INTERNATIONAL COPYRIGHT PIRACY: A GROWING PROBLEM WITH LINKS TO ORGANIZED CRIME AND TERRORISM

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

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INTERNATIONAL COPYRIGHT PIRACY: A GROWING PROBLEM WITH LINKS TO ORGANIZED CRIME AND TERRORISM

THURSDAY, MARCH 13, 2003

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

The Subcommittee met, pursuant to call, at 9:10 a.m., in Room 2141, Rayburn House Office Building, Hon. Lamar Smith [Chairman of the Subcommittee] presiding.

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

I'm going to recognize myself and the Ranking Member for opening statements, and we'll certainly put the opening statements of all other Members, without objection, into the record. And after that, we'll move immediately to our witnesses and look forward to hearing their testimony.

Today, the Subcommittee will conduct its second hearing on copyright piracy. The first hearing addressed peer-to-peer copyright infringement on university campuses. The Subcommittee now will examine the extent of international copyright piracy and whether there are links between this activity and organized crime and terrorism.

The rise of the Internet and new digital media has changed the way that the public enjoys entertainment products, including music and movies. One of the advantages of digital formats, such as CDs and DVDs, is that they offer extremely high-quality reproduction of audio and video. A major disadvantage is that digital formats make the works very susceptible to piracy. Since every digital copy offers a perfect reproduction, these works are easily copied and distributed over the Internet on a global basis.

Last year, American copyright-based industries suffered more than $9 billion worth of piracy-related losses in 56 countries. Half of those losses affected the music industry. In fact, there was one pirated music product for every three sold worldwide.

In 2000, the annual seizure of pirated discs for the Motion Picture Association was 1.9 billion units. By the close of 2002, it was up to 6.1 billion units. In just 2 years, the annual piracy rate had increased five times.

In some places, such as Asia and parts of the former Soviet Union, pirated software accounts for nearly 90 percent of the soft-

ware used. At the close of 2002, for example, seizures of pirated Microsoft products alone exceeded $1.7 billion.

The copyright industries drive the engine of the American economy. Exports and foreign sales of U.S. copyrighted products total $100 billion, which helps the national balance of trade. Copyrighted works are a result of American creativity. When properly commercialized, these works lead to jobs, profits, and a more enjoyable quality of life for us all.

There is good reason why the Founders embraced the concept of intellectual property protection. They realized that if creators cannot gain from their creations, they will not bother to create. And actors and writers and composers and singers cannot gain if their work is stolen. Would any other American industry be able to sustain its operations for long if a third of its sales were lost to theft?

A recent article in Time Europe noted that an average drug dealer pays $47,000 for a kilo of cocaine with an estimated street value of $94,000, which yields 100 percent profit. For the same $47,000 investment, a pirate could buy or produce 1,500 pirated copies of Microsoft's Office 2000 professional software and resell it for a profit of 900 percent.

In other words, the overhead for pirating copyrighted material relative to other illegal economic activities is minimal, the profits are exceptional, and the relative risk level of attracting the attention of law enforcement officials is low. Well, low risk and high profit is how criminals view piracy.

In the end, it really doesn't matter whether the pirates are individuals or crime organizations. One thing is clear. Their activity is rising, and it must be addressed.

That concludes my opening statement, and now I'll recognize the Ranking Member, Mr. Berman of California, for his.

Mr. BERMAN. Well, thank you, Mr. Chairman. And I want to commend you for putting together the third week, the third straight fine hearing, and I appreciate your scheduling this and organizing it.

And I particularly want to thank you for inviting Joan Borsten Vidov to testify. She's a constituent of mine, and she's been a friend for a very long time, a very long time. She brings a valuable perspective to the hearing, that of an American entrepreneur whose business has been dramatically impacted by a foreign government's sustained campaign to steal her rights to intellectual property.

Because we usually hear about copyright piracy from large corporations or celebrities, we often lose sight of the impact that piracy has on individual American entrepreneurs or copyright owners.

While Internet—international hard goods piracy may seem a dull subject to some, it is a critical issue to U.S. copyright holders. The aggregate hard good piracy losses suffered by U.S. copyright industries in foreign nations are pretty astounding. You've mentioned some of the figures. You talked about 56 countries. I have an estimate that it probably equals $20–$22 billion annually worldwide, not including Internet piracy.

Individual foreign countries—China, $1.85 billion; $770 million in Brazil; $800 million in Italy; $757 million in Taiwan; and $756 million in the Russian Federation. Another interesting statistic—93

percent of business software sold in China, 47 percent of music sold in Taiwan, 80 percent of movies sold in the Russian Federation were pirated.

In 2001, 99 percent of entertainment software sold in Brazil was pirated, while, in 2002, 55 percent of entertainment software sold in Italy was pirated.

