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INTERNATIONAL PIRACY: THE CHALLENGES OF PROTECTING INTELLECTUAL PROPERTY IN THE 21ST CENTURY

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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INTERNATIONAL PIRACY: THE CHALLENGES OF PROTECTING INTELLECTUAL PROPERTY IN THE 21ST CENTURY

THURSDAY, OCTOBER 18, 2007

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

The Subcommittee met, pursuant to notice, at 10:04 a.m., in Room 2237, Rayburn House Office Building, the Honorable Howard Berman (Chairman of the Subcommittee) presiding.

Present: Representatives Berman, Watt, Jackson Lee, Sherman, Schiff, Lofgren, Sutton, Coble, Sensenbrenner, Smith, and Goodlatte.

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

I would like to begin by welcoming everyone to this hearing, International Piracy: The Challenges of Protecting Intellectual Property in the 21st Century.

I will recognize myself for an opening statement.

Almost a year ago, in connection with bilateral negotiations on the Russian Federation's accession to the World Trade Organization, the Russian government and the U.S. reached an agreement regarding actions to improve the protection and enforcement of intellectual property rights in Russia.

Just last week, the U.S. requested the WTO establish a dispute settlement panel to challenge China's restrictions on the importation and distribution of products of copyright-intensive industries such as theatrical films, DVDs, music, books, and journals.

This hearing will update us on the status of our efforts in these two specific countries, which many have identified as the primary culprits in allowing piracy and counterfeiting to flourish.

We also will look at the piracy problem in other countries and the challenges America faces when trying to alter the legal landscape and enforcement mechanisms available.

This is an effort to ensure that other countries do not thrive on the backs of American creativity.

Today's witnesses will speak to the importance of IP to the global economy. I would like to use my time to move beyond that particular aspect of the issue to identify causes for the lack of adequate protection for IP in some places, and to talk about solutions and incentives to address the problem.

Hopefully these will dovetail with the IP enforcement bill that I hope to be introducing shortly with the Chairman of the full Committee, Mr. Conyers, as the lead author, along with the Ranking Member of the full Judiciary Committee, Mr. Smith, and Ranking Member of this Subcommittee, Mr. Coble.

The Organization for Economic Cooperation and Development recently released their report on the Economic Impact of Counterfeiting and Piracy together with suggestions to enact stronger criminal penalties and increase enforcement of national laws, strengthen cooperation between government and industry, and educate consumers.

These are the cornerstones of effective IP protection. Each of the participants—governments, industries and the consuming public—must have the will to do it, the will to respect intellectual property rights.

Sometimes that will comes naturally, as when the participants understand that IP enforcement is in their own interest. That occurred, at least for a brief moment in China when they saw counterfeit 2008 Olympic T-shirts appearing on street corners.

But sometimes outside inducement is helpful. Some nations, such as Russia, do not yet meet international standards in their IP laws. Others, such as China, may have good laws on the books but often fail to enforce them.

How do we get Russia, China and other emerging market economies to, as Mark MacCarthy of Visa states, "do the right thing?"

We have the tools of persuasion and trade benefits at our disposal and, of course, international law in accession to the WTO. Sometimes it takes a little nudge for a country to see the light.

Industry, not only those who own the rights, but those who benefit from use of those rights, must also have the will to protect intellectual property.

Whether it be Internet service providers, or financial services such as banks and credit card companies, such intermediaries often facilitate piracy through their servicing of illegal transactions.

While there may be legal ambiguity as to whether their conduct meets the legal definition of contributory infringement, industry clearly has a responsibility. Their refusal to use the technical tools at their disposal now to stop piracy exacerbates the problem.

They should understand that effective IP enforcement improves economies and ultimately, therefore, their own bottom line.

Take, for instance, Baidu, the Chinese counterpart to Google. It is responsible for much of the Internet piracy in China. Their continued activities have dissuaded any legitimate down-stream services from entering that market.

I am more than a little surprised that a company can be traded on the New York Stock Exchange and still maintain practices that are so destructive of the ability of the Chinese digital market to develop in a legitimate manner.

And I don't mean just to pick on Russia and China. Although they have garnered the lion's share of the headlines, trading partners such as Chile, India, Turkey, Venezuela and others have been cited for their inadequate commitments to IP protection.

Even, I am sad to say, our neighbor to the north needs to improve. To date, they have still not updated their laws to comply with the 1996 WIPO Copyright Treaty.

On Tuesday night, the Governor General of Canada presented the new government's agenda to Parliament: Our government will improve the protection of cultural and intellectual property rights in Canada, including copyright reform.

While formal commitments are necessary, they aren't sufficient. They must be backed by results.

Now, I recognize the Ranking Member of the Subcommittee for his opening statement, Mr. Smith, if he has one, and then Mr. Conyers, chairing, actually, another hearing at this time of this task force——

Howard?

Mr. COBLE. Thank you, Mr. Chairman. I want to join you in welcoming all to our hearing this morning.

I want to commend you, Mr. Chairman, and Ranking Member Smith. I believe you all convened at least three hearings on this very significant subject in 2005.

The investment in time, capital and effort needed to obtain a valid patent, trademark, or copyright is enormous, as you all know.

The reward for that investment is supposed to be the exclusive right for a limited time to manufacture, market or license an invention, product or work.

But that reward is of little incentive or value if individuals and governments are unable or, in the latter instance, sometimes unwilling to provide meaningful protection and enforcement to the owners of intellectual property rights.

A number of developments in recent years have overwhelmed the methods that countries traditionally employ to prevent legitimate producers from being exposed to unfair competition and to protect consumers from health and safety risks associated with unsafe goods.

The expansion of transnational trade and the development of the Internet as a commercial tool and the ability of producers anywhere in the world to cheaply and rapidly produce, distribute and transport goods to virtually any other point of the globe have revolutionized not merely the relationships between producers and consumers but also the relationships between and among nations and their citizens.

To protect the legitimate interest of nations and inventors with respect to promotion of intellectual property rights, Mr. Chairman, it seems the United States is party to numerous international multilateral and bilateral agreements.

Our ability to ensure these agreements and understandings are properly carried out, not merely here at home, but also in the markets overseas that demand the creative products Americans are so skilled at producing, is fundamental to the continued vitality of our economy.

When you consider that our copyright industry typically receives about half of its revenue from outside the United States, industries that rely on IP protection account for over half of all U.S. exports, and these industries together represent about 40 percent of the U.S. economic growth, it is obvious why it is so important that we

ensure that foreign governments respect the rights of our producers.

One of the principal methods that our government uses to promote these interests is the Section 301 review process, which was established pursuant to the Trade Act of 1974.

Among other things, Section 301, as you know, requires the U.S. trade rep to publish an annual report that details foreign government policies or practices that violate a bilateral or multilateral trade agreement or are unreasonable, unjustifiable, are discriminatory and are unnecessarily burdensome to the United States commerce.

For many years, the Section 301 Report has documented various violations by the governments of China and Russia, as you just pointed out in your statement, Mr. Chairman, with respect to the protection and enforcement of U.S. intellectual property rights.

Indeed, the failure of China in particular to reduce its levels of counterfeiting and piracy, which in many copyright sectors routinely approaches 90 percent, has led to the United States filing two IP-related complaints at the WTO.

Rather than stealing the thunder of our witnesses, who can describe in great detail the status of our concern with China and Russia and other countries of priority to U.S. IP owners, I want to first acknowledge the progress the Administration, Congress and private industry have made in recent years in improving the exchange of information and developing strategies to improve the situation for IP owners.

There are no quick fixes in this area as complex as this. Real progress require most sustained attention and a bipartisan commitment.

Mr. Chairman, I spoke a little longer than I usually do, but I don't know of any subject that impacts our economy any more significant than what we are discussing today.

President Reagan once summed up the U.S. policy of negotiating arms control agreements as "trust, but verify." In my view, meaningful progress in the promotion of intellectual property rights requires a similar transparency. In other words, we need a little less trust and a lot more verification.

I thank you, Mr. Chairman, and I yield back my time.

[The prepared statement of Mr. Coble follows:]

PREPARED STATEMENT OF THE HONORABLE HOWARD COBLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH CAROLINA, AND RANKING MEMBER, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

Statement of The Honorable Howard Coble
Ranking Member, Subcommittee on Courts, the Internet and Intellectual Property
Oversight Hearing entitled "International Piracy: The Challenges of Protecting Intellectual Property in the 21st Century"
October 18, 2007

Thank you, Mr. Chairman. I want to thank you for scheduling this important oversight hearing on international piracy.

At the outset, I want also to recognize the dedication and foresight of our full committee Ranking Member, Rep. Lamar Smith, who convened 3 hearings when he chaired this Subcommittee on the subject of international piracy.

The investment in time, capital and effort needed to obtain a valid patent, trademark or copyright is enormous. The reward for that investment is supposed to be the exclusive right, for a limited time, to manufacture, market or license an invention, product or work.

But that reward is of little incentive or value if individuals and governments are unable or, in the latter instance, sometimes unwilling to provide meaningful protection and enforcement to the owners of intellectual property rights.

A number of developments in recent years have overwhelmed the methods that countries traditionally employ to prevent legitimate producers from being exposed to unfair competition and to protect consumers from health and safety risks associated with unsafe goods.

The expansion of trans-national trade, the development of the Internet as a commercial tool and the ability of producers anywhere in the world to cheaply and rapidly produce, distribute and transport goods to virtually any other point on the globe have revolutionized not merely the relationships between producers and consumers but also the

relationships between and among nations and their citizens.

To protect the legitimate interests of nations and innovators with respect to the promotion of intellectual property rights, the United States is party to numerous international, multilateral and bilateral agreements.

Our ability to ensure these agreements and understandings are properly carried out not merely here at home but also in the markets overseas that demand the creative products Americans are so skilled at producing is fundamental to the continued vitality of our economy.

When you consider that: 1) our copyright industry typically receives about half of its revenue from outside the U.S.; 2) industries that rely on IP protection account for over half of all U.S. exports; and 3) these industries together represent about 40% of U.S. economic growth, it is obvious

why it is so important that we ensure that foreign governments respect the rights of our producers.

One of the principal methods our government uses to promote these interests is the Section 301 review process, which was established pursuant to the Trade Act of 1974. Among other things, Section 301 requires the U.S. Trade Representative to publish an annual report that details foreign government policies or practices that violate a bilateral or multilateral trade agreement or are "unreasonable, unjustifiable, or discriminatory" and/or unnecessarily burdensome to U.S. commerce.

For many years, the Section 301 report has documented serious violations by the governments of China and Russia with respect to the protection and enforcement of U.S. intellectual property rights.

Indeed, the failure of China, in particular, to reduce its levels of counterfeiting and piracy, which in many copyright sectors routinely approaches 90%, has led to the U.S. filing two IP-related complaints at the WTO.

Rather than "stealing the thunder" of our witnesses who can describe, in great detail, the status of our concerns with China, Russia and other countries of priority to U.S. IP owners, I want to first acknowledge the progress the Administration, Congress and private industry have made in recent years in improving the exchange of information and developing strategies to improve the situation for IP owners.

There are no quick fixes in an area as complex as this. Real progress requires both sustained attention and a bipartisan commitment.

The international trading system is rules-based. Respect for those rules demands that there be serious consequences for countries, which have voluntarily agreed to abide by the "rules of the road", but instead choose to consistently and continually fail to honor their commitments.

President Reagan once summed up the U.S. policy in negotiating arms control agreements as "trust but verify." In my view, meaningful progress in the promotion of intellectual property rights requires a similar transparency. In other words, we need a little less trust and a lot more verification.

With that, Mr. Chairman, I yield the balance of my time.

Mr. BERMAN. Well, thank you very much, Mr. Coble, and your comments reminded me that, in fact, we have had a number of hearings on this subject building up to this point.

Our colleague from Texas, Mr. Smith, as Chairman of the Subcommittee over the last few years, and now as Ranking Member of the full Committee—I recognize him for his opening statement.

Mr. SMITH OF TEXAS. Thank you, Mr. Chairman. You mentioned Mr. Conyers a while ago.

Like Mr. Conyers, I am a Member of the Antitrust Task Force, which also happens to be meeting right now, so I suspect that he and I will be shuttling back and forth and maybe even substituting for each other as the morning goes on.

But I do want to thank you, Mr. Chairman and Ranking Member Coble, for convening this very important oversight hearing.

As has already been mentioned, we have had three Subcommittee hearings on this subject already, which is clearly an indication of how important this Subcommittee thinks this subject is, and it is nice to have this as a bipartisan subject of interest as well.

At the outset of the first hearing, I noted one of our purposes 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 American consumers.

I don't quote myself very often, but I thought that was a particularly good statement from a couple of years ago. [Laughter.]

The potential harm to consumers that results from the rampant production and distribution of illegal goods is, of course, not limited to purely economic harm.

Recently, Chinese-manufactured toothpaste was recalled because it contained a chemical used in antifreeze. And Connor O'Keefe, a 7-year-old British boy, tragically died after reportedly being electrocuted by a counterfeit Nintendo Gameboy charger.

These cases illustrate the danger posed by the failure to stop the manufacture and distribution of unsafe and counterfeit goods.

The enormous scope of today's counterfeiting activity and the unprecedented ability of pirates to distribute their illegal wares quickly and on a global scale pose new challenges to policy makers around the world.

When government officials and countries who profit from illegal commerce actually facilitate it, these challenges are tougher.

When the U.S. trade representative released her annual Special 301 Report earlier this year, China and Russia were once again included on the priority watch list. It came as no surprise.

That designation reflects a judgment that these countries fail to provide an adequate level of intellectual property rights protection or appropriate market access to intellectual property owners.

China is posed to become the second-largest trading nation in the world, and Russia is seeking to join the World Trade Organization.

The U.S. and other countries that support the international rules-based trading regime must take steps to ensure that these and other countries which enjoy the benefits of free trade also exercise the responsibilities that that free trade requires.

Since our hearings in 2005, the U.S. government has stepped up its dialogue with Congress and industry stakeholders and has sought to monitor and improve international respect for IPR.

While today's hearing topic is broader than the subject of Chinese and Russian IP theft, I do hope our witnesses will address several specific topics.

These include offering their views on Russia's implementation of their bilateral IPR agreement which was signed with the U.S. on November 19th, 2006, and the current situation with respect to the two complaints the U.S. filed against China at the World Trade Organization for IP violations.

Before concluding, Mr. Chairman, I would like to take a moment to recognize the service of Victoria Espinel, to our left, the assistant U.S. trade representative for intellectual property and innovation, who is one of our four witnesses.

I understand that she will be leaving government service soon. In May 2005, she served as the only common witness at our two back-to-back hearings on IP theft.

She has brought an unparalleled dedication and commitment to her duties at USTR, and in doing so she has brought credit and credibility to our international efforts to improve respect for intellectual property rights.

And we thank you for your efforts and appreciate your being here, perhaps to testify for the last time.

Mr. Chairman, with that, I will yield back.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF THE HONORABLE LAMAR SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND MEMBER, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

Statement of The Honorable Lamar Smith
Ranking Member, Judiciary Committee
Oversight Hearing entitled "International Piracy: The Challenges of Protecting Intellectual Property in the 21st Century"
October 18, 2007

Thank you, Mr. Chairman and Ranking Member Coble for convening this important oversight hearing. I move to strike the last word.

This hearing follows 3 Subcommittee hearings that were conducted in 2005 that focused on the subject of IP theft in relation to the nations of China and Russia.

At the outset of the first hearing, I noted:

> One of [our] purposes ... 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 American consumers.

The potential harm to consumers that results from the rampant production and distribution of illicit goods is, of course, not limited to purely economic harm.

Indeed, recent high-profile recalls of Chinese manufactured products in the U.S., which included toothpaste that contained diethylene glycol, a chemical commonly used in antifreeze, and the tragic death of Connor O'Keefe, a 7 year-old British boy, who was reportedly electrocuted by a counterfeit Nintendo GameBoy charger illustrate what can occur when authorities fail to stop the manufacture and distribution of unsafe and counterfeit goods.

The enormous scope of today's counterfeiting activity and the unprecedented ability of pirates to distribute their illicit wares quickly and on a global scale pose new challenges to policy-makers around the world.[2]

These challenges are exacerbated when the acquiescence or worse, active involvement, of government officials in some countries who profit from the production, transportation or distribution of these goods in illegal commerce, intervene to either facilitate the activity or thwart enforcement efforts.

When the U.S. Trade Representative released its annual Special 301 report earlier this year, it came as no surprise that China and Russia were again included on the priority watch list - a designation that reflects a judgment that these countries fail to provide an adequate level of intellectual property rights (IPR) protection or enforcement, or appropriate market access to intellectual property owners.

At a time when China is poised to become the second-largest trading nation in the world and Russia is seeking to join the World Trade Organization, it is imperative the U.S. and other countries that support the international rules-based trading regime take the steps necessary to ensure that these and other countries, which enjoy the benefits of free trade, also exercise the responsibilities that are commensurate.

Since our initial hearings in 2005, the U.S. government has stepped up its dialogue with Congress and industry stakeholders and has been aggressive in seeking to monitor and improve international respect for IPR.

While today's hearing topic is broader than the subject of Chinese and Russian IP theft, I do hope our witnesses will address several specific topics.

These include offering their views on Russia's implementation of the Bilateral IPR Agreement, which was signed with the U.S. on November 19, 2006, and the current situation with respect to the two complaints the U.S. filed against China at the World Trade Organization (WTO) for IP violations.

Before concluding, I'd like to take a moment to recognize the service of Victoria Espinel, the Assistant US Trade Representative for Intellectual Property and Innovation, and one of our witnesses on today's panel.

I understand Ms. Espinel has accepted a teaching position at George Mason and will soon be leaving government service.

In May 2005, Ms. Espinel did not waver when asked to serve as the only common witness at our two back-to-back hearings on IP theft.

Even more impressive was the fact - if I recall correctly - that she had never testified before a Congressional committee before doing so twice that day.

Ms. Espinel has brought an unparalleled dedication and commitment to her duties at USTR.

In doing so, she has brought great credit and credibility to our international efforts to improve respect for IPR.

Ms. Espinel, thank you for your efforts.

With that, Mr. Chairman, I yield the balance of my time.

Mr. BERMAN. Thank you, Mr. Smith. And in the interest of proceeding to our witnesses and—you know, we have a vote on, so I would ask other Members to submit their statements for the record.

I would ask the Members to submit any opening statements by the close of business Wednesday. And without objection, all opening statements will be placed into the record.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

Statement of the Honorable John Conyers, Jr. for the Hearing on International Piracy: The Challenges of Protecting Intellectual Property in the 21st Century Before the Subcommittee on Courts, Internet, and Intellectual Property

Thursday, October 18, 2007, at 10:00 a.m.
2237 Rayburn House Office Building

Last April, I had the great honor of visiting the People's Republic of China and discussing with government officials and business leaders our shared interests in promoting global security and economic policy.

As our nations continue to work together to promote peace, prosperity, and cooperation, I do hope that China expends greater efforts to deal with intellectual property piracy. For instance, it is estimated that approximately 90% of all copyrighted material sold in China was pirated and that last year alone Chinese piracy cost American firms more than $2 billion in lost sales. Each year, global piracy results in the United States losing up to $250 billion through lost sales and tax revenue.

But, the problems presented by piracy and counterfeiting are not limited to lost sales and tax revenue. Let me highlight three major issues they present:

1. Hurts American Competitiveness and Jobs

First, piracy and counterfeiting hurt American competitiveness and jobs. In the 21st century global economy, intellectual property is the principal engine for the creation of wealth. According to the State Department, intellectual property protection is vital to more than half of U.S. exports in the past decade compared to less than 10% fifty years ago.

And, it is a problem that not only hurts a few industries, like the movie and music industries, but hurts a broad spectrum of industries. American manufacturers and workers are directly impacted by the rampant piracy of software, video games, books, and magazines as well as the widespread counterfeiting of pharmaceuticals, electronics, batteries, auto parts, industrial equipment, and toys. Everyone from software engineers in California to auto workers in my home state of Michigan are hurt by piracy.

The loss of hundreds of thousands of American jobs each year can be directly attributed to piracy and counterfeiting. According to the Department of Commerce, our Nation's auto industry alone could hire an additional 200,000 workers if counterfeiting is eradicated.

2. Threat to Consumer Safety

Second, counterfeit goods are inferior in quality and often pose a threat to consumer safety. The very nature of a counterfeit product is it is inherently hard to detect and, thus, presents a particularly dangerous situation when it gets into legitimate distribution channels.

For example, nearly 20% of Chinese consumer products were found to be substandard, according to a recent nationwide inspection. The inspection revealed food laced with industrial chemicals, baby clothes contaminated with toxic chemicals, and cell phone batteries that can explode under certain conditions. Recently, defective tires from China were found to have caused an accident in Pennsylvania resulting in two deaths. Thereafter, 450,000 Chinese tires had to be recalled because they lacked a safety feature which could prevent tire treads from splitting and falling apart.

In 2005, New York police discovered thousands of fake auto parts, such as brake pads and fuel pumps. Such counterfeits do not undergo rigorous safety testing required of legitimate manufacturers and, therefore, present a significant safety hazard. They can also cause exponential damage. For

example, a counterfeit oil filter which costs around $5 could cause thousands of dollars in engine damage.

3. National Security Issue

Third, piracy and counterfeiting also threaten our national security. Transnational organized crime and terrorists are major players in the international supply chain of pirated and counterfeit goods. Interpol Secretary General Ronald Noble recently testified before Congress about various links between intellectual property crimes and terrorist networks, including Al-Qaeda and Hezbollah. For example, an Al-Qaeda training manual suggested counterfeiting as a potential source of financing for its operations.

By all accounts, international piracy and counterfeiting are serious issues with grave ramifications beyond economic loss. Accordingly, I am particularly looking forward to hearing from our witnesses today about how we can address these issues.

Mr. BERMAN. Without objection, the Chair will be authorized to declare a recess of the hearing at any point. And maybe we could have Ms. Espinel testify.

So let me quickly introduce our witnesses and join with you, Mr. Smith, in acknowledging the fine work of our first witness. That will be Victoria Espinel. She is the Assistant USTR for Intellectual Property and Innovation.

She is the Chief Policy Advisor to the United States Trade Representative and the administration on Intellectual Property and Innovation, and trade issues and the chief U.S. trade negotiator for intellectual property issues.

She seems like the right person to have here for this subject. She oversees enforcement of the intellectual property protection required under International Trade rules, authors the annual Special 301 Report of international Protection of Intellectual Property Rights, and was involved in creating the President's multi-agency initiative to combat global counterfeiting and piracy, otherwise known as the STOP initiative.

Welcome, and I will have you perhaps give your testimony, and then I will introduce the rest of the panel afterwards but still hope you could stick around. It is your last shot—and for questions after this. Thank you.

TESTIMONY OF VICTORIA A. ESPINEL, ASSISTANT U.S. REPRESENTATIVE FOR INTELLECTUAL PROPERTY AND INNOVATION, OFFICE OF THE U.S. TRADE REPRESENTATIVE, WASHINGTON, DC

Ms. ESPINEL. Thank you for inviting me to speak today about some of the work the U.S. government is doing to strengthen protections and enforcement of intellectual property rights around the world, including in China and Russia.

It is a great privilege that I have had the opportunity to work with the leadership displayed in this Committee in protecting one of America's greatest comparative advantages, our creative class.

I would also like to commend your skilled and dedicated staff members for all of their efforts as well. As Mr. Smith mentioned, this was, in fact, the first Subcommittee that I testified in front of on this issue, and it will likely be the last, at least in my capacity as assistant USTR.

So, I want to say what a true pleasure it has been to work with the Members of this Subcommittee and to work with your excellent staff.

There are a number of challenges that we face in protecting American rights overseas, including weak laws, a lack of political will by some of our trading partners, and the increasing scope and sophistication of counterfeiters and pirates.

We use and devote considerable resources to addressing these problems. The free trade agreements that we negotiate contain comprehensive chapters on intellectual property outlining our model for protecting intellectual property, a model that is the world's gold standard.

Our FTAs get results. We have consistently seen stronger laws and better enforcement of those laws from the FTAs that we conclude.

Another tool is Special 301, which has been mentioned by the Chairman, the Ranking Member and Mr. Smith. This report has been successful in encouraging countries to institute reforms or to increase enforcement in order to avoid elevation on the list or to improve their standing on the list.

Another serious challenge that we face comes from advancing technology and from the increasing scope and sophistication of counterfeiters, including dissemination over the Internet and highly organized distribution networks, some with links to organized crime.

USTR is keenly aware that counterfeiting and piracy is a threat to the health and safety of our consumers and to our economy. In order to address this, we need to ensure that our own system is as strong as possible.

We need a new international consensus on stronger rules for civil, criminal and border enforcement. And we need to increase global cooperation with our trading partners.

With that broad overview of USTR's approach to IP issues as a background, I would like to comment briefly on recent activities in China and in Russia.

China is a top intellectual property enforcement concern for us. There is no question that China must do more to protect intellectual property rights. China is making some genuine efforts, but IP infringement remains at unacceptable levels.

This year's Special 301 Report described the United States' plan to maintain China on the priority watch list and to continue Section 306 monitoring.

In addition, we conducted an unprecedented special provincial review of IP enforcement in several key provinces and independent municipalities of China.

Many of these provinces and municipalities are huge economies in their own right, and they attract significant U.S. investment. They are also on the front lines of the IP problems of many of our right holders.

We reported the results of that review in this year's 301 report, spotlighting weaknesses at the local level but also highlighting some positive efforts.

In past years, we have used the Joint Commission on Commerce and Trade to make progress on IP issues such as China joining the WIPO Internet Treaties, which are critical to ensuring IP protection in the digital age, and new rules requiring that all computers be pre-installed with legal operating system software.

Finally, in appropriate cases where bilateral dialogue has not resolved our concerns, we have taken the further step of filing cases at the WTO, using the WTO's dispute settlement procedure.

So far we have initiated two cases that relate to our intellectual property concerns. The first case involves deficiencies in China's system for protecting and enforcing intellectual property.

The second case challenges China's rules which make it difficult for movies, publications and music, products of our copyright industry, to be imported and distributed inside of China.

It is clear from these examples that we do not hesitate to file WTO cases when circumstances warrant that action. That said, we

believe these cases are evidence of need for more bilateral cooperation with China, not less.

The United States believes that continued dialogue and cooperation with China is essential to making further progress on intellectual property issues.

With respect to Russia, the Administration has made it clear to Russia's officials at the very highest levels that protection of intellectual property is a singular U.S. priority.

In November 2006 we negotiated a bilateral intellectual property agreement between the United States and Russia, which includes important and specific commitments to strengthen IP protection and enforcement in Russia.

This agreement sets the stage for further progress on IP issues in the ongoing multilateral negotiations at the WTO concerning Russia's bid to enter the WTO.

We are also conducting an out-of-cycle review of Russia under the Special 301. Russia has made progress in some areas—for example, taking steps to remove pirate optical disc plants off of government and military sites and cracking down on unlicensed optical disc plants.

These were all specific commitments in our bilateral agreement with Russia. However, more remains to be done under our bilateral agreement. We will continue to press Russia to shut down and prosecute the operators of illegal Web sites operating in Russia, including the successors to the infamous AllOfMP3.com.

Russia needs to pass legislation now pending in the Duma to strengthen customs authority. Russia needs to complete implementation of the WIPO Internet Treaties. And Russia needs to amend Part 4 of the civil code to bring it into compliance with the TRIPS agreement and other IP agreements.

In closing, Mr. Chairman, I want to assure you in the strongest possible terms that the Administration shares the view, frequently and well-articulated by the Members of this Committee, that protection of U.S. intellectual property overseas is critical to America's economic future.

With that in mind, we look forward to continuing to work with you and your colleagues to improve protection and enforcement of intellectual property around the world.

[The prepared statement of Ms. Espinel follows:]

PREPARED STATEMENT OF VICTORIA A. ESPINEL

Mr. Chairman, my name is Victoria A. Espinel, and I am the Assistant U.S. Trade Representative for Intellectual Property and Innovation. It is my pleasure to have this opportunity to speak to you today about some of the U.S. Government's work to strengthen protection and enforcement of intellectual property rights (IPR) around the world, including in China and Russia.

In order to better use our trade policy tools, the Office of the U.S. Trade Representative (USTR) created a new Intellectual Property and Innovation office in 2006. I head that office. The office also includes a new Chief Negotiator for Intellectual Property Enforcement, Stanford McCoy, and five other IPR specialists. My office is tasked with using the full range of trade policy tools around the world to better protect American industry from piracy and counterfeiting around the world, and to ensure that protection remains effective as technology continues to develop and intellectual property (IP) infringers become more sophisticated.

USTR uses a variety of tools to protect US intellectual property overseas, working in cooperation with other U.S. Government agencies, with our foreign trading partners, and with U.S. right holders. These tools include our free trade agreements,

negotiations of Trade and Investment Framework Agreements (TIFAs), WTO accession negotiations, bilateral discussions of IP issues, the Special 301 process, U.S. preference programs, and dispute settlement.

There are a variety of reasons that U.S. IP rights are violated overseas, including that: some governments have weak laws—that is, laws that are inadequate to deter piracy and counterfeiting, and some governments do not place a high priority on protection of IP. In addition, the scale and scope of piracy and counterfeiting has changed in the last decade, as we have seen the use of new means to produce and distribute infringing goods, such as the Internet, and the increasing sophistication and organization of pirates and counterfeiters on a global scale.

WEAK LAWS

Many countries' laws are inadequate to deter counterfeiting and piracy. The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) sets out certain minimum standards. However, even those countries that have implemented TRIPS may not make consistent use of those laws to deter IP theft.

USTR devotes considerable resources to working with countries to strengthen their laws. One way we do this is through negotiations of free trade agreements (FTAs). Each of the FTAs we negotiate contains a comprehensive chapter on intellectual property. Our IP chapters provide the international standard for rules to protect copyright, trademarks and patents and other forms of intellectual property, in line with U.S. law. Our IP chapters also contain high standards for enforcement, including civil enforcement, criminal enforcement and border enforcement. After we negotiate an FTA, USTR works closely with our trading partners to ensure that the agreement is faithfully implemented.

For example, as a result of the United States-Australia FTA, Australia has strengthened its laws to combat internet piracy and signal piracy. As a result of the United States-Singapore FTA, Singapore passed a law to criminalize end user piracy of software and then used that law to criminally prosecute software pirates for the first time. If the United-States Korea FTA is approved and goes into effect, Korea will be obligated to change its laws to provide greater authority to its police and customs authorities, to outlaw movie camcording, and to increase its focus on fighting book piracy.

We also work with countries on IP issues through our Trade and Investment Framework Agreement (TIFA) discussions. While a TIFA does not have as detailed IPR provisions as an FTA, we have found the TIFA discussions to be a productive forum to discuss intellectual property issues. For instance, our TIFA dialogue helped persuade Taiwan to pass legislation to make peer-to-peer file sharing services illegal. Through our TIFA dialogue, we also encouraged Taiwan to clamp down on counterfeit pharmaceuticals, leading to police shutting down 40 drug counterfeiting operations; pass legislation to create specialized IP courts; and create a task force to combat copyright infringement on university campuses.

WTO accession negotiations are another tool we have to strengthen laws. One outcome of the negotiations on Vietnam's accession to the WTO is that Vietnam will provide protections against criminal copyright and trademark violations where no such protections previously existed. Furthermore, the government has committed to address the problem of government use of illegal software and to increase enforcement against signal piracy. We have also used WTO accession negotiations to address IP concerns in Russia, which I will discuss in more detail later.

