, sophisticated Russian criminal network. In January and February 2004 two police raids and related arrests were carried out in Yekaterinburg, but the key figures were not touched and there was no noticeable impact on this criminal enterprise. While recognizing some legislative improvements, as well as in other areas of enforcement—especially against hard disc loading, or HDL piracy, which entails loading illegal software onto computers sold in the marketplace—the failure of Russian law enforcement agencies to effectively address online solicitation and sales of counterfeit software led BSA to join in this year's PFC recommendation.

IIPA has documented the problem of optical disc production and distribution in Russia since 1996, when there were two known plants. The nearly ten years of inaction by the government of Russia has allowed the problem to mushroom to today's 34 known plants. The steady growth of optical disc production has been documented (in numerous IIPA filings) as follows: In 1996, there were two known plants; in 1998, three plants; in 1999, six plants with a capacity of 60 million discs; in 2000, ten plants with a capacity of 90 million discs; in 2001, 13 plants with a capacity of 150 million discs; in 2002, 17 plants with a capacity of between 150 and 183 million discs; in 2003, 26 plants, including 5 DVD plants, with a total capacity exceeding 300 million discs; and in 2004, 34 plants, including 8 DVD plants (7 in operation), with a total of 80 lines (excluding the 3 CD-R lines), and a total capacity of 390 million discs per year.

To address optical disc production, the Russian government (formerly the Ministry of Press and Mass Media) used reproduction and licensing regulations (issued in June 2002) to provide licenses for replication facilities for optical discs and analog tapes. The regulations allow for unannounced inspections of replication plants and for the suspension, but not withdrawal, of operating licenses of facilities found to be in breach of the regulations. This is

why the provisions are inadequate—because even blatantly pirating plants cannot have their licenses revoked (withdrawn) absent a court order. Another major shortcoming is the lack of deterrent criminal penalties for such violations (e.g., seizure and confiscation of the equipment used for pirate production). In fact, last year, the government noted that four plants did have their licenses "withdrawn", but for other reasons: in one case for the failure to pay the appropriate fees; in the other three cases the plant operators asked that their licenses be withdrawn. Year-end figures on the number of licenses issued and the number of plant inspections conducted in 2004 were unavailable, probably because of the March 2004 government reorganization. Unofficial reports are that as many as 24 licenses were issued and 28 plants "inspected"—but, no surprise inspections occurred. This government reorganization resulted in a loss of enforcement momentum in 2004 when the Ministry of Press and Mass Media was transformed and the new enforcement authority (the federal service known by the acronym FSCLMM—Federal Service for Supervising Compliance with Laws Regarding Mass Communications and the Protection of Cultural Heritage) which took over the licensing function had not—in all of 2004—even begun the process of issuing or suspending operating licenses. After the reorganization, plant inspections and licensing were placed in this new federal service (FSCLMM) within the new and overarching Ministry of Culture (which has none of the experience or staff of the former ministry). Copyright policy was vested in the new Federal Service on Intellectual Property within the Ministry of Education and Science, setting up the potential for bureaucratic wrangling, or at best unclear lines of authority, over IP enforcement.

In short, the existing laws and regulations pertaining to plant licensing fall far short of IIPA's model optical disc legislation (provided to the government of Russia), and is demonstrably inadequate—evidenced by the fact that the existence of these regulations has done little to stem, or even slow, the production of pirate discs in the country's optical disc facilities. Until better provisions exist, however, the existing laws must be utilized to the fullest extent possible. Draft resolutions and legislation started to circulate at the end of 2004 to change optical disc licensing requirements, including a much-needed proposal to adopt mandatory SID codes, and another to license the importation of polycarbonates used to manufacture optical discs. In the absence of a comprehensive scheme, however, the existing regulations, and any piecemeal additions, must be seen as a starting point for action. In the long run, a comprehensive series of legal reforms is needed. These include legislative and regulatory steps—proposals that IIPA gave to the Russian government more than three years ago.

## Raids and Seizures in 2004

In 2004, there were eight actions taken against optical disc plants, including raids and seizure of illegal materials, according to industry and Russian government reports. While the raiding of plants is a positive development, enforcement problems persist. In almost all cases the plant operators go unscathed by the criminal justice system and/or the plants continue in operation.

In one example, the Economic Crime Police along with the motion picture industry's anti-piracy organization, RAPO, conducted a raid on the UVK Stimul plant in Zelenograd on June 21, 2004 (this same plant was raided in April 2003). The plant had 2 DVD lines and one CD line in operation; a total of 37,000 pirate CDs and DVDs, and 8 stampers, were seized. The plant however continued to operate, as it did after the raid in 2003, and is still in operation today, reportedly working 24 hours a day. On January 14, 2005, a Moscow court imposed a suspended one-year prison sentence on the plant's chief technician, after he confessed to

ordering the plant's personnel to replicate pirate DVDs. The court apparently heard the case under a "special procedure" in the absence of RAPO because the accused had agreed to plead guilty. While the result in this case is highly disappointing, it is nevertheless the first time that a Russian court has convicted anyone for replicating pirate DVDs. RAPO now plans to seek the immediate suspension by the Ministry of Culture of the plant's replicating license.

Other plants raided in 2004 included: the Puskino plant (3 DVD lines, seizing 25,000 pirate DVDs and computer games discs, and 800 stampers) situated on a government defense facility; the Samara plant (2 DVD lines); the Koroliov plant (2 DVD lines and one CD line); and 2 CD plants engaged in producing illegal music CDs. Raids against the Rufon/Card Media plant (in April and August 2004) have not yet resulted in the initiation of a criminal case pending further investigation by the local prosecutor's office. Following raids in cooperation with the recording industry (IFPI), the prosecutor's office did initiate criminal cases against two replication plants: the "TINE-Invest/Data Media" plant at which 35,000 DVDs and CDs were seized in April 2004 and an additional 22,721 CDs in June 2004; and the "Rubin" plant, at which 30,000 CDs were seized. Investigations are still ongoing on the activities of both plants. Separately, a criminal case against the plant "Synograph" is being considered by the Moscow Regional Noginsk City Court, and civil proceedings against "Russobit" and "ROFF Technologies" are pending before the Moscow Regional Arbitration Court.

In all of these cases, it is reported that the plants remain in operation. While criminal investigations proceed in some, but not even all instances—and with extensive delays—the operators and owners of the plants remain unpunished. In the case of the Koroliov plant that was raided on April 30, 2004, the plant continued to work illegally. RAPO and the Economic Crime Police have since intercepted trucks full of illegal DVDs leaving the plant. The plant operator pleaded guilty in December 2004 to replicating pirate product and is awaiting a sentencing hearing in February 2005. Not only should a deterrent penalty be meted out, but the court needs to order the destruction of the plant's illegal lines, as well as the closure of the plant's operations until and unless it can be inspected and licensed for legal operation.

IFPI has cooperated with 24 total cases in the past two years against optical disc producers, large warehouses, and distributors. In 21 out of the 24 cases, there has been no resolution, that is, no prosecution of the operators of illegal CD plants, as investigations have dragged on. In the other three cases, the pirate CDs were destroyed, but no sentences were handed down. The only exception to this pattern (which has been true for years) was in June 2002 when the Disc Press MSK plant (raided in September 1999) was finally closed and a Zelenograd court handed down 4-year prison sentences to two operators of the plant. In February 2004, there was a one-year conditional sentence given to a manager of the Zelenograd plant which was raided in December 2002, resulting in the seizure of 234,493 pirate CDs (over 59,000 were music CDs). The more typical case is that of the Synograph plant, raided in October 2000. There was a four year criminal investigation aimed at the director of the plant; a court hearing is scheduled for early 2005, and the plant is still in operation.

The Samara plant raid, conducted by the Economic Crime Police in April 2004, is another example of the frustrations of poor enforcement. That plant was found to be a pirate DVD plant during a routine tax inspection at a cement factory; the police discovered two DVD lines and contacted RAPO. RAPO later uncovered over 7,000 pirate DVDs and 30 stampers at the plant. However, although the plant director was questioned and a criminal prosecution prepared, the local prosecutor closed the criminal case twice in 2004 (it was reopened the first time after a regional prosecutor ordered the case re-opened). The plant, without a license,

remains in operation. The local prosecutor ordered the seized stampers to be returned to the plant operator, and RAPO has again filed a protest with the prosecutor to re-open the case.

In August 2004, the Moscow Economic Crime Police, RAPO, and IFPI raided a warehouse located on a military base in Odintzovo, near Moscow and uncovered 1 million pirate discs. A nearby second warehouse was found that contained an additional 1.5 million pirate discs. The discs included DVDs, VCDs, and MPEG-4 CD-ROMs containing movies, as well as music and interactive games. A criminal investigation has been initiated, but no criminal case has been opened yet.

In short, the copyright industries can report some successful raids and seizures in 2004, but these activities have not resulted in any appreciable reduction in the amount of pirate optical disc product being produced in Russia, nor in meaningful criminal convictions. Pirate manufacture continues unabated and the pirates are getting more entrenched.

To address retail piracy, two years ago, the government of Russia adopted a legal ban on the street sales of audio and audiovisual products, for example, at kiosks, especially in Moscow. This was a promising step that resulted, at least in the short term, in a significant reduction in the availability of pirated home video entertainment, especially on the streets of Moscow. However, the ban has been irregularly enforced and music CDs remain widely available. Retail cases have resulted in some administrative fines, but these are generally of a *de minimis* nature.

In 2004, as in prior years, the federal police and the IP unit in the Ministry of the Interior were generally cooperative in running raids against major pirates (although the Unit "R" has had IPR enforcement jurisdiction taken from it). However, the raids run by the police and the municipal authorities were not generally followed up by prosecutors and the courts. The pattern of successful raids without successful prosecutions (with a few exceptions) is a recurring problem. In addition, it is estimated that up to 70% of pirated product seized in raids in Russia finds its way back into the market through either the Veteran's Fund or the Trade Houses in the Ministry of Justice, which both claim the right to sell pirate discs on the open market. The government of Russia must put a stop to these practices.

In total, major warehouse raids have been successful in the total numbers of DVDs and CDs seized. As in recent years, about half of the DVDs contained two feature films. The film industry's anti-piracy organization, RAPO, seized over 4.75 million pirate DVDs in raids on warehouses and outlets across Russia in 2004; in 2003, this number was approximately 1.4 million DVDs.

In 2004, the recording industry (IFPI) assisted in the investigation of, and in raids and seizures on, a number of suspected producers and distributors of illegal recorded material. Only a handful of cases made it to the courts (mainly as administrative proceedings) and even then, the disposition was disappointing because the operators received neither deterrent penalties nor imprisonment. A total of 1,530 police raids (on different levels in various regions) were carried out with the participation of the Russian experts (IFPI). These resulted in the seizure of: 2,086,000 CDs; 17,600 cassettes; 28,400 CD-ROMs; 209,500 music DVDs; 130 stampers; 74 units of recording equipment; 656,000 CD inlays (the printed material for the jewel boxes); 126,000 blank CD-Rs; and 11,200 music VHS tapes.

In 2004, the business software industries focused their enforcement activities on the prevention of hard disc loading ("HDL piracy") by computer resellers, and on the illegal use of software by corporate end-users ("end-user piracy"). The business software industry is aware

of approximately 50 raids on hard disc loading operations, and approximately 25 end-user raids conducted in various parts of Russia. Regarding resellers, recent signs of police action—especially in Moscow and the surrounding region—are encouraging, even though to date only a small number of these cases have resulted in criminal convictions. Regarding end-user enforcement, there are persistent problems, especially prosecutorial procedures and delays. For example, the difficulty in proving intent and the inability to impose criminal liability on legal entities under Russian law are two obstacles to enforcement. Consequently, the identification and prosecution of the specific individuals making actual installations is needed—a very tough enforcement standard. As a result, most end-user cases end up treated as administrative misdemeanors.

RASPA, a Russian anti-piracy organization, continues to conduct raids on behalf of some Entertainment Software Association (ESA) member companies, but these are mostly seizures of street market inventory. ESA believes that the Russian government must take action against the organized criminal syndicates that run the key piracy operations involved in the production, distribution and export of pirated entertainment software products. These syndicates are destroying not only the Russian market, but also markets in many other countries. These same syndicates are believed to control distribution of pirate entertainment software products in Russia, Ukraine, and much of Eastern Europe as well. Pirated entertainment software products, primarily for play on personal computers, are shipped from Russia to Poland, Latvia, Lithuania and other neighboring countries. While domestic production is still high, pirated materials produced in Ukraine are also being shipped through the Russian markets. Pirated cartridge-based video games in Russia are imported from China, and some of the pirated console game material is imported from Malaysia. Piracy at Internet cafés is also problematic; of the 7,500 cafés in the country, only 10% are licensed, with the remainder using either pirated or unlicensed product. Flea market–type venues are increasing in the country (it is estimated that there are about 50,000 in the country); this is the primary outlet for pirated video games in the country.

The key issue for the entertainment software industry in Russia is organized criminal syndicate involvement. There are a few syndicates that control the entire market for pirated optical disc entertainment software products, both domestically and for export. Shutting down these syndicates will significantly impact the entertainment software piracy problem. Furthermore, not only do these syndicates produce, distribute and export, they are also trying to hijack the trademarks of ESA member companies by attempting to record the company trademarks themselves, and using the false recordations to exploit pirated copies of the games. It is imperative that the government begin to address in earnest criminal syndicate involvement in piracy.

## Continued High Piracy Levels and Other Problems

Very high estimated piracy levels in all copyright sectors accompany massive losses, as noted in the chart above. These high piracy levels cost the Russian economy millions of dollars in lost jobs and lost taxes. For example, the motion picture industry alone estimates lost tax revenues on DVDs and videos in Russia was $130 million last year. In another study undertaken by the software industry, it was estimated that if levels of piracy could be reduced to regional norms (that is, realistic levels), ten of thousands of jobs and several hundred million dollars in tax revenues would be realized from that sector alone.

The only way to bring down these piracy levels and losses is for Russian authorities to use deterrent criminal penalties against the operators of optical disc plants and crime syndicates. Instead, Russia continues to mete out low penalties and only a small number of jail sentences for piracy.

The motion picture industry reports that with 90% piracy rates for DVDs, sales of legitimate DVDs have fallen back to 1999 levels, despite significant increases in the number of households with DVD players as well as efforts by foreign producers to quickly get legitimate locally replicated DVDs into the Russian market. Evidence that piracy is negatively impacting home video sell-through revenues is revealed by comparing box office growth with home video growth. Between 2000 and 2003, box office spending in Russia rose by a cumulative 438%, compared with only 75% cumulative growth for home video sell-through over the same period. This runs counter to the trend in virtually every other country where the motion picture industry does business, where home video grew much faster than box office revenue during the last three years. Television piracy, especially outside of Moscow, remains a problem, and cable piracy abuses outside of Moscow are rampant.

The recording industry reports that the closure of the former Gorbushka market resulted in the migration of illegal sales to the nearby building of the Rubin Trade Center (La-La Park), where most of the dealers sell pirate audio products. New pirate markets are prospering on the outskirts of Moscow (for example, Tsaritsinio, Mitino, etc.). A major raid was undertaken by the police and RAPO against the Tsaritsinio market on January 28, 2005 (netting 67,000 discs and temporarily closing 52 shops in the market); five criminal investigations have commenced with more cases expected. Audiocassette piracy levels remain very high (above 68%), as well as CD piracy (over 65%), despite major raiding activity and the expenditure of major resources by IFPI. Overall losses in the recording industry were $411.9 million in 2004.

The level of piracy for entertainment software is at 73% of the market. Russian syndicates control 100% of the production in Russia of PlayStation® video and personal computer games. About half of certain PlayStation® games (such as PlayStation2® games) come from Malaysia, while for other materials such as PlayStation1® and certain personal computer games, the majority of illegal material is produced in Russia, though there are some copies imported from Ukraine. Cartridge-based video games (like Nintendo Game Boy products) continue to be imported from Asia, particularly China. The retail markets in St. Petersburg and Vladivostok are all full of pirate videogame product.

One example of the failure of the Russian enforcement regime to work effectively is the control that criminal syndicates have over entertainment software piracy in Russia. There are four principal criminal syndicates which control the production and distribution of pirated entertainment software in Russia, and the scope of their operations do not appear to have diminished. The syndicates attach "logos" or "brand" names to their illegal product and localize the illegal copies they produce even before legitimate product is released into the market. These same groups control not only illegal distribution networks in Russia, but also in surrounding countries. It is widely believed that the Russian groups control piracy operations in much of Eastern Europe including the markets in Poland and Latvia, and that they also have ties with syndicates operating in Ukraine. One ESA company reports that in 2004, one of these piracy syndicates attempted to register one of the company's trademarks for a videogame product that was being pirated by the syndicate. Given these circumstances, it is imperative to use the criminal code against organized criminal syndicates, and that the Russian government focus its attention on a course of action to fight piracy by the criminal syndicates.

Book piracy continues to hurt the publishing industry in Russia. Although increased licensing of legitimate product has sporadically resulted in some improvement in the piracy rates, significant and lasting improvement has remained elusive. While bestsellers were the target of the pirates in the 1990s, popular items for pirates now also include an array of reference works and textbooks, increasingly a large market in Russia as the penetration of English-language materials in the market grows. Unlicensed imports of pirated reprints from neighboring countries, and pirated reference books and medical texts, still abound. Illegal commercial photocopying is also a problem, especially in the academic sector.

Publishers are also experiencing a degree of Internet piracy, mostly in the form of unlicensed translations of fiction bestsellers available for download on websites in Russia. This phenomenon is appearing in a number of countries worldwide, but seems to be especially problematic in Russia. The "hidden print run" and "overrun" problems remain, where printers of legitimate editions deliver additional unauthorized copies to unauthorized distributors before delivering books to legitimate publishers. The Association of American Publishers (AAP) estimates losses in Russia in 2004 at $42 million.

In 2004, the Russian government, including certain senior members of the Putin Administration, continued to note a "pricing" issue with IIPA which raises serious questions about their commitment to fighting piracy. There have been a number of reports in which Russian officials have suggested that the prices for legitimate goods are to blame for the piracy problem. This comment reflects both an ignorance of what is happening in the marketplace, and a misunderstanding of the nature of the problem that we confront in Russia. The criminal enterprises manufacturing and distributing pirate product are largely servicing foreign markets (at least for music and film), making the Russian price for legitimate materials wholly irrelevant to their motivation or profitability. As noted earlier, Russian manufactured product has been found in over 25 countries over the past year. In addition, existing efforts by certain industries to offer low cost Russian editions have not had the effect of reducing piracy rates. The record industry, for example, is already manufacturing locally, and sells legitimate copies for an average price of $6 to $8 dollars—a price that is extremely low, not just in relation to prices for music elsewhere, but also with respect to other consumer goods sold in Russia. The motion picture producers have also lowered the prices of DVDs offered in certain Russian markets to about $10. Similarly, entertainment software products are already reasonably priced. It is not the price of legitimate product that is creating opportunities for piracy—it is the opportunity for easy profits that has brought criminal enterprises into this business, and Russia must stop offering such excuses for its inaction.

## Criminal Enforcement

The criminal enforcement system in Russia remains the weakest link in the Russian copyright regime resulting in the extraordinarily high piracy levels and trade losses. At the retail level, there is no practical alternative for running anti-piracy actions other than using the municipal authorities (even though the criminal police have the authority—they just do not use it), and in these cases pirates are subject to administrative, not criminal, remedies that have proven ineffective. Although legislative efforts were undertaken (in 2003) to "fix" the Criminal Code, implementation of these provisions remains troubling.

Four years ago, to assist in combating piracy, an Alliance for IP Protection was formed. It combined the forces of IFPI Moscow, RAPO, BSA and RASPA—thus combining the representatives of the recording, motion picture and software industries, as well as some of the entertainment software companies.