As piracy percentages climb in a particular nation, it becomes increasingly difficult for U.S. copyright owners to establish a legitimate market. In some cases, as with entertainment software in Brazil, U.S. copyright owners have had to abandon the market entirely. They simply can't justify the expense of maintaining a presence in a nation where the demand for their copyrighted works is almost entirely met by vastly cheaper pirated versions.

The piracy-related inability of U.S. copyright owners to access a legitimate market in many foreign countries results in real harm to the U.S. economy. The core copyright industries make a tremendous contribution to the U.S. economy, accounting for more than 5 percent of the U.S. gross domestic product. That's more than the deficit will be in about 5 or 6 years. [Laughter.]

Mr. BERMAN. How much greater would the contributions to the U.S. economy be if U.S. copyright owners could access foreign markets otherwise dominated by pirate product? Our Microsoft witness will speak to some real numbers, but I do want to remark on his estimate that in 2008, software piracy will cost the U.S. $1.6 billion in lost tax revenue.

These numbers and percentages can seem dry, and their sheer size sometimes begs skepticism. And that's why Joan's presence today, I think, is so important. Her personal story of intellectual property theft by the Russian government provides a context to these numbers, just as she provides a face for U.S. victims of international copyright piracy.

I don't want to steal her thunder, but I want to highlight a couple of the issues that I think her particular situation represents. In Joan's case, the theft of her intellectual property rights is not some private syndicate operating in distant shadows within a foreign government, but it is the foreign government itself—the Russian Federation government.

Through the establishment of dummy corporations, fraudulent license transfers, and illegal pressuring of Russian courts, the Russian Federation government has attempted to deprive Joan of her valid license to copyrights for a library of Soviet era animation.

Where a foreign government is itself stealing intellectual property from a U.S. citizen, it is particularly appropriate for the U.S. Government to demand that the foreign government stop the theft. Conversely, it would be entirely inappropriate for the U.S. to grant any special trade privileges, such as WTO accession or GSP benefits, to a foreign nation whose government is stealing intellectual property from a U.S. citizen.

I know your particular focus, Mr. Chairman, is on the links between organized crime, terrorism, and this international piracy. In that regard, I wish to note that intellectual property theft by a government represents the very essence of organized crime.

In any nation, there is typically no bigger organization than its government and no greater power. Thus, when the government

steals intellectual property, it is engaging in organized crime of the highest magnitude.

I thank you again, Mr. Chairman, for scheduling the hearing and yield back.

[The prepared statement of Mr. Berman follows in the Appendix]

Mr. SMITH. Thank you, Mr. Berman.

Let me introduce our witnesses today. Our first witness is the Honorable John G. Malcolm, currently a deputy assistant attorney general in the Criminal Division of the Department of Justice, where his duties include overseeing the Computer Crime and Intellectual Property Section, the Child Exploitation and Obscenity Section as well, the Domestic Security Section, and the Office of Special Investigations.

An honors graduate of Columbia College and Harvard Law School, Mr. Malcolm served as a law clerk to judges on both the United States District Court for the Northern District of Georgia and the 11th Circuit Court of Appeals.

Our next witness is Rich LaMagna, who is the senior manager of worldwide investigations at Microsoft, where he manages global anti-piracy investigations. In this capacity, he provides policy and operational guidance to members of the Microsoft worldwide anti-counterfeiting team.

Mr. LaMagna received his B.A. from Gettysburg College in 1970 and a master's of arts in liberal studies from Georgetown University in 1996. He is a graduate of the Foreign Services Institute in Chinese and French studies and is fluent in Cantonese, Mandarin, and French.

Our next witness is Jack Valenti, who is president and chief executive officer of the Motion Picture Association of America. Born in Houston, Texas, Mr. Valenti became a highly decorated serviceman while serving in the Army Air Corps in World War II. In 1952, he co-founded the advertising political consulting agency of Weekley & Valenti.

He is perhaps best known, however, for his service as a special assistant to President Johnson from 1963 to 1966. On June 1, 1966, Mr. Valenti resigned his White House post to assume the helm at MPAA. He has a B.A. from the University of Houston and an MBA from Harvard.

Our last witness is Joan Borsten Vidov, who is president of Films by Jove, Inc., a California-based film production and distribution company, which acquired in 1992 worldwide rights to most of the award-winning animation library of Moscow's Soyuzmultfilm Studio.

Ms. Borsten received her B.A. in comparative literature from the University of California at Berkeley and her M.S. in bilingual education at USC.

Welcome to you all. Without objection, your entire written testimony will be made a part of the record. I would ask you all to try to keep your comments within the 5 minutes allotted. But we very much look forward to hearing from you all today.

And Mr. Malcolm, we'll begin with you.