LACK OF PRIORITY

Another challenge that we face is that some governments do not place a high enough priority on protecting intellectual property. To address this problem, we use the Special 301 process to encourage specific trading partners to place a higher priority on addressing identified IP problems. Each April, USTR issues a Special 301 Report cataloguing specific IPR problems in dozens of countries worldwide. A trading partner's ranking in the report sends a message to the world, including potential investors, about its commitment to IPR protection. Special 301 also affords an opportunity to give credit where it is due, as in our decision to improve countries' standing when there are significant improvements in IPR protection and enforcement.

The Special 301 Report has been successful in encouraging countries to institute reforms or increase enforcement to avoid elevation on the list or to improve standing on the list. For example, Indonesia had been listed as a Priority Watch List country for a number of years and was interested in improving its standing. Our concerns about illegal OD factories in Indonesia helped persuade Indonesia to significantly increase enforcement actions, in particular against manufacturers and retailers of

illegal optical discs. These continued and sustained actions, which demonstrated there was political will to do more on protecting IPR, caused Indonesia's standing to be improved to Watch List. We are continuing to work with Indonesia to further improve IP protection on the basis of an Action Plan developed when we improved its standing on the Watch List.

Last year we started a new program called the Special 301 Initiative intended to make the Special 301 process even more effective. Under the Special 301 Initiative we have focused attention on a group of countries where we believe there is a good possibility of progress through increased engagement. This has proved a success; we have in fact seen concrete results over the past year in terms of stronger legislation and better enforcement as result of the Special 301 Initiative.

TECHNOLOGICAL CHANGES AND SOPHISTICATION OF COUNTERFEITERS

Another of our challenges comes from advancing technology and from the increasing scope and sophistication of the activities of pirates and counterfeiters. Counterfeit and pirated products are manufactured and then exported around the world using increasingly sophisticated and highly organized distribution networks, some with links to organized crime. The Internet, for example, is creating great economic opportunities and facilitating wide dissemination of information, but it is also a means to distribute vast quantities of pirated material around the world quickly and at very low cost. To give another example, product counterfeiting spans a remarkable array of products, not only luxury goods and apparel, but also pharmaceuticals, electronics, baby formula and auto parts, among many others.

USTR is keenly aware that counterfeiting and piracy is an increasing threat to the health and safety of our consumers and to our economy. We need a strong international regime for IP protection; we need an international consensus of strong rules for civil, criminal and border enforcement; and we need to continue to increase global cooperation with our trading partners.

Along with challenges, we have some new opportunities. One such opportunity is that other countries are increasingly aware of the harm that counterfeiting is causing to their domestic economies and consumers and are increasingly concerned that lack of IP protection will inhibit their ability to innovate. As governments like Brazil, China, and India pursue policies to become more innovative, they have a greater stake in the international IP system. A second opportunity is that other countries are becoming more interested in cooperating with the United States on protecting IP. There is a growing international realization that we need strong cooperation in order to stop the manufacture and trade in counterfeit and pirate goods. USTR has worked to capitalize on these opportunities to strengthen the international IP regime and to increase cooperation with our trading partners.

With that broad overview of USTR's approach to IPR issues as background, I would now like to comment briefly on recent activities in China and Russia, two countries that have been the topics of hearings before this subcommittee.

CHINA

China is a top IPR enforcement concern for us.

There is no question that China must do more to protect intellectual property rights. China is making some genuine efforts, but IPR infringements remain at unacceptable levels.

Let me start with some of the recent efforts China has taken to improve IPR protection and enforcement. In July, as a result of the ongoing work of experts in the U.S.-China Joint Liaison Group for Law Enforcement, Chinese and FBI law enforcement successfully worked together in their largest joint IP investigation to date, Operation Summer Solstice. Among other things, this operation dismantled a major international criminal network engaged in optical disc piracy; seized half-a-billion dollars in pirated U.S. software and over $7 million in assets; arrested 25 suspects in China; and dismantled 6 manufacturing and retail facilities. China also agreed in May to cooperate with U.S. Customs and Border Protection (CBP) to fight exports of counterfeit and pirated goods.

That said, we see evidence of unacceptable levels of IPR infringement most vividly in the numbers of infringing goods seized at U.S. borders. CBP mid-year statistics for 2007 showed that China was the source of 81 percent of infringing goods seized at U.S. borders. China's high share of seized goods is not particular to the current year.

USTR and the Administration as a whole continue to respond to this critical concern by making innovative use of our full range of trade policy tools. First, USTR has augmented our focus on the unique challenges of China with the appointment

last year of a Chief Counsel for China Trade Enforcement, Claire Reade, who leads our China Enforcement Task Force.

Second, this year's Special 301 Report described the United States' plan to maintain China on the Priority Watch List and to continue Section 306 monitoring. In addition, we conducted an unprecedented special provincial review of progress on IPR issues in several key provinces and independent municipalities of China. Many of these provinces and municipalities are huge economies in their own right, and they attract significant U.S. investment. They are also on the front lines of IPR problems for some U.S. right holders. We reported the results of that review at the end of the 2007 Special 301 report, spotlighting weaknesses at local levels, but also highlighting positive efforts, innovative initiatives for fighting Internet piracy in Beijing, pilot programs on enforcement in Shanghai, and deeper engagement with international right holders in Jiangsu province.

In past years, we have used the Joint Commission on Commerce and Trade (JCCT), which Ambassador Schwab jointly chairs with Secretary Gutierrez, to get results on IPR. For example, as a result of past JCCT commitments:

- China introduced rules that require computers to be pre-installed with licensed operating system software;
- China agreed to step up work to combat counterfeit goods at trade fairs and consumer markets; and
- China joined the WIPO Internet Treaties, which are critical to ensuring IP protection in the digital age.

As I mentioned earlier, we have also used our Special 301 process—USTR's annual report card on international IP protection—to highlight China as a top IPR enforcement priority. Our analysis of China is the most in-depth and detailed of any country covered in the Special 301 Report.

Finally, in appropriate cases, where bilateral dialogue has not resolved our concerns, we have taken the further step of filing World Trade Organization (WTO) dispute settlement cases. So far we have initiated two cases that relate to our IPR concerns.

The first of these cases involves deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks on a wide range of products. Specifically, our panel request focused on three main issues: quantitative thresholds in China's law that must be met in order to start criminal prosecutions of copyright piracy and trademark counterfeiting and that appear to create a substantial safe harbor for those who manufacture, distribute, or sell pirated and counterfeit products in China; rules for disposal of IPR infringing goods seized by China's customs authorities; and the apparent denial of copyright protection to works poised to enter the Chinese market but awaiting censorship approval from China's authorities. The WTO panel in this case was formally established at a meeting of the WTO Dispute Settlement Body on September 25.

Our second WTO case challenges China's barriers to trade in books, music, videos and movies. Our panel request focuses on a legal structure in China that denies foreign companies the right to import publications, movies, music, and videos, as well as on China's rules that severely impede the efficient and effective distribution of publications and videos within China. In addition, this panel request addresses market access barriers affecting the distribution of movies, as well as the distribution of sound recordings over the internet and the mobile phone network.

It is clear from these examples that we do not hesitate to file WTO cases when circumstances warrant that action. At the same time, these cases are evidence of the need for more, not less, bilateral engagement with China. The United States believes that continued bilateral dialogue and cooperation can lead to further progress in these and other areas. The United States will continue to put serious efforts into its joint work with China on innovation policy, intellectual property protection strategies, and the range of other important matters in our bilateral economic relationship through the U.S.—China Strategic Economic Dialogue and the JCCT.

Moving ahead with that work will of course require a willingness to cooperate on the Chinese side. We have seen that in some areas, such as the recent law enforcement actions I mentioned earlier, and we hope to see it in other areas as well.

RUSSIA

With respect to Russia, the Administration has made it clear to Russia's officials at the highest levels that the protection of IPR in Russia is a U.S. priority. As we have moved into the multilateral phase of the negotiations on Russia's accession to the WTO, we have continued to reinforce the importance that both the Administra-

tion and Congress place on full implementation of all the commitments in our November 2006 Bilateral IPR Agreement.

The 2007 Special 301 Report describes the Bilateral IPR Agreement between the United States and Russia, concluded in November 2006, which includes important commitments to strengthen IPR protection and enforcement in Russia. Under the terms of the agreement, Russia committed to take action to address piracy and counterfeiting and further improve its laws on IPR protection and enforcement. The agreement sets the stage for further progress on IPR issues in ongoing multilateral negotiations concerning Russia's bid to enter the WTO. This year's Special 301 Report continued heightened scrutiny of Russia by maintaining Russia on the Priority Watch List and announcing plans for an Out-of-Cycle Review.

In August, we received comments from the public, including from U.S. industry and the Russian Federation, as part of the Out-of-Cycle Review of Russia's protection of intellectual property. A major purpose of that review is to scrutinize Russia's implementation of the Bilateral IPR Agreement. That review is ongoing.

In the meantime, we continue to work intensively with our Russian counterparts to achieve progress on the outstanding bilateral and multilateral issues related to Russia's WTO accession, including implementation of TRIPS.

Russia has made clear progress in some areas. For example, they are taking steps to move optical disc plants off of restricted military-industrial sites, cracking down on unlicensed optical disc manufacturers, passing laws to curb abuses by rogue copyright collecting societies, and issuing helpful new guidance for the prosecution of criminal IPR cases. These were all specific commitments in our bilateral agreement.

However, more remains to be done pursuant to our bilateral agreement. For example, we will continue to press Russia to shut down and prosecute the operators of illegal websites operating in Russia, including the successors to the infamous allofmp3.com. Russia needs to strengthen its supervision of licensed optical disc plants, including better laws and regulations and more enforcement. Russia still needs to make legislative changes to implement its TRIPS requirements to protect pharmaceutical test data. It must pass legislation now pending in the Duma to strengthen Customs' authority to take actions ex officio with respect to suspected exports and imports of pirated or counterfeit goods. Russia needs to complete implementation of the WIPO Internet Treaties, and it must amend Part IV of its Civil Code to ensure full compliance with TRIPS and other IPR agreements. Some of these actions are overdue—a concern that we raised with our Russian colleagues at our bilateral Intellectual Property working Group in Moscow on September 24 and 25 and during other recent meetings with the Russian Federation in Geneva and Washington. We have been assured that the process of compliance is moving ahead.

In closing, Mr. Chairman, I want to assure you in the strongest possible terms that the Administration shares the view, so frequently and well articulated by the distinguished members of this subcommittee, that protection of U.S. intellectual property overseas is critical to America's economic future. With that in mind, we look forward to continuing to work with you and your colleagues to improve protection and enforcement of IPR around the world.

Mr. BERMAN. Well, thank you very much, Ms. Espinel.

And I think at this point I will recess the hearing. I believe it is one vote, so we will be right back and introduce the rest of the witnesses, hear their testimony and then questions.

Thank you.

[Recess.]

Mr. BERMAN. Let me introduce the rest of the panel and reconvene the meeting. The next witness will be Eric Smith, who represents the International Intellectual Property Alliance.

The IIPA is a private-sector coalition of seven copyright-based trade associations which represent over 1,900 companies in the movie, music, business software, and video game publishing industries.

Since co-founding the IIPA in 1984, Mr. Smith has represented the IIPA before U.S. and foreign governments with the primary objective of opening foreign markets to U.S. copyrighted products and

reducing piracy levels through improved legal protection and effective enforcement.

He was the principal representative of the copyright industries in the WTO's TRIPS and NAFTA intellectual property negotiations, and served on the U.S. delegation at the diplomatic conference leading to the adoption of the WIPO Copyright Treaty and Performances and Phonograms Treaty in 1996.

I would just add that I had the pleasure of spending a couple of days with him at a conference on these subjects this past summer, and both enjoyed it and found him incredibly knowledgeable on this whole subject.

Dr. Loren Yager is Director of International Affairs and Trade of the U.S. Government Accountability Office.

Dr. Yager has managed GAO efforts to document U.S. efforts to enforce intellectual property rights at home and abroad, the Federal approach and strategy for improving intellectual property rights enforcement, and small business efforts to obtain patent protection.

Additionally, Dr. Yager has completed reports and provided congressional testimony on a wide range of topics, including China import remedies, customs and border protection's in-bond system, offshoring of U.S. services, terrorist financing, global corporate responsibility, illegal textile transshipment and the World Trade Organization, China's WTO compliance, the *maquiladora* industry, container security, and a variety of other subjects.

Lastly, Mark MacCarthy is Senior Vice President of Global Public Policy at Visa. He represents Visa before international public policy makers around the world and in the United States before the Congress, the Administration, the Federal Trade Commission, the banking regulators and other regulatory agencies.

Mr. MacCarthy is responsible for Visa's global public policy initiatives and strategies in the area of data security and privacy, electronic commerce issues such as Internet gambling and Internet pharmacies, and product innovation such as Visa's contactless payment platform and prepaid cards.

If I recall correctly, he also worked in this place for a good period of time.

Gentlemen, all your written statements will be part of the record in its entirety. I would ask you to summarize your testimony in 5 minutes or less.

There is a timing light at your table that supposedly works now, and when 1 minute remains, the light will switch from green to yellow, and then to red when the 5 minutes are up.

I am tempted to let Mr. Coble add his admonition about what that light means, but I'm not doing that. Mr. Smith, why don't you begin?

TESTIMONY OF ERIC H. SMITH, PRESIDENT, INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE (IIPA), WASHINGTON, DC

Mr. SMITH. Chairman Berman, Ranking Member Coble, Members of the Subcommittee, it is an honor and pleasure to appear before the Subcommittee for the third time on this topic, twice in 2005, to again provide an update on global copyright piracy.

Piracy continues to rage around the world and is a threat to U.S. growth and U.S. jobs. While the situation is slowly improving each year on the physical piracy front, with some individual country exceptions, Internet piracy is now truly a global problem with U.S. content fueling that piracy in most countries.

Increasingly, we all must focus on online piracy as a threat to e-commerce and to U.S. leadership in producing and globally distributing high-value content.

The U.S. maintains a huge comparative advantage, as was said by Mr. Coble, in the production and distribution of creative works, filmed entertainment, music and recordings, business and entertainment software, and books and journals that make up the IIPA family.

And for most of these industries, 50 percent of their revenues derive from outside the U.S.

This comparative advantage has meant that these creative industries now account for an ever-increasing portion of the GDP, about $819 billion in 2005, or close to 7 percent of the U.S. GDP; over five million jobs, which is about 4 percent of total employment; and $110 billion in foreign trade revenues, making it one of the largest contributors to trade in our economy.

Perhaps most important is that these industries accounted for over 13 percent of the growth in the economy in 2006. Global piracy threatens that growth path. We have been wiretapping what Internet piracy has done to our recording industry and threatens to do to others as well.

A study came out this month that for the first time was able to quantify the impact of global piracy on the U.S. economy, $58 billion in losses, lost jobs, lost tax revenues, lost waves.

The study concluded that all these numbers were conservative. In my written statement, I detailed IIPA members' initiatives and challenges in dealing with this problem, and I won't repeat them here.

But Mr. Coble was quite right. On the enforcement side there just aren't any quick fixes.

Suffice it to say that the copyright industries depend critically on good laws and enforcement and that governments are central to making that happen.

Our government has led the way and without the help of USTR and other agencies and from Congress for providing the trade tools to assist in awakening our trading partners to the need to protect our intellectual property, including for the benefit of their own citizens and creators, we would be in truly dire straits.

We have witnesses many successes in the last 20 years, driven in part by good work from our government.

I do want to report on the two countries that have provided the greatest challenges for us, China and Russia. The situation in China since we last reported to you at the end of 2005 is mixed.

IIPA members, with the exception of the business software industry, have not seen much progress at all, mostly at the margins. Losses continue at very high levels, hovering between 80 percent and 90 percent of the market, making it almost impossible to do business there.

The biggest problem, again, as before, is China's stubborn reliance on a flawed administrative enforcement system that simply lacks any incentive for pirates to leave this lucrative business, and China's almost total failure, really, to employ criminal remedies, which has been the only way we have been able to reduce piracy levels in the rest of the world.

The business software industry, through China's meeting some key JCCT commitments with respect to legalizing software use in the industry's biggest customer, the Chinese government, has seen a 10 percent decrease in piracy rates and a resulting 88 percent increase in sales since our last report to you in 2005.

And I can guarantee you the rest of my members would love to see that kind of progress, too.

Internet piracy is our most urgent concern. The biggest ISP search service in China, Baidu, which was mentioned, is reportedly responsible for 50 percent of illegal downloads.

We think the Chinese government is also very concerned about Internet piracy, has passed good regulations dealing with the protection of content online, but, again, enforcement is weak and criminal enforcement is spotty at best.

Overall, we have only counted six concluded criminal cases involving U.S. works since 2001, when China joined the WTO, a record that must change if China is ever to reduce its high piracy levels and make a real market for copyrighted material.

And China is a closed market in terms of market access for our cultural industries, another problem that prevents them from selling in the Chinese market.

The pirates, of course, enjoy complete market access for our products, and through this theft enjoy the economic benefits that should come to our own citizens.

Russia remains a continuing frustration. The November 2006 IPR agreement, Russia's pathway to WTO accession, we hope and continue to hope will be complied with. And if so, we will see a much better market there.

Russia has made some progress, as Victoria has outlined, but even here we await the true fruits of that progress. For example, while Russia promised to cancel leases for the pirate O.D. factories housed on protected government reservations, that process is still in process.

No direct results yet. No plant owner has been convicted, and very few criminal cases with deterrent penalties can be counted.

We await real progress, and meanwhile IIPA's year 2000 GSP petition remains in limbo with Russia still receiving over $500 million in unilateral benefits in 2006, with our industries, in turn, suffering close to $2 billion in losses.

Mr. Chairman, it is there in our testimony, in our written testimony, it is there for all to evaluate how serious Russia is in working to solve its massive piracy problems.

If I might, Mr. Chairman, one word about Canada.

Mr. BERMAN. One sentence.

Mr. SMITH. The situation there is not good. The law is antiquated and unequipped to deal with online piracy, which is growing. Enforcement is not a high priority there. We definitely need improvements in Canada. Thank you.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF ERIC H. SMITH

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Written Statement

of

Eric H. Smith
International Intellectual Property Alliance (IIPA)

before the

Subcommittee on Courts, the Internet, and Intellectual Property
United States House of Representatives
on

"International Piracy: The Challenges of Protecting Intellectual Property in the 21st Century"

October 18, 2007

Chairman Berman, Ranking Member Coble, and other distinguished Subcommittee members, I am Eric Smith and IIPA and its members thank you for continuing these oversight hearings, begun in May 2005, to review the key piracy markets of China and Russia -- and, at this hearing, the general state of protection and enforcement of our members products around the world. We are again honored to appear before you on behalf of the seven trade associations -- representing over 1,900 U.S. companies -- that make up the IIPA. These associations represent the motion picture (the major studios and the independents), music and recording, business and entertainment software, and the book and journal publishing industries. Virtually all of our members have appeared before this Subcommittee at some point and they all thank you for the support you have given them and their members over the years.

It will be no surprise to this Subcommittee that piracy continues to rage on a global basis, severely damaging the U.S. economy, reducing GDP, lowering economic growth and hurting U.S. jobs. China and Russia, countries about which you have heard much from our industries, from our government and in the press, are only the tip of an iceberg that should be shrinking, but instead continues to block the path of our country receiving the full economic benefits from the significant comparative advantage we have in the creative sector of the global marketplace.

The Importance of the Copyright Industries to the U.S. Economy and the Cost of Piracy

Before getting to the subject of the state of protection and enforcement in key markets around the world, we believe members could benefit from a review of some key statistics that demonstrate both the critical role that the creative industries play in our economy (and in other countries around the world) as well as a review of new work that has recently been done to measure the harm caused by global piracy to the U.S. economy.

Since 1990, when the seminal study was published by IIPA measuring the economic role of the copyright industries in our economy, these industries have steadily increased their percentage contribution to U.S. GDP, U.S. jobs and U.S. foreign trade, often at multiples of the rate of growth of the economy as a whole. In our most recent study, published in early 2007, the "core" copyright industries accounted for over $819 billion or over 6.5% of the U.S. GDP in 2005 ($173.7 billion in 1990). They accounted for 5.38 million jobs, or over 4% of U.S. employment (3.3% in 1990) and were paid average wages 40% higher than the national average. Contributions to foreign trade (foreign sales and exports) exceeded $110.8 billion ($22.3 billion in 1990), larger than any other major sector of the U.S. economy. To show the comparative advantage and overall strength of these industries, the author, Steve Siwek, was able this time to measure these industries' contribution to overall economic growth occurring in 2005 -- almost 13% or double the contribution to GDP. In short, Mr. Chairman, almost no other industry sector occupies such an increasingly important role in the U.S. now and into the future.

We are the world's leader in producing creative products. But our task is to convince our trading partners where high piracy levels persist that their economies are suffering, that their GDP and job growth is stunted by their failure to take this issue seriously. The World Intellectual Property Organization (WIPO) is working with about 20 countries on studies that use the same methodology as the U.S. study with the goal of illustrating one simple truism, that failure to protect copyright effectively from piracy is just bad economic and development policy, pure and simple. The studies completed this far show, to some surprisingly, that copyright industries represent from 3% to 5% of GDP even in developing countries and tend to create new jobs at a much higher rate than those economies as a whole, sometimes up to three times.

For the first time, data became available which allowed Steve Siwek, who also authors the IIPA studies, to measure the loss to the U.S. economy from global piracy. He could not do so for all the copyright industries, but that recent study, done for the Institute for Policy Innovation (IPI), concluded that global copyright piracy cost the U.S. economy at least $58 billion in total output in 2006, costs American workers 373,375 jobs and $16.3 billion in earnings, and costs federal, state, and local governments $2.6 billion in tax revenue.

These numbers, which are conservative, are still staggering and make evident that the protection of one of our countries greatest assets -- our creativity and our entrepreneurial skills in bringing that creativity to the global marketplace -- is a policy "must" for our country.

Global Piracy and the Tools to Fight it

So how are we doing in redeeming these potential gains and potential growth for the American people as a whole? Unfortunately, and at the risk of understatement, the answer is not as well as we should be. Our Congress has provided the Executive branch with a panoply of tools to tackle this challenge and over the years since the mid-80's, huge strides have been made, through the tireless efforts of USTR and other U.S. trade and IP agencies in partnership with the private sector. At that time, most of the developing countries in Asia had piracy rates near 100%, and with a few exceptions that record is manifestly better after 20 years of very hard work. But there is only so much that one country, even the U.S., can do. Other countries must take the policy decisions, develop the political will and employ it through good legislation and effective and deterrent enforcement if those gains are to come to our people and creators and their citizens and creators. Increasingly, many countries have come to this conclusion, have taken the necessary steps, and the situation is improving. We will identify some of these. But others have just begun to make the necessary policy decisions and have yet to implement them effectively. We will identify some of them too; we have spoken at two prior hearings of this Subcommittee about two of them -- China and Russia. These countries have become the poster children for all those countries where progress just isn't being made at an adequate pace.

One of the great tools that this Congress has fashioned has been the Special 301 process. Another is Congress' support of the Free Trade Agreement process beginning in the last Administration. Still another is the TRIPS Agreement which sets the global minimum standards of protection AND most importantly now, standards of effective enforcement, some of which are currently being tested before the WTO in the dispute against China. Finally, Congress, in the Digital Millennium Copyright Act (DMCA), has implemented the WIPO Internet treaties concluded in Geneva in 1996. The U.S. has been joined now by 63 and 61 other treaty members (soon to be over 80 when many EU members join) in a global effort to protect high value content on the Internet. Over 100 countries have already implemented (or are about to implement, as FTA signatories) these treaty obligations, the vast majority of them in much the same way as the U.S. did. Indeed, the U.S. has led the way by establishing the global model that has worked and has persuaded other countries to adopt much the same legislative template. This subcommittee deserves major credit for this, and we appreciate your leadership.

The Special 301 process has been a critical component of the progress made to date and continues to be a principal tool to leverage and persuade other countries to adopt essentially fair trade practices with respect to U.S. intellectual property. The copyright industries have participated actively in this process since 1989 and have greatly benefited

from this process, in terms of legal reform and improved enforcement, leading to lower piracy levels in many countries and increased sales of our companies' creative products. In turn, this has led to additions to U.S. GDP and to more U.S. jobs.

Copyright Industries' Initiatives and Challenges in the Global Struggle to Reduce Piracy

Again, before turning to discussing some of our most challenging countries, and some of the successes, Subcommittee members might benefit from a brief summary of the broader overview of these issues that is contained in IIPA's 2007 Special 301 submission. I have appended to my written testimony a copy of our transmittal letter covering IIPA's comprehensive February 2007 Special 301 submission on piracy in sixty of our key trading partners. In this submission, we report on specific actions and inactions by the country, detail specific statutory and enforcement deficiencies, and highlight their impact on the overall U.S. economy and on the U.S. creative industries. The entire report can be found on the IIPA website at www.iipa.com. In our transmittal letter, IIPA sought to put the issues facing our industries in a broader context in the process of summarizing the key global challenges to our industries and our priorities on how to deal with them. It highlights that our industries conservatively lost an estimated $16 billion in these 60 countries/territories in 2006 (data for all countries and all industries was not available).

Again it will come as no surprise that at the top of this list is securing improved and deterrent enforcement. Needed law reform to secure basic minimum rights globally has been a great success for the U.S., though further law reform to establish the legal infrastructure to fight Internet piracy remains a high priority. In that context then, IIPA has set out eight initiatives/priorities/challenges for this year, which cut across all countries.

- Securing **effective and deterrent enforcement** is at the top of the list. In addition to the use of the tools listed previously, it is critical that we make countries aware of the gains to them from reforming their enforcement systems. In addition, we highlighted the need for better coordination of enforcement training by the U.S. government, those governments in partnership with our and their industries. We called for the creation of global "best enforcement practices" which could serve as a goal that countries should reach and implement if they are to lower piracy levels.

- A major priority and challenge is the rapid growth of **Internet piracy**, as it impacts the future of electronic commerce. This growth is at alarming rates as more and more of the world's population gets connected to the Internet. The first order of business to combat this problem is to establish an effective legal infrastructure which includes ratification and full implementation of the WIPO Internet treaties (the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty). While the treaties now have 64 and 62 members, respectively (with new EU members expected soon), and even more countries have implemented their provisions, this process must continue and create a truly

global infrastructure where piracy havens cannot exist. We must also work to develop public policies that address a disturbing and growing global consumer attitude that the theft of digital content is an acceptable outgrowth of deeper Internet penetration. The healthy growth of e-commerce – critically dependent on securing a safe environment for the global transmission of valuable data, much of it protected by copyright laws – hangs in the balance.

- **Optical disc piracy** and the effective regulation of optical disc production in countries that have been unable to effectively deal with this problem is another key challenge and priority. Russia and China are a key examples of this problem. Global production capacity far outstrips global demand; using that excess capacity for pirate production has flooded the world's market with pirate optical discs containing all types of copyright material. While we have made great progress in the last ten years in reducing this threat, this work is by no means finished. Today, Internet piracy now shares the limelight with this long-standing problem. Securing effective regulation of plants in problem countries, like Russia, accompanied by deterrent enforcement is an ongoing initiative and challenge for the U.S. government and the copyright industries.

- **Piracy by organized crime syndicates** is rife particularly throughout Asia, Mexico, the states of the former Soviet Union and in Eastern Europe. Because piracy is so lucrative[1] and in many of these countries enforcement is weak and where governments are not strong enough to combat these syndicates effectively, they have taken over the business of piracy, as but another part of their illegal activities including the financing of terrorism. Our report details many examples of how organized crime syndicates go about the business of piracy. Only government intervention and government cooperation internationally can stem this growing problem – the private sector is unable to do so on its own. The U.S. government must be at the center of this effort.

- The unauthorized use of business and productivity software by governments, state-owned enterprises and private sector companies causes the largest losses globally to the business software industry -- one of the most productive and fastest-growing sectors of our economy. IIPA member, the Business Software Alliance, reported in the spring that the personal computer packaged software industry (beyond just U.S. software publishers) lost more than $32 billion globally in 2006 (counting both business and consumer software). This **"end-user copyright piracy"** also affects other copyright sectors where the ultimate business or individual consumer can now directly engage in piratical acts -- all our industries are directly affected by the ease with which copyrighted works can be copied or otherwise exploited by using the Internet. The recording and movie

[1] An always surprising statistic is that the profit margin on DVD piracy, for example, is estimated at 1150%, far exceeding the margins for trading in heroin (360%) and cocaine (1000%). See IIPA's 2007 Special 301 submission at p. 13.

industries are particularly affected. The book industry faces widespread commercial photocopying, particularly in and around universities; the entertainment software industry faces piracy in the context of the geometric growth of online games globally.

- **Piracy of books and journals**, in English and in translation, by traditional printing means, by commercial photocopying of entire editions, and through online and digital piracy, is a major problem for the U.S. publishing industry. Increasingly sophisticated technologies allow for pirate hard copies of books that are becoming more and more competitive with authorized editions. In addition, publishers are suffering from significant online piracy, mostly in the form of peer to peer trading or commercial sale of scanned versions of bestsellers and academic texts. Online piracy also affects professional and scholarly journal publishing, a mainstay of progress in the sciences, when journals which have already been put into electronic form by the legitimate publisher, appear on sites available to the ultimate, but unauthorized, user.

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

- Finally, all the gains we could achieve to reduce piracy would be worth little if countries do not afford all of our industries **full market access** to sell legitimate copyrighted products and to meet the incredible demand for them -- demand that fuels piracy around the world. Indeed, there is an intimate interconnection between market access and reducing piracy levels. We would cite China as a prime example of this interrelationship. But the problem is not limited to China.

Industry and the U.S. government have employed available tools to meet these challenges for over twenty years. We would now like to turn to reviewing the results, particularly in some key countries that IIPA has testified about previously before this Subcommittee.

The Piracy Scorecard: China, Russia and More

China: A Flawed Enforcement System Allows Piracy to Continue

Mr. Chairman, this will be our third report on the situation facing our industries in China. In my December 2005 testimony before you, IIPA's conclusion was "there has been some minor incremental progress but no significant reduction in piracy levels, either

domestically or for export." Piracy rages on in China and I am sorry I cannot report to you a different conclusion close to two years later.

Copyright pirates continue to control 80%-90% of the market in most copyright sectors. In addition, in the music, recording, motion picture and entertainment software industries, U.S. companies are doubly handicapped by the restrictions the Chinese government places on their ability to compete fairly and effectively in the market. IIPA estimates that losses to the copyright industries in China exceeded **$2.4 billion** in 2006.[2]

This doesn't mean, however, that some progress hasn't been made: Last year, for example, China's software piracy rate dropped four percentage points for the second year in a row, and it has dropped ten percentage points in the last three years. Much of this decline can be attributed to China's implementation of its JCCT commitments to legalize government software use and require preloading of legitimate operating system software on PCs sold in China. By reducing China's piracy rate by ten percentage points over three years, $864 million in losses was saved. The legitimate software market in China grew to nearly $1.2 billion in 2006, an increase of 88% over 2005. Since 2003, the legitimate software market in China has grown over 358%.

On the legal front, China adopted new regulations in 2006 to deal with protection of content over the Internet and adopted many of the suggestions made by IIPA and our members in a surprisingly transparent regulatory process. This was followed by China's accession to the WIPO Internet Treaties, fulfilling another of China's JCCT commitments.