Tracking cases for over five years, we note that less than one-third of the criminal cases were even heard by the courts, with the other two-thirds of cases dismissed for a variety of reasons. In only 20% of the criminal cases heard were the offenders punished at all—often with small fines, confiscation of pirate products, or suspended sentences (even this is very rare)—and, according to Russian statistics provided to IIPA, only 1% of those convicted of crimes were sentenced to any jail time and fewer than 25% were fined (most of these were not even deterrent fines).

In August 2004, MPA was able to get its first-ever unsuspended prison sentence for a pirate in Russia; the defendant was a video shop owner found in possession of a DVD burner and hundreds of pirate DVDs, DVD-Rs and VHS cassettes. The defendant was sentenced to three years and two months in prison; this was the second time this defendant had been convicted (he received a suspended sentence of two years in the prior case).

The business software industry (BSA) reports some encouraging enforcement developments in 2004. The police did undertake several criminal actions against illegal resellers (i.e., hard disk loaders) in 2004, and the Moscow criminal courts sentenced hard disk loaders. The most notable of these sentences was a first-ever unsuspended imprisonment sentence (six months) for a hard disk loader in February 2004. In addition, a number of other cases resulted in one or two year suspended sentences, with one or two years of probation. The Russian criminal courts issued several criminal judgments against smaller resellers (selling pirate CD-Rs) with sentences that included, for example, a two year suspended sentence plus two years of probation. In some cases, the criminal courts were also able to adjudicate the civil matter involved, making the process more cost efficient and expeditious. BSA reports consistent problems with end-user enforcement, however, due to little or no prosecutorial cooperation. Also, although the business software piracy level is estimated to be well over 87% outside of Moscow, the police there have only recently started to take action against illegal resellers. Finally, Internet piracy and piracy by organized crime networks are growing problems for the software industry, especially in the face of little prosecutorial assistance and huge procedural hurdles in the criminal courts.

## Administrative Enforcement

As in past years, retail cases are increasingly handled under administrative machinery, resulting in very small fines, or none at all. While pirate product is generally confiscated, shop operators are normally not the owners and the latter seldom get caught and fined. As in past years, the recording, business software, and motion picture industries report numerous administrative raids. However, it was also reported that these matters were less effective than in prior years because the new administrative code is more complicated, requiring the involvement of attorneys. In 2004, IFPI reported that 1,300 raids against audio pirates were undertaken, many of which resulted in administrative actions. The average administrative fine imposed was about US$50 per case; this is obviously not a deterrent penalty. RAPO reported that it is able to average nearly ten administrative court decisions a week against pirate retailers that order illegal product to be confiscated and that impose small fines (on average, less than US$200). Market seizures continue to involve the employment of huge resources, since administrative penalties remain totally inadequate to deter over the long term. The recording industry reported that although the law makes liable those who distribute material, the sources and channels of illegal material are rarely pursued. In lieu of this, most administrative actions against shop owners and sellers require payment of, on average, US$200.

## Civil Enforcement

In 2004, as in years past, the business software industry filed separate lawsuits in the arbitration court, rather than pursue civil claims as an adjunct to a criminal prosecution. As a result, several significant cases were won against software system builders who install unlicensed copies of business software onto sold computers as well as against corporate end-users that used illegal copies of software in their business operations. However, the remaining deficiencies in the copyright law—including the unclear status of temporary copies—make it very difficult to apply civil remedies in end-user piracy cases. Also, the unfortunate delay (until September 2006) in implementing the new copyright law amendment on the making available right seriously hinders enforcement actions against certain types of Internet piracy.

In 2003, the recording industry (IFPI) commenced civil claims against optical disc plants in Russia, seeking damages of millions of dollars, a prohibition against production of the pirate CD titles named in the suits, and confiscation of the machinery and equipment used by the plants. This was the first time that a civil cause of action was commenced in Russia against an optical disc plant. IFPI was being pressed to do so by the Russian government, which was convinced that civil procedures would prove effective. There is now a total of 16 IFPI civil claims lodged against two plants—Russobit and Roff Technologies. Instead of showing any effectiveness in the enforcement regime of Russia, those cases have been bogged down with procedural hurdles that will likely mean that there will be either no resolution, or a total vindication of the plant operators. That would mean the absolute failure of civil proceedings in these types of cases.

## Border Enforcement

Russia must significantly improve the lax border enforcement that permits the easy trafficking of illegal material into and out of Russia. The government of Russia should instruct Russian customs officials to address this issue and should provide them with the necessary resources to allow effective enforcement. There are numerous examples of Russian made material being seized, not by Russian authorities who failed to detect illegal product, but by enforcement authorities in other countries. To use Poland as an example because it is a major marketplace for Russian-made material, the local Polish anti-piracy organization for the film industry (FOTA) seized over 76,000 Russian-made pirate DVDs through September 2004, compared with 17,000 in all of 2002. Other destinations of Russian pirate DVDs include Estonia, Finland, Ukraine, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Israel, Turkey, and for the first time (in 2004), the UK. The music industry reports that Russian-made pirate CDs are exported to as many as 25 countries, including many of those noted above. The entertainment software industry reports that Russian sourced pirate video games are shipped into Poland, Latvia, Lithuania and Israel.

## Russian Government Efforts to Address Piracy

In 2002, the Russian government established an Inter-ministerial Commission to combat piracy, which was, at least in theory, a positive step. The commission meets quarterly and is headed by the Prime Minister. Unfortunately, the government reorganization in 2004 stalled much of the important enforcement action that the commission needed to undertake. To date, the commission has taken small steps by focusing on legislative reforms more than on truly combating optical disc production and retail piracy. The commission needs to get more decisive and focused on these key enforcement objectives including stopping the production of optical

media on military-industrial properties and at the other facilities; consideration of more effective optical media laws; curtailing piracy by street vendors and kiosks; and revisiting the question of a federal stamp for optical disc products.

The Business Software Alliance (BSA) reports on the government's increased focus on the legal protection of software. Especially encouraging are steps towards ensuring the use of licensed software within the public sector. In September 2004, the Russian government adopted a policy statement for the use of information technologies by federal governmental agencies through 2010. Among other things, the policy statement declares the need to use only licensed software as part of overall government management strategies, and sets forth a procedure for an annual report on the use of legal software by governmental agencies (including a factual listing of any copyright infringement by each agency). BSA appreciates this progress.

## GENERALIZED SYSTEM OF PREFERENCES PROGRAM

Even with piracy rates and losses among the highest in the world, Russia continues to receive trade benefits from the U.S. government. In August 2000 IIPA filed a petition, accepted by the U.S. government in 2001, to examine whether Russia should continue to be eligible to receive duty-free trade benefits under the Generalized System of Preferences program. That petition is still pending; hearings were held in October 2003 (to supplement those held in March 2001). The U.S. government now must decide whether to fully or partially suspend GSP benefits for Russia. In 2003, $429.8 million worth of Russia's imports to the United States benefited from the GSP program. During the first 11 months of 2004, $515.3 million worth of Russian goods entered the U.S. under the duty-free GSP code. While Russia was receiving these benefits, losses to U.S. industries from copyright piracy in Russia in 2004 amounted to well over $1.7 billion. The IIPA recommends that Russia should immediately lose its eligibility for GSP benefits until it improves its copyright enforcement regime.

## DEFICIENCIES IN THE RUSSIAN LEGAL REGIME

### Overview of Legal Reforms

There are a number of critical legal reforms that Russia must undertake to improve copyright protection and enforcement, as well as to ensure accession into the World Trade Organization.[6] These reforms include the need to adopt:

- Proper optical media regulations to address (with criminal sanctions) the production and distribution of optical discs and the equipment and machinery used to produce them;
- Immediate regulation of the use of copyright materials on the Internet;
- Criminal code provisions for the confiscation of equipment used to make illegal copyright materials;
- Amendments to the criminal procedure code to provide proper *ex officio* authority;
- Amendments to strengthen the implementation of the code on administrative misdemeanors;
- Amendments to the customs code (to provide *ex officio* seizure authority);

[6] A more detailed discussion of each of the proposed legal reforms, including the necessary changes to the Copyright Act, and the problems related to the draft Civil Code, discussed in this section, can be found in previous filings, available on the IIPA website at http://www.iipa.com/rbc/2003/2003SPEC301RUSSIA.pdf at page 13.

- Amendments to the copyright law to ease the role of collecting societies—which are overly regulated (and, in some cases, mandatory).

Further amendments to the criminal code may be needed if the new Article 146, as implemented, remains a problem. Amendments to the criminal code (adopted in 2003) provided *ex officio* authority to allow prosecutors, but not the police, to commence and investigate certain IPR criminal cases. This resulted from the Article 146 amendment (although the division of authority between police and prosecutors is set out in the corresponding criminal procedure code), which made the prosecution of copyright-related cases a "public" matter, meaning it no longer requires a formal complaint from the rightsholder (although as a matter of practice, such a complaint is still necessary).

A new customs code went into force on January 1, 2004, providing for measures to prevent the trade of counterfeit goods across borders. Unfortunately, the law fails to expressly provide for *ex officio* enforcement authority. Thus, even if customs officers discover shipments of obviously infringing products, they may not be able to act on their own authority, but only in those cases where rightsholders have filed written applications to suspend the release of suspect goods. A proposal to fix the *ex officio* authority problem was rejected by a key Russian *Duma* committee in 2003.

The threat of deleterious amendments in the Russian Civil Code pertaining to IPR protection remains, with the possibility of the latest draft being considered by the *Duma* in 2005. In addition, there is at present a separate law on the protection of computer programs and databases, which are also protected in the copyright law. Amendments added in the Computer Program Law of 2002 weakened enforcement for computer programs; the software industry would like to see the 2002 law repealed and all software-related provisions consolidated into the copyright law. The Russian government must not allow any amendments to be adopted that would weaken or interfere with the implementation of the copyright law.

## Optical Media Regulations

To address the problem of the unlicensed optical disc plants in Russia in a comprehensive manner, effective laws must be enacted and utilized. Two relatively minor licensing laws, and one set of regulations, have been enacted in this area of law in the past few years. But neither law nor the regulations resulted in effective action undertaken against the illegal plants. In short, regulations are needed to: (1) close plants that are caught illegally producing copyrighted material; (2) seize infringing product and machinery; (3) introduce criminal liability for infringing these regulations; (4) monitor the importation of raw materials (optical grade polycarbonate) used in the production of optical disc media; and (5) require plants to adopt source identification (SID) codes so that the source of illegally produced discs can be traced. Finally, the proper authority must be delegated to agencies and officials to undertake effective enforcement and to implement these regulations. Details of the laws and of IIPA's proposal for addressing the problem in a comprehensive fashion can be found at the IIPA website at http://www.iipa.com/rbc/2003/2003SPEC301RUSSIA.pdf on page 14.

In the immediate term, the government of Russia must use its existing authority to withdraw the licenses of illegal plants and stop their production, especially those plants operating on government soil. In addition, criminal enforcement against known commercial pirates must be undertaken. Some of the copyright industries are further frustrated that

enforcement authorities have not worked cooperatively with rightsholders in targeting known commercial pirates for enforcement action.

## Copyright Law Amendments

At long last, in 2004, Russia adopted copyright amendments including the protection for pre-existing works (prior to 1973) and sound recordings (prior to 1995). The copyright amendments were also intended to implement (for eventual accession) the WIPO digital treaties. Unfortunately, one key provision, the exclusive right of making available (and right of communication to the public), although adopted, was delayed until September 1, 2006. The new right would be a particularly useful enforcement tool for both authors and producers of phonograms. This short-sighted step means that effective enforcement of certain types of digital piracy will face unnecessary legal obstacles until at least the last half of 2006.

Other deficiencies in the copyright law (detailed in earlier IIPA reports) remain, such as overly broad private copying exceptions, weak provisions on technological protection measures (because they are linked to copyright infringement), and on collective management issues. For example, the poorly worded provisions in Article 45 permit collective management organizations to claim representation of the rights of foreign copyright owners. This provision has been used, totally contrary to logic, by a local organization in St. Petersburg to deny motion picture producers (MPA) their own rights against pirated copies of their works, thus allowing piracy to flourish. The Inter-Ministerial Commission was asked to study the problems of collective rights management in Russia, but preliminary discussion on this matter in December 2004 did not result in any actual changes.

## Criminal Procedure and Criminal Code Amendments

In 2003 the Russian Criminal Code Article 146 (pertaining to infringement of copyright and neighboring rights), was finally amended to fix the previously ambiguous "grave harm" standard. The amendments (effective December 11, 2003) increased the fixed threshold amount (i.e., value). Some of the copyright industries remain concerned that in its implementation, this threshold amount will be too high to trigger a criminal case, and as a result, will be used too infrequently. In addition, the amendments replaced the minimum fines, previously linked to multiples of the minimum wage, with fixed amounts.

Article 146 provides for fines of up to 250,000 rubles (or ~US$8,800), or up to 18 months of the defendant's income, or correctional labor (from 180 to 240 hours), or imprisonment of up to five years for unlawful acts that constitute a "significant amount." The November 2003 amendments (replacing amendments adopted in April) define "significant damage" as a fixed threshold rather than scaled to the minimum daily wages. The fixed thresholds are as follows: 50,000 rubles for the lowest level criminal violation (about US$1,775), and 250,000 rubles for the most serious criminal violation (about US$8,800). This means that any activity below US$1,775 cannot be treated as a criminal matter. The amendments unfortunately leave almost all retail and some wholesale activities outside the scope of criminal prosecution.

Some of the copyright industries remain concerned that the threshold in the newly adopted Article 146 will thus fail to give the police the necessary tools when they are conducting initial raids, and will complicate anti-piracy campaigns as authorities must sift through determinations concerning whether a case should be brought under the criminal code or the administrative code. There was, in years past, a proposal to lower the threshold to 50 times the

minimum wage, or US$150, but what was adopted was a significantly higher threshold. The implementation of Article 146 will be closely monitored by IIPA to see whether further amendments are needed.

Last, there are now efforts underway to revise Article 146 to add criminal penalties for illegal acts with respect to technological protection measures and rights management information. The IIPA supports adoption of such criminal penalties necessary to enforce against digital piracy.

There are several other criminal code/criminal procedure code amendments that need to be adopted.

First, the government of Russia should introduce and the *Duma* should adopt amendments to add specific substantive and procedural provisions for all types of actions, including criminal, civil and arbitrage proceedings. In 2004, amendments were made to Article 49 of the copyright law, but not to the criminal code or the criminal procedure code, to grant police a legal basis to confiscate infringing goods, materials, and the equipment used to produce such items. The current Criminal Code (Article 146) does permit the confiscation and destruction of pirate and counterfeit goods—that is, the illegal copies themselves. However, it does not explicitly provide for the confiscation and destruction of the "machinery" used in the making of illegal copies. Now the copyright law makes clear that copies as well as "materials and equipment used for the reproduction of counterfeit copies of works or phonograms and other tools" used to violate the criminal law can be confiscated. However, local counsel advises that these new provisions in the copyright law will not be used in criminal cases, much less in civil or arbitrage cases, because the provisions are *not* provided for in the criminal code. Thus, as a practical matter "machinery" used to create illegal copies cannot be confiscated in criminal cases. A provision in the Copyright Law (Article 49.4) provides civil remedies for the confiscation and destruction of "materials and equipment," but it is not effective and is, in any case, limited to civil cases. Last, the available remedies are not available against legal entities, so they will prove useless in criminal enforcement actions.

Second, the government of Russia should introduce and the *Duma* should adopt amendments to increase the levels of fines because they are too low and therefore inadequate to deter commercial piracy.

Third, some of the copyright industries remain concerned that the criminal procedure code does not give jurisdiction over criminal violations to the police authorities, as it does for the prosecutors. It is our understanding that the 2003 amendments did fix one problem by revising the 1996 Criminal Procedure Code amendments so that it is no longer necessary to file a formal complaint for public crimes, including copyright offenses. Also as IIPA understands, prosecutors are entitled to supervise investigations conducted by the police (Article 146, CPC) in all cases including IPR investigations. IIPA will continue to monitor the implementation of these provisions to make certain they result in effective enforcement for all of the copyright industries.

## Other Legal Reform Issues

**WIPO Treaties; Electronic Commerce; Notice and Takedown Procedures:** As a result of the explosive growth of Internet piracy in Russia, the Russian government needs to accelerate its accession to the WIPO digital treaties (WCT and WPPT). The Copyright Law

amendments adopted in July 2004 have moved Russia closer to implementation of and therefore accession to the treaties. Unfortunately, the legislation postponed until September 1, 2006, the effective date of a key provision in the copyright law—an exclusive right of making available applicable for all authors (communication to the public right consistent with Art. 8 of the WCT) and for phonogram producers (consistent with Art. 14 of the WPPT). Russia should accede to the digital treaties as quickly as possible, and should move up the effective date of this provision. Swift and complete implementation of these treaties is critical to Russia's effective protection of creative content.

IIPA also understands that a federal draft law "On Electronic Trade" first submitted to the *Duma* in 2000 may be considered in 2005. This draft law should be carefully watched by the industries and the U.S. government to ensure that e-commerce is not over-regulated and that liability issues for copyright infringement on the Internet are dealt with in a manner to ensure that rightsholders can properly and effectively enforce their rights.

**Civil Procedure Code Amendments:** A major revision of the Civil Procedure Code (effective February 1, 2003) set the rules for initiating and examining civil cases, including disputes pertaining to copyright and neighboring rights infringements. But unfortunately, the code still does not contain the necessary civil *ex parte* search procedures (required by the WTO TRIPS Agreement). These are essential tools for effective enforcement in the software industry. In 2002, an amended Arbitration Procedures Code in Article 72 introduced civil *ex parte* search provisions in a more limited context. The software industry reports that these provisions have only been tried to date one time in actual practice (although the case was cited by the High Arbitration Court as a de-facto precedent); overall, the procedure remains a difficult and onerous proposition. A major contributor to the problem is that the judges who must impose it lack experience. The overall inefficiencies of the court-mandated bailiff system also are problematic.

**Customs Code Amendments:** The Russian *Duma* must introduce and adopt amendments to the customs code to ensure full authority to seize pirate product at the border and to bring Russia's border controls at least into compliance with Articles 51-60 of WTO TRIPS. Imports of pirate optical media product continue from Eastern Europe (especially from the Czech Republic), from other countries of the C.I.S. with production capacity (i.e., Ukraine), and from Asia.

**Code of Administrative Misdemeanors:** In 2002, a revised code on administrative misdemeanors went into force allowing administrative cases against legal entities and the imposition of fines on them in the amount from US$900 to US$1,200 for copyright infringements. Since its enactment, effective implementation of this law has been very limited because it falls under the competence of under-qualified municipal police. The Code on Administrative Misdemeanors also effectively limits the time period for the investigation of copyright infringements to several days, even when a much longer time is necessary to investigate such cases. The code needs to be amended to provide for at least a one-month period for the investigation of copyright infringing cases, as it does in other cases of administrative misdemeanors. Amendments to the code are set for consideration by the *Duma* in early 2005. IIPA understands the current draft would permit a two month administrative investigation, which, if adopted, would be satisfactory for effective enforcement. IIPA urges its adoption.

**Civil Code:** The effort to include detailed copyright provisions as part of comprehensive civil code reform remains a continuing threat to strong IPR protection. For over 11 years, opponents of strong copyright protection have threatened to "redo" and weaken the copyright law with provisions in the civil code. The copyright law should remain self-standing, and nothing in the civil code should undermine that detailed law or its implementation. Last, any revision of the

civil code should not be used to delay in any way the speedy adoption of the copyright law amendments.

**Stamp Tax and the Tax on Video Rental Profits:** In 2001, the Moscow city government replaced its requirements that all video and audio cassettes, optical discs and computerized information carriers have a "protective identification mark" (i.e., a stamp tax), with another law (Ordinance No. 73) that abolished the stamps but created a registration stamp/mark in lieu. Effective January 1, 2004, the Moscow City government required a city identification system. Several alternative systems, including a federal stamp, and a self-regulating system have since been under consideration (most recently at the December 2004 Inter-Ministerial Commission meeting). The copyright industries strongly recommend that anti-piracy systems, whether in the form of stamps or otherwise, be voluntary and left to the individual rightsholders. Mandatory systems have been shown to slow the development of legitimate markets and thus help the pirates. The entertainment software industry reports that the current registration stamp system is causing many retail establishments to stop the sales of legitimate product for fear of running afoul of the law, while pirates continue to operate in open markets.