STATEMENT OF JOHN G. MALCOLM, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, UNITED STATES DEPARTMENT OF JUSTICE

Mr. MALCOLM. Thank you, Mr. Chairman. I'll try to abide by the time limits you set.

Mr. SMITH. Turn on your mike. Is it——

Mr. MALCOLM. There we go. Okay.

Mr. Chairman, Members of this Committee, thank you for inviting me to testify today. I am pleased to offer the Justice Department's views on the links among organized crime, terrorism, and intellectual property piracy.

The focus of this hearing is extremely important, and I commend you, Mr. Chairman, for your attention to this issue. At the outset, I would like to take this opportunity to acknowledge your considerable and consistent support of law enforcement during your distinguished tenure as Chairman of this Committee. You've played a vital role in many cybersecurity issues, and the department is, indeed, grateful for your support.

The strong enforcement of intellectual property laws is a priority for the Department of Justice, and with the assistance of this Subcommittee, we will continue to wage an aggressive battle against piracy in the months and years ahead.

As you know, Mr. Chairman, with Congress's generous support, Attorney General Ashcroft has established 13 Computer Hacking and Intellectual Property (or CHIP) units across the Nation. These specialized units, which are comprised of dedicated Federal prosecutors whose primary focus is on prosecuting high-tech crimes, including intellectual property crimes, help the Justice Department to keep pace with the rapidly changing face of high-tech crime.

The establishment of these specialized units ensures that individuals who misuse technology to further criminal activity will not find a safe haven in the United States.

Congress also allocated resources that have allowed the department to significantly increase the size of the Criminal Division's Computer Crime and Intellectual Property Section, or CCIPS, as it's more commonly known.

Intellectual property protection is one of CCIPS's core responsibilities. CCIPS now has a deputy chief whose sole responsibility is to oversee and manage 10 attorneys within the section who are dedicated to IP enforcement. These attorneys are developing a focused and aggressive long-term plan to combat the growing threat of piracy.

As my written testimony outlines, Mr. Chairman, the Justice Department has achieved many significant victories as of late against IP pirates. One of those cases is Operation Buccaneer. To date, over 20 convictions have been attained in this ongoing investigation of online international piracy groups. The sentences in these cases have been the longest ever imposed for online piracy, ranging from 33 to 46 months imprisonment.

Just yesterday, CCIPS, working with the CHIP unit in the eastern district of Virginia under the able stewardship of U.S. attorney Paul McNulty, indicted Hew Raymond Griffiths, a leader in some of the most well-known online piracy groups around the world. Griffiths, whose screen name was Bandido, directed the actions of

many of the defendants I mentioned before who have already been convicted and sentenced.

Over the course of the past 2 years, while Operation Buccaneer systematically dismantled the criminal organizations he managed and incarcerated many of the people he supervised, Mr. Griffiths remained in Australia, seemingly beyond the reach of U.S. law enforcement. However, the department will seek to extradite Mr. Griffiths for criminal prosecution.

The decision to extradite Griffiths for his role in intellectual copyright piracy should send a strong signal around the world. For too long, people engaged in piracy have believed that if they were outside the borders of the United States, they could violate our intellectual property laws with impunity. They're wrong.

This indictment and the extradition sends a clear and unequivocal message to everybody involved in illegal piracy that, regardless of where you are, the Justice Department will find you, investigate you, arrest you, prosecute you, and incarcerate you.

In the battle against piracy, international cooperation is essential, and Operation Buccaneer has been precedent setting in this regard. Indeed, U.S. law enforcement continues to support its counterparts in the United Kingdom, Sweden, Finland, and Norway, who are investigating individuals in those countries in connection with this ongoing operation. Our commitment to strong intellectual property rights enforcement will not stop at our borders.

Mr. Chairman, piracy today is big business—a worldwide, multibillion dollar illicit economy, which robs legitimate industries and creators of income, while driving up the costs to consumers. Not surprisingly, criminal organizations are playing a more prominent and dangerous role in piracy around the globe.

My written testimony describes two different, yet equally troubling types of criminal organized activity that are emerging globally—organized online piracy groups, such as the one run by Mr. Griffiths, and traditional organized crime syndicates operating primarily from Asia to Eastern Europe.

While it's true that online piracy or warez groups do not fit squarely within the definition of organized crime used by the department, they are nonetheless responsible for placing a massive number of pirated movies, music, games, and software into circulation each year and represent a significant and growing threat to intellectual property rights around the globe. They specialize in being the first to release new pirated software to the warez community for unauthorized and unlimited reproduction and distribution.

These online groups are extremely security conscious, often utilizing the latest technology to hide their illegal operations. Like legitimate companies, top-tier warez groups have clear hierarchies and divisions of labor. Rank and position within warez groups are based on a variety of factors, including special skills, length and quality of service to the group, and reputation within the warez scene.