Industry used these new regulations to engage websites and ISPs to take down infringing materials. The authorities took administrative action in some of these cases, and while a number of websites have closed, administrative penalties have been low and the resources devoted by the government have not been nearly adequate to the task, the punishments have not been deterrent, regulatory obstacles remain and the problem continues to get worse. The administrative authorities have not, for example, taken action against ISPs that have failed to promptly remove infringing materials. In addition, those authorities have recently issued non-binding rules setting onerous requirements for notifying ISPs and getting them to execute promptly take downs. These "rules," even though not binding, have given comfort to ISPs and they have increasingly failed to cooperate with right holders. The authorities are even suggesting that notifications must be via physical letters with much supporting materials rather than by e-mail as is done in every other country. These requirements undermine the efficacy of the procedures to either removing the infringing material at all and certainly cripple our members' ability to see prompt action.

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[2] This loss number does not include losses due to piracy of motion pictures or entertainment software for which 2006 data was unavailable. See http://www.iipa.com/pdf/IIPA2007TableofEstimatedTradeLossesandPiracyLevelsfor2006ASIA060607.pdf

To illustrate how serious Internet piracy in China has become, according to surveys, one of the largest Internet sites in China, Baidu, is alone responsible for 50% of all of the illegal downloads of music in China. While Baidu holds itself out as a mere search service, it engages in practices such as compiling "top 100 lists," including of American chart music, and then providing "deep links" directly to infringing files on other illegal services, thereby engaging in the kind of "inducement" of infringement that should be held illegal. Unless Baidu is prevented from continuing such unfair and illegal practices, legitimate Internet distribution of recorded music will never take place; no company will be willing to enter the market with a legitimate service under such conditions. This remains a number one priority for the U.S. record industry and is a threat to all legal Internet services dealing in legitimate content.

The bottom line, Mr. Chairman, is that the Chinese government stubbornly continues to adhere to a flawed enforcement system, relying on administrative inspections, raids, seizures and low, non-deterrent sanctions imposed by administrative enforcement authorities rather than employing its police and prosecutors to bring criminal actions against piracy, with deterrent penalties. China can rightfully point to massive raiding activity by many agencies of the government. Unfortunately, since these raids lead only to small administrative fines, all of this enforcement activity has had little impact on street-level piracy.

Over the last two years the motion picture and recording industry have conducted three detailed surveys of the retail marketplace for their products in the key major cities in China. In the last half of 2006, China undertook a heavily publicized "100-day campaign" against piracy. The surveys these industries took both before and after the "campaign" showed little, if any, change in the actual retail market.

Retail shops either moved physically or moved their pirate product to the back of the store. While some stores closed, others were opened and many raided stores reopened. Why? Because there was no effective incentive to get out of the piracy business, fines were small and criminal actions, which could have had a deterrent effect -- as they have in almost every other country in Asia -- were non-existent.

In part this was because the threshold for criminal liability is set so high that retail piracy is simply not a criminal act in practice. This is one of the claims in the WTO IPR case now pending in Geneva.

Even if the thresholds did not exist at all, the Chinese government has shown, with regard to manufacturing of pirate optical discs, that it is not -- yet at least -- willing to employ criminal sanctions in even serious cases.

An example of this failure is the recording and motion picture industry's almost Herculean efforts to try to persuade Chinese enforcement authorities to bring criminal actions against 20 optical disc plants against which there was dispositive forensic evidence infringing discs found in markets all over the world were produced in those

plants. Our latest information is that none of these 20 cases are being prosecuted; the criminal authorities almost invariably sent the industries back to the administrative authorities. "This is their job," they said. These are large factories sending millions of units of pirate product throughout China and globally. Until the police and prosecutors make it their job, little will change.

The record, as far as we are able to ascertain it in China's non-transparent enforcement regime, is that there have been only six criminal cases involving U.S. copyrighted works (and only a few more actions involving works of other WTO members) since 2001, when China joined the WTO.

In addition, Customs enforcement is simply not a priority for the government, and as such, pirated and counterfeit products continue to flow largely unabated out of the country.

We recognize that, for the most part, this is a grim report and the Chinese regularly accuse us of exaggeration and "misunderstanding the Chinese system." But many of our industries run anti-piracy programs in 100 countries around the world. We look for results, not process. While there has been some progress, those results simply are not there, Mr. Chairman.

That said, as an overall assessment, I must highlight some of the areas where we have seen progress for some industries. As noted above, the business software industry has benefited from the government's efforts to legalize software use in the central and provincial governments, that industry's biggest customers. Those efforts should continue, and become institutionalized within the budgeting and procurement processes for all government entities. The industry benefited when the Chinese passed a regulation forcing all computer manufacturers in China and those companies importing hardware into China to load only legal operating systems on those computers As noted above, this has resulted in increased sales for that industry. China has committed to extend its legalization efforts to enterprise software use, and it is our hope that those efforts will be stepped up considerably. With regard to enforcement against the business software industry's main piracy problem – "end-user" piracy – industry's efforts have been hampered by an endemic lack of resources for the agency charged with enforcing administrative regulations against such piracy Additionally, the Chinese have failed to interpret their criminal law as covering this "end-user" piracy.

The book and journal publishing industry has benefited from some increased administrative enforcement against piracy of textbooks in the university environment, but much more needs to be done and the industry is seeking high level engagement with the Ministry of Education. But it should be noted that while administrative enforcement has made a minor dent here, the nature of these "infringers" is far different that those we are talking about for the industries that face optical disc manufacturing, export and retail piracy and counterfeiting.

The entertainment software industry has been able to take significant advantage of the massive demand for online gaming in China and piracy has been minimized in this market by the effective use of "technological protection measures." However, the "hard goods" marketplace is virtually non-existent for most of these companies, with piracy at very high levels, the same as for other "hard goods" industries.

Mr. Chairman, we reported to this Subcommittee in December 2005 that industry is severely hampered by the lack of meaningful statistics available on enforcement in China. By not publicizing to us or to its own citizens that piracy per se is a serious crime and that it imposes very heavy penalties on these illegal acts, it gives comfort to the pirates, who know that the government is in effect turning a blind eye to their infringements. China is fully experienced with stamping out illegal conduct – when it wants to and when it threatens a political value that it considers fundamental. China is using this lack of transparency to wage a propaganda war that is cheating its own creators and hiding its non-deterrent enforcement system from public view. We must continue to insist that China's system become far more transparent at every level – and that it be effective.

China: No Movement on Market Access for Most Industries

As we have noted here and in our previous appearances before the Subcommittee, there is a direct symbiotic relationship between piracy and China's severe market access restrictions on the motion picture, music, entertainment software and book publishing industries. The plain fact is that U.S. copyright products have almost total access to the Chinese market, in pirate copies with billions of dollars being earned by pirates, not by the rightful owners of that product.

Efforts were made in the two most recent JCCT meetings to improve this situation for U.S. copyrighted cultural products -- to liberalize market access commitments enshrined in the WTO Accession Protocol and to persuade the Chinese to bring other practices which we believe violate its WTO commitment into full compliance. U.S. government efforts on this front met with total resistance. The Chinese government made crystal clear that they had no intention of opening up its market further to cultural products beyond their minimal commitments in the WTO. It is this unwillingness to move at all on either front that formed the motivation, we believe, for the U.S. government's market access claims on behalf of some of the copyright industries which were brought to the WTO consultation process and are poised to move to the panel stage, if the consultations fail.

China is the most closed market in the world for the U.S. cultural industries. Given the massive trade deficit which this country has with China, it is inexcusable that one of our country's most productive sectors is effectively denied entry to one of the largest markets in the world – a market where the demand for our products is deep and growing. China is allowing the pirates to steal money straight out of the pockets of the millions of creators and workers in our industries and of Chinese creators as well.

Market access restriction are myriad and serious. The publishing, motion picture and recording industries face restriction on their trading rights (right to import), and on distribution within the country. The recording industry faces discriminatory censorship requirements not imposed on local record companies. The entertainment software industry faces slow censorship procedures for its hard goods and online game products, giving the pirates an almost insurmountable lead in this fast-moving, hit-driven videogame market. The motion picture industry also faces censorship delays as well, plus the Chinese only allow twenty foreign films, from all sources, into their market every year and constrain the distribution of those films to a government-owned and controlled duopoly.

China: Conclusion

At the December 2005 hearing, IIPA was asked to list those actions which we wanted the Chinese government to take to get a handle on its piracy and market access problems. We do not need to repeat them here. Our recommendations would be virtually unchanged from almost two years ago.

Russia: A Good IPR Agreement with the U.S. in Need of Implementation

Russia is at a critical juncture in the development of its IPR regime. On November 19, 2006, Russia signed a Bilateral IPR Agreement ("IPR Agreement") with the United States. The IPR Agreement is a free-standing bilateral trade agreement, as well as Russia's roadmap to WTO accession, with respect to intellectual property protection and enforcement.

The Agreement reflects Russia's acknowledgment of the many legal reforms and enforcement steps it needs to implement in order to develop a modern and effective copyright system. Russia's full compliance with the IPR Agreement is essential for the high piracy rates in Russia to come down and in order to develop a healthy environment for U.S. (and other foreign) copyright-based businesses to operate in Russia. The IPR obligations require Russia to implement very specific legal reforms, to undertake "meaningful enforcement," and to do so "on a priority basis."

Russia has undertaken some legal reform and enforcement measures in the past few years, and more since the IPR Agreement was signed. Unfortunately, Russia is presently not meeting its obligations under the IPR Agreement especially with regard to Russia's dual problems of optical disc ("OD") and Internet piracy. In fact, since our last testimony before this subcommittee regarding piracy in Russia two years ago, piracy rates have continued to hover around 65%-80% of the market for the copyright industries.

As a result of these enforcement problems and the high piracy rates in Russia, the IIPA recently testified in support of denying Russia's continued benefits under the

Generalized System of Preferences (GSP) program.[3] In 2006, Russia benefited from over $512 million in duty free GSP imports into the United States. In contrast, U.S. companies suffered losses of over $1.95 billion due to copyright piracy in Russia (as detailed in our February 12, 2007 Special 301 filing).[4]

The number of optical disc (i.e., CD and/or DVD) plants in Russia has more than tripled in just the last three years, so that at present there are close to 50 plants. Production capacity has nearly tripled as criminal operations have encountered little hindrance in expanding their activities. In short, Russian optical disc piracy is a massive problem. Russia agreed to address the optical disc problem on a comprehensive basis, with the objective of permanently closing down illegal plants. Russia was supposed to conduct "repeated, unannounced inspections" of all known OD plants. These inspections were to "take place regularly, without prior notice, and at any time, day or night." Criminal proceedings were to be initiated "[i]f evidence of unauthorized production of optical media bearing content protected by copyright or related rights on a commercial scale is found..." In addition, Russia agreed to adopt an effective OD licensing law, However, Russia has not met these obligations. Instead, according to IIPA's information, this year, Russian authorities have inspected only three out of an estimated 50 manufacturing facilities under the old inspection law, and have not yet released a draft of any new law or regulations.

In 2006 and 2007, IIPA members witnessed some improvements in enforcement, primarily at the retail level against vendors of illegal optical disc materials and companies involved in the installation and use of pirated software, and some large-scale raids against warehouses storing illegal material. In another improvement from prior years, some deterrent sentences and prison terms have been applied by Russian courts, including some (albeit a few) aimed at serious repeated offenders. Over the past few years, a few people employed by the plants were convicted – after extensive delays in criminal investigations – but most have received suspended sentences. In the business software area, BSA reports an increase in the number of civil actions commenced by right holders that have had a deterrent effect on illegal activities to the benefit of legitimate software distributors.

While these improvements are important, overall, there is little deterrence – by way of criminal penalties – against those who continue to conduct large-scale commercial piracy in Russia. Clearly, the priority for IIPA members in Russia is to step up significantly enforcement activity to provide adequate and effective enforcement of IPR violations, including the imposition of criminal deterrent penalties. In short, Russia is undertaking some enforcement activity – and by some measure, more than in prior years, but still much more needs to be done to meet the requirements of the IPR Agreement.

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[3] http://www.iipa.com/pdf/IIPARussiaGSPPre-hearingBriefSept2007.pdf
[4] http://www.iipa.com/rbc/2007/2007SPEC301RUSSIA.pdf

The IPR Agreement obligates Russia to combat the growing threat of Internet piracy "with the objective of shutting down websites that permit illegal distribution of content protected by copyright or related rights" (and especially for websites whose servers are situated in Russia). Russia has taken some action in this regard (according to the Russian Government identifying 166 offending sites and closing 72 of them). In June, the most notorious website (even noted in the IPR Agreement), allofmp3.com, was taken down, and to this point has not resurfaced at that Internet address. However, another site, nearly identical and apparently owned and operated by the same company has sprouted up in its place, and the illegal distribution of copyrighted material continues there, as well as on many other sites. Investigation of Internet distribution of other types of works, such as business and entertainment software, books, as well as music and film material, by a variety of technical means, must be stepped up by criminal investigators. Few, if any, criminal cases have been pursued against illegal website operators.

Last, while IIPA notes the many legal reforms that Russia has undertaken (see the IIPA's recent Out-of-Cycle Review and GSP filings),[5] Russia has agreed to many key reforms that have not yet been adopted. The list of legal reforms (more fully detailed in those recent IIPA filings) include: (1) improvements to Russia's basic copyright code (now a part of Civil Code at Part IV); (2) the Criminal Code which needs to be amended to make legal entities liable for IPR crimes; (3) the Customs Code which must be amended to add *ex officio* authority (IIPA understands this amendment is now pending in the Duma); and (4) the complete implementation (in the Civil Code) and ratification of both digital treaties – the WCT and the WPPT. In addition, and most importantly, are the long-promised optical disc regulations, which would properly regulate the licensing of plants (and their equipment and raw material used in production), the (surprise) inspection of plants, the closure of illegal plants and the sanctions to be imposed – including criminal penalties – for violations.

Russia: Conclusion

IIPA members sincerely hope that the U.S. government and the Russian government can make progress in implementing the comprehensive IPR Agreement. Only the full implementation of this Agreement will result in improving Russia's IPR regime for the benefit of U.S. and Russian authors and producers, and will permit Russia, by fully complying with TRIPS, to accede to the World Trade Organization. We look forward to working with the Russian and U.S. governments, and members of this subcommittee to meet these goals, to see the IPR Agreement fully implemented and the Russian IPR regime improved.

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[5] http://www.iipa.com/pdf/IIPARussia2007OCRSubmission.pdf; http://www.iipa.com/pdf/IIPARussiaGSPPre-hearingBriefSept2007.pdf

Beyond China and Russia: Canada

Enforcement and law reform problems are not limited to countries like China and Russia. The situation in Canada, for example, is truly disappointing. Not only is enforcement inadequate but Canada is one of the last countries in the developed world to adopt modern law reforms to deal with the new technological environment of the Internet. Canada is clearly behind the times.

The U.S. government has been urging Canada to address its piracy problems for years. Canadian law enforcement has at least acknowledged the problems, including the role of organized criminal gangs; but Canada's inadequate laws have left them handcuffed. Bills to modernize Canadian law and enforcement practices, particularly with respect to the Internet, have been mysteriously stalled within relevant Ministries, notwithstanding the public support of the relevant Ministers and the issuance of a number of Parliamentary calls to act.

Canada recently adopted a much needed amendment to outlaw camcording in theaters. This was a significant and welcome development in the fight against the piracy of motion pictures.

Other needed laws, however, are only in the drafting stage with no one knowing what these drafts will provide. Customs enforcement in Canada is inadequate and it is extremely difficult to get ISPs to cooperate in taking down infringing material given, in this respect, the woefully inadequate copyright law. Illicit filesharing is not clearly illegal and Canada is now a center for servicing this activity, damaging the U.S. market and others around the world.

Canada must move quickly to solve these problems.

Beyond Russia and China: India

India is fast becoming an economic powerhouse like China and increasingly investment is moving there. The situation facing our industries continues to remain stagnant with over **$750 million** in estimated losses and continuing barriers to entry into the market. The courts continue to be overburdened with little improvement in sight, at least on the key criminal side of the enforcement equation. India is desperately in need of law reform not only to deal with the Internet (like Canada it has yet to adopt legislation implementing the WIPO Internet treaties) but to deal with optical disc piracy (both draft laws have languished for years), and enforcement should be strengthened for all industries. India could be a great market for the copyright industries if needed legal and enforcement reforms are made soon. The Indian government at both the federal and state level must muster the political will to push through long-needed reform. USTR has commenced a bilateral "Trade Policy Forum" with India and IPR is solidly on that agenda.

Have Any Countries Dealt Successfully with Piracy?

While piracy will never be eliminated in any country, there have been some notable success stories, both in key areas and overall.

Singapore: Singapore was a pirates' haven in the 1980s but it soon recognized that its economic growth path depended critically on IPR protection. It passed a reasonably good law in 1987 and was one of the first countries to sign and implement an FTA with strong protection and enforcement provisions. But probably most important has been its willingness to support effective criminal actions against piracy. Piracy rates are among the lowest in Asia (5%-10% for audio and video piracy, 39% for business software).

Taiwan: Taiwan without question was the "Counterfeit Capital of Asia" in the 1980's but through effective and deterrent criminal enforcement, in most sectors, piracy rates came down significantly to 10-15% in the late 1990s, but then increased to over 50% in these areas by 1992-3 as a result of its allowing OD piracy and organized crime to take over. It has since tackled this problem effectively, again through aggressive and deterrent enforcement, such that today, pirate OD exports are virtually non-existent. Even Internet piracy has been put at the forefront of government attention. A major pirate service, Kuro, was criminally convicted and Taiwan recently adopted a law criminalizing peer to peer piracy. While the struggle is constant, and vigilance is still required when it comes to Taiwan's domestic market—especially on its university campuses, Taiwan has come a very long way from its notorious beginnings.

Brazil: Recent successes in Brazil on copyright enforcement have been significant. Brazil has done a noteworthy job of tackling physical piracy, especially optical disc piracy, with a significant number of raids and seizures of pirated product. Moreover, despite its political rhetoric (Brazil has been on the opposite side from the U.S. on almost every IPR issue at the international level), its copyright law is a modern one, even implementing many aspects of the WIPO Internet treaties (which it still needs to ratify). Importantly, good cooperation with copyright industries exists within the CNCP (National Council to Combat Piracy and Intellectual Property) on work plan prioritization and operational matters. There is increasing enforcement cooperation between federal and state authorities.

Despite these welcome successes, however, work must continue to address the high levels of copyright piracy and ineffective criminal enforcement that have marked the Brazilian market for many years. Piracy remains prevalent at the same hot spot locations due to the failure to prosecute and hold offending parties accountable. Internet piracy is on the rise, and more engagement regarding book piracy on university campuses.

Pakistan: Three or four years ago, Pakistan was a major global exporter of pirate OD product manufactured in unregulated plants throughout the country. Under pressure from

the U.S., it took on this challenge and OD exports have all but ceased. However, its record in other areas, particularly book piracy, remains abysmal.

Ukraine: While no one would hold up Ukraine as a success story across the board, it has taken effective action against its version of *allofmp3.com*, setting a good example for its reluctant neighbor, Russia

FTAs: As noted above, this process has been a major success for our industries. The copyright standards in the FTAs are truly excellent and models for all countries.

Conclusion

As this Subcommittee knows so well, meeting the challenges faced by the copyright industries in a globalized -- and online -- world will require resolute action by the U.S. government and by the governments of our trading partners. While it is essential that copyright owners throughout the world join together with their governments to protect and nurture these industries which are, and will increasingly be, critical to global growth and trade, we cannot meet these challenges alone. Focused, effective government action is a necessary component in fighting the scourge of piracy.

The U.S. government has risen to meet these challenges and we are grateful for the long-standing support we have enjoyed from USTR, from the State and Commerce Department and from the Copyright Office and the Patent and Trademark Office over the years. This Subcommittee has been at the forefront, not only in recognizing the importance of intellectual property to growth and jobs, but in exercising constant vigilance to see that U.S. interests are protected. We thank you, Mr. Chairman, Ranking Member Coble and all the members of the Subcommittee for all the support you have given our companies and these issues over the years.

I would be pleased to answer any of your questions.

Mr. BERMAN. Thank you very much.

Dr. Yager?

TESTIMONY OF LOREN YAGER, DIRECTOR OF INTERNATIONAL AFFAIRS AND TRADE, U.S. GENERAL ACCOUNTABILITY OFFICE (GAO), WASHINGTON, DC

Mr. YAGER. Good morning, Mr. Chairman, Members of the Subcommittee. I am pleased to be here today to report on our work on intellectual property protection before the Subcommittee of the U.S. Congress that has identified this topic as one of its primary areas of focus.

Prior hearings of this Subcommittee have focused on the patent reform act, trying to create the right formula for stimulating creative and inventive activity in the United States.

Ultimately, once the patents or other protections have been granted, it will only be meaningful if there is protection of IP in the United States as well as in other countries.

Today I will discuss the increasing challenges to IP protection as advances in technology and changes in global manufacturing make counterfeiting and piracy an ever greater threat.

As requested, I will summarize the work the GAO has performed on two subjects, first the nature of the risk that U.S. corporations face in protecting IP, and second, U.S. methods for implementing and coordinating United States' intellectual property enforcement activities.

My remarks are based on a variety of assignments the GAO has conducted for the Congress related to IP protection over the past 5 years.

The first major subject I would like to cover in this statement is that the risk to IP is increasing for U.S. firms, for a number of reasons.

For example, as the technological and manufacturing capability in Asia increases in industries such as the semiconductor industry, more complex parts of the production process are being carried out in countries like China, which puts more U.S. technology at risk.

A second reason is that high profits and technological advances have also raised the risk of IP infringements by encouraging and facilitating counterfeiting and piracy.

Economic incentives for counterfeiting and piracy include low barriers to entry and high profits, given that there is no repayment of the research and development or other reward for the inventive activity.

In addition, technology has allowed high-quality, inexpensive and accessible reproduction and distribution, particularly in the digital industries.

At the same time, the level of deterrence has not kept pace with the level of profitability. For example, there has been weak enforcement in some countries, and China is a country where the combination of production capability as well as export capacity is unique.

However, there are many other countries where enforcement challenges have persisted despite U.S. efforts.

The second subject I want to cover is the U.S. domestic efforts to protect intellectual property can also be improved.

The United States faces significant obstacles to coordinating domestic efforts and ensuring that strong intellectual property protection remains a priority.

One of the biggest obstacles is the crosscutting nature of the issue and the necessity for coordination between the large number of agencies involved in IP protection.

In my written statement, I have included a figure showing the different agencies and sub-agencies involved in IP protection, and the figure includes policy agencies such as USTR, enforcement agencies such as the FBI, as well as technical offices such as the copyright office.

We took a close look at the IP coordination structure in the United States and found that it lacks permanence as well as some other features that are central to the success of this type of effort.

We also reported on the efforts of customs and border protection to interdict counterfeit goods at the U.S. border and found that the bulk of customs enforcement outcomes in recent years have been accomplished within certain modes of transport, product types, and have been restricted to a very limited number of ports.

For example, only 10 of the 300-plus ports are responsible for three-fourths of the seizure value, but yet these were not necessarily the largest ports in terms of import volume.

We made a series of recommendations to customs that we believe will help them better focus their IP inspection activities.

In conclusion, Mr. Chairman, having the right formulas for creating intellectual property is of limited value unless there is sufficient protection for the works that are created, and this hearing directly addresses that issue.

There is little disagreement, at least domestically, with the need to strengthen protection, but the difficulty is in how to best achieve that goal in the face of the strong economic incentives for counterfeiting and the limited resources available to protect it.

While there are many elements of a successful national strategy, continuity is central to success, whether that is in the efforts to encourage trading partners such as China, the domestic efforts of U.S. agencies, or in the oversight by Congress.

We appreciate the opportunity to discuss some of our findings before this Subcommittee and would be happy to help consult further to help achieve the long-term goals.

Thank you, Mr. Chairman. I would be happy to answer any questions.

[The prepared statement of Mr. Yager follows:]

PREPARED STATEMENT OF LOREN YAGER

United States Government Accountability Office

GAO

Testimony

Before the House Judiciary Subcommittee on Courts, the Internet, and Intellectual Property

For Release on Delivery
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INTELLECTUAL PROPERTY

Risk and Enforcement Challenges

Statement of Loren Yager, Director
International Affairs and Trade

GAO-08-177T

GAO
Accountability-Integrity-Reliability

Highlights

Highlights of GAO-GAO-08-177T, a report to House Judiciary, Subcommittee on Courts, the Internet, and Intellectual Property.

Why GAO Did This Study

Intellectual property plays a significant role in the U.S. economy, and the United States is an acknowledged leader in its creation. Industries that relied on IP protection were estimated to account for over half of all U.S. exports and employed about 18 million Americans in 2006. However, legal protection of IP varies greatly around the world, and several countries are havens for the production of counterfeit and pirated goods. Counterfeit products raise serious public health and safety concerns, and the annual losses that companies face from IP violations are substantial. Eight federal agencies undertake a wide range of activities in support of protecting IP rights, and two mechanisms coordinate protection efforts: the National Intellectual Property Law Enforcement Coordination Council (NIPLECC) and the Strategy for Targeting Organized Piracy (STOP!). GAO was asked to address: (1) the nature of the risks that U.S. corporations face in protecting IP, particularly in countries such as China, and (2) U.S. methods for implementing and coordinating domestic IP enforcement activities. This testimony is based on issued GAO reports that focused on IP protection and related trade matters.

What GAO Recommends

In prior reports, GAO made a number of recommendations to various agencies to strengthen their management of their IP enforcement efforts.

To view the full product, including the scope and methodology, click on GAO-GAO-08-177T. For more information, contact Loren Yager at (202) 512-4128 or yagerl@gao.gov.

October 18, 2007

INTELLECTUAL PROPERTY

Risk and Enforcement Challenges

What GAO Found

U.S. intellectual property is increasingly at risk of theft as U.S. firms become more integrated into the world economy and the production of more sophisticated processes and investments move overseas. High profits and technological advances have also increased the risk of IP infringements by making counterfeiting and piracy more attractive and easy to conduct. At the same time, deterrents such as penalties and other measures have failed to keep pace. The seriousness of these risks has been exacerbated by weak enforcement in some countries, particularly China.

While the U.S. faces significant obstacles when trying to ensure effective IP protection abroad, it also faces serious challenges in coordinating domestic efforts and ensuring that IP protection remains a priority. The large number of federal agencies involved, due to the cross-cutting nature of IP protection, makes coordination particularly important. However, GAO's recent report on coordinating mechanisms for federal IP protection, we found that the effectiveness and long-term viability of the coordinating structure is uncertain. In addition, each of the agencies involved in IP has multiple missions, and it is a challenge to ensure that IP enforcement is a sufficiently high priority. GAO's report on the efforts of the Customs and Border Patrol (CBP) to interdict counterfeit goods at the border found that the bulk of CBP's enforcement outcomes in recent years have been generated by pockets of activity within certain modes of transport and product types as well as among a limited number of port locations. While the number of seizure actions has increased, this growth can be attributed to a growing number of small-value seizures made from air-based modes. CBP lacks an approach to further improve border enforcement outcomes; it has been focused on efforts that have produced limited results, while not taking the initiative to understand and address the variations among ports.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to report on our work on intellectual property (IP) protection before the subcommittee of the U.S. Congress that has identified this topic as one of its primary areas of focus. I appreciate the opportunity to provide some insights from GAO's wide range of work on this issue. As you know, intellectual property is an important component of the U.S. economy. Prior hearings of this subcommittee have focused on the patent reform act, trying to create the right formula for stimulating creative and inventive activity in the United States. Ultimately, however, patents will only be meaningful if there is real protection of IP in the United States as well as other countries. Today, I will discuss the increasing risk and enforcement challenges to IP protection as advances in technology and changes in global manufacturing make counterfeiting and piracy a greater threat.

This hearing is particularly timely, as during the last year a number of news stories have raised severe doubts among the American people about the quality and safety of products imported from China and the ability of the Chinese government to regulate its manufacturers. While some of the goods that posed risks in recent months were legitimate goods associated with U.S. firms (Mattel), it is well known that counterfeit goods from China pose risks to U.S. consumers, and unlike the situation with legitimate goods, there is little recourse to go back to the importer or manufacturer and demand that the risks be eliminated.

I know that many of these issues are familiar to members of this subcommittee, particularly as this panel held back-to-back hearings on China and Russia IP theft in May 2005. As requested, today I will summarize the work that GAO has performed in two areas: (1) the nature of the risks that U.S. corporations face in protecting IP, particulary in countries such as China, and (2) U.S. methods for implementing and coordinating U.S. IP enforcement activities.

My remarks are based on a variety of assignments that GAO has conducted on IP protection over the past 4 years. Some of this work was focused on the challenges that U.S. firms face in securing IP protection abroad, and some has focused on the extent to which U.S. firms rely on nations like China and India as part of their production chain. We have also done extensive work on the international and domestic efforts undertaken by U.S. agencies to coordinate their efforts to address IP theft and piracy issues. Finally, we have drawn from some of our ongoing work for the Senate regarding federal efforts to enforce IP rights at the border. We

made several recommendations during the course of this work, with which the recipient agencies generally agreed. Our work was conducted in accordance with generally accepted government auditing standards.

Summary

U.S. intellectual property faces increasing risk of theft as U.S. firms integrate into the world economy and the production of more sophisticated processes and investments move overseas. For example, as the technological and manufacturing capability in Asia increases, such as in the semiconductor industry, more complex parts of the production process are being carried out in countries like China. High profits and technological advances have also raised the risk of IP infringements by encouraging and facilitating counterfeiting and piracy, while the deterrents, such as penalties and other measures, fall short. Economic incentives for counterfeiting and piracy include low barriers to entry, high profits, and limited or low legal sanctions if caught. At the same time, technology has allowed accessible reproduction and distribution in some industries. The severity of these risks has been intensified by weak enforcement in some countries, particularly China, whose enforcement challenges have persisted despite U.S. efforts.

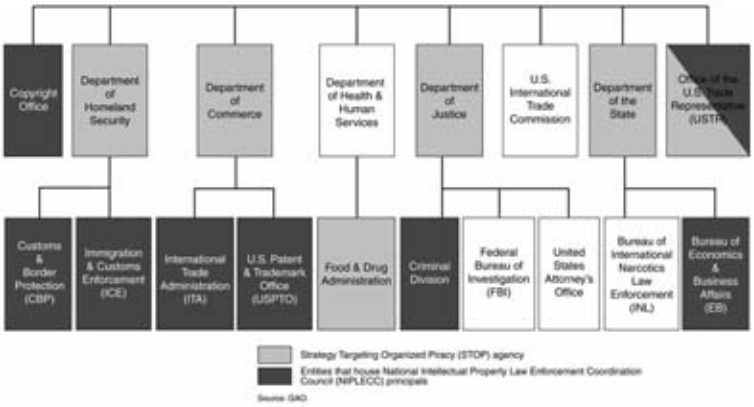
The United States faces significant obstacles to both providing effective IP protection abroad while coordinating domestic efforts and ensuring that strong intellectual property protection remains a priority. The cross-cutting nature of the issue and the necessity for coordination is evident given the large number of agencies involved in IP protection. However, we recently reported on the law enforcement coordinating council and found that the effectiveness and the long-term viability of the current IP enforcement coordinating strncture is uncertain and made particularly challenging by agencies' multiple missions. Our report on the efforts of the Customs and Border Patrol (CBP) to interdict counterfeit goods at the border found that the bulk of CBP's enforcement outcomes in recent years have been accomplished within certain modes of transport and product types and have been restricted to a limited number of ports. For example, 10 ports are responsible for three fourths of the value of the goods seized. Despite recent increases in seizure outcomes, CBP lacks an approach to make further improvements in its level of seizures. We found that CBP has focused on efforts that have had limited results and has not taken the initiative to understand and address the variations in seizure outcomes among ports. For instance, CBP lacks data with which to analyze IP enforcement trends across transport modes and has not tried to determine whether certain ports have been relatively more successful in capturing IP-infringing goods.