Also interfering with the development of legitimate markets is the high taxation system on video rentals. Since 2002, a 24% profit tax on revenue from video rentals, along with other "vice" activities such as gambling, has been in effect. This tax is very high (although an improvement from the previous 70% rate). The GOR felt that lowering the tax to 24% would help the video market's growth in Russia, but the lingering high rate combined with the growth of DVD piracy has, for the most part, overwhelmed the legitimate market for rentals.

**Rome Accession and Article 16 Reservation:** Russia acceded to the Rome Convention on May 26, 2003. IIPA is very troubled by Russia's decision to make an exception to its national treatment obligations and adopt the reservations permitted by Article 16 of the Rome Convention. In short, this reservation will mean that American record producers and performers will be denied broadcasting remunerations even though the U.S. is a member of the WPPT (and even after Russia accedes to that treaty). This is a very unfortunate and shortsighted decision by the government of Russia and one that IIPA hopes will be reversed.

Mr. SMITH. Thank you, Mr. Schwartz.

Mrs. Richardson.

**TESTIMONY OF BONNIE J.K. RICHARDSON, SENIOR VICE PRESIDENT, INTERNATIONAL POLICY, MOTION PICTURE ASSOCIATION OF AMERICA**

Ms. RICHARDSON. Mr. Chairman, Mr. Berman, Members of the Subcommittee, thank you for inviting me to testify today, and for holding these back-to-back hearings on China and Russia.

As the witnesses outlined this morning, the problems in China are very serious. But the challenges we face in Russia—lawlessness, physical danger, and corruption—are even more daunting. Until Russia reforms its ways, the U.S. Government should stop considering, and start removing, the special breaks we give to Russian exports into the United States under the Generalized System of Preferences.

And I agree with you, Mr. Chairman. Before the United States supports Russia's accession to the WTO, Russia needs to reduce theft at home and stem exports of pirated goods. As Members of Congress, you are key players in Russia's bid to join the WTO. Please, let Russia know and let the Administration know that your vote on permanent normal trade relations will be in question unless Russia makes meaningful progress in protecting intellectual property.

I'm going to say some tough things about Russia today. But before I do, I want to acknowledge that there are also honest officials in Russia who put their lives on the line in trying to protect against intellectual property. They must be as frustrated as we are with the high levels of corruption.

Last October, police raided a warehouse and found it full of pirated video games. According to the Wall Street Journal, which you cited in your letter, the pirate got help from a corrupt Russian legislator, who then charged the police with running an illegal raid. For the next 3 months, the police had to defend themselves, instead of fighting piracy. And the pirate? Probably remains in business today.

Let me give you a few examples of how organized and dangerous piracy is in Russia. Polish customs officials working on the border with Russia have uncovered false-bottomed compartments in both trains and cars, full of pirated copies of our films destined for markets all over Europe. This isn't "mom and pop" investment. This is organized crime.

At least nine of the 34 factories that replicate CDs and DVDs, and possibly considerably more, are located on government-owned property in Russia, the so-called "restricted access regime enterprises." Given the location of these plants, civilian authorities have serious difficulties in gaining prompt access. Any delay in access during a raid allows the pirates time to destroy the evidence of infringing activity.

Nor are the pirates afraid to use violence. Two years ago, a thug shot at the car that was driven by our anti-piracy investigator. The incident occurred just after a major raid against a pirate facility. It was a clear effort to intimidate our anti-piracy team. Fortunately, our employee was not hurt. The assailant now resides in a

psychiatric hospital. And the person who funded the attack? No doubt, he's still making money from our films.

Corruption has become endemic at every level of the enforcement system in Russia. As Eric Schwartz mentioned, 70 percent or more of the pirated goods that are seized during raids find their way back into the marketplace. And what's worse, often the pirated goods are sold by the trade houses that are associated with the justice ministry or by their veterans' funds.

Prosecutors often shelve cases resulting from major optical disc plant raids. Even the rare cases that end up in sentencing have no deterrent value. Of the eight raids conducted last year against pirated factories, all of the plants remain in operation today, and continue to pirate. In half of the cases that were prosecuted—and only four were prosecuted—lower-level employees were targeted; not the owners. All of the cases—all three of the cases—that reached judgment, resulted in suspended sentences. There is no deterrence in the system.

My written testimony provides a summary of several anti-piracy actions last year. Any one of these cases could have been an innocent mistake or could have another honest explanation. But taken as a whole, they create a disturbing fact pattern that can only be understood as corruption or massive indifference.

In one case, local prosecutors closed the criminal case. The regional prosecutor ordered it reopened. The local prosecutor again closed the case; ordered the seized stampers returned to the plant operator. And the plant remains in operation today.

In another case, two and a half million pirated discs were seized from two related warehouses on one of these restricted access facilities. Within days of the raid, over a million of the discs had mysteriously disappeared from the sealed warehouses. The owner got a 2-year sentence—suspended, of course.

We will see no progress in enforcing against intellectual property crime in Russia unless President Putin himself demands accountability from his senior officials. Until then, corrupt officials will continue to afford protection to the pirates.

Mr. Chairman, on behalf of the Motion Picture Association of America, and the thousands of law-abiding Americans who work in the movie industry and whose livelihoods are threatened by piracy, I want to thank you for inviting me to testify and for your support to this industry over the years.

[The prepared statement of Ms. Richardson follows:]

PREPARED STATEMENT OF BONNIE J.K. RICHARDSON

Mr. Chairman, Ranking Member, Members of the Committee:

I would like to thank you for inviting me to testify before you today on the important topic of international intellectual property theft in Russia. I commend you for holding back-to-back hearings this morning to illuminate the problems of IP theft in China and Russia. As serious as problems are in China, and they are serious indeed, the challenges we face in protecting our intellectual property in Russia are even more daunting. Lawlessness, physical danger, and corruption are part of the daily challenges we face in trying to protect our rights in Russia.

Russia is one of the largest producers and exporters of pirated DVDs and other copyrighted products in the world. Russia needs to lower the incidence of copyright theft at home and stem the export of pirated goods before the United States supports Russia's accession to the WTO. Our Government also needs to use all the tools in its bilateral arsenal to send this message, including suspending Russia's eligibility for preferential trade benefits under the Generalized System of Preferences.

If the United States Government acts now, it won't have to choose between American economic interests and our geopolitical goals. If the US Administration tells the Russians, clearly and unambiguously, that the United States will not accept Russia as a WTO partner until they have taken effective actions to control the rampant optical disc piracy, then the choice will not be ours—it will be Russia's. Russia will have to choose between coddling criminals and tolerating corruption on the one hand and joining the world trade community on the other. Congress can help ensure that both Russia and the Administration know that a grant of Permanent Normal Trade Relations to Russia, which is a prerequisite to WTO relations, will be endangered without meaningful progress on protecting intellectual property.

THE "GOOD GUYS" IN RUSSIA

In my remarks today I will focus on what is wrong in the fight against piracy in Russia today. But, I want first to acknowledge the dedicated and courageous officials in Russia who have fought hard to secure adoption of good copyright laws, and who put their own safety on the line in trying to enforce those laws against the organized criminals who run the piracy business in Russia. These honest men and women must be as frustrated as we when their laws aren't implemented, when their raids aren't prosecuted, or when their prosecutions result in paltry sentences.

Chairman Smith cited a May 12 article from the *Wall Street Journal* from May 12 in his "Dear Colleague" letter of the same date. I would like to append this article to my testimony, because it vividly illustrates the price that honest officials in Russia can pay for trying to do their jobs. After a raid last October on a warehouse full of pirated videogames, the pirate enlisted the help of a Russian legislator, who complained to prosecutors, city officials, and police's own internal affairs office. The police, who were trying to enforce Russian copyright law, ended up spending the next three months defending themselves. And the pirate remains in business.

Certainly the Russian film industry, who have basked in the light of such local and international successes as last year's superhit *"Night Watch"* or this year's all time box office record holder *"Turkish Gambit,"* have to be angered that the revenues from the successful home video sales of their fine films go to the pirates instead of to the Russian creators.

THE AMERICAN ECONOMIC INTEREST

The US filmed entertainment industry has a surplus trade balance with almost every country in the world. No other American industry can make that claim. Ensuring the continued economic health of the film industry, and of other U.S. intellectual property rightsholders, is in our national interest and in the interest of the ordinary Americans who enjoy those films, as well as the costumers, the carpenters, the set painters, the sound technicians, the fire safety workers, whose jobs rely on the creation of filmed entertainment and other forms of copyrighted works. Piracy, massive thievery really, threatens the continuing viability of this important economic engine.

AN ORGANIZED CRIME

In Russia, the people procuring, producing, and distributing pirated copies of our movies are affiliated with large and dangerous international criminal syndicates and gangs. Organized crime figures own the modern factories that cost well in excess of a million dollars, and operate 24 hours a day, seven days a week, cranking out millions of pirated discs. They ensure protection for the distributors and retailers who sell eight pirated copies to every two legal copies my members manage to sell in Russia.

No small-scale, independent operator could afford the false-bottomed compartments in trains and cars which Russian organized crime uses to export pirated copies of our films to other organized criminal syndicates all across Europe. Pirated movie discs from Russia are readily available throughout Europe and the Middle East. The odds are high that every dollar or euro spent on these pirated goods is put into the pockets of bad people who will spend it in a way that is not consonant with our safety and security.

Another example of the failures of the Russian enforcement regime comes from IIPA's annual Special 301 report and relates to the control that criminal syndicates have over entertainment software piracy in Russia. There are four principal criminal syndicates that control the production and distribution of pirated entertainment software in Russia. The syndicates attach "logos" or "brand" names to their illegal product and localize the illegal copies they produce—before the legitimate product is released into the market. These same groups control illegal distribution networks in Russia, as well as in the surrounding countries. It is widely believed that the

Russian groups control piracy operations in much of Eastern Europe including the markets in Poland and Latvia, and that they also have ties with syndicates operating in Ukraine. One ESA company reports that in 2004, one of these piracy syndicates attempted to register one of the company's trademarks for a videogame product that was being pirated by the syndicate.

A LARGE, GROWING, AND VERY DANGEROUS PROBLEM

In 1996 there were two known optical disc plants in Russia. The subsequent years of inaction by the government of Russia allowed the number of factories to mushroom to today's 34 known plants, resulting in a serious problem—production capacity that far exceeds legal demand in Russia. The excess capacity is, of course, devoted to illegal production for the local market and for export. Unfortunately, Russia has yet to put in place an effective optical disc regulatory regime to fight illegal production at its source.

According to our data, at least nine of these factories are located on property owned by the Russian military, or "restricted access regime enterprises." The location of these plants creates serious difficulties for ensuring prompt access to these plants for the civilian authorities. Any delay in access allows the pirates time to destroy evidence of infringing activity.

Let me be clear, the people heading these organizations have no qualms about resorting to violence or bribery to conduct their operations. Two years ago, shortly after a major raid against a pirate facility, in what clearly was designed as an intimidation effort, a thug shot at the car in which one of our anti-piracy investigators in Russia was driving from work. Fortunately our employee was not harmed. The assailant now resides in a psychiatric hospital, while the funder of the attack likely grows ever more wealthy from the lucrative—and in Russia—extremely low risk, piracy game.

THE EXPORT PROBLEM

Russia is now one of the world's largest exporters of illegally copied optical discs. Exported Russian pirated discs have been found in over 27 international markets. The exported DVDs generally contain multiple language tracks. Frequently the exported discs do not include a Russian language track—a clear indication that the pirated discs were produced solely for the export market. The result is a serious erosion of legitimate sales in Europe that threatens the lucrative Western European markets.

WIDESPREAD CORRUPTION

Corruption has become endemic at every level of the enforcement system in Russia. The lure of a bribe has long been common among poorly paid police. By now, many prosecutors have succumbed to corruption. There is even reason to suspect that some judges may have been influenced by the pirates.

One indication of prosecutorial corruption is the number of requests prosecutors make of rightsholder organizations to return seized material to prosecutors because they "need to show the evidence to the judges." In fact, the goods confiscated during raids on factories and warehouses are returned to commercial channels to which the prosecutors are connected.

The *Wall Street Journal* article cited above estimates that 70% of confiscated merchandise winds up back on the market. MPAA has estimated that up to three quarters of the pirate product seized in raids finds its way back onto the market via Veterans' Funds and the Trade Houses of the Justice Ministry.

The number of times prosecutors have tried successfully to shelve cases resulting from major OD plant raids or ducked prosecution of the public and notorious pirate website "Allofmp3.com" also points to rampant corruption.

In 2004, there were eight raids against optical disc plants, including raids and seizure of illegal materials. In all cases, the factories remain in operation to this day with evidence of continued piracy. When prosecutions took place, the prosecutors tended to target lower-level employees, instead of the owner. Three of the cases that reached judgment resulted in suspended sentences and the fourth still awaits a final decision.

In fact, the only time MPA has been able to get an unsuspended prison sentence for a pirate in Russia, the defendant was a video shop owner, not a large-scale factory owner. The video shop owner was sentenced to three years and two months in prison. The defendant was a repeat offender, having received a two year suspended sentence in his first conviction.

Below is a brief summary of several of the factory cases that together create a disturbing fact pattern that can only be understood as a reflection of corruption or massive indifference.

A DISTURBING PATTERN OF SENTENCING AND FAILURE TO CLOSE PLANTS

- *The UVK Stimul plant in Zelenograd* was raided June 21, 2004, the second raid against this plant in ten months.
  - 37,000 pirate CDs and DVDs and 8 stampers were seized.
  - The plant continues to operate, reportedly working 24 hours a day.
  - On January 14, 2005, a Moscow court imposed a *one-year suspended prison sentence* on the plant's chief technician, after he confessed to ordering the plant's personnel to replicate pirate DVDs. The prosecution claimed the accused acted alone, without reporting to the management of the company. The defendant pleaded guilty and the court ruled under simplified procedures without full consideration of the case.
- *Data Media plant in Koroliov,* raided on April 30, 2004.
  - The plant operator pleaded guilty in December 2004 to replicating pirate discs. Sentenced on February 28 to a *suspended two year prison term.*
  - Despite an alleged closure of the plant by police, trucks full of illegal DVDs intercepted leaving the plant in July 2004, were found with 22, 771 pirated CDs and DVDs.
  - Two further criminal cases are pending against the same accused arising from these subsequent seizures.
  - Plant remains in operation, continues to work illegally.
- *ZZMT plant in Zelenograd,* raided December 2002
  - 234,493 counterfeit CDs seized.
  - The defendant, the human resources officer not believed to be an owner or major organizer, was sentenced February 2004, to *one year suspended sentence.*
  - Defendant ordered to pay $180,000 damages to rightsholder.
  - Plant continues to operate. A disc matched by forensics to this plan was found in Kiev in March 2005.

EXAMPLES OF CASES NOT PROSECUTED

- T3The Okapi plant, Puskino, raided February 2004,
  - 25,000 pirate DVDs and computer games discs, and 800 stampers seized.
  - Situated on a government owned, restricted access facility.
  - Closed in early 2004—after equipment was returned by court order to its alleged owners and moved it to an unknown site to continue manufacturing.
- *Samara plant,* found to be a pirate DVD plant during a routine tax inspection at a cement factory in April 2004;
  - 7,000 pirate DVDs and 30 stampers uncovered.
  - Plant director was questioned, a criminal prosecution prepared.
  - Local prosecutor closed the criminal case.
  - Regional prosecutor ordered the case re-opened.
  - Local prosecutor again closed the case, ordered the seized stampers returned to the plant operator.
  - The plant, an unlicensed plant, remains in operation.
- *Warehouse in Odintzovo* near Moscow raided August 2004, over 1 million pirate discs seized. A nearby second warehouse contained an additional 1.5 million pirate discs.
  - Located on a military camp.
  - Within days of the raid, over a million of the discs mysteriously disappeared from the "sealed" warehouses.
  - Industry anti-piracy group nevertheless managed to get legal guardianship of over 100,000 of the seized, pirated DVDs.
  - On March 15, 2005, a court in Odintzovo imposed a *suspended two year prison term* on the owner.

- The one bit of good news—remaining DVDs still in legal custody were ordered to be destroyed August 2004.

Given the extent of corruption, seeking enforcement from within the bureaucracy is largely a waste of time. We will not see progress in enforcement against intellectual property crimes in Russia unless President Putin directs all relevant agencies to make the fight against copyright piracy a priority. Until the President himself demands accountability from his senior officials, corrupt officials will continue to afford protection to the pirates.

CONCLUSION

Mr. Chairman, on behalf of the Motion Picture Association of America, as well as the thousands of law-abiding people who work in the movie industry and whose livelihoods are threatened by piracy, I want to thank you again for inviting me to testify today and for your support to this industry over the years. As I have attempted to describe today, piracy in Russia is a large, growing and dangerous problem. Russian enforcement institutions have not demonstrated any intention to deal with this problem seriously. We need your help to ensure that Russia does not continue to benefit from US trade preferences, while continuing to coddle the pirates who rob us blind. We also need your help to ensure that Russia addresses its piracy problems *before* it is permitted to join the WTO.

**ATTACHMENT**



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THE WALL STREET JOURNAL.

**In Russia, Politicians Protect Movie and Music Pirates**
By Guy Chazan
1,061 words
12 May 2005
The Wall Street Journal
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English
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Moscow -- RUSSIAN POLICE thought they had a chance to catch a big fish in the piracy world last fall when a man selling counterfeit software they had nabbed gave them the name and address of his supplier.

They staked out the warehouse in the basement of a dingy apartment block and moved in last October. Behind a steel door concealed by boxes they found a huge stockpile of illicit videogames.

As officers carted away the stash, they paid little heed as one of the store's owners claimed, "we'll never be charged, because we have friends in high places."

Seven months later, he's turning out to be right. Though forensic tests quickly confirmed the games were fake, the trader has teamed up with a friendly lawmaker to mount a fierce and so far effective defense. Instead of pressing their own charges, police discovered that they themselves were under suspicion.

Russia has emerged as the front line in Hollywood's global war against piracy. China may still be the world's top producer of illegal computer software, CDs and DVDs, but authorities there are getting serious about cracking down. In Russia, the Kremlin has been promising to deal with the problem for years, but industry officials say under President Vladimir Putin it's gotten worse, not better.

A key reason is that Russia's pirates, who cost U.S. businesses an estimated $1.7 billion in losses last year, have cultivated increasingly cozy links to the government that's supposed to police them. Counterfeiters are lining up political patrons and locating factories inside secret military facilities where law-enforcement agencies can't touch them.

"Two years ago, the Russian government said it would eradicate all music piracy in two years," says John Kennedy, head of IFPI, a London-based organization that represents 1,500 record companies world-wide. "Instead it's increased by 30%."

Russia, IFPI says, is now the world's biggest exporter of pirated music products, and the second-biggest market for such products after China. Counterfeit music CDs made in Russia have turned up in 27 countries around the world, including the U.S. Hollywood is pushing Washington to impose trade sanctions.

Thanks to high-level connections, efforts to prosecute pirates have borne little fruit in Russia. The few cases that end in convictions usually lead to suspended sentences, and as much as 70% of confiscated merchandise winds up back on the market.

Legislator Vladimir Ovsyannikov makes no bones about his relationship to the owner of the Moscow warehouse, Sergei Kaluzhenok.

"A politician isn't a politician unless he can offer krysha -- to bandits, prostitutes, or state officials, it doesn't matter," he said in an interview. "They are all his voters, after all."

"Krysha," which means "roof" in Russian, was the word used in the early 1990s for the numerous protection rackets that sprouted as Russia lurched toward capitalism.

