

Testimony of

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on

"Piracy of Intellectual Property"

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

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

IIPA's Special 301 Report on Global Piracy

I have appended to my written testimony a copy the transmittal letter covering IIPA's comprehensive February 2005 Special 301 submission on piracy in 67 of our key trading partners. This 600-plus page report, which IIPA submits annually to USTR, details specific statutory and enforcement deficiencies in these countries and highlights their impact on the overall U.S. economy and on the U.S. creative industries. The entire report can be found on the IIPA website at www.iipa.com. In the attached transmittal letter, IIPA summarizes the key global priorities of our industries and summarizes the conclusions of the overall report. It highlights that our industries conservatively lost an estimated

\$12 billion in these countries/territories in 2004 (data for all countries was not available) and IIPA estimates that its global losses in all countries were an estimated \$25-30 billion.

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

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

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

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

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

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

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

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

Russia: The New China

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

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

Scope and Nature of the Piracy Problem in Russia

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

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

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

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

First, 70% or more of the seized material ends up back in the marketplace either through lax enforcement (or corruption), laws permitting charitable sales of such property, or the conclusion without prosecution of criminal investigations. As an example, over one million of the 2.5 million illegal CD and DVD copies seized in a raid last year "disappeared" before the case went to trial.

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

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

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

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

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

Most of our description of piracy in Russia has been limited to problems pertaining to hard-copy piracy, but there are growing problems related to digital piracy as well. In fact, the world's largest server-based pirate music website - allofmp3.com - remains in operation after a criminal prosecutor in early 2005 reviewed the case and determined (wrongly) that current Russian copyright law could not prosecute or prevent this type of activity. This decision not to prosecute has been upheld on appeal. In fact, this interpretation of the Russian law is contrary to all the assurances the Russian government gave the U.S. government and private sector during the years-long adoption of amendments to the 1993 Copyright Law; those amendments were finally adopted in July 2004.

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

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

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

The Russian Government's Legacy of Failed Commitments

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

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

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

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

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

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

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

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

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

In the 1992 Bilateral NTR Trade Agreement, the Russian government committed to provide effective criminal penalties and enforcement. In 1996, Criminal Code amendments were adopted (after a 1995 veto) but a deficient provision (a "grave harm" threshold) prevented effective enforcement. In 2003 an amendment to "fix" the grave harm

provision was finally adopted, but implementation of these criminal provisions remains a matter of concern, and there is no initiative to use these tools, if they even work properly, as part of effective enforcement.

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

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

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

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

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

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

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

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

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

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

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

In addition, existing efforts by certain industries to offer low cost Russian editions have not had the effect of reducing local piracy rates. The record industry, for example, is already manufacturing locally, and sells legitimate copies for an average price of \$6.00 to \$8.00 U.S. dollars--a price that is extremely low not just in relation to prices for music

elsewhere, but also with respect to other consumer goods sold in Russia. It is not the price of legitimate product that is creating opportunities for piracy--it is the opportunity for easy profits that has brought criminal enterprises into this business, and Russia should stop offering such excuses for its continuing inaction.

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

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

What Can the U.S. Government Do?

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

? Condition Russia's entry into the World Trade Organization (WTO) on meaningful copyright law enforcement;

? Designate Russia as a Priority Foreign Country (PFC) after the on-going out of cycle review by U.S.T.R.; and

? Deny Russia's eligibility for the Generalized System of Preferences (GSP) duty-free trade benefits.

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

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

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

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

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

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

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

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

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

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

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

* * * *

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

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

In sum, Russia's commercial piracy problem must be addressed immediately by the Russian authorities. IIPA recommends that the U.S. government take the necessary trade steps to deny Russia trade benefits (such as GSP) and entry into the World Trade Organization until Russia takes clear and effective steps to bring this illegal activity under control. This country can no longer afford inaction.

Piracy in China: A Lack of Political Will?

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

Recent Actions by the U.S. Government on China

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

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

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

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

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

The Plight of the Copyright Industries Due to Piracy in China

The Business Software Industry

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

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

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

The Motion Picture Industry

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

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

The Entertainment Software Industry

The entertainment software industry, one of the fastest growing copyright-based industries, faces similar high piracy rates and estimates the value of pirated videogames in the market at \$510 million in 2004. Demand for entertainment software products is growing rapidly but is being soaked up primarily by the pirates. This demand is exemplified by the exploding popularity of "massively multiplayer online role-playing games" (MMORPGs) where literally thousands of players can compete against one another simultaneously. Demand for MMORPGs in China grew at 40-45% over expectations in 2004. This increasing demand has fueled, in part, the growth of Internet cafés in China. (It is estimated that there are close to 200,000 Internet cafes in the country, with a seating capacity of between 100-300 seats, of which 60% are involved in game play.) While U.S. game publishers, represented by IIPA member, the Entertainment Software Association (ESA), have engaged in some licensing of the cafes, the vast majority of the product used is pirated, either available at the café or downloadable from the Internet. This dire situation has been all the more exasperating since the Chinese government extensively regulates the activities of these Internet cafes and often and vigorously revokes licenses for actions the government deems inappropriate. However, as far as we know, the government has never sought to include in this extensive regulatory scheme prohibitions against the widespread and blatant piracy at these cafes in its business licenses (which are otherwise very thorough). Moreover, no copyright enforcement of any kind has occurred. The legal infrastructure governing the Internet still is not helpful to copyright enforcement. Takedown of pirate sites is negligible; penalties non-existent.

Cartridge-based handheld games are also hard hit by the pirates with manufacturing and assembly operations throughout China with exports throughout Asia, Latin America, the Middle East and Europe. Enforcement attempts have been relatively successful in terms of raids and seizures but, like with other industries, administrative fines are non-deterrent and criminal enforcement action very rarely undertaken, even against factories generating millions of

dollars in illicit profits. Entertainment software products are also subject to a protracted content review process, by two separate agencies contributing to market entry delays. Given the immediate nature of the demand and lifecycle of best selling games, this leaves the pirates virtually uncontested in the market prior to the official release of a new title. There are also Internet and investment restrictions that must be significantly eased or abolished.

The Book Publishing Industry

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

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

Enforcement against this vast piracy is spotty and all done administratively through the local and national copyright bureaus. Any resulting administrative fines are non-deterrent. We know of no criminal enforcement against piracy of books not originating in China (books for which the copyright is held by a foreign entity).

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

The Recording Industry

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

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

Market access restrictions are severe, contributing to piracy and market losses. U.S. record companies cannot "publish" or release a recording without permission of a state owned company and cannot manufacture, distribute or engage in retailing of its products, which artificially segments the market and makes it extraordinarily difficult for this

world class industry to participate in the Chinese market. Its products are subject to censorship while domestic (as well as pirate) recordings are not - a national treatment violation.

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

Actions to Be Taken by the Chinese Government

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

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

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

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

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

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

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

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

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

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

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

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

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

Thank you.