Background

Intellectual property, for which the U.S. government provides broad protection through means such as copyrights, patents, and trademarks, plays a significant role in the U.S. economy, and the United States is an acknowledged leader in its creation. According to the U.S. Intellectual Property Rights Coordinator, industries that relied on IP protection were estimated to account for over half of all U.S. exports, represented 40 percent of U.S. economic growth, and employed about 18 million Americans in 2006. However, the economic benefits that copyrights, trademarks, and patents bring are threatened by the fact that legal protection of IP varies greatly around the world, and several countries are havens for the production of counterfeit and pirated goods. The global illicit market competes with genuine products and it is difficult to detect and take actions against violations. Although the public is often not aware of the issues and consequences surrounding IP theft, counterfeit products raise serious public health and safety concerns, and the annual losses that companies face from IP violations are substantial. The Organization for Economic Cooperation and Development recently estimated that international trade in counterfeit and pirated products in 2005 could have been up to $200 billion.

Eight federal agencies as well as entities within them undertake a wide range of activities in support of protecting IP rights, as shown in figure 1. These are the Departments of Commerce, State, Justice, Health and Human Services, and Homeland Security; the U.S. Trade Representative (USTR); the Copyright Office; the U.S. International Trade Commission; within Justice, the Federal Bureau of Investigation (FBI); and within Commerce, the U.S. Patent and Trademark Office (USPTO). In addition, two entities coordinate IP protection efforts: the National Intellectual Property Law Enforcement Coordination Council (NIPLECC), created by Congress in 1999, and the Strategy for Targeting Organized Piracy (STOP), initiated by the White House in 2004. (These are discussed later in this testimony.)

Figure 1: Primary U.S. Agencies and Entities Supporting U.S. IP Rights



Source: GAO

Note: NIPLECC is required to consult with the Register of Copyrights on copyright law enforcement matters. Immigration and Customs Enforcement, while not an original member, was reported as a member of NIPLECC in the council's fifth annual report issued in September 2006.

U.S. agencies use policy initiatives and enforcement activities to improve IP protection in the United States and abroad. Policy initiatives include reviewing IP protection undertaken by foreign governments and negotiating agreements that address intellectual property. Trade policy initiatives to increase IP protection and enforcement are primarily led by USTR, in coordination with the Departments of State, Commerce, USPTO, and the Copyright Office, among other agencies. Enforcement activity in the United States includes detecting and seizing IP-infringing goods at the U.S. border and investigating and prosecuting those who engage in IP-infringing activities. The Department of Justice, including the FBI, and the Department of Homeland Security's Customs and Border Protection (CBP) and Immigration and Customs Enforcement take actions such as engaging in multicountry investigations involving intellectual property violations and seizing goods that violate IP rights at U.S. ports of entry. The Food and Drug Administration (FDA) also investigates intellectual property

violations for FDA-regulated products as part of its mission to assure consumer safety.

U.S. Intellectual Property Increasingly at Risk As Firms Operate Globally and Economic Incentives and Technology Facilitate IP Theft, Which is Exacerbated by Weak Enforcement

U.S. intellectual property is increasingly at risk of theft as U.S. firms become more integrated into the world economy and the production of more sophisticated processes and investments move overseas. High profits and technological advances have also increased the risk of IP infringements by making counterfeiting and piracy progressively attractive and easy, while the deterrents, such as penalties and other measures, fail to keep pace. The seriousness of these risks has been exacerbated by weak enforcement in some countries, particularly China, whose enforcement problems has persisted despite U.S. efforts.

Global Operations Increase the Risk of IP Theft

The risk of IP theft increases as U.S. companies operate more globally and locate their production facilities in other countries. Our report on the U.S. semiconductor industry illustrates this movement of production to other countries and increasing concerns about IP theft.[1] Initially, U.S. firms invested in overseas manufacturing facilities such as India and China, to perform the labor-intensive assembly of semiconductors for export to the United States. However, as the technological and manufacturing capability in Asia increased, more sophisticated parts of the process have been sourced in India and China. This shift where more advanced technology is being used abroad creates a greater risk for those firms involved by making advanced technologies protected by IP laws more readily available to those who might want to copy them illegally.

The shift of operations to overseas facilities is also evident in the U.S. investment statistics. For example, we reported in December 2005 that U.S. investment in China has been growing, and the value of U.S. affiliate sales in China began to exceed the value of U.S. exports to China in 2002.[2]

[1]See GAO, *Offshoring: U.S. Semiconductor and Software Industries Increasingly Produce in China and India,* GAO-06-423; Sept. 7, 2006.

[2]See GAO, *China Trade: U.S. Exports, Investment, Affiliate Sales Rising, but Export Share Falling*, GAO-06-162, Dec. 12, 2005.

U.S. companies have generally concentrated their investments in China in the manufacturing sector, in industries such as transportation equipment, chemicals, and computers and electronic products. U.S. investment in China funds the creation of U.S. affiliates, who then sell in China and to other countries, including the United States. U.S. affiliate sales of goods and services have become an important avenue for accessing the Chinese market. Factors such as the growing Chinese market, lower labor costs, and China's accession to the World Trade Organization (WTO) have drawn U.S. companies to increase their investment and sales in China.

Economic Incentives and Technological Advances Also Raise the Risk of IP Violations

Economic incentives to commit counterfeiting and piracy activities contributed to the growth in IP rights violations in recent years. Economic incentives include low barriers to entering the counterfeiting and piracy business, potentially high profits, and limited or low legal sanctions, including penalties, if caught. For example, one industry pointed out that it is much more profitable to buy and resell software than to traffic in cocaine. In addition, the low prices of fake products are attractive to consumers. The economic incentives can be especially acute in countries where people have limited income. Economic incentives have also attracted organized crime in the production and distribution of pirated products. Federal and foreign law enforcement officials have linked intellectual property crime to national and transnational organized criminal operations. The involvement of organized crime increases the sophistication of counterfeiting operations, as well as the challenges and threats to law enforcement officials confronting the violations.[8]

Technological advances have lowered the barriers to counterfeiting and piracy by allowing for high-quality, inexpensive, and accessible reproduction and distribution in some industries. The mobility of the equipment makes it easy to transport it from one location to another, further complicating enforcement efforts. Industry and government officials described this as the "whack-a-mole" problem — when progress is made in one location, piracy operations often simply move. Likewise, the Internet provides a means to transmit and sell illegal software or music on a global scale and provides a sales venue for counterfeit goods. According to an industry representative, the ability of Internet pirates to hide their

[8]See GAO, *Intellectual Property: U.S. Efforts Have Contributed to Strengthened Laws Overseas but Challenges Remain*, GAO-01-912 (Washington D.C.; September 8, 2001).

identities or operate from remote jurisdictions often makes it difficult for IP rights holders to find them and hold them accountable.

How economic incentives and technological advances can contribute to IP piracy can be seen in the optical media industry (CD's, DVD's). The cost of reproduction technology and copying digital media is low, making piracy an attractive employment opportunity, especially in a country where formal employment is hard to obtain. According to the Business Software Alliance, a CD recorder is relatively inexpensive. The sometimes large price differentials between pirated and legitimate CDs also create incentives for consumers to purchase pirated CDs – even those who might have been willing to pay a limited amount extra to purchase the legitimate product. Low-cost, high-quality reproduction and distribution in some industries are creating increasingly strong incentives for piracy. Private sector representatives have identified Russia as a prominent source of pirated software and optical media, which include music, movies, and games. For instance, USTR reports that the U.S. copyright industries estimate that they lost in excess of $2.1 billion in 2006 due to copyright piracy in Russia. The U.S. copyright industries also reported that in 2006 Russia's optical disc production capacity continued to be far in excess of domestic demand, with pirated products apparently intended for export as well as domestic consumption.

While a number of factors increase the risk of IP theft, the deterrent effect of IP enforcement efforts has not kept pace. A number of industry officials believe that the chance of getting caught for counterfeiting and piracy, along with the penalties, when caught, are too low. CBP only inspects a small percentage of containers entering the country each day even for counterfeit goods seized at the border. CBP officials said that the enforcement penalties are not an effective deterrent. In reviewing CBP penalty data for fiscal years 2001 through 2006, we found that less than 1 percent of the penalty amounts were collected. Federal officials we interviewed remarked that the penalties or even the loss of goods through seizures are viewed by counterfeiters as the cost of doing business. In work we did several years ago on small business efforts to patent abroad, we reported that patent attorney experts viewed the potential for unauthorized production as well as the level of IP infringement and enforcement in other countries as highly important factors that needed to be considered in developing a foreign patent strategy.[4] They also advised

[4]See GAO, *International Trade: Experts' Advice for Small Businesses Seeking Foreign Patents*, GAO-03-910, (Washington D.C.: June 26, 2003).

that firms need to understand the practical—or enforcement—value of the patent, and China and Russia were both mentioned as countries where the patents were of limited value but the situation was improving.

Weak Enforcement Exacerbates the Risk of IP Theft, Particularly in China

China's track record for enforcing IP laws has been historically weak. We reported in October 2002 that when China joined the WTO in 2001, some WTO members noted concerns about enforcement of IP regulations in China, and the majority of China's commitments in its WTO accession agreement were intended to address these concerns.[5] For example, members raised concerns about filing civil judicial actions relating to IP violations in China, and they noted that the way in which damages resulting from IP violations were calculated often resulted in inadequate compensation. We identified 32 IP rights related commitments made by China in its WTO accession agreement, about half of which were related specifically to IP enforcement.

Based on our 2002 survey, U.S. companies with a presence in China considered China's commitments in the area of IP rights to be the most important of those made in its WTO accession agreement However, they also recognized that they were going to be among the most difficult for China to implement, particularly those related to rule of law and reforming state owned enterprises. Indeed, in our 2003 follow-up interviews, respondents reported that China had implemented its IP rights commitments only to some extent or to a little extent.[6] Our ongoing work on federal IP law enforcement actions reiterates this concern about IP infringement in China. Sixteen of the thirty companies and industry associations we interviewed cited China as the primary country producing and distributing IP-infringing goods. They went on to note that these are

[5]See GAO, *World Trade Organization: Analysis of China's Commitments to Other Members*, GAO-03-1, (Washington D.C.; October 3, 2002).

[6]See GAO, *World Trade Organization: Selected U.S. Company Views about China's Membership*' GAO-02-1956 which was released on September 23, 2002; *World Trade Organization: U.S. Companies' Views on China's Implementation of Its Commitments*' GAO-04-508 March 24, 2004.

often substandard products that are sold in grey markets[7] or through the Internet.

USTR put China on its Special 301 Priority Watch List[8] in 2005 on the basis of serious concerns about China's compliance with its WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)[9] obligations as well as with commitments it made in a subsequent bilateral forum in 2004. In addition, China remains subject to Section 306 monitoring.[10] USTR also identified IP rights protection in its February 2006 Top-to-Bottom review[11] of U.S.-China trade relations as one of China's greatest shortcomings and greatly enhancing China's IP rights protection became a priority goal for the United States. The review outlined a number of action items for the United States to undertake to achieve this goal, which included increasing U.S. enforcement staff levels, enhancing cooperation with the private sector, and promoting technical exchanges between U.S. and Chinese agency officials.

The United States has undertaken other actions with regard to IP violations in China. The United States requested WTO dispute settlement consultations with China on a number of IP rights protection and

[7]The grey market usually refers to the flow of new goods through distribution channels other than those authorized or intended by the manufacturer or producer. Grey market goods are not generally counterfeit. Instead, they are being sold outside of normal distribution channels by companies which may have no relationship with the producer of the goods.

[8]The annual Special 301 process, which refers to certain provisions of the Trade Act of 1974, as amended, requires USTR to annually identify foreign countries that deny adequate and effective protection of IP rights or fair and equitable market access for U.S. persons who rely on IP protection. According to USTR, countries or economies on the Priority Watch List do not provide an adequate level of IP rights protection or enforcement, or market access for persons relying on intellectual property protection.

[9]The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which came into force in 1995, broadly governs the multilateral protection of IP regulations. TRIPS established minimum standards of protection in various areas of IP and provides for enforcement measures for members.

[10]According to USTR, countries with serious IP-related problems are subject to another part of the Special 301 statute, Section 306 monitoring, because of previous bilateral agreements reached with the United States to address specific problems raised in earlier reports.

[11]USTR's Top-to-Bottom review assessed the benefits and challenges in U.S-China trade following China's first four years of membership in the World Trade Organization, as China neared the end of its transition period as a new member. The review reflects the input of Congress, China experts, industry, public testimony and other U.S. government agencies.

enforcement issues and conducted a special provincial review over the past year to examine the adequacy and effectiveness of IP rights protection and enforcement at the provincial level. In October 2004, we recommended that the USTR and Secretaries of Commerce, State, and Agriculture (USDA) take steps to improve their performance management of their agencies' China-WTO compliance efforts. For example, we recommended that USTR set annual measurable predetermined targets related to its China compliance performance measures and assess the results in its annual performance reports, and that the Secretary of Commerce should take further steps to improve the accuracy of the data used to measure results for the agency's trade compliance related goals. We made similar recommendations to the other agencies. Not all of the recommendations have been implemented to date, but some agencies have reported looking into modifying both their performance plans and unit level plans. This month, we are sending a team to Beijing to follow up on U.S. agency activities, including their response to these recommendations.

USTR reports that China has made progress in some areas, such as completion of its accession to the World Intellectual Property Organization (WIPO)[12] Internet Treaties, and its ongoing implementation of new rules that require computers to be pre-installed with licensed operating system software. However, in other areas, the USTR reports that little progress has been made. Despite anti-piracy campaigns in China and an increasing number of IP rights cases in Chinese courts, overall piracy and counterfeiting levels in China remained unacceptably high in 2006. USTR reports further that the U.S. copyright industries estimate that 85 percent to 93 percent of all copyrighted material sold in China was pirated, indicating little or no improvement over 2005. Trade in pirated optical media continues to thrive, supplied by both licensed and unlicensed factories and by smugglers. Small retail shops continue to be the major commercial outlets for pirated movies and music and a wide variety of counterfeit goods, and roaming vendors offering cheap pirated discs continue to be visible in major cities across China. According to USTR, piracy of books and journals and end user piracy of business software also

[12]The World Intellectual Property Organization (WIPO) is a specialized agency of the United Nations. It is dedicated to developing a balanced and accessible international intellectual property (IP) system, which rewards creativity, stimulates innovation and contributes to economic development while safeguarding the public interest. WIPO was established by the WIPO Convention in 1967 with a mandate from its Member States to promote the protection of IP throughout the world through cooperation among states and in collaboration with other international organizations. Its headquarters are in Geneva, Switzerland.

remain key concerns. In addition, Internet piracy is increasing, as is piracy over closed networks such as those of universities.

Finally, the United States has dealt with China's poor IP enforcement through efforts at the U.S. border. China accounts for by far the largest share of IP-infringing goods seized by CBP. For instance, China accounted for 81 percent of the value of goods seized in fiscal 2006, increasing from 69 percent in fiscal 2005 and nearly half in fiscal 2002. Chinese counterfeits include many products, such as pharmaceuticals, electronics, batteries, industrial equipment, toys, and many other products, some of which pose a direct threat to the health and safety of consumers.

U.S. Efforts to Coordinate IP Activities and Enforce Laws at the Border Need Improvement

While the U.S. faces significant obstacles when trying to ensure effective IP protection abroad, it also faces some significant challenges in coordinating domestic efforts and ensuring that this issue remains a priority. The large number of agencies involved in IP protection issues (see figure 1) demonstrates the cross-cutting nature of the issue and the importance of coordination. However, in our recent report on the law enforcement coordinating council, we found that the effectiveness and the long-term viability of the coordinating structure is uncertain. Another challenge is that each of these agencies have multiple missions, and within the agencies it may be a challenge to ensure that IP enforcement gets sufficient priority. Our report on the efforts of CBP to interdict counterfeit goods at the border found that the bulk of CBP's enforcement outcomes in recent years have been generated by pockets of activity within certain modes of transport and product types as well as among a limited number of port locations. Despite recent increases in seizure outcomes, CBP lacks an approach to further improve border enforcement outcomes, and has been focused on efforts that have produced limited results, while not taking the initiative to understand and address the variations among ports.

Lack of Leadership and Permanence Hampers Effectiveness and Long-Term Viability of IP Enforcement Coordinating Structure

We reported in November 2006 that the current coordinating structure for U.S. protection and enforcement of intellectual property rights lacks clear leadership and permanence, hampering its effectiveness and long-term viability.[13] Created in 1999 to coordinate domestic and international IP law enforcement among U.S, federal and foreign entities, the National Intellectual Property Law Enforcement Coordination Council (NIPLECC)[14] has struggled to define its purpose, retains an image of inactivity within the private sector, and continues to have leadership problems despite the addition of a Coordinator for International Intellectual Property Enforcement as the head of NIPPLEC, made by Congress in December 2004. In addition, in July 2006, Senate appropriators expressed concern about the lack of information provided by NIPLECC on its progress.

In contrast, the presidential initiative called the Strategy for Targeting Organized Piracy (STOP), which is led by the National Security Council, has a positive image compared to NIPLECC, but lacks permanence since its authority and influence could disappear after the current administration leaves office. Many agency officials said that STOP has increased attention to IP issues within their agencies and the private sector, as well as abroad, and attribute that to the fact that STOP came out of the White House, thereby lending it more authority and influence.[15] While NIPLECC adopted STOP as its strategy for protecting IP overseas, its commitment to implementing STOP as a successful strategy remains unclear, creating challenges for accountability and long-term viability. For instance, although NIPLECC's most recent annual report describes many STOP activities, it does not explain how the NIPLECC principals plan to carry out their oversight responsibilities mandated by Congress to help ensure successful implementation of the strategy.

STOP is a first step toward an integrated national strategy to protect and enforce U.S. intellectual property rights, and it has energized agency efforts. However, we previously reported that STOP's potential as a national strategy is limited because it does not fully address important characteristics of an effective national strategy. For example, its performance measures lack baselines and targets to assess how well the

[13]See GAO, *Intellectual Property: Strategy Targeting Organized Piracy (STOP) Requires Changes for Long-term Success*, GAO-07-74 (Washington D.C.; November 8, 2006).

[14]NIPLECC was established under Section 653 of the Treasury and General Government Appropriations Act, 2000 (Pub. L. No.106-58), 15 U.S.C. 1128.

[15]See figure 1 for NIPPLECC and STOP members.

activities are being implemented. In addition, the strategy lacks a risk management framework and a discussion of current or future costs – important elements to effectively balance the threats from counterfeit products with the resources available. Although STOP identifies organizational roles and responsibilities with respect to individual agencies' STOP activities, it does not specify who will provide oversight and accountability among the agencies carrying out the strategy. While individual agency documents include some key elements of an effective national strategy, they have not been incorporated into the STOP documents. This lack of integration underscores the strategy's limited usefulness as a management tool for effective oversight and accountability by Congress as well as the private sector and consumers who STOP aims to protect.

In our November 2006 report, we made two recommendations to clarify NIPLECC's oversight role with regard to STOP and improve STOP's effectiveness as a planning tool and its usefulness to Congress: First, we recommended that the head of NIPLECC, called the IP Coordinator, in consultation with the National Security Council and the six STOP agencies, clarify in the STOP strategy how NIPLECC will carry out its oversight and accountability responsibilities in implementing STOP as its strategy. Second, we recommended that the IP Coordinator, in consultation with the National Security Council and the six STOP agencies, take steps to ensure that STOP fully addresses the characteristics of an effective national strategy. In our April 2007 testimony, we reported that the IP Coordinator said that NIPLECC had taken some steps to address our recommendations, including working with OMB to understand agencies' priorities and resources related to IP enforcement.

U.S. Border IP Efforts Demonstrate the Need for Improvements

In our April 2007 report, we foundthat the volume of goods entering the United States every year is substantial, and creates a challenge for CBP in terms of ensuring that these shipments do not carry weapons of mass destruction or illegal drugs and that appropriate duties are collected on imports.[16] CBP also has the responsibility to ensure that counterfeit goods do not enter through the 300 plus U.S. ports, but detecting and seizing IP-

[16] *Intellectual Property: Better Data Analysis and Integration Could Help U.S. Customs and Border Protection Improve Border Enforcement Efforts*, GAO-07-735 (Washington D.C.; April 26, 2007).

infringing products from among this large volume of traffic is difficult. CBP efforts in this regard include (1) targeting suspicious shipments, (2) examining goods to determine their authenticity, and (3) enforcing IP laws through seizure and penalty actions.

CBP faces challenges in targeting shipments, in part, because its primary computer-based targeting method is not equally effective in all modes of transport (that is, sea, air, truck, and rail). For example, CBP officials believe counterfeiters are increasingly using express consignment services to move commercial quantities of goods into the United States, but their computer- based targeting method is less effective in this environment. Determining during an examination whether IP infringement has occurred can be challenging because of high counterfeit quality and the complexity of U.S. IP laws. Interaction among port staff, CBP's legal and product experts, and rights holders is required to make these determinations. When violations are found, CBP is authorized to seize the goods and, if warranted, assess penalties against the violator.

Although CBP has reported increases in the number and value of IP seizures, our analysis found that the bulk of these seizures have been generated by a limited number of ports and that recent increases in seizure actions can be attributed to a growing number of small-value seizures made from air-based modes. For example, 10 ports are responsible for three fourths of the value of goods seized. In addition, nearly two-thirds of seizure value since 2001 has been concentrated in certain product types - - footwear, wearing apparel, handbags, and cigarettes. However, seizures of goods related to public health and safety have been small. Although penalties assessed for IP violations have grown steadily since 2001, CBP has collected less than 1 percent of assessed amounts. For example, CPB collected approximately 600,000 dollars of the 136.6 million dollars assessed in 2006.[17]

CBP has undertaken steps to improve its border enforcement efforts, but it lacks data with which to analyze IP enforcement trends across transport modes, and it has not analyzed ports' IP enforcement outcomes to determine whether certain ports have been relatively more successful in capturing IP-infringing goods. In addition, a lack of integration between

[17]Fiscal year 2006 is reported based on data provided in January 2007. CBP officials said that the amount collected may change because some penalty cases are still being processed, but they said that future adjustments are unlikely to significantly change the disparity between penalty amounts assessed and collected.

the ports and CBP's trade policy office hinders it from making further improvements.

Given the challenging environment in which CBP must process the vast influx of goods into the United States every day, it is particularly important that the agency utilize data to effectively focus its limited enforcement resources to those areas where they can be most effective. As a result, we have made a number of recommendations to the Commissioner of CBP. These include improvements in enforcement data as well as increased use of enforcement data to understand enforcement activities and outcomes.

Concluding Observations

This committee made a significant investment in the current legislative session in moving IP legislation to try to find the right formula for protecting and stimulating creative and inventive activity in the United States in the area of patent reform, and encountered a number of differing views on how to establish that formula. However, having the incentives for creating intellectual property is of limited value unless there is sufficient protection for the works that are created, and this hearing directly addresses that issue. There is little disagreement — at least domestically — with the need to strengthen protection, but the difficulty is in how to best achieve that goal in the face of the strong economic incentives for counterfeiting and the limited resources to prevent it. GAO has performed a large body of work for the Congress of aspects of these issues, and has put forward some specific recommendations regarding the importance of coordination as well as methods to be effective in the context of competing priorities. We appreciate the opportunity to support this subcommittee and the Congress as it continues to address these issues.

Mr. Chairman, this concludes my prepared remarks. I would be pleased to respond to any questions you or other members of the subcommittee may have at this time.

Contacts and Acknowledgements

Should you have any questions about this testimony, please contact Loren Yager at (202) 512-4347 or yagerl@gao.gov. Other major contributors to this testimony were Christine Broderick, Nina Pfeiffer, Jason Bair, Diana Blumenfeld, Shirley Brothwell, Adam Cowles, Karen Deans, and Addie Spahr.

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Mr. BERMAN. Thank you, Dr. Yager.

And, Mr. MacCarthy?

TESTIMONY OF MARK MacCARTHY, SENIOR VICE PRESIDENT FOR GLOBAL PUBLIC POLICY, VISA INCORPORATED, WASHINGTON, DC

Mr. MACCARTHY. Thank you, Mr. Chairman, and Ranking Member Coble and Members of the Subcommittee. Thank you for the opportunity to testify before you today. Visa operates a global electronic payments network in more than 170 countries around the world.

We do not issues Visa cards and we do not arrange for acceptance of Visa cards by merchants. These relationships are handled by our network of 16,000 financial institutions throughout the world.

To protect the Visa brand, to promote electronic commerce and because it is the right thing to do—and thank you, Mr. Chairman, for that quotation there—Visa goes beyond any legal requirements to prevent the use of our payment system for illegal electronic commerce transactions.

Our policy is clear and unambiguous. Our systems should not be used for illegal transactions.

We work cooperatively with law enforcement around the world, and we take special steps in cases of criminal activity and activity that threatens health and safety.

For example, we search the Internet for merchants selling child pornography or illegally distributing controlled substances, and we expel them from our system as soon as they are discovered.

The subject of today's hearing is different. It relates to complaints by third-party business entities that Internet merchants are violating their intellectual property rights.

Now, Visa can't be the law enforcement agency for violations of intellectual property rights on the Internet. Still, we have policies and procedures in place to handle these third-party complaints.

Our global policy is this: If a transaction would be illegal in either the jurisdiction of the merchant or the jurisdiction of the cardholder, we don't want that transaction.

The AllOfMP3.com and allTunes.com case illustrates how this policy works. In that case, Visa officials received a documented complaint from IFPI, which represents copyright owners internationally.

They asserted that AllOfMP3.com, a music download site located in Russia, was infringing on the copyrights of their members. We conducted a legal assessment, including a review by outside counsel, and concluded that under Russian law and under the law of the vast majority of the customers of AllOfMP3.com, the merchant's transactions were illegal.

After appropriate notice, the Russian bank working with the site stopped processing its Visa transactions. This was in September of 2006. At the end of September 2006, the bank also stopped processing transactions from an affiliated download music site called allTunes.

And then the owner of allTunes sued the bank in a Russian court. Visa was a party to that litigation on the side of the bank.

And in June 2007, the owner won a judgment that the bank had violated its contract with the merchant, and the bank would be required to provide processing services.

In response to the bank's claim that the merchant was acting illegally, the court determined that there were no rulings in Russia establishing that allTunes was making illegal use of exclusive rights belonging to some rights holder.

Later on, in August of 2007, in a different case, a Russian court issued a ruling relating to a criminal copyright infringement case initiated by IFPI against the owner of AllOfMP3.com. This ruling stated that there and not been sufficient confirmation of any illegal activity by the site's owner.

The court implied that this and similar sites would be in compliance with Russian law to the extent that they paid for rights from a Russian collective rights society.

These court cases created a challenge for us. To preserve our cross-border policy, we decided to allow the local bank to provide only domestic service to the site involved in the court case, but transactions from customers in other countries would not be allowed.

Now, what lessons can we learn from this case? First, Visa has policies and procedures in place to handle these kind of issues. Second, private-sector enforcement in this area is limited. Visa can only make decisions where the underlying law is reasonably clear.

In this circumstance, the local law appeared reasonably clear to us, to our local bank and to the record companies. But a local court thought otherwise.

As a result, Visa's client bank was exposed to legal liability for withdrawing service to a merchant that was found to be operating legally under local law.

We are simply not in a position to clarify local law, to override it, or to resolve conflicts between different legal systems.

There are clearly system limitations on our ability to block illegal transactions when the laws of many countries conflict. Potentially we would have to deal with conflicting regimes in the 170 countries around the world where we operate.

And this leads to my third and final point. When local laws are not clear, governments and aggrieved businesses cannot put private-sector intermediaries like Visa in the position of resolving the issues.

Ultimately, this will require government-to-government discussions that harmonize local legal structures.

Thank you again for the opportunity to testify today, and I am happy to answer any questions you might have.

[The prepared statement of Mr. MacCarthy follows:]

PREPARED STATEMENT OF MARK MACCARTHY

WRITTEN STATEMENT

OF

MARK MACCARTHY

ON BEHALF OF

VISA INC.

BEFORE THE

SUBCOMMITTEE ON COURTS, THE INTERNET AND INTELLECUTAL PROPERTY

OF THE

COMMITTEE ON THE JUDICIARY

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 18, 2007

Chairman Berman, Ranking Member Coble, and Members of the Subcommittee, my name is Mark MacCarthy and I am Senior Vice President for Global Public Policy for Visa Inc. Thank you for the opportunity to testify today on the important issue of international intellectual property protection.

Visa operates a global electronic payments network and is a widely recognized consumer brand. Visa facilitates global commerce through the transfer of value and information among financial institutions, merchants, consumers, businesses and government entities in more than 170 countries and territories worldwide.

Visa Inc. is a global company headquartered in San Francisco, California. The company's operating regions include: Asia-Pacific; Canada; Central and Eastern Europe, Middle East and Africa; Latin America and the Caribbean; and USA. Visa Europe is a separate and independent legal entity that is an exclusive licensee of Visa Inc.'s trademarks and technology in the European region.

Visa provides its financial institution clients with a broad range of platforms for consumer credit, debit, prepaid and commercial payments. Visa's network and payment platforms deliver significant value to our clients and their customers in terms of greater efficiency, security, convenience and global reach. Visa Inc. does not issue cards, set cardholder fees or interest rates or arrange for merchant acceptance of Visa cards. These relationships are managed by our network of more than 16,000 financial institution clients worldwide.

Our financial institution clients reported that, as of March 31, 2007, they had issued more than 1.4 billion cards carrying our brands. And, according to our financial institution clients, these cards were accepted at more than 27 million merchant outlets and

one million ATMs, and the total payments and cash volume on these cards during the twelve months ended March 31, 2007 was more than $3.3 trillion.

Electronic commerce is an important channel of commerce for Visa. Worldwide, excluding Europe, electronic commerce accounted for 9% of our total sales volume in 2006. In the U.S. electronic commerce was 12% of our total sales volume in 2006, up from 11% in 2005. Cross region transactions where the merchant is in one country and the customer is in another are also significant. For example, 4% of Visa sales for U.S. based electronic commerce merchants come from abroad.

To promote growth in this channel of commerce, to protect the Visa brand and because it is the right thing to do, Visa goes beyond any legal requirements to prevent the use of its payment system for illegal electronic commerce transactions. Visa policy is unequivocal and clear: our system should not be used for illegal transactions.

We work cooperatively with law enforcement in the United States and around the world to aid their law enforcement efforts. We take special steps in cases of criminal activity and activity that threatens health and safety. For example, we search the Internet for merchants selling or advertising child pornography or illegally distributing controlled substances and expel them from our system as soon as they are discovered. We work cooperatively with law enforcement, other payment brands and the National Center for Missing and Exploited Children in the Financial Coalition Against Child Pornography to share information and take collaborative steps against child pornography merchants.