Sporting a crew cut, a black shirt and gray polka-dot tie, Mr. Ovsyannikov, 43 years old, spent most of his career as a welder, a miner and a worker at a Siberian railroad yard before he became a parliamentary aide in 1997. Elected to the Duma in 2003, he works from a cramped office decorated with Orthodox icons and a large whiskey bottle.

Mr. Ovsyannikov is a member of the Liberal Democratic Party, an ultraright outfit led by nationalist Vladimir Zhirinovsky. In the late 1990s, the party made headlines when it included several known criminals in its list of electoral candidates. Its members have also demanded reduced penalties for CD pirates.

Mr. Kaluzhenok says he's never even met his parliamentary protector. He enlisted his support through "Sword and Shield," an organization close to Mr. Ovsyannikov which helps out businessmen in trouble with the law -- for a $300 monthly fee.

Mr. Ovsyannikov says he's defending Mr. Kaluzhenok from a corrupt police force that he says is "acting at the behest of his competitors." He's proud of slowing down the police probe into his client. "The great thing about being a Duma deputy is that people have to react to you," he says.

After the October operation, Mr. Ovsyannikov fired off letters to prosecutors, city authorities and the police's internal security service complaining the raid was carried out without a search warrant. Over the next three months, officers were summoned for days of interrogations by different agencies. Their own investigation ground to a halt.

Finally cleared of improper conduct, police took a fresh stab at the Kaluzhenok case in late December, launching a second raid on his warehouse. They found a newly installed steel door, and had to summon emergency assistance to cut out the lock. But behind that was another door, with a red sign on it saying the warehouse was now Mr. Ovsyannikov's public office.

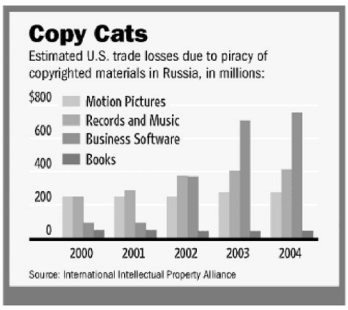
Police contacted the lawmaker, who said he didn't even know he had an office there. "I have 15 of them, and I can't tell you where they all are," he said. "All these street names get muddled up in my head."

Mr. Ovsyannikov said his numerous offices function as drop-in centers where voters can make complaints or ask for help. He said he's never seen most of them, even though his name hangs on the doors of all 15. He denies police claims that the practice is just a ploy to protect business premises from searches.

Shortly after police made the call to Mr. Ovsyannikov, two of his assistants turned up at the scene. They told them they could not enter the office because it enjoyed "parliamentary immunity." The police squad called off the search.

In January, Mr. Ovsyannikov complained about the second raid, saying police had damaged his property. Fresh interrogations involving five government agencies dragged on for three more months. In March, the police were once again cleared of misconduct.

Mr. Kaluzhenok is still in business, selling videogames at a big Moscow computer and DVD market. With his Land Rover Discovery sport/utility vehicle and Italian leather jacket, he's clearly doing well. But he also acknowledges that some of the software he sells could be fake. "It's up to the police to decide what's counterfeit and what isn't," he says. "I haven't a clue."

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Mr. SMITH. Thank you, Ms. Richardson.
Mr. Gerson.

**TESTIMONY OF MATTHEW T. GERSON, SENIOR VICE PRESIDENT, PUBLIC POLICY AND GOVERNMENT RELATIONS, UNIVERSAL MUSIC GROUP**

Mr. GERSON. Mr. Chairman, Congressman Berman, thank you very much for inviting me to testify today on behalf of the Universal Music Group and the Recording Industry Association of America, and for taking the time to dedicate today's hearings to two very important problems that we face: piracy in China and piracy in Russia.

In my years knocking around this Committee, I've learned a few things; and among the most important is to recognize that the people sitting behind me are starting to get hungry. So I'm going to be brief, and I'm going to try not to repeat some of the things that have already been said.

We envision Russia as a terrific market for both local and international businesses, and have made significant investments in the arts, and have made investments in the many businesses that it takes to bring CDs to market. We've signed and distributed local bands; we've promoted them outside of Russia. We manufacture our product locally in Russia through Russian-owned businesses. We've developed special budget lines to bring legitimate product within the buying power of the average Russian citizen.

We've also tried to raise awareness within Russia of the social, cultural, and economic costs of piracy. Through IFPI, the federation of music trade associations from around the world, the industry invests millions in a wide variety of anti-piracy, pro-music activities. But we're frustrated.

And as you observed, Mr. Chairman, all our efforts are stymied when law enforcement fails to prosecute the crimes that they can identify and easily find. Our best intentions and best efforts are undermined when the few convictions lead to slaps on the wrist or penalties that are insignificant and really just a cost of doing business.

Despite our work with the Administration, despite interactions between the United States and Russia at the highest levels, as cited by Ms. Espinel, piracy is growing. The Russian government sees our bill of particulars. They can read our Special 301 submissions. They can read what we say about GSP. They know exactly what we know, and they're failing to act.

Now, Bonnie and Eric gave you a sense of what's happening with physical piracy. We're starting to see the same disregard when it comes to Internet piracy. Through online servers based in Russia, a site called "allofmp3.com" sells music to anyone in the world willing to pay about 10 cents a song. The problem is that "allofmp3.com" has not secured the rights to do so, and doesn't bother to pay the people who wrote the songs or recorded the songs or own the copyrights.

There's no question about the law. At the very least, "allofmp3.com" is violating the reproduction rights afforded by Russian copyright law and the criminal code, and the laws of country where those songs are downloaded.

Now, industry observers—industry investigators looked at the website; worked closely with the Moscow city high-tech crime unit; and submitted a substantial body of evidence to the Moscow prosecutor. In February, the prosecutor dismissed the case. And in doing so, he conveyed a damaging message to the public and, frankly, a damaging message to those of us trying to establish legitimate businesses there.

We need to do some messaging of our own. And by that I mean the copyright industries and U.S. policymakers need to make it clear that failure to control piracy has clear ramifications for the Russian government. First, as has been said, USTR should really reexamine Russia's eligibility for GSP. It's wrong that U.S. taxpayers should, in effect, be helping to finance Russian exports to the United States, while the rights of U.S. intellectual property owners are being systematically neglected.

Second, we really do have to learn from the China experience. By every measure, by every expert and every witness, the China WTO has failed. The commitments that were made, the efforts that were made before China entered WTO haven't done what's necessary for America's patent, copyright, and trademark industries. And we just have to learn what went wrong, and correct it when it comes time for Russia to be admitted, or to be considered for admission, into WTO.

Third, I believe Congress should delay consideration of PNTR for Russia. As with admission to WTO, Russia should not be rewarded with Permanent Normal Trade Relations until it has demonstrated sufficient and sustainable reform. The word "sustainable" is one that you used, Mr. Chairman. That's really what's at stake here.

Let me make a few final observations. WTO accession is not a political prize. It represents a commitment to abide by international rules. WTO as an institution and global confidence in free and fair trade are quickly undermined when agreements and commitments go unenforced.

In addition, we have to face facts. Today, the Administration and the Congress has a certain amount of leverage because Russia wants PNTR and Russia wants WTO. And once they attain those goals, the leverage that we have is going to diminish significantly.

I've got a few seconds left so, you know, Congressman Issa mentioned the problem he's having with patents over amplifiers. It is not so long ago that in this room we talked only about music and movies and software being pirated. But today, we can talk about Congressman Issa's amplifiers, or somebody who manufactures altimeters in Mr. Goodlatte's district. Or I loved the example in the L.A. Times a couple of weeks ago about hot sauce. It's a favored brand in L.A., and is being imported illegally from China, as well. It is touching every aspect of the American economy, and we really need to take aggressive steps.

And finally, just to follow up on a point that Myron Brilliant made, it's not just U.S. industries getting hurt. There are industries in China and businesses in Japan and businesses in Europe that are being hurt by the piracy that takes place in China and in Russia. And maybe there are things that we can do on a multilateral basis with our trading partners, with other businesses who are trying to succeed in the global marketplace.

Thank you. And I really want to thank you, Mr. Chairman, Congressman Berman, and your staffs, for doing so much over so many years to help the U.S. creative industries.

[The prepared statement of Mr. Gerson follows:]

PREPARED STATEMENT OF MATTHEW GERSON

Mr. Chairman and Members of the Committee, my name is Matthew Gerson and I am Senior Vice President for Public Policy and Government Relations at the Universal Music Group. I appreciate the opportunity to appear before you today on behalf of my company and the Recording Industry Association of America to discuss the problems that we confront as we attempt to establish and build businesses in the Russian Federation.

Universal Music Group [UMG] is the world's leading music company with wholly owned record operations or licensees in 77 countries. Its businesses also include Universal Music Publishing Group, one of the world's largest music publishing operations.

Universal Music Group consists of record labels Decca Record Company, Deutsche Grammophon, DreamWorks Records, Interscope Geffen A&M Records, Island Def Jam Music Group, Lost Highway Records, MCA Nashville, Mercury Nashville, Mercury Records, Philips, Polydor, Universal Music Latino, Universal Motown Records Group, and Verve Music Group as well as a multitude of record labels owned or distributed by its record company subsidiaries around the world. The Universal Music Group owns the most extensive catalog of music in the industry, which is marketed through two distinct divisions, Universal Music Enterprises (in the U.S.) and Universal Strategic Marketing (outside the U.S.). Universal Music Group also includes eLabs, a new media and technologies division.

The Recording Industry Association of America (RIAA) is the trade group that represents the U.S. recording industry. Its mission is to foster a business and legal climate that supports and promotes its members' creative and financial vitality. Its 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% of all legitimate sound recordings produced and sold in the United States. In support of this mission, the RIAA, among other things, works to protect intellectual property rights worldwide.

International markets are vital to RIAA's companies and our creative talent. Foreign sales account for over fifty percent of industry revenues. This strong export base sustains and creates American jobs and is a key reason that the core copyright industries—including music, movies, software and videogames—account for some 6 percent of U.S. GDP.

However, as this subcommittee well knows, America's creative industries are under attack. Piracy has grown in recent years with the advance of digital technology that facilitates both physical and online piracy. Indeed, high levels of piracy and trade barriers that complicate our efforts to enter or operate in foreign markets plague all of America's copyright owners and creators.

Despite the enormous challenges that the copyright industries face, I want to highlight one great benefit that we enjoy—the consistent and committed work of this subcommittee. Your work over the years is in no small measure responsible for the extraordinary success of America's creators. Your focus has enabled us to entertain, educate and inspire people all over the globe. I would also like to recognize the State Department, the U.S. embassies around the world, the United States Trade Representative, the Department of Commerce, the Patent and Trademark Office and other agencies staffed with dedicated and talented officials committed to the continued vitality of this uniquely successful sector of the U.S. economy.

The other witnesses on this panel will elaborate on the current state of piracy in Russia. To avoid repetition, I will describe some of the efforts that Universal has taken to build a business in Russia, and the industry's efforts to bring our piracy problems to the attention of U.S. policymakers as well as officials in Russia.

But the position of the music industry and many in the content community is easy to summarize—the piracy situation in Russia is untenable, as made clear in the Thursday, May 12 *Wall Street Journal* article circulated by Chairman Smith.

To protect the American businesses that invest in creativity, and the artists and others who earn their livelihoods in the production and distribution of intellectual property, the U.S. Government should take a hard look at the economic and political mechanisms at its disposal. Until we can be certain that there is a demonstrated and sustainable commitment to enforcing intellectual property laws, the Congress and Administration should—

- reexamine the GSP benefits currently afforded Russia;
- delay its consideration of PNTR—and the benefits that come with Permanent Normal Trade Relations;
- withhold support for Russian membership within the World Trade Organization (WTO).

DOING BUSINESS IN RUSSIA

Russia is a very exciting music market that is ripe with opportunities for both local and international business. But these opportunities are stymied by the second largest pirate music market in the world—estimated at $330 million U.S. dollars—where two-thirds of all recordings are illegal copies.

Universal Music is the biggest record company in Russia and we have made very significant investments in the arts in Russia as well as the many disciplines involved in bringing a CD to market. We have signed and distributed local bands, and have promoted them outside of Russia. We manufacture our product locally through Russian-owned third parties. We have developed special budget lines to bring legitimate product within the buying power of the average Russian citizen. And we have tried to raise awareness within Russia of the social, cultural and economic costs associated with their failure to create more favorable conditions for investing in creativity.

The cultural impact of American music and the role of a U.S. record company is exemplified by a Russian act called Bering Strait. I saw them a couple of years ago at Wolf Trap where they were opening for another Universal band. The band plays country music—that's right, country music—and was on their first American tour. The tour was a real success as they were embraced by audiences—most of which never thought they would see Russian musicians putting their own spin on familiar bluegrass melodies.

Because we are so committed to the Russian market, we have joined with industry allies to do everything in our power to address music theft. Through IFPI—the International Federation of the Phonographic Industry, a federation of music trade associations from around the world—the industry invests millions in anti-piracy activities. However, those efforts are stymied when law enforcement fails to prosecute the crimes and criminal enterprises that are identified. We have agonized over the few judicial sentences that have been granted, which each time result in a relatively small fine easily assumed as a cost of doing business. We have struggled as the Russian Government refuses to act against fraudulent collecting societies that grant "licenses" to pirate internet sites.

AN ONGOING TREND

Russian piracy is not a new problem for the recording industry, and our interaction with the U.S. Government on this point is long standing. For the past several years, the International Intellectual Property Alliance [IIPA] has, through its Special 301 and GSP submissions, documented the extensive copyright violations going on in Russia. This year the U.S. copyright industries urged the U.S. government to suspend Russia's eligibility for any duty-free trade benefits accorded through GSP, and were disappointed when the Government decided not to do so. It was equally dismaying when the U.S. Government did not identify Russia as a "priority foreign country" under Special 301, and instead choose to keep them on the priority watch list.

Nearly two years ago, on September 16, 2003, RIAA CEO Mitch Bainwol joined the CEO's of America's major record companies in writing to President Bush. A complete copy of that letter is attached to this testimony, but the main points were:

- To ask President Bush to raise piracy during an upcoming Summit with Russian President Vladimir Putin and urge him to "take immediate steps to curtail his country's illegal production and export of pirate products—an activity that has been on the rise for the past three years and which severely harms American and Russian creators alike."
- To emphasize that, "the success or failure of initiatives to strengthen copyright protection on the global stage has a profound bearing on U.S. economic competitiveness. It will dictate whether the global economic and legal environment will sustain America's artistic and intellectual heritage. No less is at stake than the genius and individuality that lie at the core of our national soul, and the dangers posed are great and immediate."
- To set out the facts. At that time—just two years ago—Russia was "home to 28 known optical disc plants ("optical discs" refers to CDs, DVDs, CD-ROMs, and other disc based products) with a production capacity of over 330 million

discs a year. Demand for legitimate discs in Russia, on the other hand, is unlikely to exceed 30 million discs per year. This excess capacity is used to produce and then export pirate materials, and investigations have led to the seizure of Russian manufactured pirate discs in over 25 countries. The U.S. copyright industries have been losing more than $1 billion a year to piracy in Russia, and we have been sustaining this level of loss for 5 years."

- To clarify why more action was necessary. "President Putin has taken certain steps over the course of the past year, but they have not been adequate to address this intolerable situation. The thrust of our request to the Russian Government—oft repeated by the excellent and dedicated Ambassador of the United States to Russia, Ambassador Vershbow—has been to introduce and implement effective controls over the operations of the CD plants . . . Ambassador Vershbow delivered a document to the Government of Russia more than one year ago that listed the names and addresses of the [pirate] facilities [but they continue in operation today]."

I urge you to read the entire text of that letter from industry CEO's because an understanding of what we have tried is critical if we are to properly respond today. President Bush did indeed raise his concerns about copyright piracy with President Putin on several occasions, and President Putin in turn pledged to address it. To date, the response has been inadequate.

In fact, the statistics demonstrate a dramatic increase in music theft, certainly not a crackdown. According to RIAA:

- The 28 replication plants in 2003 have grown to 34 plants in 2005. Five plants would be sufficient to meet the needs of the legitimate Russian market. As a result of that excess capacity, Russia is the world's largest exporter of pirated music.
- Production capacity which stood at an alarming 330 million a year in 2003 now stands at 488 million units.
- At least 9 of these production plants are located on so-called "Russian State Restricted Access Regime Enterprises" in which the Russian Government itself is the owner of the premises.
- Russia is now home to some of the world's only Internet-based pirate pay download services—such as allofmp3.com.

The case of allofmp3.com helps illustrate the music industry's frustration. Through online services based in Russia, it sells music to anyone in the world willing to pay ten cents a song. The problem is that allofmp3.com has not secured the rights to do so—and doesn't bother to pay the people who wrote and own the songs being sold. There is no question about the law—at the very least allofmp3.com is violating the reproduction rights afforded by Russian Copyright Law and Criminal Code, and the laws of the countries where the songs are being downloaded.

Once again, IFPI investigated and in 2004 began working in close collaboration with the Moscow City High-Tech Crime Unit. Both IFPI and the High-Tech Unit submitted formal complaints—including supporting documentation—to the Moscow City Prosecutor's office.

In February 2005, without much explanation, IFPI received notice that a regional Moscow City Prosecutor declined to accept the matter for further investigation. Clearly the Prosecutor failed to appreciate the seriousness of the matter and misapplied the law. In doing so, he conveyed two incorrect and damaging messages to the public—that the service is legal and that it is legal to download from the service wherever you may be. Similarly, the Prosecutor sent yet another clear signal to those trying to establish legitimate businesses.

WHAT SHOULD BE DONE?

We need to change the political calculus so that failure to control piracy has clear ramifications for the Russian Government—ramifications that outweigh the costs associated with stopping piracy. Specifically:

**(1) USTR should reexamine Russia's eligibility to participate in the Generalized System of Preferences until it has satisfactorily protected intellectual property from theft.** It is wrong that U.S. taxpayers should, in effect, be helping to finance Russian exports to the U.S. while the interests of U.S. intellectual property owners are being systematically undermined. The United States needs to point out how failure to address copyright piracy will impede Russia's goals, whether such goals relate to attracting foreign investment, joining the WTO, or other matters.

**(2) We must learn from the China experience. Congress should insist upon demonstrated and sustainable reform before supporting Russia's accession to the WTO.** By every measure, the steps taken before China was admitted to WTO have failed America's patent, trademark and copyright industries. The U.S. should ensure that relevant legal and enforcement measures are in place and implemented before we accept Russia into the WTO. WTO accession is not a political prize—it represents a commitment to abide by international rules. The WTO institution and global confidence in world trade rules is quickly undermined when WTO parties openly mock trade discipline.

Let's face it—today Congress has some bilateral leverage because Russia wants to enter WTO. Once they are in, the leverage diminishes significantly. Secretary of State Rice alluded to that reality in an April 20, 2005 interview in Moscow in response to a question about WTO—

> "We are very supportive of Russia's effort to join the WTO. We think this would be good for world trade, good for Russia. There are certain performance criteria in the WTO that have to be met. And we need to resolve the issue of intellectual property rights. At this point, the legal framework in Russia to prosecute those who engage in piracy is not very strong, and that really must be taken care of before WTO accession . . .
>
> It has to be understood, and I hope the Russian people will understand that when the United States supports WTO accession, this also has to be accepted by the American Congress. And so we have to have performance on these outstanding issues so that when we go to the American Congress, the WTO accession can go through without difficulty."

**(3) Delay consideration of PNTR for Russia.** As with admission to the WTO, Russia should not be rewarded with Permanent Normal Trade Relations until it has demonstrated sufficient, meaningful and sustainable reform.

CONCLUSION

Mr. Chairman, I will do the safest thing on earth—I will conclude by quoting you. When you circulated the May 12 *Wall Street Journal* article you observed that the article, "underscored the importance of achieving significant reform of the Russian intellectual property rights enforcement system before admitting Russia into the WTO."