We work with the Secret Service, the FBI, the Federal Trade Commission, and state Attorneys General to assist their efforts to stop fraud, identity theft, and data breaches. We have worked with the Department of Justice and State Attorneys General

to respond to their concerns about illegal online tobacco merchants. Finally, in response to Congressional concerns regarding illegal Internet gambling we devised a coding and blocking scheme that prevents US cardholders from engaging in illegal Internet gambling while also allowing offshore gambling merchants to provide service to cardholders in jurisdictions where Internet gambling is legal.

The subject of today's hearing is different. It relates to complaints by third-party business entities that some Internet merchants, typically located outside of the United States, are violating their intellectual property rights. For example, music companies have a business model that is under attack from illegal download sites, and counterfeiters and pirates violate the trademark rights of other companies.

Visa is not a law enforcement agency and cannot police the Internet for all possible violations of third-party intellectual property rights. The volume is too great and Visa is able to address only the clearest violations of these rights. So the way forward in international intellectual property protection is fundamentally a matter for the affected countries and territories to deal with through judicial and law enforcement co-operation.

Visa does have in place policies and procedures to handle these third-party business complaints, but we do not use a coding and blocking scheme analogous to the one we use for Internet gambling. This is so for several reasons. First, our codes are for business activity, not legal status. For example, music download sites can use an appropriate merchant category code, but this code doesn't distinguish between legal ones and illegal ones. Second, Internet gambling merchants and sites involving intellectual property protection are subject to different legal regimes around the world. Internet gambling seems to be illegal in the United States, but legal in many other jurisdictions.

So it makes sense from a system perspective to let legal Internet gambling merchants introduce these transactions into the Visa network as long as they are properly coded as gambling transactions and have the financial institutions where the transactions are illegal block them. On the other hand, Internet merchants that are involved in intellectual property infringement are typically violating the laws of most countries. So the best way for Visa to respond to complaints involving infringement is not to require the infringing merchant to code the transaction properly, but to prevent that entity from entering the infringing transactions into the system, or to restrict its ability to enter transactions into the system to those few jurisdictions where the transaction might be legal.

The Visa process for handling third-party business complaints starts when a business entity approaches us with clear, documented evidence of illegal electronic commerce activity, and adequately identifies the infringing, usually foreign, Internet merchant. They provide us with substantiation that an electronic commerce activity is illegal and furnish documentation that Visa cards are used for this illegal activity. Normally, these complaints are not of criminal activity and do not involve health and safety issues. But they do pose a business problem to these companies and we do attempt to respond, especially in what appear to be large magnitude cases, although we are not legally required to do so.

Our response involves an assessment of legality. This is made easier if there has been a regulatory or judicial decision that establishes the illegality, but this is usually not the case. If the buyer and seller are in the same legal jurisdiction, the assessment can be relatively straightforward. But we do not receive many complaints when the transaction is domestic, within one jurisdiction. Companies tend to pursue effective domestic

remedies in these cases. Most complaints are cross-border, involving the merchant in one location and the customer in another. If the legal situation in both countries is the same, the assessment of legality can be relatively uncomplicated. But what if the merchant is in one jurisdiction, the customer is in another and the laws are not the same?

After wrestling with these issues, Visa developed a policy for cross-border transactions: if a transaction would be illegal in either the jurisdiction of the merchant or the jurisdiction of the cardholder, we don't want that transaction.

If Visa determines that the type of transaction is illegal in either jurisdiction, we do what we reasonably can to assist the complaining IP or other rights holder. This task is complicated by our corporate structure. Since Visa does not work directly with merchants, we need to locate the bank that has the merchant account. In the case of an offshore merchant, this will involve working closely with regional Visa Inc. officials or officials at the separate entity, Visa Europe, who have responsibility for that bank. Once we provide the complaint to the bank involved, that usually that resolves the issue. In most cases, the bank does not want the business and terminates the merchant or takes other action to bring the merchant into compliance with our policy. If the transaction is illegal and the bank does not take action, we can take further enforcement action against the bank.

In some cases, however, the merchant resists our enforcement efforts, insists on the legality of the underlying activity and goes to court in the local jurisdiction to vindicate what it perceives to be its rights under local law. This is what took place in the case involving Allofmp3.com and Alltunes.com

In this case, Visa officials received a documented complaint by IFPI (the International Federation of the Phonographic Industry), which represents copyright owners based in more than 70 countries, that Allofmp3.com, a website located in Russia, was infringing on the copyrights of their members by allowing downloads of music without having obtained the authorization of the copyright owners. We conducted an assessment of the legal situation, including a review by outside counsel, and concluded that under local Russian law and under the laws of the vast majority of the merchant's consumers – located primarily in the United States and Great Britain – the merchant's transactions were illegal. In this context, Visa determined that generally we did not want any illegal music download sites in our system. We were thereby able to extend enforcement against this one site to different sites or to the same site processed by a different bank. After appropriate notice, the Russian bank working with Allofmp3.com stopped processing its Visa transactions in the summer of 2006. At the end of September 2006, the bank also stopped processing Visa transactions from an affiliated music downloading site called Alltunes.com.

The owner of Alltunes.com sued the bank in a Russian court (Visa was a third party in this litigation on the bank's side) and in June 2007 won a judgment that the bank was in violation of their contract with the merchant and would have to continue to provide processing services. In response to the bank's claim that the merchant was acting illegally and so in violation of Visa rules, the court determined that there were no court rulings in Russia establishing that Alltunes.com was making illegal use of exclusive rights belonging to some right holders.

In August 2007, a Russian court issued a ruling related to a criminal copyright infringement case initiated by IFPI against the owner of Allofmp3.com, which stated that there had not been sufficient confirmation of any illegal activity by the owner of Allofmp3.com. Even though the copyright owners had not given permission to Allofmp3.com, Alltunes.com and similar sites to sell copies of their music, a Russian collective rights society was deemed to be operating legitimately under Russian law. The court implied that Allofmp3.com and similar sites would be in compliance with Russian law to the extent that they paid for rights from a Russian collective rights society. This ruling thereby suggested that these sites might be legal in Russia.

The problem is that at the moment the Russian law contains apparently conflicting provisions regarding the rights of collective rights societies. On the one hand, the law clearly states that participation in a collective society is voluntary for the right holders. A collective right society acts based on the authorities granted by right holders. On the other hand, the law also states that a collective rights society may issue licenses and collect royalties on behalf of right holders even without their permission.

These court cases created a challenge for Visa. We had responded to a documented complaint of copyright infringement, but the local courts ordered our local client bank to continue to provide service. Yet these transactions would still be illegal under the laws in virtually every other country in the world. To preserve our policy of not allowing transactions in our system that would be illegal in either the jurisdiction of the cardholder or the jurisdiction of the merchant, Visa decided to allow the local Russian bank to provide only domestic service to the particular Russian download site involved in

the court case. International transactions from customers in other countries would not be allowed.

We think this policy adequately responds to the complicated legal situation in this case. But what lessons can we learn from this case in regard to the issues of international infringement?

First, Visa has policies and procedures in place to deal with international infringement issues. We respond to documented complaints from third parties in this area. We have adopted a global policy to resolve difficulties that arise in cross-border jurisdiction circumstances: if a transaction would be illegal in either jurisdiction, it should not be in our system.

Second, the Allofmp3.com and Alltunes.com case illustrates the limits of private sector enforcement efforts in cases of international infringement. Visa can only make decisions --and ask its affiliated banks to take corrective action -- when the underlying law and legal violation is reasonably clear. In this situation, it appeared reasonably clear to our local bank, to us and to the record companies that Russian law did not allow the activities of Allofmp3.com and Alltunes.com. But a local court thought otherwise. As a result, Visa's client bank was exposed to legal liability for withdrawing service to merchants found to be operating properly within local law. We are simply not in a position to clarify unclear local law or to override it. .

In some cases our systems can accommodate conflicting local laws. In the case of Internet gambling, which appears to be illegal in the United States, but seems to be legal in large parts of the rest of the world, we were able to devise a coding and blocking scheme which allowed issuing banks to block transactions where they appeared to be

illegal. In the Allofmp3.com and Alltunes.com case, the activity appears to be legal in Russia, but appears to be illegal just about everywhere else. In this case, we are able to block international transactions before they enter the Visa system for authorization outside Russia. But what about a more complicated case between these extremes, where the laws of many countries conflict with the laws of the rest? There are clearly system limitations restricting our ability to block illegal transactions in these circumstances, since we potentially would have to deal with the combinations of the legal regimes in the 170 countries and territories where we operate.

And this leads to my third and final point, when local laws are not clear or are not consistent, governments and aggrieved businesses cannot put private sector intermediaries like Visa in the position of resolving the conflicts and lack of clarity. Ultimately resolving these issues requires government-to-government discussions that harmonize local legal structures. It is only within these harmonized legal structures, that private enforcement efforts such as Visa's can fully succeed.

Mr. BERMAN. Well, thank you all.

And I am going to wait till the end of Member questioning to ask my questions and will recognize now, for 5 minutes, the Ranking Member of the Subcommittee, Mr. Coble.

Mr. COBLE. Mr. Chairman, I thank you for that.

For the information of the witnesses, some weeks ago in my district a church had a fundraiser, and the high bidders, Mr. Chairman, were assured that they would be my guests for lunch.

So if I don't appear in the Members' room on or about 11:30, they are not going to be happy with me. I have got to pick up the tab. Thank you, Mr. Chairman.

Ms. Espinel, given that China is the fourth-largest economy in the world, and——

Mr. BERMAN. Is this an online program?

Mr. COBLE. No. No. [Laughter.]

He always disarms me, but with a smile on his face.

Given that China is the fourth-largest economy in the world and poised to become the second-largest training nation in the world, why should it be considered a developing nation?

And let me ask you this, Ms. Espinel. Are there any economic or trade benefits that extend to China based on this designation?

Ms. ESPINEL. Well, certainly, with respect to the area that I cover, intellectual property, we do not believe that China's status as a developing country—and I am not conceding that China is a developing country or has any particular status.

But if China asserts that it is, we don't believe that that should serve as any excuse for China not to strengthen its intellectual property system and adequately protect American interests consistent with the obligations and commitments that it has under the WTO.

Mr. COBLE. And I wanted to ask Mr. Smith a question, but I want to put one more question to Ms. Espinel.

Your statement referred generally to some of the commitments contained in the bilateral IPR agreement, but it did not make clear which, if any, of the specific actions that the Russian government was obligated to complete by June 1st of this year have been satisfactorily performed.

If you will, Ms. Espinel, can you identify which commitments were required to be performed by 1 June and the USTR's current assessment of Russia's performance on each?

Ms. ESPINEL. I would be happy to. There are two categories of commitments. Some were required to be in place by June 1st.

Some, particularly as related to enforcement, are commitments that Russia signed up to start acting on immediately and commitments that we think should continue after their WTO membership is complete, should we come to that point.

Two that I want to highlight in particular—one of the commitments that Russia made in the bilateral agreement was to shut down or to terminate the leases of illegal optical disc plants that are operating on government sites, what are referred to as restricted access sites.

And Russia has made progress in this are. I believe there are 17 such plants. Russia has terminated the leases—or by the end of

this year, Russia should have terminated the leases on 16 of those 17 plants.

And I can assure you we won't forget about the one that is remaining. But that is significant progress on an issue that has been a point of contention between the U.S. and Russia for some time.

Russia has also stepped up enforcement against illegal, unlicensed optical disc plants. They have conducted seven raids of unlicensed plants this year. They have conducted 17 raids of warehouses where illegal product is stashed. So that is progress.

However, there are a number of areas where Russia still needs to make considerable progress, and we will continue to push them on that.

And a few of those areas are—for example, there is customs legislation that they committed to pass that has not yet gone into force. It is now pending in the Duma.

But Russia needs to pass that customs legislation to give their customs authorities more authority to take action at the border.

Russia needs to take action against illegal pirate Web sites—the successors to the AllOfMP3, which have been mentioned by some of my fellow panelists.

Russia needs to make amendments to its civil code to bring it into compliance with the TRIPS agreement. Russia needs to complete its accession to the WIPO Internet Treaties to protect copyright in the digital age.

So again, while Russia has made some progress in some areas, there are still a number of areas where Russia needs to make further progress in order to be in compliance with the agreement that we have negotiated.

Mr. COBLE. I thank you.

Mr. Smith, for some time the IIPA members call upon the United States government to utilize the WTO dispute settlement mechanism to press our concerns regarding China.

Now that we have done so, what do you consider to be the next most important steps that the USG can take to improve conditions for IP owners in China?

Mr. SMITH. Well, I think that case has to proceed apace. It is an important case, and I think Ms. Espinel can probably give you the details. IIPA is not directly involved in that case. It is a subgroup of our group called the China Copyright Alliance.

But I think that case has to proceed, and I think the people who are involved in that case feel very certain that that case will go well.

And I think the key is going to be, if that is true, the implementation phase of that case when it is completed to try to leverage additional improvements beyond those—the actual panel decision on the narrow facts of the particular claims that are being brought.

Mr. COBLE. I thank you for that.

Mr. Chairman, I know my red light is on, but if I may make one more statement, Mr. Chairman.

The international trading system, lady and gentlemen, is rules-based. And respect for those rules demands that there be serious consequences for countries which have voluntarily agreed to abide by the rules of the road but yet choose to consistently and continually fail to honor their commitments.

And I think that is one of the impediments, Mr. Chairman, that we must encounter successfully.

Thank you.

And thank you, Mr. Chairman.

Mr. BERMAN. Thank you, Mr. Coble. I couldn't agree with you more. Of course, one of the questions I plan to ask later to Ms. Espinel is what about the situation where we don't comply with this rules-based system, but we will save that for later.

The gentleman from North Carolina, Mr. Watt, is recognized for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

I want to first applaud the Chair for convening this important hearing. I am new to this Subcommittee.

There probably hadn't been a more consistent theme for a set of involvements that I have had in international travel since I have been in Congress than this one issue.

I don't think I have ever been to a foreign country on a congressional delegation trip, on an informal trip, on anybody's dime where there hadn't been an aggressive discussion of how we attack the piracy and theft of intellectual property and its products.

And I guess if I had made an opening statement, it would have paralleled Ms. Espinel's that we started off thinking that in most countries it was primarily a question of weak laws or no laws.

We progressed beyond that to a recognition that having a set of laws on the books, without some effective enforcement mechanism and policing and sanctioning process, wasn't very helpful.

And the third point she made was that despite all of those efforts, after 15 years in Congress, the explosion of international trade and the opportunities for people to engage in piracy and intellectual property theft have gotten bigger, and bigger, and bigger and bigger.

So one walks away from a hearing of this kind with a sense of frustration, a much, much better understanding of a description of the problem, which all of the witnesses were very well equipped to describe.

What seems always lacking at the end of these kinds of hearings is not a lack of understanding about what the problem is but what can we do more aggressively to try to solve the problem.

And so let me start with Mr. Yager and Mr. MacCarthy. First of all, maybe I will start with Mr. MacCarthy, just to see whether other facilitators of the economic transactions—credit card issuers, banks that facilitate the transfer of money and facilitate commerce in the regular course of events—aside from the off market itself.

I am not much on using the term black market for reasons that some people might understand better than others.

But what is the general attitude of facilitators of financial transactions? Are they consistent with the ones that you have expressed here? Are they being aggressively engaged? And what more can they do to help us with this problem?

Mr. MACCARTHY. I can't speak in detail for all of the financial service providers in this area, but in general they have policies and procedures that are similar to the ones that I described, which is they have in place a process for evaluating complaints that come to them, investigating them and then taking appropriate action.

Even if the systems—the traditional systems that are involved in electronic commerce could stamp out these kind of transactions within their systems—and for reasons I mentioned in my testimony, it seems unlikely that they will be successful in doing that completely.

But even if they could, there are alternative payment mechanisms out there that are ready to move into the gap and to provide payment services when the traditional payment providers are successful in driving the illegal activity out of their circumstance.

We have seen that already in the context of child pornography, where there is a coalition against child pornography that the financial institutions have organized, and we are working cooperatively together with the National Center for Missing and Exploited Children.

And what we found is that the success that we have had in driving those kind of transactions out of our system has been mirrored by the use of alternative payment mechanisms for those transactions. Various kinds of e-cash or digital cash are stepping in to be the transaction processor of choice.

Similar things are happening in Internet gambling. As we are using our coding and blocking mechanism to reduce the use of regular payment cards for Internet gambling transactions, those merchants are turning to the automated clearinghouse and using that as the mechanism for completing the transactions.

And that mechanism is not, you know, a kind of underground operation. That is the same mechanism that many people use to get their payment from employment. It is the same mechanism that people use for many recurrent payments, for their mortgages or utilities or their rental payments.

But it is a harder system to control. There is less ability to know exactly who is doing what on that system. And it is the kind of system that can be used as an alternative mechanism when the traditional payment mechanisms have done what they can to drive the illegal transactions out of them.

Mr. WATT. You may be depressing everybody in the room if I allow you to go further.

My time has expired.

Mr. Yager, and you don't have to answer this now, if the GAO has done some specific set of recommendations about how we may approach solutions—I mean, I understand the problem. There is a great description of the problem that you have outlined in your testimony.

But if there are a set of solutions that you all—came up in the process of doing the GAO study, I would welcome——

Mr. YAGER. Let me just answer that very briefly. We have done a lot of work. Obviously, Ms. Espinel has covered what happens abroad.

Some of the work that we have done has to do with what can be done in the United States to raise the level of deterrent, because that is really what we are talking about, trying to create a bigger deterrent for the operations.

So a couple of the very specific studies we did had to do with the customs and border protection that operates at our borders when the goods are coming across.

One of the keys there is that there has to be a greater extent and a greater level of seizure activity, because we found in looking at their seizure efforts that they were highly concentrated in certain specific ports, and some of the major ports are not getting much seizure activity.

And there isn't awareness by the management of this problem to try to learn how it is that some ports are doing so much better than others. What can they learn internally to make sure that that kind of skill exists at all ports?

The second recommendation and the second issue that we brought up in our report is that in some cases there are penalties assessed against seized goods, but one of the things that we found is less than 1 percent of those penalties are currently being collected.

Penalties without payment are not an effective deterrent, so there has to be greater attention to not just levying the fines but collecting the fines from those that are abusing the laws.

So I think that also means at some point a greater threat of prosecution in the United States. So I think that the deterrent level needs to be raised.

Certainly, a lot can be done abroad, but there are also things that can be done domestically, and we have some very specific suggestions as to how that could be done.

Mr. WATT. And I know my time is over, but it seems to me that there is a parallel effort going on here to intercept the prospect of terrorism before it gets to the borders that you are talking about.

Mr. YAGER. That is right.

Mr. WATT. Is anybody looking at the—I mean, we tend to look at this stuff in silos.

I would like the benefit, at some point—not right now—of knowing whether anybody is even talking to each other across those silos to try to figure out some common steps that we could be making on the intellectual property front while we are making steps on the terrorism, counterterrorism front.

Mr. Chairman, I am way over my time, and I will yield back.

Mr. BERMAN. Perhaps a hearing on whether we should take the military option off the table—well, never—no. [Laughter.]

Just based on order of appearance, I am going to recognize our newest Member of the Subcommittee, from Ohio, Ms. Sutton.

Ms. SUTTON. Thank you, Mr. Chairman. And Mr. Coble is gone, but I want to thank you both for not only, of course, Mr. Chairman, for holding the hearing but also for the remarks and the questions that Mr. Coble asked while he was present.

This is an extraordinarily important issue, and I see it as—in reflecting upon Mr. Coble's words, as part of a bigger problem that our international trading system is broken. And I have a number of questions, but I would just like to sort of draw some things together.

And I was struck, Ms. Espinel, when you were talking about the privilege to protect our creative class.

And I absolutely concur that this is an enormous issue, and I am sympathetic and looking forward to finding ways to make this work so that our businesses and our workers are not left at a disadvantage in this country.

But I was struck by the use of the words that you chose, protect and protect and protect against sort of these illegal tactics being employed by others.

When I use that language to talk about other sectors of our economy, like the traditional manufacturing sector, just talking about stopping unfair trading practices that are being employed and sometimes subsidized by other countries, I am called a protectionist.

Do you ever get—are you ever called a protectionist, or do you fashion yourself one?

Ms. ESPINEL. No. In the sense that that word is used, protectionist in terms of—obviously, my office, USTR as a whole, are strong proponents of free trade.

We see our free trade agreements—we see our free trade agenda—as being a way not just to increase market access for U.S. products but also for a way to build the world economy and a way to help other countries build their own economy.

In terms of intellectual property protection, yes, the mission of my office is to protect American industry, but we also strongly believe that other countries have a role, a true stake, in the international IP system.

We have talked a lot today about challenges. One of the opportunities we have is that there are many countries around the world that want to become innovators, that I think see their future as being part of the knowledge economy.

And I think as that continues, they will then see that they have a greater stake in the international IP system. Amd I think there is also a growing realization among our trading partners that while the U.S. does a tremendous amount to protect the right holders, we cannot do it alone.

This problem that we are discussing of global trade and counterfeit and pirate goods is an area where we need increased cooperation with our trading partners.

I think more and more of some of the trading partners that share the U.S. concerns are aware of that. And USTR has been working very actively to try to capitalize on that and to try to come up with some new and creative ideas to increase that cooperation with our trading partners, because without that cooperation, it is difficult for us to truly be effective.

Ms. SUTTON. I appreciate your response, and I concur with the promise of trade as a tool that can lift up people worldwide and can benefit beyond our borders and that it should be that kind of a tool, and I am a proponent of making it that kind of tool.

I again go back to my belief—and I think it is, frankly, also supported by the testimony that we have heard here today—that there are problems, however, with the gap between the promise of trade and what is actually playing out out there.

And we are trying to find ways not only with intellectual property, obviously, but with other veins. It is a multifaceted problem. And it has to be approached in a multifaceted way.

But I was just curious—and I understand—and I don't believe that that is protectionistic, what you said.

But I think it is an interesting dichotomy, where we hear the protection against illegal subsidies by foreign countries in one vein

being called—if somebody who rails against that says that with respect to illegal dumping of steel, for example, they are a protectionist, if you want to do something to fix that.

And I also just simply—I am not going to have a lot of time here, but I also just simply reject the idea that there aren't things internally that we need to be focusing our attention on also.

We heard testimony by others on the panel about the actions that the United States can and should properly take to deal with this issue.

And of course, again, I believe there are actions that we can take in the rest of the facets of this huge, huge issue of international trade.

I guess my time is up. I just wanted to know, to the extent—you know, we see these illegal subsidies from other countries.

Are countries in any way complicit in the pirating of intellectual property, to your know, other than the United States, outside of the United States?

Ms. ESPINEL. That is an excellent question, and a complicated one. And I know we are short on time here, so I am going to speak concisely but then would be happy to follow up in more detail.

Going back to your first point on protectionism, that term is generally used for countries that are trying to protect their local industry from competition. And we talking about protecting intellectual property—it is exactly the opposite.

We are not trying to protect our right holders——

Ms. SUTTON. With all due respect, I understand the theory of what protectionism is. That is not how that word is often used.

It is also used to try to shut down people who want to fight against unfair similar, in a different vein, kinds of illegal subsidies, to just remove the unfair advantage, to have rules enforced.

Sometimes it is used for that purpose of shutting down that debate because, unfortunately, there are some who are benefitting from those unfair tactics. I understand the difference between—there is a gap here between what the word really means and how it is used. That is my point, and I appreciate that.

Ms. ESPINEL. Exactly.

Ms. SUTTON. Thank you.

Ms. ESPINEL. And in protecting intellectual property, we are trying to increase market access. We are trying to make sure that there is a market for our legitimate products overseas so that we can compete on a level playing field.

Ms. SUTTON. Exactly, exactly. And I support that proposition, and I also support it in other venues.

Ms. ESPINEL. With respect to your second question, governments' complicity—and again, we would be happy to follow up in more detail—there are some instances where we feel that governments themselves not only are not enforcing their laws but may be complicit.

And one of the things that we have talked about are the illegal optical discs that have been operating on Russian military sites. That has been an enormous focus and enormous concern.

And that is one of the key commitments in the bilateral agreement with Russia, to stop that. So again, happy to follow up with

you in more detail. There are some instances of that, and it is something that we obviously go after quite aggressively.

Ms. SUTTON. I appreciate the time.

Mr. BERMAN. I mean, it is a very interesting question. And for example, one example is good—I think—I don't know if we can do it right at this second, but a more comprehensive sense of countries that are not merely enforcing their laws, but that are actually actively facilitating the theft—is one that the Subcommittee generally would be very interested in getting some more specifics on.

Ms. ESPINEL. Well, we would be happy to follow up.

Ms. SUTTON. Thank you, Mr. Chairman.

Mr. BERMAN. Yes. Just one more diversion based on Ms. Sutton's question. We did in the late 1990's, as a response to Chinese activities in counterfeiting, propose a series of countervailing tariffs that by virtue of their impact—by the way, their impact was on some U.S. importers as well as on Chinese companies and the Chinese government.

But as a result of those countervailing tactics, they actually took some steps they had not been willing to take to avoid those countervailing duties from actually coming into place.

Ms. ESPINEL. Right.

Mr. BERMAN. I think that is a little bit where Ms. Sutton is focusing, a thing that on its own might be protectionist in that situation was simply a tool to deal with the blocking of violations of trading rules.

Ms. Lofgren? I am sorry.

Ms. LOFGREN. Thank you, Mr. Chairman.

I do appreciate this hearing, and I think that we perhaps have the potential of accomplishing something, and I give you credit for that.

Often times, those of us who follow these issues tend to focus on actually the relatively small area where there is disagreement, in the DMCA where we are arguing about the technology mandate and freedom and First Amendment issue, instead of focusing on the issue where there is no disagreement, where you have vast piracy and we should have an effective enforcement regime.

And so I was actually wanting to follow up, Dr. Yager, on your report on the 1 percent penalty collection, because, you know, we are not doing a very good job, actually, of inspecting. That is something that most people don't realize.

And the gentleman from North Carolina is correct. I mean, it not only has IP issues. There are national security issues involved with that.

But even for the small amount we inspect, to assess the penalties and then not collect them, I mean, is really counterproductive.

What recommendations do you have? I mean, this is not a new thing. I mean, your prior reports identified a similar issue.

Mr. YAGER. Well, I think one of the things that we noticed, and this also gets back to Mr. Watt's question, is that the Department of Homeland Security—its primary mission, obviously, is protecting the homeland and trying to ensure that no weapons of mass destruction get through the U.S. ports.

But one of the things that we have observed is that they have some very important—what are now called legacy functions, and

that is collecting trade revenue, for example, where these are tariffs or countervailing duties.

It is protecting against drugs entering the United States, protecting against intellectual property that comes into the United States.

In the series of reports that we have done, whether it is on IP or whether it is on customs revenue or another one called an in-bond system, we are finding that DHS has not found a good balance between their new function and their existing legacy functions.

Some of those functions are not getting the kind of attention that is necessary, and not only these weaknesses and problems in the IP area, but also—in fact, it also has a relationship to even performing the security function, because we found that one program allows goods to come into the United States and not officially enter until they get to a domestic port somewhere in the interior.

We found that that program actually makes it more difficult for CBP to screen even for weapons of mass destruction. So I think Mr. Watt's point and your question are on target in that DHS needs to find the ability to not just perform their primary function but to also spend the time and make sure they are performing these legacy functions, because the legacy functions are quite important.

Ms. LOFGREN. Well, I wouldn't refer to them as legacy functions, because I actually voted against the creation of the Department of Homeland Security, a vote that looks better and better in that respect.

But the department was passed with not just a security measure, but taking over the entire function of the customs bureau and the like.

Now, wouldn't it be true that with this level of performance by the Department of Homeland Security our ability even to adequate impose countervailing tariffs would be in doubt?

Mr. YAGER. We are currently performing work on the issue of their ability to collect countervailing duties. One of the problems that we have is that the duties are finally assessed sometimes years after the goods have entered.

In some cases, the deposits that have been made are not sufficient, and therefore you can't collect the full amount of the duties.

So there certainly are a number of issues at Customs and Border Protection where they can be doing a better job of enforcing U.S. trade laws.

Again, finding that balance between their primary mission and these other missions is something that we have commented on in a number of reports, and we think they can do better on these issues.

Ms. LOFGREN. Have you done a look at the impact that this failure has had on the value of patents in the United States?

Mr. YAGER. We haven't looked at that specifically.

One thing I think where we do have industry-specific information—we look at the kinds of seizures that they have made over the past 5 years or so, and I think there has been a lot in the area of the garment, and footwear and clothing industries. I mean, the dominant category are those kinds of products.

Ms. LOFGREN. So it is trademark infringement?

Mr. YAGER. Yes. In many cases, though, where you would expect to see a much higher level of seizures—for example, with pharmaceutical products and things of that nature, where there are really health and safety issues, the percent of overall seizures in those areas is quite low, about 1 percent or 2 percent.

So I think there certainly are opportunities to take a hard look, as we have recommended for CBP. They have made that a priority area, but ultimately we haven't seen the results of demonstrating or indicating that that priority actually affects what people do at the border.

Ms. LOFGREN. Mr. Chairman, I think that this is—I hope that we can follow up on this aspect. I serve on the Homeland Security Committee and unfortunately have the opportunity on a regular basis to find dysfunction in virtually every element of the department.

But this is one that, you know, actually is within our jurisdiction here, and maybe we could—you know, the customs inspectors, I think, and the whole customs function has really been treated shabbily in the whole department.

And I think the morale among the employees is low as a consequence. And it is perhaps something that we could pursue further. And I think it is an area where we would have broad agreement here on the Committee, if we could get some changes.

Mr. YAGER. If I could just make one quick answer, we certainly found a lot of people in customs—when we visited ports, we visited ports all over the United States. There are many people who are very dedicated to this mission.

It is a very tough mission, because the movement on ports is relentless. The amount of goods coming by train, truck, and ship is staggering. They have a very hard job. They do need support, and some of them don't feel like they are getting that support.

Ms. LOFGREN. Well, I am glad you mentioned that, because I certainly would not want my criticisms to be directed at the people who are trying, under trying circumstances—but the problem has been in the department a lack of leadership, a lack of organization and structure that dedicated people can actually successfully implement. And this is still another example of that.

My time is up, I know, Mr. Chairman. I thank you for this hearing and this opportunity.

Mr. BERMAN. I thank the gentlelady.

And I recognize the gentleman from California, Mr. Schiff.

Mr. SCHIFF. Well, thank you, Mr. Chairman, and also thank you, Mr. Chairman, for letting me go out of order. I have to run in 5 minutes, so I know I won't take more than that amount of time.

But I did have one question, Ms. Espinel. Two years ago, we had a hearing before this Subcommittee focused on IPR issues and Russia and China. At the time, your office was continuing its review of Russia's IPR regime as part of the WTO extension negotiations.

Back in 2005, I asked you to identify clear metrics or the specific criteria you presented to Russia so that they would know precisely what we expected of them and so that we could hold your office accountable, and together we could hold the Russians accountable if those metrics were not reached.

You responded at the time that in terms of benchmarks there were two key items the U.S. had made quite clear that Russia needed to address.

First you noted that Russia had a massive optical disc piracy problem, and you indicated they must close the optical disc plants and also show us the equipment seized and destroy the plants so they are unable to reopen.

Now, in your 2007 report, and I will quote from it, you provide that the U.S. copyright industries estimates they lose in excess of $2.1 billion in 2006 due to copyright piracy in Russia.