We agree completely, and appreciate the seriousness with which this Committee will approach WTO accession if it is presented to the Congress.

Thank you for inviting me to participate in this hearing. I would be glad to answer any questions you may have.

Mr. SMITH. Thank you, Mr. Gerson.

My first question I'd like to address to Ms. Espinel. You mentioned in your testimony that we are continuing interagency review of a petition filed by the U.S. copyright industries to withdraw some or all of Russia's benefits under the U.S. Generalized System of Preferences, the GSP program.

It so happens that that particular issue was raised by every one of the other witnesses. That's one of two common denominators that I've seen. But the question really is this. Reviews can only go on so long. When do you think you will actually decide something in that regard?

Ms. ESPINEL. Well, as you may know, the review of this GSP petition has been a longstanding process. And we are reconvening an interagency group to review the GSP petition with Russia and with some other countries in the coming months.

I appreciate the frustration that has been expressed with the length of time that the GSP review has been outstanding. I appreciate hearing the concerns that have been expressed by industry. And we will consider all of the suggestions made with them with respect to GSP, but also with respect to some of the other suggestions they've made.

I just want to note that this is obviously a deep-rooted problem in Russia. This is not just related to intellectual property. This will require widespread systemic reform by Russia.

Mr. SMITH. Right. But when do you think you will actually make a decision whether or not to deny Russia some of the benefits? You mentioned the frustration. You certainly felt it a minute ago when Mr. Schwartz testified given his experience. Do you know of any kind of timetable within your office, USTR, that might be of interest to us?

Ms. ESPINEL. I'm not aware of any timetable. There is no deadline that I can offer you today. But I will just note that with Ambassador Portman newly onboard, we are examining our strategy with Russia. I think it's very helpful to get this input from industry.

Mr. SMITH. Okay.

Ms. ESPINEL. And we will consider that.

Mr. SMITH. And you can be assured that we will monitor what you all do or don't do in the coming weeks, as well. The second common denominator was interesting to me, because all witnesses mentioned it, as well. And that was the problem with the optical disc plants in Russia which are producing something like three or four times the actual number of discs that are used or purchased by those who live within the Russian Federation themselves. That is clearly a flaunting of U.S. interests. What is going to be done about that?

Ms. ESPINEL. The problem of optical disc manufacturing in Russia is that the scale of the problem is deeply disturbing. We have made IP enforcement—but, in particular, this issue of optical disc protection—a top priority in our bilateral discussions with Russia, and in particular in our accession negotiations. Again, we share the concern, we share the frustration. One other——

Mr. SMITH. Okay. We're going to give you the benefit of the doubt today. You've been sharing our frustrations and sharing our concerns. And normally, we'd come back at you for a lack of commitment; but you do have a new boss, you do have a new ambassador. And I have great faith in him and his willingness to address some of these issues. So let's just assume that good faith on your part.

Ms. ESPINEL. One thing I would like to note that the Administration has been doing, which is a new action. It isn't directed solely at Russia. In fact, to some extent, it is directed at many of our trading partners, including China and Russia. But this is the STOP initiative which I alluded to briefly.

I think it's particularly relevant with respect to this problem of optical disc manufacture in Russia. Because the major purpose of STOP is to try to stop the illegal trade in counterfeit pirated goods, to stop exactly the kind of problem that we're seeing in Russia, this massive export of illegal optical discs.

So we have been working domestically to tighten our own borders. But we have also been reaching out to trading partners around the world that are also—that share a perspective on this problem and are also facing this, to have them tighten their borders, to try to eradicate the market by cleaning up the supply chains of legitimate retailers, or retailers that would like to be le-

gitimate retailers, and to try to stop these goods after they leave Russia and as they move around the world.

Mr. SMITH. Okay. Thank you, Ms. Espinel. I'm going to do on this panel what I asked the previous panel, and that is to ask the other three witnesses what your top priority would be, as far as what the United States should be doing, what the United States Trade Representative should be doing to change our policies.

And Mr. Gerson, we'll begin with you. You'll need to go fairly quickly, since my time is almost up.

Mr. GERSON. I will be quick about it. We have to make it clear that failure to control piracy has clear ramifications for the Russian government. There are three items out there that we've mentioned: GSP, WTO, and PNTR. There are opportunities to make the point, and we should move forward using those tools that are at our disposal.

Mr. SMITH. Very good. My thought, real quickly, Russia has already been on the Priority Watch List for 9 years. When does it finally get to be on the Priority Country Watch List?

Ms. ESPINEL. Well, USTR announced this year a special out-of-cycle review of Russia because of the level of concern that we have. So at the conclusion of that out-of-cycle review, we will determine whether or not Russia will be moved up to PFC.

Mr. SMITH. Good. That's progress. Thank you. Mrs. Richardson?

Ms. RICHARDSON. I agree with what Mr. Gerson said, so I'll go from the general to the specific.

Mr. SMITH. Okay. Good.

Ms. RICHARDSON. The U.S. Government needs to tell Russia to put a comprehensive optical disc regulatory scheme in place right away. They need to tell the President of Russia that he needs to take ownership of this issue and stop the corruption. Only he can do it. And they need guidance from the supreme court to get tougher sentences.

Mr. SMITH. Great. Thanks. Mr. Schwartz?

Mr. SCHWARTZ. This is an agreeable panel. I agree that—I think what they need are deadlines. That has worked in the past. A year ago, when the U.S. Government suggested to the Russian government that June 30, 2004 was going to be a trigger date for the removal of some or all GSP benefits—and it was just done at an informal level—we saw a lot of activity on the Russian side. Probably, it helped produce the Russian copyright law amendments of last July. So I think they need a deadline.

And failing that, I mean, within that deadline, they need to go and inspect all 34 plants. This is not that difficult to do. And if they don't by that deadline, then they need to understand there are consequences. And these deadlines just can't keep extending out and extending out.

Mr. SMITH. Okay. Thank you, Mr. Schwartz. I happen to agree with you. I don't think anything gets done unless there is a deadline. And that's part of the problem.

Now, that brings us to the end. But Ms. Espinel, you haven't given us too many deadlines, but you've mentioned 6 months several times. So I'm going to take that as a deadline for a lot of the actions by the office. And obviously, you can expect an oversight

hearing in 6 months. We'll hope for a lot of progress. Thank you all.

The gentleman from California, Mr. Berman.

Mr. BERMAN. Thank you, Mr. Chairman. In defense of the Trade Representative's Office, when a decision to deny GSP preferences, or elevate from the Priority Watch List to the Country Watch List—I take it, that's important because some sanctions flow from being elevated to that list? Automatically?

Ms. ESPINEL. Not quite automatically. But it causes the—We have to initiate an investigation, and at the end of that investigation we could then impose sanctions. So it does sort of start a chain of action.

Mr. BERMAN. In other words, it has more meaning than a Priority Watch List?

Ms. ESPINEL. Yes.

Mr. BERMAN. All right. So before a decision to take away GSP, or elevate to a list, or to say we're not interested in beginning accession talks in terms of the WTO, is this a decision made by the Trade Representative? Or does he have to clear it with some other agencies first?

Ms. ESPINEL. We make decisions on all three of those things by interagency consensus. So this is not—this is not the sole decision of the United States Trade Representative. This would be a decision made by the U.S. Government, in consultation with our full interagency group.

Mr. BERMAN. And who is on that interagency group?

Ms. ESPINEL. A range of agencies. But the agencies that tend to be most deeply involved in intellectual property issues, I would say, are the Department of State, the Department of Commerce, with the sort of sister agency of the Patent and Trademark Office, the Department of Justice to some extent, I think particularly frankly with respect to the enforcement issues——

Mr. BERMAN. Is it done in the context of intellectual property issues, or is it done in the context of U.S.-Russia relations?

Ms. ESPINEL. There would actually be overlap between both groups. But primarily, it's done through a TPSC process—a TPSC group, that focuses on intellectual property issues.

Mr. BERMAN. And when they've cleared something as appropriate from an intellectual property point—I mean, it sounds to me like we've got—one would need to do a lot more reviews to have a compelling case of both inadequate laws and a massive lack of enforcement and a totally inadequate sanctions system within Russia. When the interagency intellectual property group thinks something has to be done, then what happens?

Ms. ESPINEL. If the interagency intellectual property group decides, at not just the TPSC level, but at the higher political level—if we have a consensus from the U.S. Government, then the USTR will move forward to implement the decisions that the interagency group takes. But I think, following up on what you said, the problems that we face with Russia are complicated. And there are a lot of competing interests that are being weighed in Russia.

And this is not in any way to undermine or detract in any way from the seriousness of the problem that we are facing in Russia,

but I think that is a partial explanation for why the interagency process in this case has been a long one.

Mr. BERMAN. But like in the case of the GSP petition, how many years now? Five years? Four years. But I guess my point is, if we think—which I do—that this situation is quite outrageous, that we wouldn't tolerate this in another sector of the economy, this kind of action, throwing all our ammunition at you may not produce the result.

We may want to—we may want to get—put pressure on the Administration to give greater weight to this issue than they are now doing, in order to allow you to move ahead with some of the options that have been suggested and that you have indicated receptivity towards, but not endorsement of. In other words, shall we at least add others to our target list here?

Ms. ESPINEL. Well, I think I'm here today because Ambassador Portman is very concerned about intellectual property in Russia and very interested in hearing the views of this Committee specifically. So I would, you know, welcome—we welcome input from this Committee.

But in addition, it is a joint U.S. Government decision that will have to be made. So I can't speak for other agencies, but I am sure every agency in the U.S. Government would be interested in hearing the views of this Committee.

Mr. BERMAN. I'm not so sure about that. If performance is—if the past is prologue.

One last question, then, on the digital piracy issue, can we get a sort of a *Grokster* kind of decision in—does Russia have a copyright framework for indirect and contributory infringers that we could legitimately ask them to pursue at this point?

Mr. SCHWARTZ. I'll answer that. The answer is, yes, they do. What they did in their 2004 amendments was to adopt provisions in their law for eventual implementation of the digital treaties. One of the things that they did do, unfortunately, was to delay implementation of the making available right for sound recordings until September of 2006, because of some internal opposition to it. But the answer is, yes.

But the type of piracy that Mr. Gerson was talking about, this is a hosted server, the MP3. This is not a difficult copyright case.

Mr. BERMAN. This is——

Mr. SCHWARTZ. This is protected under the 1961——

Mr. BERMAN. This is not the P-to-P problem?

Mr. SCHWARTZ. Not at all. It's hosted on a server site. So that's why the reproduction right, which has been in the Russian law since 1993, would clearly outlaw this type of activity.

Mr. BERMAN. Was that Russian guy who broke the DVD encryption, was he an agent of the government at the time? No, never mind.

Mr. GOODLATTE. [Presiding.] I thank the gentleman. Ms. Espinel, what lessons would you say the U.S. Trade Representative has learned from China's accession to the WTO and our subsequent inability to persuade the Chinese to meaningfully enforce intellectual property rights, that you've applied to the pending Russian application for WTO membership?

Ms. ESPINEL. Well, I think China and Russia are actually countries that are in very different positions. I think there are—I think the governments there have different attitudes. So I don't think necessarily what applies to one would apply to the other.

Mr. GOODLATTE. What difference in the Russian attitude would you perceive that would make them better than the experience we've had with China?

Ms. ESPINEL. Well, what I was going to—I think in the earlier China hearing some of the panel had expressed the view that having China in the WTO was helpful, to some extent; that it was better to have China in the club, it was better to have the obligations of the TRIPS agreement as Chinese commitments than it would be to have China without.

Mr. GOODLATTE. But all that was done without China having the—not just the legal framework, but really the mindset, the kind of judicial structure, the kind of police structure and so on, that would be willing to go out and enforce these laws. They're now in the WTO and, yes, we can bring a WTO case against them, but we're really struggling from very far behind. Isn't the same thing true in Russia?

Ms. ESPINEL. Well, that's sort of what I was going to. I think right now we're at a critical point in accession negotiations with Russia. I think we have—you used the word "leverage"—but we have an opportunity to impose meaningful deadlines on Russia in the accession negotiations. And I think we would take very seriously the concerns that we have heard from industry about not letting the——

Mr. GOODLATTE. Would we require to see some of this activity before we admit them to WTO, or simply get a timetable that they would commit to after they join the WTO? Because that's the problem we have with China.

Ms. ESPINEL. Well, as I was saying, I think we will take very seriously, and Ambassador Portman will take very seriously, the concerns that were raised from industry to not let Russia into the WTO until they have made meaningful commitments to us on intellectual property.

It has, obviously, been a huge priority in the accession negotiations, and it's something that we have been pressing Russia very hard on. But I will admit there is still a lot of progress—we have not seen nearly the progress that we feel Russia needs to make. So we will continue to press. And I think we see, and will continue to see, the accession negotiations as an appropriate forum for us to press Russia to make meaningful changes.

Mr. GOODLATTE. And then, on the very specific subject that we've been talking about here, the optical disc plants, what does the USTR intend to do to ensure that the Russian government and Russian officials immediately inspect these optical disc plants that are operating on property owned by the Russian military, the so-called "restricted access regime enterprises"?

Ms. ESPINEL. The optical disc plant is at the top of our priority list of IP concerns with Russia. This has—there is actually an action plan that we have given to Russia recently in dealing with their optical disc products—their optical disc problem—including through some of the measures that have been discussed here. Like

unnotified searches and seizures of the production plants has been a key element of that. So it is something that we are definitely pressing very hard. It is at the very top of the list of issues that we have with Russia.

Mr. GOODLATTE. Thank you. Mr. Gerson, as the world's largest music company, you are, I'm sure, aware of the extent to which European and Japanese companies are experiencing similar difficulties protecting their IP in Russia. I wonder if you might indicate whether you think the U.S. alone can persuade the Russian government to achieve adequate and effective enforcement of IP rights; or do you believe that we need to have some multilateral action here?

Mr. GERSON. No, I agree with the statement made in the earlier panel by Myron Brilliant. I think there is an important opportunity to work with the Japanese and European businesses and parliamentarians, other government officials, to together try to come up with a plan to address what's going on in China and in Russia.

And, you know, to answer a question that you asked Ms. Espinel, there has to be something to learn from the China experience. There has to be another provision, another paragraph, another tool to put in there to guarantee enforcement of trade agreements.

WTO as an institution and global confidence in free and fair trade are undermined when agreements and commitments aren't enforced. And if they can't be enforced, we need to do something so that there is the power to enforce them.

Mr. GOODLATTE. I agree with that. What signs do you see of European and Japanese governments coming together to cooperate with us in such a thing? Do you think they're so anxious to get Russia into the WTO that they're going to let this slide? Or do you think they really will be willing to hold back and do what's necessary to, in a multilateral way, press the Russians to do what we've been pressing them to do?

Mr. GERSON. In some respects, I think that you and Congressman Berman might be in a better position to answer that. You interact with your counterparts in other governments from time to time, and over the years have built up relationships with those who are committed to doing something in this area.

We work with other music industry—our music industry colleagues in other countries. We hear their frustrations. In many cases, they look to the United States as a leader in this area.

But I think it would be terrific to try to identify government officials, parliamentarians, others who want to work with us to find the right tools to use to deal with piracy that's not only affecting America's music and movie industry any more; it's affecting everyone, including, you know, the manufacturer in your district of an altimeter. Who would have thunk it? But that's where this piracy trend is going. It's affecting every sector of the economy.

Mr. GOODLATTE. Well, let me ask that question of Ms. Espinel, then. What is the U.S. doing to reach out to the Europeans and Japanese and others that have a strong interest in protecting intellectual property rights, to pull together that kind of multinational, multilateral coalition that could put this pressure on Russia?

And as a follow-on to that, do you believe that folks in these other countries in a position to join us in that effort will see the need to confront Russia now, before they join the WTO?

Ms. ESPINEL. One of the major things that the Administration has been doing, particularly in the last few months, is reaching out to trading partners like Japan and Hong Kong and Singapore, to try to come up with a collective plan to address the problems, the type of problems that we're seeing in Russia. We are also going to be reaching out to the Europeans in early June, both to the commission and to some of the European countries that are facing the same problems that we have and share similar concerns that we have.

I will tell you preliminarily that I have been encouraged by discussions that we've had. I think there is actually a lot of interest in cooperating. I think there is a growing recognition that the United States and certainly no other single country can do this alone; that in order for countries that care about protecting intellectual property to combat this effectively, we are going to have to cooperate together.

But—so I am hopeful that the STOP initiative is going to bear some—in the short term, some very real, concrete results with our trading partners in Asia and with Europe.

Mr. SCHWARTZ. If I could just——

Mr. GOODLATTE. Yes, let me go ahead, and I'll give Mrs. Richardson a chance, too. I didn't mean to neglect both of you. But go ahead.

Mr. SCHWARTZ. From my experience, I think that, yes, the cooperation makes a lot of sense. But I think in a more sophisticated negotiation, the European Union, for one, has always understood that these issues are at the forefront of importance for the U.S. And therefore, at the end of the day, they allow the U.S. to negotiate this issue, in exchange for concessions, while the European Union is negotiating for other things—for whatever else that they need.

And so the cooperation idea is a good one. But, in defense of Ms. Espinel and the U.S. Government, who do as good a job as possible, in trying to get that cooperation, when the negotiations are ongoing, that is the bilateral negotiations between the EU and Russia on WTO accession, I really think that the rest of the world looks to the United States on this issue; not only as a leader, but as the one that has to make the tough decisions.

Mr. GOODLATTE. Ms. Richardson?

Ms. RICHARDSON. I just wanted to point out that to the best of my knowledge, the Europeans have already closed out their WTO negotiations with Russia. They may be willing to lend us moral support, but I think their negotiating leverage is gone.

Mr. GOODLATTE. Good point.

Yes, the gentleman from California.

Mr. BERMAN. Just I am reminded, from Mr. Schwartz's comments, there have been times—forget the problems with the Europeans prioritizing things, hoping that the U.S. will carry the day on intellectual property protection. I remember the days when the U.S. was twisted between something for the farmers, and aban-

doning the people involved in intellectual property protection, so——

Mr. GOODLATTE. Don't put me in a world of hurt, here. [Laughter.]

Mr. BERMAN. In other words, these pressures come in many different places. I mean, it will be interesting to see if we can get the Europeans just to uphold the arms embargo they agreed to on China; let alone this. So it's—I mean, I wonder to what extent we really can get the—particularly in some of these intellectual property areas, where we're doing so—we're so far ahead of them in terms of product and revenues, whether we can get them to step up to the plate.

And then, when Ms. Richardson points out they've already come to terms, that's sort of like saying—maybe our raising the issue with the Europeans will at least keep them from yelling at us about not moving fast enough on Russia. But I'm skeptical about our effectiveness in getting that kind of a wide coalition on this particular issue. I think we're going to have to make some tough—I hate to say it—sort of unilateral decisions here.

Mr. SCHWARTZ. And that is why, you know, the bilateral tools that we have, like providing GSP benefits, I think could be successful; because here Russia is gaining $500 million in trade preferences from the U.S. as a bilateral matter, and obviously, the U.S. has a strong interest in seeing this problem fixed. And it would seem to be a quid pro quo here.

Mr. GOODLATTE. And a nice chicken dinner with your trip to the movies is a winning combination. They don't have to be at odds with each other.

Mr. BERMAN. Chicken Kiev.

Mr. GOODLATTE. There you go. Absolutely. Absolutely. Our largest export to Russia, by the way, of any kind.

Well, folks, this has been an outstanding panel. We really appreciate your contribution. It's a major challenge. And whether the U.S. can pull together some help from Asian and other countries to leverage what we need to get from the Russians, or whether we have to hold out and do it on our own, I don't know; but I believe we should.

This is too important. It's too much at stake. There are hundreds of thousands, if not millions of American jobs involved here, with the amount of money that we lose in pirated intellectual property in China and in Russia. And we need to start fighting back a lot more aggressively than we have.