The U.S. copyright industries also reported in 2006 Russia's optical disc production capacity continued to be far in excess of domestic demand, with pirated products apparently intended not only for domestic consumption but also for export.

Second, you indicated at that hearing a couple years ago that tackling the Internet piracy problem in Russia must be addressed and indicated that there are raids and prosecutions, but that we needed to see people actually put in jail.

But again, reading from your 2007 report, you state poor enforcement of IPR in Russia is a pervasive problem. The U.S. notes that prosecution and adjudication of IP cases remains sporadic and inadequate in Russia. There is a lack of transparency and a failure to impose deterrent penalties.

We all know about AllOfMP3.com, et cetera. Long and short of it, it has been nearly 2 years. You shared benchmarks with us. I don't see any progress.

Why did we conclude bilateral negotiations when none of these benchmarks were satisfied? Isn't it clear that Russia's IPR regime is nowhere near ready for admission to the WTO?

Ms. ESPINEL. Since the hearing in 2005, we have actually expanded the benchmarks that we have given to Russia, and we have done that in a very concrete way.

In November of 2006, we negotiated in the context of Russia's bilateral accession agreement with the United States.

We negotiated a very specific agreement with Russia that lays out a blueprint of very specific commitments and actions that they need to take in order to come into the WTO on intellectual property protection and enforcement.

And that agreement between us, I think, serves as an excellent series of benchmarks that Russia will need to complete if they are, in fact, going to enter the WTO.

That agreement includes some of the issues that we discussed at that time, including taking action against optical disc plants and taking action against illegal pirate Web sites.

It, in fact, actually added a series of other commitments that Russia also needs to comply with—for example, strengthening customs authority, amending the civil code so that it is in compliance with the TRIPS agreement and other IP agreements.

Russia has made some progress on some of those commitments, but they are certainly not in compliance with the agreement that we negotiated with them.

And until they are in compliance with that agreement, we have made very clear to Russia that compliance with that agreement is essential to Russia being able to enter the WTO.

Mr. SCHIFF. Well, I mean, you know, right away, it sounds like the Russian benchmarks aren't being met any more than the Iraqi benchmarks.

And you know, we—I asked the question for a reason 2 years ago, because we wanted something to measure progress by, because, you know, the rhetoric we hear usually is the same, "They are making progress. You know, this is—we are turning the corner. They are really going to be serious now."

And so we ask, you know, what can we measure this by so that when we meet 2 years from now—and I am concerned that we meet 2 years from today, and either we will have new benchmarks because the old ones weren't met, or we will have Russia that is part of the WTO that is doing what China has done as part of the WTO, which is very little, as far as I can see, in terms of enforcement.

Ms. ESPINEL. Well, then, to be more specific in terms of the benchmark that we have laid out in this agreement and the commitments, one of them, as you mentioned, was optical disc plants.

Russia has 16 optical disc plants that have been operating on military sites. That has been an enormous concern for the United States. One of the commitments in this agreement was that they had to terminate the leases on those optical disc plants.

That is an area where Russia has made progress that we can measure, and they have terminated 15 of those 16 leases, and those plants should be removed by the end of the year. That is one very concrete measure we can look at in terms of Russia making progress.

But I completely agree with you, there are many areas where Russia has not yet met the benchmarks that we have set for them, and until Russia does that, the United States will not allow them into the WTO.

And I think that accession negotiation that we have with the WTO is one of the most powerful tools that we have to push Russia to make progress on these issues, and we will continue to use it to the full.

Mr. BERMAN. Mr. Sherman?

Mr. SHERMAN. Thank you.

Mr. BERMAN. Recognized for 5 minutes.

Mr. SHERMAN. Mr. Yager, what percentage of the incoming cargo do we inspect? And who pays for the inspections?

Mr. YAGER. At the present time, Mr. Sherman, 100 percent of the cargo is inspected at least in terms of the paperwork. It is not, obviously, opened. So the first thing is for security purposes——

Mr. SHERMAN. Okay. Let me ask the question this way. What percentage of the cargo do we actually open up the container, look what is inside, and make sure we don't have counterfeit disks inside?

Mr. YAGER. In terms of intellectual property protection, it is much less than 1 percent.

Mr. SHERMAN. Much less than one—now who pays for the inspection?

Mr. YAGER. In general, the inspections are performed by CBP officers either at the port or in warehouse locations near the port.

But the costs and the delay are borne by the shippers and ultimately the——

Mr. SHERMAN. The costs—so if my container is opened and looked at, I pay for that as an extra fee?

Mr. YAGER. There is not an extra fee. There is a delay. And obviously, any time that cargo——

Mr. SHERMAN. Okay. I am talking not about the delay. I am talking about—you know, there is a guy. He is looking.

Mr. YAGER. Right.

Mr. SHERMAN. So he is getting a salary. Who is paying for that?

Mr. YAGER. This is the U.S. Customs Service. The U.S. Customs Officials are the ones who are——

Mr. SHERMAN. And so that is out of general tax revenue?

Mr. YAGER. Correct.

Mr. SHERMAN. Okay.

I am going to mispronounce your last name, Ms. Espinel. Would it be a violation of WTO for us to say that the owner of the container—that we impose a fee on each container coming in, we use those fees exclusively to look inside every container?

Ms. ESPINEL. That is an excellent question, and I would want to make sure that my answer is as accurate as possible, so if I may, I would like to get back to you on that so we can give you a precise and accurate answer.

It is not obvious to me that there is any WTO issue——

Mr. SHERMAN. Okay, so——

Ms. ESPINEL [continuing]. That would arise from that, but I wouldn't want——

Mr. SHERMAN [continuing]. We have a situation, then, where the importers of this country and ultimately all of those who consume imported products, which means all of us, are imposing a host of risks and costs on America—the risks of weapons of mass destruction, the risk of pirated products, toys with lead in them.

And we are not doing anything to open the boxes. We just bring them in. We look at less than 1 percent. And there we may just, you know, pass a Geiger counter over it to make sure that if there is a nuclear weapon inside at least they have been smart enough to shield it with lead.

So if we wanted to prevent people from importing pirated disks and fraudulent brake pads and all the other illegal products, not to mention drugs, coming into this country, we would actually have to open the packages—open the containers.

That would cost money, and that cost would be borne by our importers, which, I might add, would help us on the balance of payments situation, where right now all of the costs, societal costs, of piracy, et cetera, are not borne by the importers but, rather, borne by the society at large.

Have we ever threatened China with loss of access to U.S. markets if they do not—I don't care what agreements they sign, because that is absolutely meaningless.

But if they actually don't create a circumstance where everybody I talk to visits Beijing and says, as they are walking around, they are tripping over stands selling pirated movies, pirated music, et cetera, what does China have to lose?

And why are they laughing at us so hard when we fail to do anything?

Ms. ESPINEL. I think China is one of the most important trading relationships that we have, and——

Mr. SHERMAN. Well, excuse me, aren't our exports to China about the size of our exports to Belgium?

Ms. ESPINEL. Yes, but the Chinese economy—the Chinese imports—not just our export economy——

Mr. SHERMAN. Okay. If you think that you get rich by importing, then the Chinese trade relationship is critically important. If you think you get rich by—society gets rich by high corporate profits, then China is important.

But if you think in terms of U.S. jobs, better focus on Belgium. That is to say, exports are what creates jobs. So in any case, it is an important trading relationship, at least in one direction.

What have we threatened the Chinese with?

Ms. ESPINEL. And I understand the frustration that you are expressing. I think before taking action to shut down Chinese market access to the United States, we have to look very carefully at the consequences that would have on U.S. consumers, on the U.S. public as a whole.

But your comment that China——

Mr. SHERMAN. Yes, somebody might actually get a job in the textile industry. It could happen.

Ms. ESPINEL. Your comment that China is laughing at us I would respectfully disagree with. I would agree that China——

Mr. SHERMAN. Have you had your——

Ms. ESPINEL [continuing]. Needs to do more.

Mr. SHERMAN [continuing]. Hearing checked?

Ms. ESPINEL. But China has made progress. China is not in the same situation—and I think that is in part because of U.S. pressure, but I think that is also because the Chinese government has recognized that its reputation as a manufacturing source around the world, the primary manufacturing source, of counterfeit and pirated goods, is not a benefit to it.

That is not at all——

Mr. SHERMAN. Are you saying that any American diplomat just walking around the streets of Beijing will not, without even looking for it, run into pirated goods for sale?

Ms. ESPINEL. I am not disagreeing at all that there is a massive problem in China and that you will find counterfeit and pirated goods quite easily in China.

The Chinese authorities have taken some actions against those, but clearly they have not done enough and——

Mr. SHERMAN. These actions they have taken that you have bought off on, for the most part, and apologize for here, are so ineffective that it is easier to buy pirated goods in China than it is to buy chewing gum here in the United States.

Ms. ESPINEL. I also want to take this opportunity to point out that we have been encouraging the Chinese to do a better job here, one of the most effective tools that we have at USTR—and of course—is WTO dispute settlement.

And we have recently filed cases against China at the WTO. That is something the Chinese government is obviously quite displeased with our doing so.

Mr. SHERMAN. They are quite displeased because they tell you—they put on an act in front of you, and you buy it.

They are quite displeased because they can walk into a room, point to the most recent highly ineffectual action you have taken, pound the table, cry—if they are really good actors—and convince you that way that your ineffectual actions are somehow having some effect, and then leave and then laugh, but only behind your back.

Ms. ESPINEL. Well, I would say that it is certainly our hope that the cases we have brought at the WTO will not be as ineffectual as you seem to think that they will be.

We have rights at the WTO. We chose to exercise those rights when it became clear that we were not going to be able to resolve some of our differences with China.

And it is my personal belief that these cases, while certainly not addressing the entire IP issue in China, will be effective at increasing enforcement in China.

Mr. SHERMAN. I yield back. My time has expired.

Mr. BERMAN. If extra time would bring a consensus—— [Laughter.]

Mr. SHERMAN. If I could have just 30 seconds, I would like to commend to the Chair the bill that has been introduced in the Senate, and three of us introduced it in the House, and that is the Intellectual Property Rights Enforcement Act.

And I hope that we either pass that separately or, better yet, include it in the larger package. And I think that we will have strong support in the Senate for that approach.

Mr. BERMAN. And just on that subject, I mentioned it in my opening statement, but some of the issues here that have been raised in the reports and by all of you in one way or another, are going to be addressed in a larger enforcement bill that Chairman Conyers and I will be introducing 3 weeks ago—I mean, no, coming up soon. [Laughter.]

I recognize myself now.

Just initially, Ms. Espinel—and by the way, I am sorry you have to spend your birthday testifying here. But by and large, there could be worse places to testify than here. And happy birthday.

Mr. SHERMAN. Happy birthday. [Laughter.]

Mr. BERMAN. We will skip the karaoke singing.

But just on the issue of Russia accession, what is the trade representative—the Administration—thinking about in the context of timing? The U.S.-Russia bilateral agreement that was a precondition, is that complete and signed off on?

You have talked about the intellectual property part of that agreement, but is the overall agreement done?

Ms. ESPINEL. We have concluded the bilateral phase. We are now in the process of conducting what we call the multilateral phase of the negotiations. So that is the part of the process where all of the WTO trading partners together negotiate the terms of Russia's final accession into the WTO.

Mr. BERMAN. Does that mean that all the bilaterals Russia has entered into are concluded or are there other countries that are still negotiating their bilateral agreements with Russia?

Ms. ESPINEL. The last I knew, there were two that were open, but those may have concluded recently, so I should double check——

Mr. BERMAN. So we are in the multilateral——

Ms. ESPINEL. It is a very small number.

Mr. BERMAN. We are in the multilateral phase now.

Ms. ESPINEL. Yes.

Mr. BERMAN. And it is not until it is concluded that you will come to Congress with an effort to repeal the Jackson-Vanik provisions which are a precondition to——

Ms. ESPINEL. The multilateral phase has to be completed before Russia can come into the WTO. And obviously, part of that, as well, will involve the Jackson-Vanik——

Mr. BERMAN. And my guess is this is not a 2007 issue for Congress. I mean, you would like it to have been a 2005 issue, but the other things you are doing means that at this point Jackson-Vanik isn't the main thing that stands in the way of Russian accession and——

Ms. ESPINEL. At this point what stands between Russia and its desire to join the WTO is making progress on a number of areas, but including making progress on IP, to come into compliance with the bilateral agreement that we negotiated with them.

The pace and process of the multilateral process will depend on Russia. There is very intense engagement going on with the Russian Federation in Geneva.

But there are a number of areas where Russia needs to make progress, not just intellectual property. And again, ultimately, the pace of that negotiation will depend on how quickly Russia is able to make progress sufficient for the United States to be comfortable for it to come into the WTO.

Mr. BERMAN. At one point you testified about a gold standard. The U.S., on intellectual property enforcement, is the gold standard. But we are not quite pure as driven snow yet.

What are our obligations in terms of compliance with international trade rules? Where do we fall short?

Ms. ESPINEL. Well, overall, the United States system—the United States laws are very strong.

Mr. BERMAN. I am talking in the intellectual property area; I am not getting off into a discussion about agriculture subsidies or anything else.

Ms. ESPINEL. Thank you.

In the intellectual property area, we have a very strong system. I think our system is and should be a model for the world. But there are two aspects of our system that have been challenged at the WTO and have been found to be inconsistent with the WTO.

And those two aspects—one of them is with respect to our copyright law, certain exceptions under our copyright law, and one of those is with respect to certain aspects of trademark enforcement.

I don't want to suggest that our inconsistency with the WTO is anything comparable to the scale of the problem that we have, for example, in China or in Russia.

Mr. BERMAN. Nor would I.

Ms. ESPINEL. But it is a blemish on our record, and it is a problem for us bilaterally and at the WTO.

As the U.S. pushes very hard for other countries to fully implement their WTO commitments, these cases do have the effect of hurting our credibility. And we believe it would be a benefit to us if these issues were resolved.

Mr. WATT. Will the gentleman yield?

What was the second issue? One was copyright and the second one was——

Ms. ESPINEL. And the second one is with respect to certain aspects of trademark enforcement related to assets that have been seized by the Cuban government.

Mr. BERMAN. This is an issue that revolves around Section 211 that was stuck into an Omnibus Appropriations bill, I believe in the dark of night, in the days when that was still done.

Mr. WATT. You mean last year. [Laughter.]

Mr. BERMAN. Well, not in the last days that it was still done, about 5 years, 6 years, 7 years ago, dealing with a trademark held by a French company, and that was challenged at the WTO, and the WTO found that our action violated our obligations under TRIPS.

Is that a fair summary?

Ms. ESPINEL. That is correct.

Mr. BERMAN. And just on that subject, to close that subject, would USTR support an effort to repeal one or both of those provisions?

Ms. ESPINEL. Yes. USTR would support an effort to amend our laws on both of those provisions, and we feel like that would be a benefit to us in trying to push other countries to come into full compliance with their WTO obligations.

Mr. BERMAN. Mark MacCarthy told an interesting story of Visa's efforts to do the right thing in the context of the AllOfMP3.com site and this other site, allTunes, and what happened in Russian courts.

Is the trade representative's office trying to create clarity of what Russian laws are? To do what I think he logically said their company cannot do, which is to get an understanding about what the law is, and what constitutes illegal actions in Russia in terms of intellectual property protection?

Ms. ESPINEL. Yes. Mr. MacCarthy made the point that it is difficult for Visa to try to clarify local laws, but that is one of the things the USTR can try to do.

My understanding of the case is that Media Services, the company that operated allTunes, was able to successfully argue in Russian court that it was not acting illegally because it was paying royalties to collecting societies, collecting societies that were not authorized by the rights holders.

That is one of the issues, one of the very specific issues, that we addressed in the bilateral agreement that we negotiated with Russia.

One of the commitments that they have made is to change their law so that it is clear that collecting societies can only, in the Internet context, can only collect on behalf of right holders that have au-

thorized them to do so, and that should resolve this particular issue.

That change is one that has actually already been made in Russia's civil code, and it should go into effect in January of 2008. And it should resolve or clarify that particular problem in the Russian legal system.

Mr. BERMAN. Do you disagree with that? Is that news to you, or is that——

Mr. MACCARTHY. No, that is roughly our understanding of the legal situation in the Russian Federation right now.

I should mention that the complication of local Russian law means only, from our point of view, that for the time being, at least, these sites that we have received complaints about have to be permitted to operate within the Russian Federation itself.

Insofar as international transactions are concerned, our policy is to make sure that they are not processed using Visa cards.

So for example, someone sitting here in the United States or in London who wants to go to one of these sites to use their card to make a purchase would not be able to do it under our cross border policy.

Mr. BERMAN. I just have to say that I think this is a case where the company you represent has shown real leadership, and it has done the right thing, and I hope other financial service providers that facilitate online transactions will follow the example that you have showed here.

Mr. Watt? I mean, I have got more, but I could go for 20 minutes.

Mr. WATT. Let me just follow up on what Mr. McCarthy said. It is, I assume, true that somebody could still sit in Russia, under what Ms. Espinel has said—internal to Russia, the law would still be——

Mr. MACCARTHY. Our interpretation of Russian law right now is that we don't have the legal standing to say to the Russian banks that operate within Russia, "You have to stop processing transactions for domestic transactions."

Mr. WATT. So what do you say about that, Ms. Espinel?

Ms. ESPINEL. The change that Russia has made to the civil code, which is one of the commitments that they agreed to do in their bilateral agreement with the United States—this change that they have enacted should fix that problem in the context of sites like AllOfMP3 on the Internet, and that change should go into effect in Russia in January of 2008.

Mr. BERMAN. Because they use the royalty collection society, which was sort of a phony deal—it never was authorized by the people to whom the royalties were owed—they claim that is what made what they were doing legal.

They were making payments to this society and now——

Mr. MACCARTHY. Exactly, and that they prevailed in court. And if that changes in January of 2008, we would then be able to move forward in the context of addressing the local distribution of this music.

By the way, just in terms of the successor sites to AllOfMP3 and allTunes, our understanding is that allTunes is in business these days, but they are not taking Visa cards at all. And another site

called MP3Sparks is also in business, but they are not taking Visa cards at all.

Mr. WATT. Mr. Smith seems not quite as satisfied with what you all are saying.

Mr. SMITH. No, I think everything that was said here is completely accurate.

We in industry and, I think, lawyers that are familiar with the Russian law when it was passed in the early 1990's have always concluded that this case, this particular case, was decided wrongly, that, in fact, existing Russian law made these acts, including collecting societies representing—purporting to represent record companies that they don't represent, was a violation of Russian law.

And it is true that the 2008 amendments will fix that specifically. But I think every lawyer who has looked at this, including, I think, Visa's lawyers—we all scratched our heads and said, "Wait a minute. This is already a violation of Russian law, and this should have been solved years ago."

Mr. WATT. I have no further questions.

Mr. BERMAN. The gentleman from Virginia, Mr. Goodlatte?

Mr. GOODLATTE. Thank you, Mr. Chairman.

And I want to thank all the panelists. I am sorry I have not been able to be present earlier, but two other hearings, one in this Committee and one in the Agriculture Committee, have kept me elsewhere.

But I am very pleased that you have taken up this subject, Mr. Chairman. It is one that is very important to me. I serve as one of the co-chairs of the International Antipiracy Caucus and welcome the exposure that you have afforded this issue.

One of the things that I raise with other countries when I have the opportunity to do so, whether representatives come here, whether I am meeting with them in other places, is to point out that it is in their interest to support intellectual property law and the build-out of the infrastructure necessary to both have the law and enforce it.

Because if they hope to transition into an innovation-based economy—many countries that are developing have many creative scientists and researchers and people involved in the technology community and other areas where the advancement of intellectual property is worth protecting—entertainment, artists, and so on.

And that we are not asking them to enforce those laws just out of our interest in protecting what we export to those countries, but that it is in their interest to do that for the development and growth of their own intellectual property community.

We have been hearing reports that China is beginning efforts to transition from a manufacturing-based economy to an innovation-based economy. And it seems like this could present a unique opportunity to make headway with the Chinese on the importance of intellectual property.

So I would direct this to Ms. Espinel and to Mr. Smith. But in light of this apparent desire on the part of the Chinese, are there additional opportunities we should be pursuing to leverage this critical time to encourage China to take its own intellectual property laws more seriously as well as its obligations to honor the intellectual property of other nations' inventors and authors?

Ms. ESPINEL. I would say that I agree with you. I think China's desire to become a leader in innovation does present an opportunity.

I think there are actually several other countries as well, major trading partners, that see themselves as wanting to enter into the future and build a knowledge economy. And I think all of those do present a real opportunity for us.

We have a number of tools that we use to push China and other countries to further strengthen intellectual property. But I think what you have just raised is—in terms of what we can do more—I think that is an opportunity for the United States to try to cooperate further on China.

So USTR is best known, in many ways, for the stick approach, for the Special 301 Report, for WTO dispute settlement, and we will continue to use all of those tools as aggressively as we feel is warranted in order to make progress.

But I think countries—where there is an opportunity for a country to recognize that it is in their own domestic interest to be protecting intellectual property, I think the United States, USTR and the other government agencies can build on that desire through cooperation, through using, for example, our system as a model, and having dialogues with China, for example, on how to build a system that is closer to the U.S. system and is modeled on the U.S. system in some of the ways that we have encouraged innovation, so for example——

Mr. GOODLATTE. I know that in some countries—Russia, for example—at least a few years ago we were making pretty serious efforts to help translate U.S. intellectual property law, decisions and documents related to it, into Russian, that we were trying to help them with the court system and how they would handle disputes in this area and so on.

Do we have any initiative like that with the Chinese? Have they shown any interest in working with us in terms of looking at laws that respect property rights?

Ms. ESPINEL. I think the Chinese do pay close attention to the laws. One specific example I could cite that pertains to China and, actually, India as well is our Bayh-Dole legislation.

Bayh-Dole in the United States is extremely effective in terms of increasing research of industry and building partnerships between universities and industry, thereby increasing the number of products that were brought to market.

China is looking at our Bayh-Dole system—India is looking at our Bayh-Dole system—because it has proved to be successful.

And while Bayh-Dole is not an intellectual property rule per se, having China and India and other countries become innovators, begin to build their system or base their system on aspects of the U.S. system that have been successful, I think will, long term, be very effective in helping us improve IP enforcement as they see that they have a greater stake themselves domestically in protecting intellectual property and as they see themselves having a greater stake in the international system for protecting intellectual property.

Mr. GOODLATTE. Thank you.

If I might, Mr. Chairman—I notice my light has already gone on, but I had a lot of competition——

Mr. BERMAN. Well, you would be the only person to have actually observed it. [Laughter.]

Mr. GOODLATTE. Well, if you would give me that preference, I would like to ask one more question.

Mr. BERMAN. It wouldn't be preference. It would be nondiscrimination.

Mr. GOODLATTE. I thank the Chairman for his indulgence.

And I will ask this to all the panel members. But it follows along with what we have just been talking about. The Internet provides the means for massive copyright infringement in a single instant.

While the U.S. has strong laws against online piracy, it seems that most of the discussion about international IP theft centers around the production of pirated products in physical form.

How bad is online piracy in Russia and China? And do these countries' IP laws address online piracy sufficiently? And do you see any evidence that these countries are inclined to make any decent attempt to combat it?

Start with Mr. MacCarthy.

Ms. ESPINEL. Start with Mr. Smith.

Mr. SMITH. I think the one area——

Mr. GOODLATTE. You are welcome to address my first question, too, Mr. MacCarthy.

Mr. SMITH. I will. Actually, I think China is very interested in pursuing the digital environment in an aggressive way, and I think we see it with the software industry in China that has seen more gains than any of our other industries.

So I think there is a place there where we can intervene and gain some things. Unfortunately, that interest does not extend to the cultural industries where China is immensely protectionist.

But with respect to the Internet—and I think you see it in the Internet environment—in 2006 they passed Internet regulations with respect to protecting content, and it was a very transparent process, quite surprisingly for China.

We made three sets of comments. The regulations came out actually quite good and not that far from U.S. law. And I think China is interested in protecting on the Internet.

What they haven't done yet, and hopefully they will do, is they haven't taken those regulations and then enforced them. What we are facing in the Internet environment is just simply what we are facing in the physical environment—bad enforcement, no criminal enforcement and very weak administrative enforcement.

And lots of confusion in the ISP community has been recently generated by some nonbinding regulations the government has put out which have caused more burdensome notice requirements, if you are familiar with those.

It is just a situation that hopefully China will, as distinct from maybe some other areas, find to be really in their interest.

And of course, they want to control the Internet. We all know that. So the content issues sort of play into that political necessity that they have.

Mr. GOODLATTE. Thank you.

Mr. MacCarthy, do you want to add anything to that?

Mr. MACCARTHY. I could just repeat some of the main points that I made in my testimony, which is when we were involved with two of the Web sites in Russia, we got caught up in complications from local Russian law.

One of the court cases ruled against our local bank, that they had violated their contract by cutting off service to that merchant, and seemed to want a ruling from a competent court within Russia before they would allow us to withdraw service.

And the second case was a case not brought by us and not involving us directly, IFPI, where the owner of one of these sites was absolved of taking any illegal action whatsoever under Russian law.

As I talked about before, this situation may be improved in January of this year when a revision to their law on collective rights society goes into effect.

In the meantime, what we have done is we have tried to take account of the differences in local jurisdictions by making sure that international transactions from the Russian sites are not processed within the Visa system.

Mr. GOODLATTE. Thank you.

Mr. Yager?

Mr. YAGER. Yes, Mr. Goodlatte, just a couple of quick answers. With regard to the issue of the trading on the Internet in the near future, certainly, as the other countries' bandwidth increases and a greater share of the populations there are able to secure these songs, movies online, that will become a greater issue.

I think there is a certain amount of time, depending on the countries, before that happens on a wide-scale basis.

But if I could also address the other point that you made about linking with like-minded countries, or at least expressing their own interest, even in cases where the country as a whole may not feel that it is in their interest to give full protection. There may be industries within the country that can be useful for education purposes or others.

And I give the example of Brazil. They have some very important recording artists, and a significant share of the music sold in Brazil is from domestic artists. And these folks have been quite successful in putting out the message that it is stealing, which is a long-term process in trying to get that message across.

So I think even in countries where there have been larger challenges, there are domestic industries that the United States can link up with.

On the other side of that coin, there are also countries—for example, in South America, again—Paraguay is not a country that has a lot of content. An entire city exists in order to just take advantage of the illegal trade across the border.

Ciudad de Este is a city that exists between the two giants of Argentina and Brazil, and it seems like everything that happens in that city is to take advantage of those trade opportunities. And many of those, obviously, are illegal.

So I think that can work in places like China over the longer term as well as other countries, but in some countries that don't have a lot of content production, it is going to be a tougher sell.

Mr. GOODLATTE. Thanks.

Ms. Espinel?

Ms. ESPINEL. With respect to China, China has joined the WIPO Internet Treaties to protect digital projects over the Internet, which is progress.

And we have noticed, and we note in our Special 301 provincial review report this year, that there have been some increased efforts, particularly in Beijing—have some innovative programs for fighting Internet piracy.

With Russia, they have reported that they have opened 30 investigations this year against illegal Web sites. Now, clearly, this is a significant problem in Russia still, but that is a significant increase over last year.

My last point I wanted to make is one of the challenges I think we face in fighting Internet piracy around the world is that the—there is no clear international regime for fighting Internet piracy the way there is for some other aspects of intellectual property.

And one of the things that USTR would like to see is to see a stronger—a consensus on stronger rules for enforcement, including a consensus on new rules for fighting Internet piracy.

Mr. GOODLATTE. Thank you.

Thank you, Mr. Chairman.

Mr. BERMAN. Well, thank you.

I am going to ask one question to Mr. Smith, and then I will recognize the gentlelady from Texas.

You may have touched on this, but do you think the Special 301 review is an effective tool? We list countries year after year. Is there something beyond that we should be doing, either in lieu of or instead of this Special 301 review?

Mr. SMITH. I think Special 301 continues to be effective. I think there is debate about that.

Because most of our trading partners are now in the WTO, we can't use Special 301 as we did in the case you mentioned in 1995 and 1996 against China, where we were able to unilaterally retaliate.

Mr. BERMAN. Say that one more time. What aren't we able to do?

Mr. SMITH. Because the United States is, and all our trading partners are, now in the WTO, unilateral retaliation, with an exception I will mention in a minute, is no longer possible.

Like with China, our dispute has been taken through the WTO dispute settlement system, which would result, if we win that case, in the possibility of retaliation.

Mr. BERMAN. What were the tariffs on the steel dumping? That was after WTO.

Mr. SMITH. Oh. Well, that is a different part—I mean, you can unilaterally add tariffs on——

Mr. BERMAN. Steel gets it but IP doesn't?

Mr. SMITH. I can't answer that question whether or not it would be WTO-legal to do something in the IP area.

Mr. BERMAN. Well, actually, I think WTO found there wasn't.

Mr. SMITH. But what I am talking about is the ability to stop at our border goods coming from China because of—without going through the WTO dispute settlement process.

We do have other tools, though. We have all our unilateral trade preference tools—GSP, CBERA—where if countries don't—and in Russia, which gets $500 million in GSP benefits. Those benefits are

removable, suspendable, for failure to effectively protect intellectual property.

So that is another tool, and that is part of Special 301. But countries still don't want to be on those lists, and we feel that that process continues to work to persuade and make countries aware of the need to improve their intellectual property protection.

So we are strongly supportive of the Special 301 process. Could it be improved? I think it can be improved. And I think there are things that USTR is doing—for example, looking at enforcement agreements.

There are things like that that can be done, and a more aggressive use of the 301 process I think is possible than is now being done. But basically, I think our industries believe that the process has been pretty successful.

Mr. BERMAN. All right. Well, I think our last questions will come from the gentlelady from Texas, Ms. Jackson Lee.

Ms. JACKSON LEE. Mr. Chairman, thank you very much for holding this hearing.

And I apologize to the witnesses for being delayed in an overlapping hearing. I will narrow my inquiry to a comment and then a question. Frankly, I think that we are severely disadvantaged.

And I thank the Chairman for continuing his oversight on some of these many issues involving intellectual property—but severely impacted and damaged by the fact that trade, intellectual property, is all wrapped up in foreign policy.

And many times, we are more concerned about not offending our perceived ally as opposed to protecting the intellectual property of Americans and the ability for our economy to churn.

I frankly believe that the trade imbalance, for example, is a stark example, particularly with China, of how skewed our foreign policy and trade policy has gotten.

So with respect to the protection of intellectual property, sometimes we yield, even with the 301 review, to not offending.

I would like to ask each of you to express your level of anguish or anger at the present state of intellectual property thievery.

And also, as I heard Ms. Espinel mention stronger piracy laws, if each of you would—and if this has been asked and answered, forgive me, but each of you give me again what kind of legislative fix, the strongest legislative fix, we could get to impact in particular both Russia and China, but others, in terms of intellectual property—strengthening 301?

I have heard it mentioned that it is a fair process and you are happy. But any other legislative fixes that would be helpful in what is still an ongoing problem with the thievery of our intellectual property.

And I will start with Mr. MacCarthy.

Mr. MACCARTHY. In terms of the bigger picture, our access to information about the problem comes largely from intellectual property owners who come to us with complaints.

And in that regard, we have a process in place for dealing with those kind of complaints. We think that process resolves the responsibilities that we have in that area.

We think it is a balanced and legitimate use of our complaint process to come to us when there are these kind of difficulties. It

is a business problem for many, many copyright owners, and we are pleased to step forward to process the complaints when they come to us in an appropriate fashion.