So I hope that'll be the watchword of our new U.S. Trade Representative, and we look forward to working with him. And I thank you all for your participation today.

[Whereupon, at 1:30 p.m., the Subcommittee was adjourned.]

# APPENDIX

## MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE HOWARD L. BERMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND RANKING MEMBER, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

Mr. Chairman,

Thank you for scheduling back-to-back hearings on the scourge of international intellectual property piracy with a focus on China and Russia, two of the countries that present the greatest challenges to intellectual property enforcement. Because there are unique enforcement issues with respect to each country, it is appropriate to address these areas separately. The problem we confront, however, is the same: how to prevent billions of dollars in losses to the American economy as a result of an unfettered ability to pirate.

From almost the beginning of recorded history, China has served as a provider of desired goods. Marco Polo traveled the world to bring back goods made in the Orient. Today, China's economy has grown to include the manufacture of many different products, including clothing, purses, software, computers, and movies. While just as desired as the goods of Marco Polo's day, these modern goods often are not the legitimate product of the original source; instead, these are goods that are copied, reverse engineered and—with limited investment and no payment to the creator—sold for a negligible price to China's 1.3 billion citizens and exported in massive quantities to other countries, including America.

The impact of counterfeiting and piracy on American innovators and the general public is impossible to quantify with precision. Pharmaceutical researchers that invest in the development of drugs lose the ability to control the safety of their products. Studios that produce movies are unable to realize the full measure of profit from their creations. Car manufacturers cannot control the quality of their parts. But perhaps most egregious is that because of piracy, American jobs are lost and American creators lose the benefits of their contributions to the world of creativity.

The Chinese government and some Chinese companies appear to have an interesting philosophy about piracy. They point to their robust laws on intellectual property, show you attempts at enforcement with a televised raid of a market stall, and describe their involvement in the issue by lending you educational materials for high schools on the importance of respecting intellectual property. Piracy, they claim, is not to be tolerated.

Yet the reality is that not only is piracy tolerated, but the government typically turns a blind eye to allow the benefits of piracy to accrue to Chinese consumers. These cheaper products, it is argued, provide the Chinese population with the luxury items they desire, but may not be able to afford. I have heard some in the Chinese government assert that the pirates are merely providing cheaper products for those who cannot afford to buy bread, in essence functioning as "Robin Hoods" for these goods. Yet this argument holds little credence when those goods are openly exported around the world, disrupting existing markets for legitimate product. As noted by the Chamber of Commerce, in the year ending October 31, 2004 the value of Chinese counterfeits coming into U.S. markets seized by the U.S. increased 47 %.

Rampant piracy has enabled the Chinese economy to move forward rapidly in the race of technology by building off the innovation of others without investing the initial time and capital in development of the product. Their goal of being a dominant market power is no longer in the distant future, but is becoming a reality now in part as a result of pilfering the fruit of many American ideas.

If the government in China sincerely wanted to stop piracy, it could. Clearly when piracy hurts Chinese interests, the government has been motivated to step in. When t-shirt knockoffs of the Beijing 2008 Summer Olympics were being sold, the govern-

ment was quick to close down the shops and fine the counterfeiters. In 2001, the government tore down 690 billboards that illegally associated products with the event and ripped fake Olympic emblems off 67,000 taxis. It is a shame that these billboards likely sat on top of markets which sold counterfeit Gucci bags and that the taxis were dropping off customers to buy pirated DVDs.

This Saturday, the Washington Post reported that the administration will likely cap imports of clothing as a result of the glut of Chinese products entering the American market. There is a far more compelling case for the administration to be forceful with China about its willingness to tolerate intellectual property violations. A precondition to China entering the World Trade Organization was that it implement intellectual property protections. They have been given time to address this concern and have failed. It is time for the administration to bring a WTO case and confront China in a meaningful way. If we provide the will for them to put a stop to piracy, they will find a way.

I look forward to hearing from our witnesses. I am especially interested in hearing from USTR and what steps they are taking to protect America's most valuable treasure: our ideas and creations.

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PREPARED STATEMENT OF THE HONORABLE BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. Chairman, thank you for holding these important oversight hearings on intellectual property theft in China and Russia.

In China, an estimated 95% of motion pictures and 90% of business software are pirated. In Russia, 80% of all motion pictures and 87% of business software are pirated. Considering that the core copyright industries account for 6% of U.S. GDP and the total copyright industries account for approximately 12% of U.S. GDP, it is clear that America's businesses are facing a serious problem. In fact, the FBI estimates that U.S. businesses lose between $200–250 billion a year to counterfeit goods.

Recently, China and Russia have received attention for intellectual property rights violations within their borders. For example, in April, the Office of the United States Trade Representative released its "Special 301" report, and elevated China to the "priority watch list" due to its failure to protect intellectual property rights.

We must make sure that each nation recognizes that piracy is a global problem. The growth of piracy among organized crime rings is illustrative of its global scope.

The combination of enormous profits and practically nonexistent punishments by many foreign governments makes copyright piracy an attractive cash cow for organized crime syndicates. Often specializing in optical disc and business software piracy, these crime rings are capable of coordinating multi-million dollar efforts across multiple national borders. For example, on December 19, 2001, Mexican officials raided numerous locations in Mexico in an effort to bust an organized crime ring there. These officials uncovered 12.5 million blank CD-R's and arrested eleven members, some of whom were armed with high powered weapons. Subsequent investigations revealed that the blank CD's were made in Taiwan, shipped to a shell company established in the U.S., and then shipped to Mexico, where the actual illegal copying and distribution occurred. We must meet this type of highly organized piracy with highly organized coordination and enforcement efforts.

Another disturbing trend is the growing willingness of many foreign governments to condone the use of, and even use, pirated materials. At its best, government sets the standards for the protection of rights. At its worst, government encourages and even participates in the breach of those rights. Now is the time for each country in the international community to choose which path it will take with regard to intellectual property rights.

We all must realize that copyright piracy and counterfeiting are serious problems that do not merely affect private companies' bottom lines in the short term. They also discourage investment and innovation in the long term, which will eventually lead to fewer consumer choices—a repercussion that affects entire societies and economies. Governments must work together to reward creators and punish thieves.

In addition, counterfeit goods can pose serious risks of bodily harm and even death. The U.S. Chamber of Commerce estimates that trade in counterfeit goods makes up between six and nine percent of all world trade. With products as essential as airplane parts and car brakes being faked, we must focus attention on this growing problem for the sake of our citizens.

Recent treaties, such as the TRIPS agreement, provide the legal framework for member countries to aggressively enforce their copyright laws. Article 61 of the TRIPS agreement specifically requires member countries to establish criminal proce-

dures and penalties to be applied in cases of copyright piracy. We already have many tools to combat international piracy. Now we must put these tools to work. The United States must lead by example and rigorously enforce our copyright piracy statutes. However, we must also work with the international community to encourage other countries to do the same. Only when we coordinate our efforts to combat piracy will we see substantial results.

I look forward to hearing the testimony of our expert witnesses about the scope of piracy and counterfeiting in China and Russia, and learning about the steps we can take to solve these growing problems.

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PREPARED STATEMENT OF THE HONORABLE ELTON GALLEGLY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Thank you for holding these two hearings today, Mr. Chairman.

Intellectual property is at the heart of the American success story. Over the last 200 years, the United States has emerged as the leader in innovation and development of new technologies and these innovations and developments are in turn the heart of the American economy. Intellectual property systems that encourage innovation made this possible.

Unfortunately, bad actors scorn the protection of innovation and development and favor systems that foster free riding on the backs of others. US trade partners must respect intellectual property. They not only must have laws on the books proscribing infringement, but also have enforcement mechanisms in place to make them stick. I am particularly concerned about recent revelations that pirating operations may be operating on land owned by the Russian government.

California industries have seen billions of dollars of losses. These losses do not only involve losses to the recording and movie industries, though I am very sympathetic to the particularly large losses in those sectors. American products from shaving razors to auto parts to pharmaceuticals are also being copied and sold in violation of international law. Former Attorney General Ashcroft reported late last year that intellectual property crimes cost the US economy $250 billion and 300,000 jobs in 2003. DVD piracy alone reportedly accounts for $3 billion a year in losses to the US economy.

As the government, we have a duty to protect the rightful owners of property, intellectual and otherwise. The health of our economy depends on it.

I am interested in hearing the testimony of the witnesses and hearing about what we have learned from our dealings with China that can be applied to other countries where piracy is a problem.

Thank you, again, Mr. Chairman. I yield back my time.

PREPARED STATEMENT OF THE AMERICAN CHAMBER OF COMMERCE
PEOPLE'S REPUBLIC OF CHINA

**Statement of the**

**American Chamber of Commerce**
**People's Republic of China**

**Concerning**

**AmCham-China's Views on China's IPR Enforcement Record**

Emory Williams
Chairman, Board of Governors

Before the

Subcommittee on Intellectual Property
Judiciary Committee
House of Representatives
United States Congress

May 17, 2005

Thank you Mr. Chairman and members of the Subcommittee for this opportunity to present the views of AmCham-China, the American Chamber of Commerce, People's Republic of China.

My name is Emory Williams. I am the Chairman of the Board of Governors of AmCham-China.

AmCham-China, which is based in Beijing, is an organization that represents the interests of the American business community in China. Along with its sister organization in Shanghai, AmCham-China represents over 2000 companies and individuals from virtually every state in the union, including small to medium sized businesses and U.S. exporters without a formal presence in China. We do not represent the interests of Chinese companies or the PRC government. AmCham-China and its member companies are in the field every day fighting for market access for U.S. products and services.

One of our core tasks is to meet with the Chinese government on a broad range of issues such as for greater market access of U.S. goods/services, timely implementation of China's WTO obligations, increased enforcement of intellectual property, and continued improvement of China's legal system and business environment.

AmCham-China and its member companies – given our on-the-ground presence and years of in-country first-hand experience – are committed to assisting this Subcommittee and members of Congress in obtaining information and data to assist it with respect to its investigation concerning the issues addressed in this forum today.

I am here today to share our concerns and efforts with respect to IPR protection and enforcement in China.

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Since its accession to the World Trade Organization (WTO) in December 2001, China has made significant improvements to its laws governing intellectual property rights (IPR). However, there has been minimal progress in establishing a system of effective enforcement.

Indeed, counterfeiting and piracy problems in China are worsening and affecting both Chinese domestic and foreign brands. More sophisticated infringement schemes, combined with an increasing number of exporters, mean more counterfeits are showing up in foreign markets. Piracy not only amounts in a tremendous loss of revenue to IPR holders, but is also a consumer health and safety issue since counterfeit product rarely meets stringent quality standards.

The violation of intellectual property rights impacts almost all industry sectors including consumer and industrial goods. Among a few examples, computer software, films,

music recordings, clothing, cosmetics, auto parts, pharmaceuticals, and food and beverages have all felt the sting of piracy.

In the media sector, it is common for a newly released film in the U.S. to surface within days of its American release as a pirated copy in China. Pirated DVDs in high quality packaging are now widely available in DVD stores throughout Beijing, despite the Chinese government's repeated commitments to crack down on piracy.

Piracy is a deeply frustrating problem for our members. More than three-quarters of respondents to the 2004 AmCham-China & AmCham-Shanghai membership questionnaire are negatively impacted by China's poor IPR protection. Ninety percent of our members believe China's IPR protection is ineffective.

AmCham-China believes that the answer to the problem will only be tackled with stronger national leadership to address IPR enforcement issues.[1] Large department stores and markets openly selling counterfeit and pirated goods are widespread throughout China, including in Beijing itself. Chinese agencies report that they periodically raid these markets, sometimes imposing modest administrative fines on vendors. However, the fact that these markets continue to operate in the public eye, with seemingly no fear of meaningful legal penalty, creates the impression that China's national leadership lacks the will to stop counterfeiting and piracy.

Among other things, we believe that strong IPR protection is not just to protect the interests of foreign multinational corporations but also to guard the rights and interests of domestic intellectual property rights holders and to protect the health and safety of consumers worldwide that may purchase pirated goods.

With these general comments in mind, AmCham-China supports the USTR in placing China on a Priority Watch List and initiating WTO consultations with China under the TRIPS agreement. We believe that China needs to be put on notice in the strongest and most direct terms possible, that the IPR problem must be effectively contained or the USG will be forced to either take WTO action (with all the uncertainty that entails given the untested nature of the WTO TRIPS Agreement).

AmCham is in favor of exploring ways to taking action against specific regions, cities, or provinces in the PRC that are areas of flagrant IPR abuse, or specific Chinese companies which engage in repeated and gross violations of IPR.

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[1] We are pleased with Vice Premier Wu Yi's commitment, made on behalf of the Chinese government at the April 2004 Joint Commission on Commerce and Trade (JCCT) meetings, to make specific improvements in IPR laws and regulations; strengthening IPR education and enforcement; ratifying the WIPO digital treaties; establishing a joint U.S.-China IPR interagency working group to tackle enforcement issues; and promulgating the judicial interpretations on criminal liabilities standards covering prosecution, conviction, and sentences. However, the 2004 commitments have not bee fulfilled and more work needs to be accomplished.

While enforcement efforts have been lax, we believe the Chinese are growing more aware of their poor performance on IPR there is nowhere near the required effective and deterrent enforcement measures as required by WTO. As we have stressed to the PRC leadership, the key to enforcement is credible criminal sanctions that deters commercial-scale IPR counterfeiters and pirates.

For its part, AmCham-China has developed an exchange and education program of its own to encourage more effective enforcement in China and this program in general includes, among other things, the following components:

- *IPR Index of Enforcement*: AmCham-Beijing has created an IPR Index which measures whether China's IPR enforcement is improving or not. We are currently conducting the baseline survey and plan to publish the results three times a year. This information will be available to the public, including the PRC and U.S. governments. We recognize that we in the private sector – here and in China – need to provide much more data on specific examples of inadequate Chinese enforcement. Our IPR Index will aid this effort and we are also taking steps to advise and inform our members of the importance of collecting and sharing such information directly with the USG.

- *Legal Exchange and Education Efforts*: AmCham is pressing various PRC government agencies and judiciary to take certain key steps during the next year.[2] In short, we have stressed to the PRC government that several laws must be amended/adopted to provide stronger protection, enhanced penalties, and further clarification of standards. As part of its efforts, AmCham-China and AmCham-Shanghai jointly publish an English/Chinese language issues White Paper on an annual basis for purposes of educating the Chinese government on areas of concern for U.S. business, and included in the White Paper is a detailed analysis of U.S. industries' concerns with IPR enforcement. At the end of this Statement is a draft of excerpts from our White Paper and reflects some of the issues we continue to emphasize to the PRC leadership.

- *Benchmarks and Performance Criteria*: This will be indicative of its commitment to IPR (we developed this list independently but it bears many similarities to the list of tangible results expected of China in USTR's April 30 Special 301 Report):

[2] On January 19 2005, an AmCham delegation met with key members of the PRC Supreme Peoples Court (the "SPC") to exchange views on the Interpretation by the SPC and the Supreme People's Procuratorate (the "SPP") on Several Issues Concerning Application of Laws in Handling Criminal Cases Involving the Infringement of Intellectual Property (the "Judicial Interpretation") that was effective in December 2004. While the language of the Judicial Interpretation left much to be desired, Justice Huang Songyou, Vice President of the SPC, assured us that the Chinese government was serious about fulfilling its WTO commitments and gave priority to IPR protection. As stressed to the SPC, the key to enforcement is credible criminal sanctions that deter commercial-scale IPR counterfeiters and pirates. We believe that the SPC (the highest court in China) understands that effective action must be taken.

- Impose criminal sanctions against a significant number of large-scale Chinese counterfeit operations. This crackdown should be widely publicized in the media.

- There should be a significant decline in seizures of counterfeit goods at US and EU ports as a result of Chinese customs interception actions.

- Chinese patent authorities should avoid retroactive rule-making which undermines the perceived value of Chinese patents and creates unpredictability for foreign investors. An example of this behavior is the invalidation of Pfizer's Viagra patent.

- China should substantially increase its budget dedicated to enforcement of IPR and give national police the authority to operate across jurisdictions within China.

- China should substantially increase the budget for the Trademark Office to resolve the backlog of invalidation cases pending (i.e., 20,000 cases and some pending since 1999).

AmCham further believes that the U.S. Government should dedicate additional resources to counter the effect of PRC-based counterfeiting and to support China's efforts to develop an effective enforcement system, including the following:

- Significant increase of US Customs personnel dedicated to interception of Chinese counterfeit goods.

- Increase in US Customs' cooperation in cross-border criminal investigations with China and EU.

- US government, particularly USPTO, to engage in more cooperative technical assistance programs to assist China in raising the level of IP practice so that U.S. companies can benefit. An improved patent/trademark examination system may expedite the grant of IP rights to U.S. companies.

* * * *

In summary, the AmCham-China and AmCham-Shanghai believe that China has made progress in the past three years with respect to its IPR laws, but much focused and aggressive work remains in order to elevate China's system to international standards and to give worldwide IPR holders a comfort level that their intellectual property interests will be respected and protected in China, and that infringing parties will be punished. China's IPR standards and regulatory system – as a work in progress – requires strong national leadership and the dedication of capital and resources to be more effective and respected.

Thank you for this opportunity.

**Excerpts of AmCham-China and AmCham-Shanghai's Draft 2005 White Paper concerning Intellectual Property Rights issues.**

***Central Government Resources:*** The Chinese leadership needs to devote more of its political capital and bureaucratic resources to shaping a national IPR strategy and putting into place an effective IPR enforcement regime. There is a need for revised laws, regulations, and policies. The most glaring deficiency in China's IPR regime at this time is in the need to revise the one key law that was not revised when China joined the WTO – its criminal code, which should be revised to provide stronger protection, enhanced penalties, and further clarification of standards. More attention is needed on the 'big impact' items to improve local enforcement, raise public awareness and strengthen intellectual property customs protection, and enhance interagency coordination.

***Interagency Coordination:*** The lack of coordination among the many Chinese government agencies responsible IPR enforcement prevents effective enforcement. The Administrations for Industry and Commerce Trademark Divisions (AIC), AIC Economic Supervision Divisions, (Technical Supervision Bureaus (TSB), Copyright Administration offices, customs, Public Security Bureaus (PSB) Social Order Divisions, and PSB Economic Crimes Investigation Divisions (ECID), to name a few, have overlapping jurisdiction and authority. Jurisdictional issues need to be resolved and a program adopted to improve coordination.

***Customs Enforcement:*** Since its WTO accession, China has liberalized its foreign trade regime. This is a welcome development. An unintended consequence, however, is that exports of counterfeit and pirated goods from China have increased sharply in the past two years and are now a global problem. Further liberalization contemplated by the revised Foreign Trade Law may well accelerate this trend. Although verbal assurance from the Supreme People's Court provides otherwise, there is nothing in the written laws that indicates that it is illegal to export counterfeit goods from China. This should be rectified and enforcement resources provided.

The *PRC Intellectual Property Customs Protection Regulations*, in effect from March 1, 2004, and the related implementing rules, promise to improve IPR customs enforcement. We are hopeful that Chinese customs will invest in the organizational and equipment upgrades necessary to make these regulations fully effective. This includes the purchase of a centralized computer system to enable customs officials to track the activities of counterfeiters and copyright pirates.

The regulations themselves, however, contain several weaknesses. There are no provisions to transfer suspected cases of criminal liability to the public security organs. AmCham-China and AmCham-Shanghai are also concerned about the removal of administrative penalties from the customs regulations and hope that such penalties will be reinstated. Presently, however, there appear to be no punishments for willful trade in infringing goods.

Chinese regulations require IPR owners to carry a heavy burden for protecting their intellectual property. For example, companies must provide customs officials with precise information as to which port(s) counterfeit goods will be going through, even though such information is very difficult to obtain. IPR owners also are required to post bonds to cover the risk of counterclaims in the event that a court finds the detained goods are not counterfeit. The procedures and amounts are unreasonably burdensome, especially because the courts require a separate bond in the event that a seizure leads to litigation. We believe IPR owners should be allowed to post a single bond at the China Customs in Beijing covering the risk of counterclaims for all customs branches.