In terms of legislation, we don't have a general recommendations.

Ms. JACKSON LEE. What do you do? What is the relief that you give to the Internet——

Mr. MACCARTHY. If an aggrieved copyright owner comes to us with a documented complaint, and if they identify the Internet site that is involved in the alleged infringement, they give us evidence that, indeed, this is illegal activity, and they provide us documentation that Visa cards are used, we will conduct an assessment of the legal situation.

And if we find that indeed these transactions are illegal either under the laws of the country where the merchant is located or where the cardholder is located, in either jurisdiction, we will pass that information on to the banks that work within our system directly with the merchant and ask them to take corrective action.

Ms. JACKSON LEE. Now, you do a civilian relief. You are obviously processed to move that client's problem through and try to resolve it in that way.

All right, let me ask, you were getting ready to say legislatively you had a suggestion.

Mr. MACCARTHY. We don't have an affirmative suggestion for legislation on the broader issues. We don't have any expertise or competence in there.

We do think it would be unnecessary to have legislation that imposed liability on financial services intermediaries in this area. We think we have stepped forward with the kind of responsible private-sector enforcement action that should help to resolve the problem.

We talked about the limits of private sector action in that area. We can't help to resolve local laws or conflicts between local laws.

And if there are many, many conflicts among the laws in many different countries, the system I described won't work as effectively as it did in the cases that we have applied it to already.

So we don't think the legislation that would give us legal responsibilities would improve the situation, and we are already taking the steps we think are necessary to resolve the problem through private-sector action.

Ms. JACKSON LEE. Thank you.

Mr. Yager?

Mr. YAGER. Yes. We have made one recommendation to the Congress. It has to do with the coordinating group that is now bringing together the U.S. agencies to combat IP—our recommendation is to capture the energy that is currently housed within the presidential initiative called STOP and try to capture that to make that a more permanent structure.

Right now, STOP, as a presidential initiative, could go away at the end of this Administration. Obviously, intellectual property protection won't be solved by them. We think there needs to be a permanent structure to maintain that, and we made a recommendation in that direction.

We also made a number of recommendations to the U.S. agencies in terms of their attention to intellectual property and trying to find the right balance between this particular function, which is often called a legacy function, for example, in the Department of Homeland Security—trying to use the existing resources better to focus their efforts on the kinds of things that can generate intellectual property seizures.

Because even with the existing resources, we believe that seizures and penalties and prosecution afterwards can be a more effective deterrent to that crime than they are right now, and we have a number of specific recommendations in those areas.

Ms. JACKSON LEE. Is that in your statement?

Mr. YAGER. Yes, and we also cite a number of reports that we have done within the last year that have those recommendations.

Ms. JACKSON LEE. Seizures and penalties.

Mr. YAGER. That is correct.

Ms. JACKSON LEE. Thank you.

Mr. SMITH. I think our position is that with respect to foreign piracy, as opposed to customs and what happens here, there are ways to more effectively use the existing trade mechanisms that are in our current law.

And I wanted to mention that and then mention something about legislation.

Ms. JACKSON LEE. Do you want to just briefly instruct us how to be more effective in using——

Mr. SMITH. Yes. I mean, I think there are programs and unilateral trade programs that can be removed from countries that do not adequately protect our intellectual property.

That authority has tended in the last years not to be used and I think lacks credibility now with our trading partners.

Ms. JACKSON LEE. So we need to do due diligence and act upon that.

Mr. SMITH. Yes.

Ms. JACKSON LEE. If you are violating those laws, they need to suffer through what we already have in place, or partly what we have in place, which is to stop the relationship.

Mr. SMITH. That is right.

Ms. JACKSON LEE. Stop the ability.

Mr. SMITH. Also, in addition, there are trade agreements with countries that aren't WTO members that could be used effectively.

There are dispute settlement processes in the free trade agreements which are available to be used as leverage to get countries—now, we haven't needed to do that yet, but at some point we will need to do that. Those are tools that we have that will leverage improvements.

But I also think that there are things that can be done in the legislative area that may increase the credibility of this process and leverage improvements both—in the Special 301 area, I think, for example, we would like to see more and stronger representation of the IP industries in the White House.

We would like to see perhaps changes in Special 301 that tighten up the timetables, tighten up the way USTR does that business. We have some ideas there. But all of these things ultimately end

up with the—there are no quick fixes, which Ranking Member Coble mentioned at the beginning of this hearing.

There are no quick fixes. This is a long slog and a continuing push to make countries aware that it is in their interest to protect our intellectual property. All these tools help get you to that place, and that is where you need to get.

Ms. JACKSON LEE. And that is probably where we have not acted, particularly in Russia and China.

But, Ms. Espinel, I will allow you to refute what I have just said by, in addition to your answer that—I hope you will repeat also this intellectual privacy strengthening that you would like.

What is the record of the trade office and the White House on denying access to the United States based on bad actors in terms of intellectual property violations? What is your record?

What is the last five that you have denied that access?

Ms. ESPINEL. In terms of denying market access, one of the things that we have been discussing today is that, for example, using the Special 301 process to impose unilateral sanctions—our ability to do that is now somewhat restricted by the fact that most of our trading partners, including China, are members of the WTO.

And so we are not in a position where we can, for example, impose unilateral sanctions to block access consistent with our WTO obligations.

Ms. JACKSON LEE. Have you gone to the WTO? What is your current status in the WTO in terms of challenging those who have violated our agreements?

What are the countries?

Ms. ESPINEL. That said, we do have rights at the WTO. So while the WTO membership may have restricted in some ways our abilities under Special 301, membership in the WTO has also given us certain rights against countries, including China.

And we have exercised those rights at the WTO. We have recently filed two different cases against China at the WTO.

Ms. JACKSON LEE. Are they broad cases, meaning something——

Ms. ESPINEL. Yes. They impact IP enforcement and protection. That is the first case. And then there is a second case which goes after certain market access restrictions that China places on copyright products.

While that is not an intellectual property case per se, the restrictions that China has do have the impact of restricting our copyright industries' ability to access the Chinese market and, as an ancillary effect to that, they create an enormous vacuum for legitimate product and, therefore, an incentive to pirate.

So we believe that China needs to get rid of those market access restrictions both so that our products can enter the Chinese market but also to remove an enormous incentive to pirate, and we think that will be helpful in improving the enforcement situation in China.

I also want to comment on Special 301. We do feel that it is a very effective process. Countries do pay attention to their standing on the list. It has been successful in getting countries to institute reforms.

But we are always looking at ways that we can improve the tools that we have. And in fact, last year USTR logged something that

we call the Special 301 Initiative, where we were looking to see how we could better focus our resources.

And we selected a group of countries where we felt increased engagement under Special 301 will lead to progress, and that has, in fact, been successful. We have seen some concrete results come out of that, and we are planning to continue that initiative this year.

In terms of legislative fixes, I think we would look more at the international side of things. And where we see a gap in international rules to protect intellectual property is in areas where we are facing new challenges that have arisen in the last 10 years.

And two I would point to in particular are Internet piracy and the fact that counterfeiting and pirating has become a much more sophisticated, global criminal enterprise than it was 10 years ago.

Ms. JACKSON LEE. The first one was Internet piracy, and what——

Ms. ESPINEL. Internet piracy.

Ms. JACKSON LEE [continuing]. Was the second?

Ms. ESPINEL. The sophistication of counterfeiters, the fact that counterfeiters are not at this point just servicing a domestic market but are manufacturing and then distributing their products all across the world in very sophisticated ways.

We feel that we need a new set of international rules, a new consensus on how to fight those rules, if we are going to be able to effectively address that. USTR has some ideas in that regard, and that is something that we are working on actively with our trading partners.

Ms. JACKSON LEE. Thank you, Mr. Chairman.

Mr. BERMAN. Okay.

Unless people object really strenuously, I think we will adjourn this hearing. Thank all of you very much. You have really provided, I think, very helpful testimony and useful suggestions.

And happy birthday, Ms. Espinel.

[Whereupon, at 12:41 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE®

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February 12, 2007

Ms. Victoria Espinel
Assistant U.S. Trade Representative
for Intellectual Property and Innovation
Office of the United States
Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508

Re: Request for Public Comment on the Identification of Countries under Section 182 of the Trade Act of 1974 (as amended) ("Special 301"), 72 Fed. Reg. 1033 (January 9, 2007)

Dear Ms. Espinel:

This filing responds to the Request for Written Submissions appearing on January 9, 2007 in the Federal Register. The request invites submissions from the public on policies and practices that should be considered in connection with designating countries as Priority Foreign Countries pursuant to Section 182 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. § 2242 ("Special 301"). The Special 301 provisions call upon the United States Trade Representative to identify countries which, *inter alia*, "deny adequate and effective protection" to U.S. intellectual property or deny "fair and equitable market access" to U.S. persons who rely on intellectual property protection.

The International Intellectual Property Alliance (IIPA) submits our discussion of the types, levels, and costs of piracy, an evaluation of enforcement practices to reduce those levels, and the status of copyright law reform in 60 separate country reports. We also recommend where these countries should be ranked on the various Special 301 watch lists. We highlight challenges and initiatives in this letter that define the copyright industries' agenda for the coming year. We also highlight four countries which we believe could be considered for dispute settlement under their respective FTA obligations. Finally, we mention 15 additional countries/territories that we have not recommended be on a Special 301 list but which merit attention by the U.S. government in its bilateral engagements with those countries.

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

The International Intellectual Property Alliance (IIPA) is a private sector coalition formed in 1984 to represent the U.S. copyright-based industries in bilateral and multilateral efforts to improve international protection of copyrighted materials. IIPA comprises seven trade associations, each representing a significant segment of the U.S. copyright community. These member associations represent over 1,900 U.S. companies producing and distributing materials

protected by copyright laws throughout the world—all types of computer software, including business applications software and entertainment software (such as videogame CDs, DVDs and cartridges, personal computer CD-ROMs and multimedia products); theatrical films, television programs, home videos and digital representations of audiovisual works; musical compositions, records, CDs, and audiocassettes; and textbooks, trade books, reference and professional publications and journals (in both electronic and print media).

On January 30, 2007, the IIPA released an economic report entitled *Copyright Industries in the U.S. Economy: The 2006 Report*, the eleventh study written by Stephen Siwek of Economists Inc. This report details the economic impact and contributions of U.S. copyright industries to U.S. Gross Domestic Product, employment, and trade. The latest data show that the "core" U.S. copyright industries[1] accounted for an estimated $819.06 billion or 6.56% of the U.S. gross domestic product (GDP) in 2005. These "core" industries were responsible for 12.96% of the growth achieved in 2005 for the U.S. economy as a whole (this means that the growth contributed by these core industries (12.96%) was almost double their current dollar share of GDP (6.56%)). In addition, the "core" copyright industries employed 5.38 million workers in 2005 (4.03% of U.S. workers) in 2005. And the report, for the first time, provides data on the estimated average annual compensation for a worker in the core copyright industries: $69,839 in 2005, which represents a 40% premium over the compensation paid the average U.S. worker. Finally, estimated 2005 foreign sales and exports of the core copyright industries increased to at least $110.8 billion, leading other major industry sectors. Those sectors include: chemicals and related products (not including medicinal and pharmaceutical products); motor vehicles, parts and accessories; aircraft and associated equipment; food and live animals; and medicinal and pharmaceutical products.

It is essential to the continued growth and future competitiveness of these industries that our trading partners provide not only free and open markets, but also high levels of protection to the copyrights on which this trade depends. This protection upon which so much U.S. economic performance rests is under constantly evolving threats, and it is critical to sustain U.S. economic competitiveness that our country's response remains flexible, innovative and committed. There are certain sectors of the U.S. copyright community, notably the music sector, that has already witnessed significant declines in foreign sales and royalty remittances as a consequence of increased levels and new forms of piracy, and it is essential that we address these problems on an urgent basis.

B. OUTLINE OF IIPA'S SPECIAL 301 SUBMISSION

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

- This letter, which (1) outlines IIPA's recommendations for cross-cutting initiatives to be undertaken by the copyright industries and the U.S. government for 2007; (2) summarizes our submission this year; and (3) points the reader to various appendices;

[1] The "total" copyright industries include the "core" industries plus those that, under conservative assumptions, distribute such products or other products that depend wholly or principally on copyrighted materials. The "core" copyright industries are those that create copyrighted materials as their primary product. *The 2006 Report* is posted on the IIPA website at http://www.iipa.com.

- Appendix A, which contains IIPA's country placement recommendations, estimated trade losses due to piracy, and estimated levels of piracy;
- Appendix B, which describes IIPA members' methodologies for calculating estimated trade losses, piracy levels, and global data on optical disc factories and production capacity;
- Appendix C, which includes all the country surveys[2] and at the end lists **15** countries that deserve continued U.S. government attention but which we have not recommended for placement on the Special 301 lists;
- Appendix D, which provides a historical chart of countries/territories' placement on Special 301 lists by USTR since 1989; and
- Appendix E, which contains the Special 301 histories of countries/territories which we have recommended for placement on a list this year, many other countries that have appeared on USTR's lists in the past and are still candidates for monitoring intellectual property practices, and certain other countries/territories that have never appeared on a USTR list but which deserve attention.

C. COPYRIGHT INDUSTRIES' INITIATIVES AND CHALLENGES IN 2006

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

The copyright industries are extremely grateful for the U.S. government's efforts in promoting copyright reform and effective enforcement. But, as is clearly demonstrated in the country surveys included in this report, organized commercial piracy, whether digital or analog, tangible or over the Internet, combined with the failure of foreign governments to enforce their existing copyright and related laws, threatens to outpace the fight to combat it. IIPA believes that a significantly heightened effort is called for to make further progress on the following objectives in 2007. We believe the tools exist to make significant progress—the issue is whether all governments have the political will to take the actions necessary to address piracy

[2] Country surveys were prepared by Michael Schlesinger, Maria Strong, Eric H. Smith, Steven Metalitz, and Eric Schwartz, and are based on information furnished by IIPA's seven member associations. We also thank the Smith, Strong & Schlesinger LLP staff, Kristen Schumacher, Tracy Baker, Jennifer Stroud and Eunice Kim, for their contributions in preparing, producing and distributing this submission. The country reports contain information which should not be construed as providing legal advice.

meaningfully and to lower piracy rates locally and globally. The following objectives are not necessarily listed in order of priority, since different issues may demand priority attention in different countries.

Effective and Deterrent Enforcement Against Copyright Piracy

The copyright industries' most important global goal is to significantly reduce piracy levels in order to open foreign markets, and create increased revenue and employment. Only through effective deterrent enforcement, as required by the WTO TRIPS Agreement and the various Free Trade Agreements (FTAs) which the U.S. has recently negotiated, can this goal be met. The lack of effective enforcement undergirds virtually all the initiatives/challenges described below, as well as the credibility of the multilateral and bilateral agreements entered into by the United States.

The industries and the U.S. government have been engaged for over twenty years in many countries to secure deterrent levels of enforcement that would bring piracy down to acceptable levels. Even following implementation of the TRIPS Agreement's new enforcement obligations in 1996 and 2000, many countries still have not meaningfully upgraded their enforcement systems to meet their international obligations by adopting effective remedies and imposing deterrent penalties. While there has been a general global upgrading of police ability (and in many cases willingness) to conduct raids against pirate production, wholesale and retail sites, such enforcement activity has not been adequate or effective. Adequate and effective deterrence requires capable and aware prosecutors and judges (or, where applicable, administrative agencies) willing to impose penalties that would remove the monetary incentives that drive the pirate trade. Many enforcement systems reflect a lack of willingness at the political level. Pirates whose vast economic gains amount to hundreds of thousands to millions of U.S. dollars simply cannot be deterred through mere monetary fines. Deterrence requires substantial prison sentences in these cases. Again and again, in country after country, our industries have witnessed major pirates either evading conviction (often as a result of systemic delays or corruption) or being slapped with monetary fines that do not come close to providing the disincentive needed to deter them from continuing in this illegal business. Again and again, raided stores reopen quickly with new pirate product, or major pirate producers continue their trade in a new guise to avoid the next enforcement action, which may never come, or may come only after the pirate has lined his pockets with millions more in illegal income.

Since no country will ultimately undertake effective reform unless it understands that it is in its own interest, it is essential that the U.S. government continue to take steps that will facilitate such an understanding and increase the capacity of willing governments to take effective action. Among the strategies that could be employed are:

- Continue to coordinate enforcement training, including localized training and capacity-building that demonstrates the benefits of deterrent enforcement.
- Foster further coordination among and between U.S. agencies, industry, and international organizations with training resources;
- Create "best enforcement practices" models, including legislative provisions and specific and practical reforms at the police, prosecutorial and judicial levels. These would be based on the TRIPS text and the U.S. FTA models, but with far greater detail to assist the enforcement authorities. This could include recommendations for "zero tolerance" policies against retail piracy and specific actions to be taken in the area of Internet piracy. It should include model sentencing guidelines that would help the authorities assess what penalties

will actually deter pirates;

- Set specific enforcement targets for countries in bilateral negotiations.

We believe the Special 301 process must specifically target enforcement in a very direct and clear way. It is a fact that many countries believe that Special 301 ranking decisions can be made on the basis of law reform, followed by enforcement "promises" alone. Experience has taught us that this simply has not worked. Countries should be made acutely aware that they will not see a change in their Special 301 placement unless they take the specific enforcement actions necessary to actually reduce piracy rates (and, conversely, that they will see a change when such actions are in fact undertaken).

Internet Piracy, Electronic Commerce and the WIPO Internet Treaties

The Scope of the Problem: Copyright piracy on the Internet and through other digital media, a serious problem for the past several years, is undergoing explosive growth and threatens to undermine the very foundations of electronic commerce in this new millennium. While broadband offers exciting prospects for the legitimate dissemination of copyrighted materials of all kinds, too often access to high-speed digital connections is being used to distribute unauthorized copies of sound recordings, software, videogames, literary material, and motion pictures. This has suppressed legitimate consumption.

The unprecedented growth of the Internet and increased availability of broadband connections, coupled with the absence of adequate copyright laws and enforcement in the online environment in many countries, has effectively turned the Internet into a highly efficient network for distribution of infringing copyright materials. Infringing product can now reach any part of the world with ease, no matter where the uploader or infringing service is located. Consequently, the U.S. copyright industries face the daunting task of trying to enforce their legal rights in an online world where borders and distances have decreasing practical significance.

An unfortunate consequence of the global nature of online communications is that inadequate protection or enforcement practices that exist in one country can foster abuses in other countries—even those quite cognizant of and responsive to online piracy challenges. Increasingly we perceive this to be the case in the United States, for example, where access to pirated products is often facilitated through the operation of "tracker sites" or repositories of pirated content housed in other countries. Insofar as countries' abilities to successfully address challenges relating to online piracy are in many ways interdependent, we encourage countries' collective attention to this large and growing problem.

Quantifying the economic losses due to Internet piracy and allocating those losses to particular countries are extremely challenging problems. Because of these challenges, IIPA's estimates of piracy levels and of trade losses due to piracy do not yet fully take into account piracy on the Internet. Yet we know that Internet piracy is growing rapidly, frequently resulting in displaced sales of legitimate product, and that an urgent response is greatly needed. For example, independent surveys in just ten of the biggest markets reveal that an estimated 20 billion songs were illegally downloaded through file sharing services in 2006 alone. This translates into billions of dollars in lost revenue at a time when sales of physical products are in decline. Entertainment software publishers estimate that as many as 10,000 to 20,000 copies of the most popular videogame titles are successfully downloaded each week. And new phenomena, like the illegal pre-loading of songs, games, and other content onto handheld devices, pose yet new digital threats to healthy electronic commerce. We hope to continue to

evolve measures and metrics to gauge the prevalence and impact of online piracy, and to find ways of expressing these figures in a manner that identifies those countries that should be held accountable.

Meanwhile, we urge governments to act quickly and on a global basis to secure the adoption of legal provisions that will prevent piracy, and to create a legal and regulatory environment that will facilitate the growth of legitimate online delivery of copyrighted materials. This entails not only the establishment of adequate rights and remedies under copyright, but also the establishment of rules that compel reasonable practices on the part of all entities involved in the transmission of copyright materials.

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

Well established international norms such as the WTO TRIPS Agreement contribute valuable elements to the needed legal infrastructure to protect electronic commerce and combat Internet piracy. In particular, WTO TRIPS contains a technology-neutral obligation to provide "expeditious remedies to prevent infringements and remedies which constitute a deterrent to future infringements" (Article 41). The fight against this new form of piracy must be conducted under the copyright principles contained in this Agreement, and particularly through application of the existing enforcement tools described there.

In addition, the two treaties adopted by the World Intellectual Property Organization (WIPO) Diplomatic Conference in Geneva in December 1996 provide an additional and more tailored framework for what is needed to protect the transmission of content in the new e-commerce economy. These treaties, the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT), are now in force, and their effective implementation is critical in the fight to control this new and ominous threat. These treaties form a key part of the international legal standards with which countries must comply in order to provide the "adequate and effective" copyright protection that is demanded under the Special 301 program. These standards include clarifying exclusive rights in the online world, and, in addition, specifically prohibiting the production of or trafficking in tools that circumvent technological protection measures (TPMs) for copyrighted works.

Finally, as described further below, the more specific and clarified enforcement obligations in the U.S. government's Free Trade Agreements also establish binding enforcement obligations which should form the underpinnings of the Internet enforcement systems in these countries, and eventually in all countries.

IIPA and its members have joined with their counterpart copyright industries around the world to push for ratification and full implementation of the WCT and WPPT in all countries. The first phase of these efforts—bringing the treaties into force through the accession to each of at least 30 countries—was completed in 2002. As of February 10, 2007, official deposits of the treaties with WIPO stood at 62 for the WCT and 60 for the WPPT. More and more countries are now beginning to legislate in this area. From the EU, Belgium has now ratified both treaties. It is expected that the other 14 original EU member states that have yet to ratify will also deposit instruments for both treaties in the near future.

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

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

These law reform and enforcement measures are critical in deterring pirates from destroying the incredibly promising new tools for making copyrighted products available globally before right holders have had a chance to gain a foothold. IIPA members have significantly increased their monitoring of, and where possible, actions against pirate product traveling over the Internet in many of the countries discussed in this submission. Webcrawlers and other search technologies have been employed to ferret out piracy occurring in many languages in addition to English. One essential tool that should be made available globally is notification of ISPs by copyright owners through cease and desist letters in order to obtain their cooperation to "take down" or block access to infringing material immediately, and otherwise to prevent infringing conduct of all kinds. The effective use of such a "notice and takedown" tool is, in turn, dependent on a system of secondary liability, which exists in some but not all countries, and which must be effectively multilateralized to encourage responsible conduct and enable expeditious action against piracy, and the deployment of available technological measures that can restrict or prevent infringing transmissions at all levels of the delivery chain.

Finally, as we know from our own experience here in the U.S., we must find a global solution that discourages unauthorized peer-to-peer file sharing through aggressive enforcement against unauthorized uploaders of infringing product, whether of musical recordings, movies, business or entertainment software or literary material, as well as against services that provide these tools for the purpose of encouraging and profiting from infringement.

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

If new legal Internet-based services for delivery of copyrighted material are to succeed, we must ensure that they are not undermined by unfair competition from unauthorized sources.

It is critical that governments, educational institutions and similar enterprises that provide broadband interconnections to their employees, students or others develop and enforce strong internal policies (such as executive orders in the case of governments) to prevent illegal file sharing of copyrighted materials, including through the use of peer-to-peer technologies. In addition, governments should help to ensure that Internet cafés use only legitimate software in the operation of their business, and that they prohibit use of their facilities for the commission of further infringements.[4]

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

Optical Disc Piracy

Piracy of optical disc (OD) products continues to cause major losses to all the copyright industries. Increasingly, all sectors of the copyright industry use a common set of media to distribute their products worldwide. These "optical disc" products include formats such as compact discs (CD), video CDs (VCD), CD-ROMs, CD-Recordables (CD-Rs), digital versatile discs (DVDs) and DVD-Recordables (DVD-Rs). An explosion in the world's capacity to produce optical disc products has been driven by the ever-growing worldwide demand for copyrighted high-tech, entertainment and educational products, but also by the potential for pirates to generate billions of dollars in illegal income. Optical disc production capacity has for years greatly exceeded the legitimate demand for such products, whether pre-recorded discs or blank media, with much of the difference inuring to the benefit of illegal pirate enterprises. Increasingly, blank recordable optical media are also used to "burn" unauthorized copies on a commercial basis and the manufacture and sale of blank media are often specifically targeted to support the piracy trade. Pirate CDs, VCDs, CD-ROMs and DVDs, CD-Rs and DVD-Rs containing protected music, sound recordings, audiovisual works, business and entertainment software and books and journals have quickly decimated the market for legitimate U.S. products. With the increased and more effective regulation of factory production, "burning" has nearly become our industries' biggest "hard goods" piracy threat.

The growth in the number and capacity of optical disc factories around the globe has been staggering. Based on our survey of optical disc production in 80 countries/territories:

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[4] In 2006, Ministers of the 21 Members of the Asia Pacific Economic Cooperation regional group recommended that "government entities" (which should include educational institutions funded by the State) should ensure that copyright usage, including on P2P networks, is legal. The APEC Ministers specifically "Recommended that APEC Leaders should endorse the principle that government entities should not use illegal software or other content on their computer networks, especially pertaining to Internet usage," noting that "This keeps APEC at the forefront of addressing the growing problem of illegal file sharing on the Internet." Leaders cemented the understanding among the APEC Members in November 2006 in Hanoi, Vietnam that all "government agencies" should ensure that copyright usage is legal. The APEC Leaders stated the following:

> We ... called on member economies to exercise appropriate oversight to achieve the objective that central government agencies use only legal software and other copyright materials; that such bodies implement effective policies intended to prevent copyright infringement on their computer systems and via the Internet, in accordance with relevant international conventions and domestic laws and regulations concerning copyright and related rights; and that central government funds are not used by contractors or recipient institutions to purchase illegal software or other illegal copyright materials.

- There were as many as **1,077 optical disc production plants** in 2006.
- Those plants had at least **8,928 production lines**.
- Total production capacity worldwide was estimated at more than **31.8 billion discs per year** in 2006.

It must be noted that in certain markets, the mere fact that there are sizable numbers of plants and production lines does not directly correlate to piracy or over-production. This is due to the fact that the plants in many markets, such as Hong Kong, Taiwan, the United States, and many European markets, fill legal orders for finished and blank discs. The following chart details this information. For 2007, IIPA identifies the key optical disc piracy production trouble spots as: **China, Russia, Thailand, Indonesia, and Nigeria**. These are markets where immediate actions should be taken by the governments to curtail optical disc pirate production.

Estimated Optical Disc Production Capacity in 80 Countries/Territories[5]

	Plants (Including CD-R)		Production Lines (Including CD-R)		Capacity in Millions (Including CD-R)	
	2006	2005	2006	2005	2006	2005
ASIA						
Australia[6]	13	13	33	24	115.5	84.0
Bangladesh	6	2	14	6	49.0	21.0
Burma/Myanmar	NA	1	NA	1	NA	3.5
Cambodia	NA	1	NA	1	NA	3.5
China	92	86	1,482	1,374	5,187.0	4,809.0
Hong Kong	90	106	733	817	2,565.5	2,859.5
India	20	20	166	166	581.0	581.0
Indonesia	28	29	145	100	507.5	300.0
Japan[6]	32	32	260	NA	910.0	NA
Korea	28	28	75	78	262.5	273.0
Laos	NA	0	NA	0	NA	0.0
Macau	1	3	1	3	3.5	10.5
Malaysia	32	41	163	NA	570.5	NA
New Zealand	3	3	6	3	21.0	10.5
Pakistan	1	11	1	38	3.5	133.0
Philippines	10	11	45	38	157.5	133.0
Singapore	20	20	99	106	346.5	371.0
Sri Lanka	2	2	2	2	7.0	7.0
Taiwan	83	89	2,795	2,755	9,782.5	9,642.5[7]
Thailand	41	42	190	155	665.0	542.5
Vietnam	5	5	12	12	42.0	42.0
SUB-TOTAL	**507**	**545**	**6,222**	**5,679**	**22,071.0**	**19,826.5**
E. EUROPE/CIS						
Belarus	1	1	2	2	7.0	7.0
Bulgaria	9	9	13	18	45.5	63.0[6]
Croatia	NA	NA	NA	NA	NA	NA
Czech Republic	4	4	14	14	49.0	NA
Estonia	3	2	4	2	14.0	7.0
Hungary	4	4	14	14	49.0	49.0
Kazakhstan	2	2	2	2	11.6[6]	11.6[6]

[5] The methodology used by IIPA to calculate estimated capacity is discussed in Appendix B of IIPA's 2007 Special 301 submission at http://www.iipa.com/pdf/2007spec301methodology.pdf.
[6] In Australia and Japan, we believe there are more production lines but that the lines listed represent those that are dedicated to production of finished discs.
[7] We revise our Taiwan estimate for 2005 for disc production capacity based on updated line numbers.

Lithuania	1	1	2	2	7.0	7.0
Poland	11	9	153	122	830.0[8]	775.0[8]
Republic of Montenegro[9]	NA	NA	NA	NA	NA	NA
Republic of Serbia[9]	4	4	6	10	21.0	35.0
Romania	2	2	3	3	10.5	10.5
Russia	53	54	130	113	455.0	395.5
Slovenia	2	2	5	5	17.5	17.5
Ukraine	7	5	17	14	90.0[8]	49.0[8]
SUB-TOTAL	**103**	**99**	**365**	**321**	**1,607.1**	**1,427.1**
WESTERN EUROPE						
Austria	5	5	10	8	35.0	28.0
Belgium	3	3	17	25	59.5	87.5
Denmark	4	5	36	36	126.0	126.0
Finland	2	3	4	6	14.0	21.0
France	15	18	146	204	511.0	714.0
Germany	28	42	240	144	840.0	504.0
Greece	11	12	31	40	108.5	140.0
Ireland	8	8	70	70	245.0	245.0
Italy	37	29	124	101	434.0	353.5
Luxembourg	1	2	18	19	63.0	66.5
Netherlands	13	17	96	107	336.0	374.5
Portugal	2	3	5	5	17.5	17.5
San Marino	1	2	1	2	3.5	7.0
Spain	16	16	108	119	378.0	416.5
Sweden	2	5	3	12	10.5	42.0
Switzerland	3	3	12	11	42.0	38.5
United Kingdom	14	16	112	128	392.0	448.0
SUB-TOTAL	**165**	**189**	**1,033**	**1,037**	**3615.5**	**3,629.5**
WESTERN HEMISPHERE						
Argentina	9	9	30	30	105.0	105.0
Brazil	13	13	84	88	294.0	308.0
Canada	17	17	130	132	455.0	462.0
Chile	2	2	2	2	7.0	7.0
Colombia	2	2	8	9	28.0	31.5
Costa Rica	1	1	1	1	3.5	3.5
Dominican Rep.	1	1	1	1	3.5	3.5
Mexico	10	9	208	205	728.0	717.5
Paraguay	4	1	15	1	52.5	3.5
Peru	2	2	3	3	10.5	10.5
United States	185	181	679	740	2,376.5	2,590.0
Uruguay	1	1	1	1	3.5	3.5
Venezuela	2	2	7	7	24.5	24.5
SUB-TOTAL	249	241	1,169	1,220	4091.5	4,270.0
MIDDLE EAST						
Algeria	4	4	10	10	35.0	35.0
Egypt	3	4	5	6	17.5	21.0
Iran	2	2	2	3	7.0	10.5
Israel	5	7	15	19	52.5	66.5
Jordan	1	1	1	1	3.5	3.5
Kuwait	1	1	3	3	10.5	10.5
Lebanon	1	1	1	1	3.5	3.5
Palestinian Auth.	1	1	1	1	3.5	3.5

[8] The capacity numbers for Bulgaria (2005 numbers only) and for Kazakhstan, Poland, and Ukraine do not follow the IIPA methodology, and are based on plant visits and/or different per line capacity estimates.