***Criminal Enforcement:*** The AmCham welcomes the release of the Judicial Interpretation on Issues Concerning Application of Laws in Handling Criminal Cases Involving the Infringement of Intellectual Property, effective in December 2004. While the Judicial Interpretation significantly reduces the numerical thresholds to trigger criminal IPR prosecutions, we are disappointed that the Judicial Interpretation fails to include language concerning, among other things, the criminal liability for exporters of counterfeits and organizational end-users (and specifically with respect to the misuse of software products); methods for calculating value of semi-finished infringing products; enhanced penalties for repeated offenders, violations of health and safety, and other aggravating circumstances; and a clear definition of "illegal business income" which appears to allow the use of the infringing party's prices and not the actual loss by the genuine owner of the IPR. Moreover, the distinction between individual and corporate infringing activity (with the threshold for unit or corporate activity being significantly higher than for individual activity) is unfortunate since it will simply encourage criminals to incorporate to avoid criminal liability. In the end, the true test of effectiveness of the Judicial Interpretation – and the resulting work of the courts and prosecutors – will be whether it is effective in deterring the rampant infringement of IPR in China and in bringing more criminal prosecutions and convictions in IP cases.

***Administrative Enforcement:*** The existing system for administrative enforcement of regulations against piracy and counterfeiting needs to be improved. The AIC and the TSBs are key agencies providing support to intellectual property rights holders, but their effectiveness is limited by policy and legal problems. For example, there are no minimum standards for administrative fines; only a maximum standard. Consequently, our members report the amount and scope of administrative fines is dropping. We encourage the government to unify standards at the local level, combat local protectionism, and enhance interagency coordination.

***Administrative Fines for Trademark Infringement:*** The State Council issued implementing regulations for the PRC Trademark Law, which entered into effect on September 15, 2002. These regulations provide, inter alia, for a dramatic increase in the maximum administrative fines that may be imposed on counterfeiters, from the prior 50 percent of turnover to the current 300 percent. Unfortunately, these increases in maximum potential fines have yet to result in a significant increase in actual penalties imposed. This is mainly due to the lack of guidelines from the State Council and the Trademark Office of the SAIC as to how fines should be calculated.

***Administrative Enforcement of Software Copyright:*** Copyright authorities at the local level are crippled by inadequate manpower, training, and resources. Appropriate steps should be taken to ensure that the National Copyright Administration (NCA) and their local offices responsible for enforcing copyrights are adequately supported, such that rights holders can have reliable access to administrative and civil remedies provided under relevant laws against end-user and other copyright pirates. Effective coordination needs to be established with the SAIC to increase the enforcement capability of the local Copyright Administration offices. There must be reliable administrative enforcement coupled with deterrent penalties to prove that corporate end-user piracy bears administrative liability. We look forward to the prompt enactment of administrative rules by the NCA and the Ministry of Information Industry (MII) to deal with Internet piracy, takedown notice procedure and ISP liability.

The following issues related to the *Computer Software Protection Regulations* (issued by the State Council on June 4, 1991 and amended on December 20, 2001) should be addressed: (1) the regulations should be modified to clarify that temporary copies of software are protected; (2) the exception under Article 17 – which allows for the unlimited use of any software for the purposes of learning and studying the design – should be amended since it goes well beyond what is permitted under the Berne Convention and the TRIPS Agreement; (3) the exception under Article 30 of the Regulations – which creates a significant loophole in the liability of corporate end-user pirates by allowing an exception to liability in cases where a party is deemed to have acted without knowledge – should also be amended as inconsistent with international standards; and (4) the requirement under Article 30 that allows for a compulsory license in situations if destruction of the illegally used software would bring great loss to the infringer – should be deleted or amended as it is vague and goes beyond the exceptions and limitations permitted by the TRIPS Agreement.

***Local Standards and Local Protectionism:*** There is significant variation among localities for interpreting liability thresholds. Currently, the provinces and municipalities have very different thresholds for determining copyright infringement. For example, the Shanghai PSB has issued its own IPR crime arrest and investigation guidelines, but we are not aware of any current efforts to provide nationwide standards. In many cases, local protectionism renders administrative enforcement ineffective. After raiding counterfeiters, trademark owners too often encounter local AICs that are reluctant (delays are often more than six months, and sometimes more than a year) to release the official administrative penalty decision letters. This has seriously hindered trademark owners' efforts to recover damages from counterfeiters in court. We welcome steps to bring cases against administrative authorities for abuse of their authority in rendering insignificant fines. We also believe that administrative authorities should be encouraged to make their decisions publicly available to ensure the system is fully transparent and in accordance with the law.

***Patent and Trademark Registration and Protection:*** Improving the trademark registration process would help deter counterfeiters who preemptively register well-known trademarks, trademark imitations, and even blatant copies of the trade dress of others. Unfortunately, the China Trademark Review and Adjudication Board (TRAB) and Chinese courts do not take bad faith into consideration in cases of preemptive trademark registration, trademark imitation, and trade dress infringement. There is also considerable delays with respect to trademark invalidation petitions before the Trademark Office, which reportedly has 20,000 undecided cases pending with some disputes filed in 1999 remain undecided.

Similarly, the China Patent Reexamination Board (PRB) and the Chinese courts rarely take bad faith into consideration when reviewing preemptive patent filing at either the invalidation process with the PRB or infringement suits in court. Currently, a legitimate rights owner has little recourse against counterfeiters that file utility and design patents, knowing that such filings lack novelty.

Delays in receiving patents or being granted market access are another problem. SIPO is understaffed to handle the large volume of applications. With the resulting backlog of patent applications, it can take up to five years to receive a patent.

The thin legal grounds underlying the State Patent Office's decision to invalidate the use-patent for Viagra represent a step backwards. In its decision to invalidate the patent, SIPO relied on new guidelines issued after the patent had been granted, and then did not allow the patentee the opportunity to meet the revised data provision standard of the new guidelines. The SIPO decision has been appealed to the courts and at this writing is still in litigation. Although we are most concerned with SIPO's rationale and procedure in invalidating this patent, which set an unfortunate precedent, we also note that the patent did not protect that legal producer. Domestic pharmaceutical companies widely copied the product and sold it through a variety of legal and illegal channels.

***Patents and Standards:*** The intellectual property policies of the standards working groups in China do not conform to international practices. International standards organizations have an intellectual property policy that defines how intellectual property is contributed and made available for implementation of standards. Generally, Chinese standards groups in high tech areas (Advanced Visual Standard (AVS), Radio Frequency Identification (RFID), Linux, Intelligent Grouping and Resource Sharing (IGRS), etc.) either have no such policy, or an unreasonable policy requiring mandatory patent pool participation, unreasonable disclosure, and compulsory licensing.

The common practice is to require members of standards working groups to place all related patents in the patent pool and to entrust only the standards group to license the technology. In addition to creating monopolistic control, mandatory patent pool participation devalues patents in subsequent negotiations, cross licensing, and defense of intellectual property. Patent disclosure obligations in working groups typically apply to the entire company rather than the individual representing the company, and cover not only patents necessary to the standard in question, but all related patents, including third party patents and patent applications. Such disclosure standards are overly broad and impractical. This is compounded by rules in some working groups that non-disclosed patents must be licensed royalty free or not asserted.

The AVS Working Group is making an effort to cooperate with international standards experts to develop an appropriate IPR policy and related legal documentation. We recommend that relevant agencies and other Chinese standards organizations study this example.

***Patent Protection for Computer Software:*** Patent examination guidelines and practices only allow patenting software-related inventions in the form of the computer that executes software (apparatus claims) or methods for operating computers using software (process claims). Protection is not allowed for computer readable media claims or programs that cause a computer to implement an innovative process (program product claims). As a result, the only one likely to be a direct infringer is the end-user who actually uses the software. This limits the use of software-related patents to protect the intellectual property of the industry. Many governments, such as the U.S., Germany, Japan, and Korea have already recognized program product claims. China's failure to do so is not only discouraging to foreign companies, but also denies protection to Chinese software enterprises at home and leaves them facing an unfamiliar environment in international markets full of competitors seasoned in patent protection of program products. We recommend revision of the patent examination guidelines to accept program products claims.

ARTICLE FROM THE NEW YORK TIMES ENTITLED "THE PIRATE KINGDOM" BY PAT CHOATE



*The New York Times May 12, 2005 Thursday*

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**SECTION:** Section A; Column 1; Editorial Desk; Pg. 27

**LENGTH:** 656 words

**HEADLINE:** The Pirate Kingdom

**BYLINE:** By Pat Choate.

Pat Choate, the author of "Hot Property: The Stealing of Ideas in an Age of Globalization," was the Reform Party's vice-presidential candidate in 1996.

**DATELINE:** Washington

**BODY:**

**CHINA is the global epicenter** of pirating and counterfeiting. By its government's own estimate, China's domestic trade in bogus goods accounts for $19 billion to $24 billion annually. That is undoubtedly a significant understatement, and it doesn't even include the stolen technologies and phony brands China exports to the rest of the world. Since welcoming China into the World Trade Organization in 2001, the United States has had a historic opportunity to stop the Chinese piracy trade. So far, the Bush administration has failed to seize it.

I opposed bringing China into the trade organization, and I don't like the idea of subordinating America's sovereignty to undemocratic international institutions like the W.T.O. But those decisions are behind us, and the worst thing we can do now is to fail to use the limited tools that the W.T.O. provides for protecting our economic interests.

On joining the W.T.O., Chinese leaders assumed certain obligations to the other 147 member states. Specifically, as a signatory to the Trade-Related Intellectual Property System, China pledged to accept minimal standards of patent, copyright and trademark protection; to treat foreigners' and its own citizens' intellectual properties equally; and to submit to the W.T.O.'s procedures for settling disputes.

Four years later, China has not met its intellectual property obligations, and the United States has failed to leverage the W.T.O. mechanisms that might bring China into compliance. Although China has passed intellectual property laws that accord with W.T.O. requirements, the Office of the United States Trade Representative reported to Congress in last December that enforcement of those laws was inconsistent, ineffective and discriminatory against foreigners. The same report found intellectual property infringement in China to be rampant, with violations worsening.

In effect, China has created a Potemkin village of intellectual property protections. Fortunately, the W.T.O. provides a way to confront that problem. If the United States can prove to a three-judge W.T.O. panel that China is out of compliance and is harming intellectual property owners, it can seek

damages. If the W.T.O. grants such a judgment, the United States can impose tariffs on Chinese goods. Those monies could then be distributed among American complainants.

The United States has used these mechanisms in the past. From 1995 to 2000, the Clinton administration filed 13 intellectual property cases at the W.T.O. against other nations. All of them were resolved to the United States' satisfaction. The United States Chamber of Commerce, hardly a protectionist group, has called for the Bush administration to initiate such a case against China at the W.T.O. But the administration remains strangely passive in the face of Chinese pirating and counterfeiting. In fact, this administration has not filed a single intellectual-property case, against any nation, at the W.T.O. since it took office.

The United States has paid a high price for those languishing W.T.O. protections. A decade ago, the United States agreed to eliminate all import quotas on textiles in exchange for the developing world's acceptance of intellectual property protections. The United States has kept its side of that deal, sacrificing almost one million domestic apparel and textile jobs to foreign producers since 1994. China, the greatest violator of the W.T.O.'s intellectual property requirements, is also the biggest beneficiary of that arrangement: Chinese producers now supply 25 percent of the clothing in the United States and are expected to provide 75 percent by 2010.

The United States should bring an intellectual property case against China at the W.T.O. Then, if China still won't honor its intellectual property obligations, President Bush and Congress will need to reconsider this country's trade relations with China.

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DEAR COLLEAGUE AND ARTICLE ENTITLED "IN RUSSIA, POLITICIANS PROTECT MOVIE AND MUSIC PIRATES" FROM THE HONORABLE LAMAR SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND CHAIRMAN, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

**LAMAR SMITH**
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http://lamarsmith.house.gov
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CHAIRMAN, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY
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**Congress of the United States**
**House of Representatives**

COMMITTEE ON HOMELAND SECURITY
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COMMITTEE ON STANDARDS OF OFFICIAL CONDUCT

May 12, 2005

**"Our bureaucracy is still to a large extent an isolated and arrogant caste [that is undermined by] corruption, irresponsibility and incompetence."**
*President Vladimir V. Putin, State of the Country Address, April 2005*

Dear Colleague:

In whatever form, the theft of intellectual property inflicts substantial economic harm on our country, our entrepreneurs, our innovators and, ultimately American consumers.

Make no mistake about it, the losses incurred are not limited solely to the traditional "core" copyright industries, which are associated with Hollywood, Nashville and Silicon Valley, but extend to virtually all manufacturers and industries throughout the economy.

The challenges faced by United States manufacturers and service providers who seek to abide honestly by international law and who respect the rights of intellectual property owners are formidable. These challenges may become insurmountable when foreign governments and elected officials condone, protect or profit from the illicit trade in counterfeit and pirated goods.

On Tuesday, May 17, 2005, the Judiciary Committee's Subcommittee on Courts, the Internet and Intellectual Property will conduct two hearings on intellectual property theft to examine the dire, and some maintain deteriorating, situations in China and Russia, respectively.

Today's Wall Street Journal contains an article entitled: "In Russia, Politicians Protect Movie and Music Pirates" that I have attached. I strongly suggest that you read it prior to next Tuesday's hearings.

The article provides a disturbing glimpse into the types of corruption problems that frustrate copyright holders' attempts to enforce the law, and underscores the importance of achieving significant reform of the Russian intellectual property rights enforcement system before admitting Russia into the WTO.

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You may find yourself asking "how it is that Russia is permitted to participate in the GSP program where the United States unilaterally provides trading benefits to Russian exporters at the same time Russian government officials are openly engaged in corrupt and lawless conduct that is intended to protect thieves and criminals?"

The United States and our economic partners need to do more to promote respect for the rule of law and to protect those companies and countries that compete honestly in world trade.

The words from President Putin quoted above acknowledge the nature of the threat we are confronting. The question we must begin to address is whether our policies and actions similarly acknowledge this threat.

Sincerely,

Lamar

Lamar Smith
Chairman
Subcommittee on Courts, the Internet
and Intellectual Property

Media & Marketing • Technology Journal

MARKETPLACE

THE WALL STREET JOURNAL.

THURSDAY, MAY 12, 2005 B1

# In Russia, Politicians Protect Movie and Music Pirates

By Guy Chazan

*Moscow*

RUSSIAN POLICE thought they had a chance to catch a big fish in the piracy world last fall when a man selling counterfeit software they had nabbed gave them the name and address of his supplier.

They staked out the warehouse in the basement of a dingy apartment block and moved in last October. Behind a steel door concealed by boxes they found a huge stockpile of illicit videogames.

As officers carted away the stash, they paid little heed as one of the store's owners claimed, "We'll never be charged, because we have friends in high places."

Seven months later, he's turning out to be right. Though forensic tests quickly confirmed the games were fake, the trader has teamed up with a friendly lawmaker to mount a fierce and so far effective defense. Instead of pressing their own charges, police discovered that they themselves were under suspicion.

Russia has emerged as the front line in Hollywood's global war against piracy. China may still be the world's top producer of illegal computer software, CDs and DVDs, but authorities there are getting serious about cracking down. In Russia, the Kremlin has been promising to deal with the problem for years, but industry officials say under President Vladimir Putin it's gotten worse, not better.

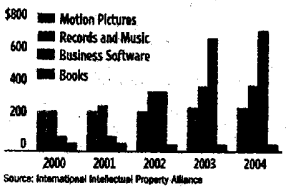
A key reason is that Russia's pirates, who cost U.S. businesses an estimated $1.7 billion in losses last year, have cultivated increasingly cozy links to the government that's supposed to police them. Counterfeiters are lining up political patrons and locating factories inside secret military facilities where law-enforcement agencies can't touch them.

"Two years ago, the Russian government said it would eradicate all music piracy in two years," says John Kennedy, head of IFPI, a London-based organization that represents 1,500 record companies world-wide. "Instead it's increased by 30%."

Russia, IFPI says, is now the world's biggest exporter of pirated music products, and the second-biggest market for such products after China. Counterfeit music CDs made in Russia have turned up in 27 countries around the world, including the U.S. Hollywood is pushing Washington to impose trade sanctions.

**Copy Cats**

Estimated U.S. trade losses due to piracy of copyrighted materials in Russia, in millions:




Source: International Intellectual Property Alliance

Thanks to high-level connections, efforts to prosecute pirates have borne little fruit in Russia. The few cases that end in convictions usually lead to suspended sentences, and as much as 70% of confiscated merchandise winds up back on the market.

Legislator Vladimir Ovsyannikov makes no bones about his relationship to the owner of the Moscow warehouse, Sergei Kaluzhenok.

"A politician isn't a politician unless he can offer *krysha*—to bandits, prostitutes, or state officials, it doesn't matter," he said in an interview. "They are all his voters, after all."

"Krysha," which means "roof" in Russian, was the word used in the early 1990s for the numerous protection rackets that sprouted as Russia lurched toward capitalism.

Sporting a crew cut, a black shirt and gray polka-dot tie, Mr. Ovsyannikov, 43 years old, spent most of his career as a welder, a miner and a worker at a Siberian railroad yard before he became a parliamentary aide in 1997. Elected to the Duma in 2003, he works from a cramped office decorated with Orthodox icons and a large whis-

*Please Turn to Page B8, Column 1*

# Russian Politicians Protect Pirates

*Continued From Page B1*

key bottle.

Mr. Ovsyannikov is a member of the Liberal Democratic Party, an ultraright outfit led by nationalist Vladimir Zhirinovsky. In the late 1990s, the party made headlines when it included several known criminals in its list of electoral candidates. Its members have also demanded reduced penalties for CD pirates.

Mr. Kaluzhenok says he's never even met his parliamentary protector. He enlisted his support through "Sword and Shield," an organization close to Mr. Ovsyannikov which helps out businessmen in trouble with the law—for a $300 monthly fee.

Mr. Ovsyannikov says he's defending Mr. Kaluzhenok from a corrupt police force that he says is "acting at the behest of his competitors." He's proud of slowing down the police probe into his client. "The great thing about being a Duma deputy is that people have to react to you," he says.

After the October operation, Mr. Ovsyannikov fired off letters to prosecutors, city authorities and the police's internal security service complaining the raid was carried out without a search warrant. Over the next three months, officers were summoned for days of interrogations by different agencies. Their own investigation ground to a halt.

Finally cleared of improper conduct, police took a fresh stab at the Kaluzhenok case in late December, launching a second raid on his warehouse. They found a newly installed steel door, and had to summon emergency assistance to cut out the lock. But behind that was another door, with a red sign on it saying the warehouse was now Mr. Ovsyannikov's public office.

Police contacted the lawmaker, who said he didn't even know he had an office there. "I have 15 of them, and I can't tell you where they all are," he said. "All these street names get muddled up in my head."

Mr. Ovsyannikov said his numerous offices function as drop-in centers where voters can make complaints or ask for help. He said he's never seen most of them, even though his name hangs on the doors of all 15. He denies police claims that the practice is just a ploy to protect business premises from searches.

Shortly after police made the call to Mr. Ovsyannikov, two of his assistants turned up at the scene. They told them they could not enter the office because it enjoyed "parliamentary immunity." The police squad called off the search.

In January, Mr. Ovsyannikov complained about the second raid, saying police had damaged his property. Fresh interrogations involving five government agencies dragged on for three more months. In March, the police were once again cleared of misconduct.

Mr. Kaluzhenok is still in business, selling videogames at a big Moscow computer and DVD market. With his Land Rover Discovery sport/utility vehicle and Italian leather jacket, he's clearly doing well. But he also acknowledges that some of the software he sells could be fake. "It's up to the police to decide what's counterfeit and what isn't," he says. "I haven't a clue."

**Toshiba Corp.**

## New HD DVD Read-Only Disc Boosts Storage Capacity 50%

Toshiba Corp. said it has developed a triple-layer HD DVD-ROM read-only disc with a storage capacity of 45 gigabytes, 50% more than its previously unveiled 30 gigabyte dual-layer disc. Toshiba is promoting HD DVDs as the high-definition successor to the current generation of DVDs. The company is holding talks to unify the next-generation DVD format with that of a group led by Sony Corp., which is promoting a separate DVD format called Blu-ray Disc. The latest development may affect those talks as both sides are trying to gain the upper hand in their efforts to forge a common standard. Toshiba's single-sided new HD DVD-ROM disc can record about 12 hours of high-definition video content on a single disc, the Japanese electronics maker said.

PREPARED STATEMENT OF THE HONORABLE HOWARD L. BERMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND RANKING MEMBER, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

Mr. Chairman,

Russia is considered by the copyright industries, as second only to China as an intellectual property pirate. Russia adopted a copyright law in 1993, and finally in 2004, remedied some key deficiencies. But it has neither enacted appropriate laws to deal with the problems of optical disc piracy, nor has it enforced the laws already on its books. Because of its poor enforcement, Russia is now one of—if not the largest—exporter of pirated music products in the world. Their pirated products have surfaced in over 27 countries, including the U.S.

Almost two years ago, a number of members of Congress sent a letter to President Bush to focus his attention on the escalating problem in Russia. Yet Russian plants are still producing tens of millions of pirated optical discs for export. U.S. copyright industries continue to lose billions of dollars and the piracy rates are estimated at 70% for every copyright sector.

In February, The International Intellectual Property Alliance released its 2005 Special 301 recommendations, a document that Mr. Schwartz will address in his testimony. Many of the suggestions provided in the IIPA report and today's testimony describe how the U.S. government can address the severity of the situation in Russia. These options are time-sensitive. We must consider one or all of the following actions: recommending the designation of Russia as a Priority Foreign Country, or conditioning Russia's entry into the WTO on meaningful copyright enforcement, or denying Russia its GSP benefits. We must move quickly because each day that goes by without a firm stance by the Administration on these possibilities lessens the importance of this issue in Russia's eyes.

When we had a hearing on international copyright piracy two years ago, a constituent of mine testified to her own personal experience of intellectual property theft by the Russian government. Before us today are representatives from the movie and music industry who will testify to the effect Russian piracy has on that segment of the American economy. These industries represented 6% of U.S. economic output and almost 5.5 million jobs in 2004. However, whether you pirate from an individual or from a corporation, the act of piracy must be stopped.

The same holds true whether the piracy is sponsored by the government itself or funded by individual citizens. While the concept of private ownership of property is relatively new in many of the formerly communist countries, the value has not been lost on them. Any government that wants the benefits of trade with America, and who is currently benefiting from trade preferences, like Russia, has a responsibility to respect American innovation. Furthermore, any citizen of a state must recognize basic rules of law, such as the prohibition on theft. The Russian government has pointed to the high price of legitimate products coming from the United States as a justification for piracy. This is tantamount to blaming the victim for the crime. It is clear that price is not the cause of piracy. The pirated goods contain language tracks that include languages that are not Russian!! Therefore, the goal therefore is not to help Russians afford DVDs of movies—piracy is providing a business opportunity to service those that live outside of Russia.

The Wall Street Journal article "In Russia, Politicians Protect Movie and Music Pirates," points to elected government officials who help protect the pirates. As I said two years ago, when a government does not exert its authority to stop the theft of intellectual property, it is entirely appropriate for the US not to grant special trade privileges such as WTO accession or GSP benefits on that foreign government. Furthermore, a government that itself is sponsoring intellectual property theft represents the essence of organized crime. In any nation, there is no bigger organization than its government, and there are few clearer prohibitions in any system of law than the prohibition on theft.

We have an opportunity now when trying to address the piracy situation in Russia to learn from our failures with intellectual property enforcement in China. Before permitting Russia's accession to the WTO, we must require stricter enforcement of Intellectual Property rights.

I look forward to hearing the witnesses describe the extent of piracy in Russia and any suggestions they may have to curtail the problem. I hope to work with Chairman to address the importance of achieving significant reform of Russian intellectual property enforcement before admitting Russia into the WTO.

PREPARED STATEMENT OF THE COALITION FOR INTELLECTUAL PROPERTY RIGHTS (CIPR)

**WRITTEN TESTIMONY**

**SUBMITTED BY THE COALITION FOR INTELLECTUAL PROPERTY RIGHTS (CIPR)**

**TO**

**THE HOUSE JUDICIAL SUBCOMMITTTEE ON THE COURTS, THE INTERNET AND INTELLECTUAL PROPERTY RIGHTS**

**MAY 24, 2005**

The Coalition for Intellectual Property Rights (CIPR) is pleased to submit written testimony to the House Judiciary Subcommittee on the Courts, the Internet and Intellectual Property Rights on the state of intellectual property protection in Russia and our recommendations to the US Government and the American business community for taking a constructive approach to achieving a higher level of IPR protection in Russia.

CIPR is a private-public partnership founded in 1999 dedicated to IPR protection and reform in Russia and other countries that comprised the former Soviet Union. Through research, education, legislative initiatives, coalition building and legal, judicial and regulatory reforms, CIPR is working with governments and businesses in the former Soviet Union and Baltic States to establish transparent and non-discriminatory IPR regimes and to adhere to international IPR standards.

CIPR represents major U.S. and international companies and business and professional associations concerned with the protection and enforcement of all IP, especially trademarks.

CIPR is the only non-governmental organization officially accredited with the CIS Interstate Council on Industrial Property Protection, comprised of the directors general of the patent and trademark office of Russia and seven other countries of the Commonwealth of Independent States (CIS). CIPR is an official observer to the World Intellectual Property Organization (WIPO) and actively cooperates with the U.S. Government as well as the American Chamber of Commerce in Russia and other Chambers from countries of the former Soviet Union, the U.S.-Russia Business Council, International Trademark Association, World Customs Organization and Interpol.

**Current State of the IPR Problem in Russia**

The scale of the problem of intellectual property rights (IPR) violations in Russia still remains quite high, particularly in product counterfeiting and copyright piracy. The USTR's recent decision to keep Russia on its "Special 301 Priority Watch List" and to

hold an Out-of-Cycle Review later this year speaks to the degree of concern held by the U.S. Government about Russia's progress to improve IPR protections.

Indeed, copyright piracy rates in Russia remain extraordinarily high. The staggering volume of pirated music, film, software products and financial losses suffered by the copyright sector in the Russian market should give pause to anyone concerned about IPR. However, trademark violations in the form of product counterfeiting of consumer goods, including food, beverages, clothing, medicines, auto parts, are also enormous in volume and should be of equal concern to the U.S. government.

The Russian government's own data show how the problem of product counterfeits has reached epidemic levels. According to the Russian Agency for Patents and Trademarks (Rospatent), in 2004 the percentage of counterfeit goods in the marketplace was between 30 to 40 percent, with estimated sales of between $2.89 to $3.61 billion, and lost tax revenues as high as $1.8 billion. Many international and Russian experts feel the estimated losses in business profits and government revenues to be much higher.

The financial losses suffered by international and Russian product manufacturers and the consumers of fake goods are but one aspect of the problem. The physical harm, even death, suffered by consumers from ingesting counterfeit foods, medicines is the tragic human cost of the fake goods trade in Russia. According to the State Duma's Education and Science Committee report, over 30,000 people die each year from fake vodka. The Russian government estimates that 3 to 5 percent of medicines are counterfeit. But industry groups, such as the Association of International Pharmaceutical Manufacturers (AIPM), estimate the level to be as high as 12 percent or more. Clearly, Russian consumers join American consumers as victims of the trade in fake goods.

Counterfeiters produce a wide range of fake consumer goods in Russia for the domestic market and for export to Europe and North America. According to AIPM, up to 70 percent of the fake medicines in the market are produced in Russia. Local manufacturing facilities produce film DVDs and music, software and entertainment game CDs, and a wide range of consumer goods. Russia is also an importer of fake goods produced in China and in other Asian nations, and is a major transit country for counterfeits bound for Europe and North America. Copyright piracy and product counterfeiting is highly profitable and has attracted the involvement of organized criminal groups in Russia and abroad.

The fight against the cross-border trafficking of fake goods could be supported by enacting an "ex officio" provision in the Customs Code, which would provide customs agents with the power to act on their own initiative and suspend the release of goods if they have evidence that intellectual property rights are being violated.

The infringement of previously registered trademarks through "bad faith" registrations of trademark is still a major problem and still needs to be addressed.

Russia's law on geographic indications should also be revised. The recent WTO decision on geographic indications has clarified that registration of geographic indications must be

refused if the geographic indication conflicts with a prior trademark right (first in time, first in right). No such refusal exists in the Russia's current law on geographic indications. The law should also be amended so that it is clear that registered geographic indications can only be used in the exact linguistic form as registered and that use of variations of the geographic indication would not be allowed. CIPR is advocating that the patent and trademark offices and the courts adhere to the WTO decision on geographic indications in cases that are brought within their jurisdictions.

Other protections needed for improved IPR include legislation to protect non-traditional trademarks (smells, sounds, etc.), to mandate destruction of all seized fake goods and their means of production, and stronger deterrents for counterfeiters in the form of financial penalties and prison time.

The scale of the problem with product counterfeiting, copyright piracy and trademark infringements is enormous and threatens Russia's economic development, public morale and international prestige.

**IP Protections in Russia**

While serious IPR issues remain in Russia, it is also important to note that the Russian Government has made tangible progress over the past several years in improving IPR protection. Russia has enacted legislative initiatives to bring its laws on trademarks, patents and other related laws up to international standards. In early 2004, Russian President Vladimir Putin signed into law the Federal Law "On Changes to the Russian Federation Law on Copyrights and Related Rights," bringing Russia nearly into compliance with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

CIPR has been encouraged by several positive steps by the Russian government and the private sector to address IPR. These include:

- The Russian State Duma accepted recommendations from IP rights owners, including CIPR, on a proposed national program "Civil and Criminal Mechanisms to Protect the Consumer Market against Counterfeits and Fake Goods," including legislative amendments, public education on counterfeits and greater cooperation between government and the private sector. CIPR anticipates several legislative initiatives to emerge from the package of IPR recommendations in 2005, including amendments for "first in time, first in right," "ex officio" customs search authority, destruction of seized fake goods and the means of production and stronger penalties for counterfeiters, including prison time.

- Enforcement actions against counterfeiters by law enforcement authorities have increased. For example, CIPR, representing the trademark holders, worked closely with the Ministry of Internal Affairs on three separate enforcement actions, including two public destruction events of millions of seized fake cigarettes and the public announcement of a raid on a counterfeit factory in

Southern Russia that resulted in the seizure of fake products, production equipment and arrest of several suspects.

- The Federal Service for the Protection of Intellectual Property, Patents and Trademarks, under the direction of Boris Simonov, has created an IP Working Group comprised of representatives from IP rights holders groups, including CIPR, to provide input on IP policy issues.

- Russian IPR holders are increasingly recognizing the importance of protecting their trademarks, patents and copyrights, and are urging the government to take action.

While enforcement actions against counterfeiters by law enforcement authorities have increased and notable improvements have been made, Russia's greatest IP challenge continues be the enforcement of IPR on a systemic and regular basis. Russia's courts and law enforcement establishment have not been able to have a noticeable impact on the fake goods trade in Russia. CIPR is working with the courts and law enforcement community, and encourages the U.S. Government to continue providing IP education and trainings to improve capabilities in enforcing IP laws.

High-level political will is vital to keeping IPR policy a top priority of the Russian government. Unfortunately, IPR policy and legislative initiatives were put on hold for much of 2004 due to the government's reorganization. CIPR believes the government's focus on IPR is returning as Russia's candidacy for WTO membership is given serious consideration by the U.S. Government. The U.S. government should continue to press ahead on key IPR matters during the U.S.-Russia Bilateral discussions.

CIPR encourages the U.S. Government to continue to work with the Federal Service for the Protection of Intellectual Property, Patents and Trademarks, who is playing a key role in the development of IP policy, and the Ministry of Economic Development and Trade, which is leading Russia's WTO negotiation team. CIPR also supports the U.S. Embassy's efforts to build relationships with law enforcement authorities, such as the Ministry of Internal Affairs, Customs Committee, Ministry of Justice and Russian Supreme Court.

**Recommendations**

The development of an international standard IPR regime of laws and effective enforcement practices will only be realized by the active involvement and commitment of all Russian and international private and public sector stakeholders. The U.S. Government has played an important and constructive role in this process. Going forward, CIPR respectfully submits the following recommendations to the Subcommittee for its consideration. These include:

- Continue the constructive encouragement with the Federal Service for the Protection of Intellectual Property, Patents and Trademarks, and other regulators and law enforcement authorities.

- Encourage official government support for draft legislation emanating from the proposed national program "Civil and Criminal Mechanisms to Protect the Consumer Market against Counterfeits and Fake Goods" in 2005.

- Underscore the importance of high level "political will" to supporting the efforts of IP regulators, policymakers and law enforcement authorities to improving the levels of protection for IPR holders and consumers.

- Expand cooperation and involvement with Russian IPR holders and consumer organizations, which are also key IPR stakeholders.

- Encourage greater cooperation by all U.S. stakeholders including companies, the US Embassy, American Chamber of Commerce in Russia, U.S. Chamber of Commerce, International Intellectual Property Alliance and others to interface and develop alliances with Russian companies, the Federal Service for Intellectual Property, Patents and Trademarks and other key government officials, the Russian Chamber of Commerce, consumer organizations, and IP groups. This cooperation would work to address IP issues and to identify common agendas, approaches and real results. CIPR organizes such a broad-based working group in Moscow.

In conclusion, Russia's legislative improvements and incremental steps towards more effective enforcement should be recognized and encouraged. However, product counterfeiting, copyright piracy, trademark infringements and other IP violations remain a major problem nationwide. Political will is essential for the Russian Government to improve enforcement. This must be done, not for the sake of only international trademark and copyright holders, but even more important, for Russian rights holders.

The US Government, working with U.S. companies, trade associations and others should continue to be an active participant in the joints efforts to improve IP laws and enforcement practices by Russian consumer groups, domestic and international business organizations and public-private partnerships, such as CIPR, in cooperation with Russian government policy-makers, regulators and law enforcement officials. A sustained, day-to-day effort by all international and Russian IPR stakeholders based on a common purpose to protect IPR is the surest path to progress.

Thank you,

Tom Thomson
Vice President
Coalition for Intellectual Property Rights (CIPR)
2000 L Street, NW, Suite 835
Washington, DC 20036
www.cipr.org

LETTER FROM THE RECORDING INDUSTRY ASSOCIATION OF AMERICA (RIAA) TO PRESIDENT GEORGE W. BUSH

September 16, 2003

President George W. Bush,
Executive Office of the President
1600 Pennsylvania Avenue, NW
Washington, D.C. 20500

Dear Mr. President:

On behalf of America's recording industry, we want to thank you for all of the attention that your Administration has given to expanding the opportunities for the U.S. creative sector in foreign markets by improving market access and the protection of copyrighted materials. We respectfully write to ask that you urge Russian President Vladimir Putin during your Summit meeting later this month to take immediate steps to curtail his country's illegal production and export of pirate products—an activity that has been on the rise for the past three years and which severely harms American and Russian creators alike.

As you may know, the US copyright-based industries, including the record industry, account for at least 5.24% of U.S. GDP, or $535.1 billion in value-added. Over a 24 year period (1977-2001), the copyright industries' share of GDP grew at an annual rate more than twice as fast as the remainder of the economy (7.0% vs. 3.0%). Also over these 24 years, employment in the core copyright industries more than doubled to 4.7 million workers (3.5% of total U.S. employment), and grew nearly three times as fast as the annual employment growth rate of the economy as a whole (5.0% vs. 1.5%). The copyright industries' foreign sales and exports continue to be larger than those of almost all other leading industry sectors, including automobiles and auto parts, aircraft, and agriculture. This historical success, however, is currently under great threat due to the significant expansion of piracy—in both on and off-line environments.

The success or failure of initiatives to strengthen copyright protection on the global stage has a profound bearing on U.S. economic competitiveness. It will dictate whether the global economic and legal environment will sustain America's artistic and intellectual heritage. No less is at stake than the genius and individuality that lie at the core of our national soul, and the dangers posed are great and immediate.

RECORDING INDUSTRY ASSOCIATION OF AMERICA
1330 CONNECTICUT AVE. NW, SUITE 300, WASHINGTON, DC 20036
PHONE: 202.775.0301 FAX: 202.775.7253 WEB: www.riaa.com

Among the variety of problems that the record industry confronts around the world, a number are truly critical. One of these issues is, of course, achieving strong protection for copyrighted materials on the internet—an issue of global dimension that looms larger each day, prejudicing US economic performance, and threatening to wholly undermine the ability to create and distribute original works. While we are grappling with this fundamental challenge, however, we still confront "traditional" piracy of physical goods—a problem that itself is rapidly expanding through the involvement of organized trans-national criminal syndicates.

There are some counties in which the level of government indifference to the theft of U.S. intellectual property is tantamount to a national policy of endorsing copyright infringement. One such country is Russia. Russia is currently home to 28 known optical disc plants ("optical discs" refers to CDs, DVDs, CD-ROMs, and other disc based products) with a production capacity of over 330 million discs a year. Demand for legitimate discs in Russia, on the other hand, is unlikely to exceed 30 million discs per year. This excess capacity is used to produce pirate materials, and investigations have led to the seizure of Russian manufactured pirate discs in over 25 countries. The U.S. copyright industries have been losing more than $1 billion a year to piracy in Russia, and we have been sustaining this level of loss for 5 years.

Mr. President, we urge you to raise this critical matter with President Putin in clear and direct terms. President Putin has taken certain steps over the course of the past year, but they have not been adequate to address this intolerable situation. The thrust of our request to the Russian Government—oft repeated by the excellent and dedicated Ambassador of the United States to Russia, Ambassador Vershbow, has been to introduce and implement effective controls over the operations of the CD plants. This is not complicated. The Russian Government knows the location of the plants. Ambassador Vershbow delivered a document to the Government of Russia more than one year ago that listed the names and addresses of the facilities. If President Putin determines that addressing this problem is a priority, it will quickly be resolved. Whether he makes such a determination is largely dependant upon how he perceives this affects the U.S.-Russia relationship. We hope that you can give him clear guidance on this point that will encourage him to take the steps that are necessary to bring Russia's performance into compliance with international standards, and that will prevent further deterioration of Russia's image.

We thank you for your attention to this matter, and once again take the opportunity to thank you for everything that your Administration is doing to advance the protection of intellectual property in global commerce. Such efforts are not only critical to our ability to continue to produce and distribute original music, but they will determine the parameters of the competitiveness of an entire, and exceedingly visible, part of the U.S. economy as a whole.

September 16, 2003

Sincerely,

Mr. Roger Ames
Chairman and CEO
Warner Music Group

Mitch Bainwol
Chairman and CEO
Recording Industry Association
of America

Mr. Andrew Lack
Chairman and CEO
Sony Music

Mr. Alain Levy
Chairman and CEO
EMI Recorded Music

Mr. Doug Morris
Chairman and CEO
Universal Music Group

Mr. Rolf Schmidt-Holtz
Chairman and CEO
BMG Music

cc:
The Honorable John Ashcroft, Attorney General of the United States
The Honorable Donald L. Evans, Secretary of Commerce, Department of Commerce
Mr. Stephen Friedman, Assistant to the President and Director of the National Economic Council
The Honorable Colin L. Powell, Secretary of State, Department of State
The Honorable Condoleezza Rice, Assistant to the President for National Security Affairs
The Honorable Alexander Vershbow, Ambassador of the United States of America to the Russian Federation
The Honorable Robert Zoellick, United States Trade Representative

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