[9] Formerly part of Serbia and Montenegro, the Republic of Montenegro formed in June 2006, and it is unclear whether any of the plants in the former Serbia and Montenegro are located in the territory of the Republic of Montenegro, hence the chart lists "NA."

Saudi Arabia	1	1	1	6	3.5	21.0
Syria	2	2	2	5	7.0	17.5
Turkey	10	10	21	25	73.5	87.5
SUB-TOTAL	31	34	52	80	217.0	280.0
AFRICA						
Nigeria	15	15	52	36	182.0	126.0
Senegal	1	1	1	1	3.5	3.5
South Africa	6	5	24	24	84.0	84.0
SUB-TOTAL	22	21	77	61	269.5	213.5
TOTALS	**1,077**	**1,129**	**8,928**	**8,398**	**31,871.6**	**29,646.6**

The growing optical disc problem confronting the copyright sectors, now familiar to governments worldwide, demands new and creative legislative and enforcement solutions. Traditional enforcement mechanisms have not been sufficient to prevent optical disc piracy from spinning out of control and flooding national, regional, and even global markets with millions of high-quality pirate products. As part of countries' WTO TRIPS obligations to provide deterrent enforcement against piracy "on a commercial scale," every country whose optical disc production facilities are producing significant pirate product should create and enforce a specialized regulatory framework for tracking the growth of optical disc production capacity, including the cross-border traffic in production equipment and raw materials, principally optical-grade polycarbonate. These regulatory regimes should include strict licensing controls on the operation of optical disc mastering and replication facilities, and the requirement to use identification tools that identify the plant in which production occurred and that help lead the authorities to the infringer. So far such regimes have been established in Bulgaria, China, Hong Kong, Indonesia, Macau, Malaysia, the Philippines, Poland, Singapore, Taiwan, Thailand, Turkey, and Ukraine, have reportedly been enacted in Nigeria, and are under consideration in Bahrain, Oman, India, Vietnam, and other countries. Increasingly, pirate optical disc production is migrating from jurisdictions with optical disc production regulatory regimes to countries that as yet have not adopted these regulatory tools or do not enforce them, such as Bangladesh, Nigeria, Vietnam, and many others mentioned in this submission.

We urge the U.S. to press every country in the regions most affected by pirate optical disc production and export—including East Asia, South Asia, Eastern Europe, Russia and the countries of the former Soviet Union and increasingly Africa—to put comprehensive optical disc regulatory controls into place promptly. Otherwise, pirate syndicates will continue to transfer their optical disc operations across borders in an effort to stay one step ahead of enforcement efforts.

IIPA and its members have developed a number of resources to help governments in fashioning an effective optical disc regulatory system. We also note that governments have recognized the importance of effective regulations. In October 2003, APEC leaders agreed on the need to "stop optical disk piracy" and endorsed a set of "Effective Practices." We commend these to all governments addressing this problem. We stand ready to work with USTR to assist governments in understanding, drafting and implementing these recommendations into national law.

As these regimes have been adopted and enforcement under them has matured, the pirates have again taken advantage of technological developments, and moved production increasingly from the "factory" locus to smaller, more mobile venues that are more private and harder to police. The newest generation of pirates uses much less expensive and more portable consumer "recordable" technology – CD and DVD "burning" on CD-Rs and DVD-Rs. That technology has now advanced so that with a very small investment, pirates can easily and

cheaply replicate thousands of copies of copyrighted products for commercial sale. We refer here not to individual consumers "burning" copies but to aggressive commercial exploitation – often by the very same syndicates that operated the factories and generate millions of dollars for the pirate operators. In some countries/territories, like Taiwan, Brazil, Mexico, Spain and many others, seizures of pirate product in 2006 were overwhelmingly of "burned" product. Commercial "burning" has probably become the biggest piracy threat in the "hard goods" market. This new development calls for innovative responses. Improved enforcement machinery must aim at implementing zero tolerance policies against the offer for sale of pirate product. If pirates have no place to sell their products, their ability to manufacture becomes superfluous. Some countries are already responding by enacting absolute bans on street sales, with some positive results. Commitment from more countries to do the same is sorely needed.

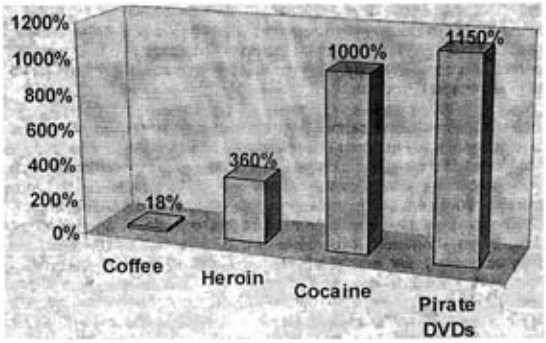
In sum, regulations controlling and monitoring production need to be adopted, implemented and enforced, and must be accompanied by general copyright enforcement. As we have monitored the development of these regulatory regimes, it has become increasingly apparent, as it has with all piracy, that enforcement is again the key to the effective functioning of these new regimes. In too many cases, the regulations are put into place and then simply not enforced. This must end. Governments must be given the authority to conduct surprise inspections of optical disc production facilities to ensure full compliance, and then must actually engage in such inspections. They must deal effectively with commercial "burning" operations, and they must use that authority accompanied by vigorous enforcement. Deterrent penalties—including license revocation, confiscation of equipment and raw materials, and heavy fines and imprisonment—must be consistently and efficiently imposed on optical disc pirates, and governments must adopt and implement zero tolerance policies on the sale of infringing materials.

Piracy by Organized Crime Syndicates

Because of the immense profits that can be garnered by producing pirate optical disc products, this illegal business has been taken over in many countries by organized crime syndicates, making it even more difficult for local authorities to combat the problem. These criminal syndicates are highly organized, are linked across national boundaries, and have powerful friends within governments. They have access to and control of large amounts of capital, and exploit complex distribution networks to engage in many kinds of criminal activity. In many cases, these powerful criminal networks are involved in multiple lines of criminal activities, including copyright piracy, drug smuggling, trade in illegal munitions, and money laundering. In some cases, the proceeds of copyright piracy have been used to fund terrorist organizations.

These syndicates control the production and distribution of pirated and counterfeit optical disc products within the domestic market and around the world. For example, syndicates with optical disc production facilities in Southeast Asia work with partners in South America to conduct a thriving trans-Pacific trade in pirate music CDs, entertainment software, and other optical disc products. These criminal networks are highly sophisticated and are becoming increasingly dangerous to deal with. Starting in 2003, responding to improved enforcement against factory pirate production, the syndicates began moving their illegal trade into CD-R and DVD-R "burning" and to the Internet. This phenomenon has grown to epidemic proportions in 2006.

In an October 2005 study by MPA, it was reported that the estimated criminal revenue in 2004 for IPR theft was $512 billion, while for drug trafficking it was $322 billion.[10] The following table from that same study shows graphically that the mark-up for DVD piracy is higher than that for cocaine and heroine, with the risk of getting caught and receiving deterrent punishment very significantly less.[11]



Source: *Adapted from UK National Criminal Intelligence Service SU/Drug Project (2004), Cocaine markup is Colombia to Spain/U.K.; Heroin markup is from Iran to U.K.; DVD markup is from Malaysia to UK*

Examples of the involvement of organized crime on a global basis include:

- In December 2005, Italy's anti-terrorist squad conducted a series of raids aimed at dismantling an arm of the Algerian-based GIA Islamic terrorist network. The group was securing funding by selling pirated CDs, DVDs and fashion goods.
- In March 2006, Uruguayan Customs seized two containers containing 2 million blank CD-Rs manufactured in Malaysia and Taiwan destined for illegal use in Brazil.
- In April 2006, Spanish police raided a gang that has produced very high quality pirate sound recordings for many years that were sold at or near the price of legitimate CDs. The pirates enormous financial benefit from their activity, included a house valued at €2 million (US$2.6 million). Their total fraud could amount to €15 million (US$19.50 million)
- In June 2006, Nigerian police raided an international marketplace in Lagos, during which pirates shot two police officers and burned a police vehicle. Tear gas had to be used to quell the violence.
- In July 2006, in a raid on a residential suburb of southern Metro Manila, authorities found, in addition to pirate (and pornographic) DVDs and CD-ROMs, several hand grenades, hundreds of rounds of 5.56 mm ammunition, and sachets of a highly addictive and illegal amphetamine derivative known locally as "Shabu" and

[10] Motion Picture Association, *Optical Disc Piracy v. Illegal Drug Trafficking*, October 2005, p. 2. About the same time, MPA released another new study, *Organized Crime & Motion Picture Piracy*, from which some of the examples in the text are taken.
[11] Id., at 3

elsewhere as "ice." The seized ammunition is of the sort used in high-powered automatic assault weapons.

- During the summer of 2006, Italy's Fiscal Police acted against a nation-wide operation involved in the online sale of pirate CDs and DVDs.
- In September 2006, Mexican police raided several warehouses and laboratories containing huge quantities of blank and pirate CDs, reproduction machinery, as well as large quantities of cocaine, marijuana and other drugs.
- In October 2006, an industry representative who was working on an anti-piracy team was shot and killed in Nakorn Pratom Province, Thailand, and in December 2006, a staff person of a company supporting the industry was attacked during a raid in Open Market in Nonthaburi Province.

The copyright industries alone cannot fight such organized criminal activity. Company representatives and counsel have in some countries already experienced threats on their lives or physical intimidation when their investigations began to make progress. In some cases, this has prevented any enforcement activity by the private sector. We look to the U.S. government for additional leadership, both here and in the appropriate bilateral and multilateral fora, to place the issue of effective copyright piracy enforcement on the agenda of agencies dealing with organized economic crime—generally, cybercrime, fraud, extortion, white-collar crime, drug enforcement, money laundering, and border and customs control. The U.S. government should encourage countries with existing anti-organized crime laws and investigative procedures to bring them to bear against syndicate operations involved in piracy. Where such laws and procedures are not in place, the U.S. government should encourage governments to adopt them and to include, among predicate offenses, intellectual property right violations.

End-User Piracy of Business Software and Other Copyrighted Materials

The unauthorized use and copying of software by businesses result in tremendous losses to the U.S. and global economies. The great majority of the billions of dollars lost to U.S. software companies from business software piracy in 2006 were attributable to this end-user software piracy. To safeguard the marketplace for legitimate software, governments must have in place both substantive standards of protection and adequate enforcement mechanisms.

For the business software industry, it is particularly critical, given the growing use of electronic networks to make software available commercially to corporate and other end users, to ensure that the reproduction right covers both temporary as well as permanent reproductions. It is likely that very soon, virtually all consumers will engage in the full exploitation of software they license and receive over a network without ever making a permanent copy on their hard drive. They will simply access the software, in accordance with mutually agreed license terms, then load it into the random access memory (RAM) of their workstation or server, use the software and, when finished, close the program or shut down the computer—all without the software ever being permanently stored on the computer's or server's hard drive. Failure to make clear that such temporary reproductions are covered by the exclusive reproduction right is a violation of the Berne Convention, the WTO TRIPS Agreement and the WIPO Copyright Treaty. Great progress has been made globally on this critical issue, and IIPA calls upon the U.S. government to continue to seek legislative changes and clarifications on this point. As of today, at least 96 countries/territories provided protection for temporary copies as part of the reproduction right either explicitly or by interpretation, or had committed to do so, or had draft legislation pending which would provide such protection.

Enforcement is a critical part of reducing global piracy rates for business software, which exceed 50% of the market in the developing world. The biggest challenge to the business software industry is to persuade governments to take effective enforcement action against enterprises that use unlicensed software in their businesses. To effectively enforce against corporate end-user piracy, countries must provide an effective civil system of enforcement, provisional remedies to preserve evidence, and deterrent criminal penalties for piracy. More specifically, it is critical that countries provide *ex parte* search orders in an expeditious manner, deterrent civil damages and criminalization of corporate end-user piracy as required by Article 61 of TRIPS. Industry, along with USTR, has raised the need for strong procedural and remedial enforcement measures around the world. Although some countries have made attempts to improve enforcement through special enforcement periods and action plans, most of these proposals for action have not been sustained over time or resulted in deterrent criminal fines and jail terms. Additionally, many countries still do not criminalize corporate end-user piracy or provide civil *ex parte* measures—even though their TRIPS obligations require both.

End-user piracy is of course not limited to software but now affects all copyright sectors. For example, in government, school and university facilities, photocopy machines are routinely used for commercial-scale book piracy. Where the government is directly involved or directly responsible for the facilities and implements used, policies and decrees must be promulgated and strictly enforced to ensure that these facilities are not used for infringing conduct.

Increasingly, for all sectors, the Internet has allowed end-user piracy to proliferate. Online venues are used to advertise and sell pirate hard goods, and unauthorized downloading of music, movies, videogames, books and journals from websites as well as through peer-to-peer file swapping services has skyrocketed. Unauthorized digital streaming, where bandwidth permits, is also growing. A great deal of this activity is being conducted through government-owned Internet Service Providers and from servers owned and operated by governments, schools and universities.

Where the activity is confined to the private sector and to private individuals, mechanisms for strict enforcement against pirate websites, P2P services and against individual uploaders and downloaders must be put into place and deterrent penalties imposed. Where lacking, legislation must be passed clarifying secondary liability as well as infringement liability for unauthorized uploading and downloading. Statutory notice and takedown regimes, with narrowly crafted safe harbors for ISPs, should be adopted, which allow for expedited action (with minimal and reasonable notification procedures) to block access to infringing material or take down infringing websites or FTP sites. Piracy directly by individuals, enterprises or government end-users is on the increase; the appropriate and effective enforcement tools must be put into place immediately.

Piracy of Books and Journals

The book and journal publishing industry faces not only the same challenges encountered by other entertainment and high-tech industries (digital and online piracy), but must contend with other methods of infringement as well. This piracy comes primarily in two forms—commercial photocopying and print piracy.

Unauthorized commercial-scale photocopying of books and journals is responsible for the industry's biggest losses in most territories worldwide. This photocopying takes place in a variety of venues—commercial photocopy shops located on the perimeters of university campuses and in popular shopping malls; on-campus copy facilities located in academic

buildings, libraries and student unions; and wholly illicit operations contained in residential areas or other underground establishments. Publishers also suffer from unauthorized photocopying for commercial research purposes in both for-profit and non-profit institutions (often accompanied by failure to compensate reprographic rights organizations ("RROs") in countries where they exist to collect photocopying royalties). These operations are highly organized and networked, and technology advances are making the problem worse. Digitally scanned covers, for instance, allow pirates to conceal text that is often of poor quality, misleading consumers into believing they are purchasing a legitimate product, and electronic files containing book text are now routinely seized as part of enforcement actions against copyshops. This shift from physical copy machines to electronic files—allowing a shop to print infringing books on demand—complicates the enforcement process due to lack of infringing stock in hard goods form. Authorities must recognize this shifting pattern and tailor enforcement incentives and activities accordingly.

In addition, the U.S. publishing industry continues to lose hundreds of millions of dollars per year from unauthorized printing of entire books, including academic textbooks, professional reference books and trade books. These printers come in two varieties. In some cases, they are licensed printers or distributors who are engaged in offset printing beyond the scope of a valid license granted by the publisher. Others are wholly illegal pirate operations that have no license from the copyright owner at all. Print piracy is especially prevalent in Egypt, Pakistan, India, China and other countries with large printing capacity, and where printing may still be less expensive for pirates than photocopying. Sophisticated printing technologies result in extremely high-quality pirate editions of books, making it difficult for users to distinguish between legitimate and pirate products.

Publishers continue to suffer from unauthorized translations of books and journals of all kinds and genres, as well as counterfeiting in the form of "bogus" books or trademark misuse. Plagiarism also abounds, most often in the form of compilations of English language material or directly translated material marketed as a local professor's own product.

These types of piracy call for the same kind of aggressive enforcement techniques discussed throughout this submission, accompanied by the political will and awareness of governments to recognize the serious damage done to economies, culture and the educational environment by letting such infringements persist. IIPA urges the U.S. government to ensure that such acts of piracy are fully covered in all bilateral, plurilateral and multilateral engagements.

Using FTAs to Improve Global Standards of Copyright Protection and Enforcement

The negotiation of bilateral and regional free trade agreements (FTAs) now occupies a place of overriding importance to the copyright industries and to U.S. trade policy. These negotiations offer an important opportunity to persuade our trading partners to modernize their copyright law regimes so they can maximize their participation in the new e-commerce environment, and to improve enforcement procedures. Since copyright issues are not being addressed in the Doha Round of multilateral negotiations under the World Trade Organization, the FTA process has become by far the most fruitful avenue to address the law reform challenges brought on by developments in technology.

At the time of this submission to USTR, FTAs with Singapore, Chile, Australia, Jordan, Morocco and Bahrain have entered into force. FTAs with four of the six nations in the Central America-the Dominican Republic-U.S. FTA have entered into force. Negotiations with Oman,

Peru, Colombia and Panama have been concluded. Negotiations with the United Arab Emirates, South Korea and Malaysia will hopefully conclude soon. Unfortunately, negotiations with Thailand are stalled. IIPA trusts and expects that the valuable precedents established in these earlier agreements will be carried forward to the ongoing FTA negotiations, and with any more FTA negotiations opened in the future. In all these negotiations, we will continue to seek, full implementation of the WIPO Internet Treaties; stronger substantive protection in other areas, including the extension of the term of copyright protection; and detailed and effective enforcement obligations that make clear the requirement to enforce copyright in all areas, including on the Internet, with expeditious and deterrent civil and criminal remedies. We again commend the Administration and Ambassador Schwab for moving swiftly and aggressively to secure new high levels of protection and enforcement that will be critical to the development of e-commerce in the coming years.

We cannot leave the important subject of the FTAs without noting the Trade Promotion Authority is about to expire soon. Without extension of this authority, it will be virtually impossible to get those important FTAs, whose negotiation are not completed by the end of March, approved by Congress so that they can enter into force. IIPA strongly urges the Congress to support the extension of Trade Promotion Authority so that this incredibly valuable FTA process can proceed to lift levels of copyright protection and enforcement in many more countries.

Market Access

In the experience of IIPA, its members and companies, there is a strong connection between a country's ability to foster the introduction of legitimate product quickly and efficiently to market, and its ability to combat piracy effectively. We call upon policymakers to recognize and draw on this relationship to help make the reduction of market access impediments a key component of ongoing efforts to combat piracy.

Our experiences show that where there are unjustifiable prohibitions on the distribution of legitimate products, impediments to the establishment of companies involved in the creation, manufacture or distribution of such products, or the imposition of prohibitively high tariffs and taxes on legitimate products entering the country, illegal operations fill the voids with piratical product. Pirates are thus able to become exclusive distributors of the prohibited content or the products that have been priced out of reach for most consumers due to high tariffs, and are rewarded accordingly by cementing strong loyalties with their dedicated consumer base.

Pirates also gain a stronger position in instances where the introduction of new products to market is unreasonably delayed, whether through lengthy content review periods, specialized packaging or stickering requirements, or arduous licensing or registration protocols. Here again, illegal operations will move to take advantage of any temporary product voids by speeding piratical copies to market, maximizing the advantage provided by their informal but highly effective exclusive distribution windows.

These delays can be particularly damaging to "hit-based" businesses that depend on strong initial sales of a relatively small number of highly popular products to recoup investments made in other, less immediately successful ones.

We urge U.S. officials and national policymakers to make elimination of market access barriers—whether such barriers are content or investment based—a priority in their discussions

with relevant foreign governments with the conscious objective of streamlining market access for legitimate products to further aid efforts to combat piracy. Specifically, policymakers should:

- Reexamine the effectiveness of, and policy justifications underlying, market access prohibitions or impediments that restrict legitimate producers' ability to compete with pirates. Industries involved in the creation and distribution of content-based products stand willing to abide by reasonable and fairly applied censorship processes. However, it is both legitimate and necessary to ask whether these measures serve their intended purpose, or whether alternative channels of distribution for these products (such as through authorized or unauthorized online delivery) render these policies ineffectual or less capable of achieving that purpose.

- Work with industry to consider ways of further streamlining those restrictions and/or processes that are deemed essential, including applicable content review, labeling or licensing requirements.

- Work with industry to promote greater understanding and transparency of applicable rules, regulations and procedures governing compliance. Greater transparency in governing regulations facilitates more rapid and more uniform compliance, and affords fewer opportunities for abuses of these processes.

- Enforce penalties for non-compliance with regulatory requirements uniformly, including against vendors of piratical product, and consider the creation of enhanced penalties for non-compliance by piratical operations.

We will continue to monitor various countries' progress along these lines, and would encourage the U.S. government and foreign governments to consider market-opening policies as an additional tool to combat piracy, and to promote economic and technological competitiveness.

D. IIPA RECOMMENDATIONS FOR THE 2007 SPECIAL 301 LISTS

This year IIPA has analyzed the copyright law and enforcement problems in 60 countries/territories and has recommended them for placement in the categories on the Priority Watch List, Watch List, and Section 306 Monitoring. We also mention specific issues in 15 additional countries/territories that deserve increased U.S. government attention.

IIPA recommends that 16 countries be placed on the Priority Watch List: Argentina, Canada, Chile, Costa Rica, the Dominican Republic, Egypt, India, Israel, Mexico, the People's Republic of China, Russia, Saudi Arabia, Thailand, Turkey, Ukraine and Venezuela. IIPA also recommends that 28 countries/territories be designated or kept on the Watch List. We also recommend that out-of-cycle reviews be taken in seven countries/territories: Russia, Indonesia, Pakistan, the Philippines, South Korea, Taiwan, and Switzerland.

IIPA recommends that USTR conduct an out-of-cycle review of Russia in 2007, and that Russia's eligibility for GSP benefits be suspended if it fails to meet the commitments that it undertook in the 2006 IPR Agreement with the United States. Russia's copyright piracy problem remains one of the most serious of any country in the world. Piracy rates for most sectors are estimated at around 70%-80% in 2006 and piracy losses exceed 2.18 billion. Despite the repeated efforts of industry and the U.S. government to convince the Russian government to provide meaningful and deterrent enforcement of its copyright and other laws against OD

factories as well as all other types of piracy—including some of the most open and notorious websites selling unauthorized materials such as www.allofmp3.com—only limited progress has been made over the years. Meanwhile, piracy continues unabated in the domestic market and pirate exports continue to flood both Eastern and Western Europe.

With respect to the People's Republic of China, IIPA recommends that USTR maintain China on the Priority Watch List. China has failed to "significantly reduce infringement levels," as promised by China's Vice Premier Wu Yi at the Joint Commission on Commerce and Trade (JCCT) meetings in April 2004. Piracy rates still hover around 90%, where they have been for years.

IIPA commends Paraguay for the efforts that it has made over the course of the past two years, and recommends that USTR continue to monitor developments in Paraguay under Section 306 of the Trade Act of 1974. At the same time, it is exceedingly important that Paraguay, and the USG, recognize that Paraguay is not in compliance with the terms of its IPR Agreement with the United States, and that the two governments quickly reach agreement on how to improve the situation.

Appendix C contains a survey of a total of 60 countries/territories. The countries/territories appear by recommended category and in alphabetical order within each category.

PRIORITY WATCH LIST	WATCH LIST	SECTION 306 MONITORING	OTHER COUNTRIES DESERVING SPECIAL MENTION
Argentina Canada Chile Costa Rica Dominican Republic Egypt India Israel Mexico People's Republic of China Russian Federation (GSP+OCR) Saudi Arabia Thailand Turkey Ukraine Venezuela	Bangladesh Belarus Brazil Bulgaria Colombia Ecuador Greece Hungary Indonesia (OCR) Italy Kazakhstan Kuwait Lebanon (GSP) Lithuania Malaysia Nigeria Pakistan (OCR) Peru The Philippines (OCR) Poland Romania South Korea (OCR) Spain Taiwan (OCR) Tajikistan Turkmenistan Uzbekistan (GSP) Vietnam	Paraguay **FTA DISPUTE SETTLEMENT** Bahrain Jordan Morocco Singapore	Azerbaijan Cambodia Hong Kong Japan Laos Latvia New Zealand Oman Singapore South Africa Sweden Switzerland (OCR)

Appendix D provides a history of countries/territories appearing on IIPA and USTR lists since 1989, a year after the Special 301 legislation became effective. Fifteen of these countries/territories have appeared on a Special 301 list each year since 1989, and are recommended by IIPA to appear there again. A 1994 amendment to Section 182 of the Trade Act, dealing with identification of "priority foreign countries," provides that the U.S. Trade Representative must take into account "the history of intellectual property laws and practices in the foreign country, whether the country has been identified as a priority foreign country previously, and U.S. efforts to obtain adequate and effective intellectual property protection in that country."[12] Under this criterion, these 15 countries/territories named by IIPA are particularly vulnerable, having failed to correct their piracy and/or market access problems during the 18 years that Special 301 has been in existence.

Ongoing GSP IPR Reviews: IIPA also calls attention to ongoing intellectual property rights reviews under the Generalized System of Preferences (GSP) trade program. IIPA has been a strong supporter of the GSP program, and over the years has filed numerous petitions requesting the U.S. government to initiate GSP IPR reviews of copyright law and enforcement practices in targeted countries.[13] As of February 12, 2007, the U.S. government is continuing GSP IPR investigations on the copyright law and enforcement practices in three countries in which IIPA was the original petitioner: Russia, Lebanon, and Uzbekistan. Now that Congress has reauthorized the GSP program, it is imperative that the Administration actually use this program and hold beneficiary countries accountable to the IPR obligations in the statute.

E. ADDITIONAL COUNTRIES: THOSE SUBJECT TO FTA DISPUTE SETTLEMENT AND THOSE DESERVING SPECIAL MENTION IN 2007

In addition to the 45 countries/territories for which IIPA has provided comprehensive country reports, IIPA also highlights issues in 15 countries/territories which deserve special attention this year but which are not recommended for placement on the Special 301 Lists. These lattter countries and the problems encountered in them are divided into two sections. The four FTA trading partners identified in the FTA dispute settlement category are Bahrain, Jordan, Morocco and Singapore. The twelve countries/territories deserving special mention are: Azerbaijan, Cambodia, Hong Kong, Japan, Laos, Latvia, New Zealand, Oman, Singapore, South Africa, Sweden and Switzerland.

F. ESTIMATED LOSSES DUE TO PIRACY

As a result of deficiencies in the copyright regimes of the **60** countries/territories highlighted in this submission, the U.S. copyright-based industries suffered estimated trade losses due to piracy in these **60 countries/territories of over $15.2 billion in 2006.**[14] On a

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[12] Uruguay Round Agreements Act Statement of Administrative Action, *reprinted in* H.R. Doc. No. 103-316, vol. I, at 362 (1994).

[13] Since 1999, IIPA (and in one case, a coalition of 6 of 7 IIPA members) has filed 18 GSP IPR petitions with USTR, requesting the initiation of IPR investigations against the following countries: Poland, Peru, Lebanon, Dominican Republic, Ukraine, Moldova, Uzbekistan, Armenia, Kazakhstan, Belarus, the Kyrgyz Republic, Brazil, Russia, Guatemala, Costa Rica, Uruguay, Thailand, and Pakistan. Of these 18 petitions, USTR initiated reviews in 10 countries: the Dominican Republic, Ukraine, Moldova, Uzbekistan, Armenia, Kazakhstan, Brazil, Russia, Lebanon, and Pakistan. IIPA withdrew its request to initiate reviews in three cases (Peru, Uruguay and Thailand). Of these 10 reviews, so far USTR has completed its investigations and terminated its reviews in 8 cases (Armenia, Moldova, Dominican Republic, Ukraine, Brazil, Pakistan, plus Turkey—a case which IIPA petitioned for in 1993 and was closed in 2001). In May 2006, USTR closed its investigation against Kazakhstan.

[14] The methodology used by IIPA member associations to calculate these estimates is described in IIPA's 2006 Special 301 submission, at www.iipa.com/pdf/2006spec301methodology.pdf.

global basis (that is, in all countries/territories including the U.S.), IIPA conservatively estimates that total losses due to piracy were **$30-35 billion** in 2005, not counting significant losses due to Internet piracy, for which meaningful estimates are not yet available.

Appendix A presents a chart which quantifies losses for the five copyright-based industry sectors—the entertainment software, business software, motion picture, sound recording and music publishing, and book publishing industries—for 2005 and 2006. In most surveys, IIPA has described the piracy levels in each of the sectors in each of these countries/territories (where available). This should prove helpful in identifying trends and in determining whether enforcement efforts have actually been successful in reducing piracy levels in the particular country.

ESTIMATED TRADE LOSSES DUE TO COPYRIGHT PIRACY IN 60 SELECTED COUNTRIES IN 2006 (in millions of U.S. dollars)

Industry	Estimated Losses 2006	Estimated Losses 2005
Sound Recordings & Musical Compositions	2,374.4	2,456.3
Business Software	10,345.0	8,684.4
Entertainment Software[15]	1,951.0	2,652.8
Books	582.5	600.5
Motion Pictures[16]	Not Available	2,913.0
Total	15,252.9[17]	17,307.0[17]

Appendix B summarizes the methodology used by the IIPA member associations to calculate these estimates. They represent a crushing burden on the U.S. economy, on U.S. job growth, and on world trade generally. They result from the blatant theft of one of this country's most valuable trade assets—its cultural and technological creativity. Appendix B also describes how IIPA and its members estimate global OD production capacity, including factories, types of OD production lines, and capacity both for production of content and blank media (CD-Rs and DVD-Rs). The use of recordable media has now come close to becoming the pirate's tool of choice, particularly as enforcement pressure on factory production has increased.

[15] 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.
[16] MPAA's trade loss estimates and piracy levels for 2006 are not yet available. However, such numbers will become available later in the year and, as for 2005, will be based on a methodology that analyzes physical or "hard" goods and Internet piracy. For a description of the new methodology, please see Appendix B of this report. As the 2006 loss numbers and piracy levels become available, they will be posted on the IIPA website, http://www.iipa.com.
[17] For many countries, the "total" loss figure does not include losses for one or more industry sectors where figures are unavailable (NA). Consequently, the totals for these countries are even more conservative.

G. CONCLUSION

Special 301 remains a cornerstone of U.S. intellectual property and trade policy. We urge the Administration to use Special 301, and the tools available under the GSP, CBI, ATPA, CBTPA, and AGOA programs, and to consider IIPA's proposals to amplify attention to ineffective and non-deterrent enforcement—to encourage the countries/territories identified in our recommendations this year to make the political commitments, followed by the necessary actions, to bring their enforcement (and where necessary their copyright) regimes up to international standards. The U.S. government should also use the WTO dispute settlement machinery to ensure that countries/territories bring their substantive and their enforcement regimes into compliance with their international obligations under TRIPS. The dispute settlement mechanisms in FTAs should also be used, where necessary, with those trading partners. We look forward to our continued work with USTR and other U.S. agencies to bring about major improvements in copyright protection and enforcement worldwide.

Respectfully submitted,

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