A typical group—which consists of people all around the world who may know each other only by their screen names—will consist of one or two leaders, two or three high-level individuals known as council, 12 to 15 staff members, and a general membership comprising anywhere from 20 to 80 individuals.

The more work somebody does for the group, the higher within the organization that person will move, and the greater access that person will have to pirated material.

What's surprising to many, Mr. Chairman, is that online piracy groups typically don't engage in piracy for monetary gain. That having been said, it would be a grave mistake to dismiss their conduct as harmless or unimportant.

On the contrary, most of the pirated movies, music, games, and software available on the Internet come from these high-level warez groups. And further, they are the source for much of the pirated products which filter their way down to less sophisticated, but more widely used distribution mechanisms, such as peer-to-peer networks.

While the pirates who steal and distribute software do not profit monetarily, the consequences to the victim companies are just as dire as if they did. For many victim companies, particularly smaller companies whose livelihood depends upon the success of only one or two products, irreversible damage occurs the moment the pirated digital copy hits the Internet.

Among emerging concerns is the fact that traditional organized crime syndicates appear to be playing a dominant role in the production and distribution of certain types of hard goods piracy, such as optical disks. This problem seems particularly prevalent in Asia and parts of the former Soviet Union. Unlike warez groups, the goal of these organized crime groups is to make as much money as they possibly can.

Highly organized criminal syndicates pose special challenges for law enforcement because they have significant resources to devote to their illegal operations, thereby increasing the scope and sophistication of their activity. They control international distribution channels, which allow them to move massive quantities of pirated goods, as well as any other illicit goods, throughout the world.

These groups will not hesitate to threaten or injure those who attempt to interfere with their operations. Throughout Asia, organized crime groups operate assembly lines and factories that generate literally millions of pirated optical discs. These groups pirate a full range of products, ranging from music to software to movies to video games. Anything that can be reproduced onto an optical disk and sold around the globe is available.

Mr. SMITH. Mr. Malcolm, we're 7½ minutes into your testimony, and I'm only half way through your written statement. I'm getting concerned.

Mr. MALCOLM. I apologize. Actually, I only had two more paragraphs, but I'll be happy to yield and would be happy to answer your questions.

[The prepared statement of Mr. Malcolm follows:]

PREPARED STATEMENT OF JOHN G. MALCOLM

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to testify before you today. This is an extremely important topic, and I commend you, Mr. Chairman, for holding this hearing. This hearing and the others recently held by the Subcommittee are providing the American public with an important look at the growing threat of intellectual property (IP) crime, which chiefly includes copyright piracy, trademark counterfeiting, and theft of trade secrets. Today I am pleased to offer the views of the Department of Justice on the links among organized crime, terrorism and intellectual property piracy.

THE DEPARTMENT OF JUSTICES ANTI-PIRACY PROGRAM

The enforcement of this nation's criminal laws protecting intellectual property is a priority at the Department of Justice. Since the beginning of his tenure, Attorney General Ashcroft has worked diligently to ensure that the prosecutorial resources needed to address intellectual property crime are in place. Shortly after becoming the Attorney General, he used additional resources provided by Congress to establish or expand Computer Hacking and Intellectual Property (or CHIP) Units in ten U.S. Attorney's Offices across the nation. These specialized units consist of dedicated federal prosecutors whose primary focus is on prosecuting high tech crimes, including IP crimes. Subsequently, the Attorney General established three additional CHIP units, and used additional funding to bolster the cyber and IP prosecutive resources in a number of other jurisdictions. The CHIP units ensure that the Department of Justice has a ready supply of prosecutors to pursue IP cases. The expertise of the various CHIP Units helps the Justice Department to keep pace with the changing face of high-tech crime. Rapid advances in technology bring new challenges to the investigators and prosecutors who handle these cases, and the establishment of these specialized units ensures that the individuals who misuse technology to further their criminal activity will not find a safe haven in the United States.

The CHIP Units complement the already existing network of Computer and Telecommunications Coordinators (CTCs) that serve in every United States Attorney's Office. The CTCs regularly receive specialized training in the investigation and prosecution of high-tech crimes, including intellectual property crimes. Many of the 94 U.S. Attorneys Offices have two or more CTCs to help meet the growing demand for trained high-tech prosecutors.

Working hand-in-glove with the CHIP Units and the CTC network is the Criminal Divisions Computer Crime and Intellectual Property Section, also known as CCIPS, which I supervise. Created as a Unit in 1991 by then-Assistant Attorney General Robert Mueller and elevated to a Section in the Criminal Division in 1996, CCIPS is a highly specialized team of over thirty-five lawyers who focus exclusively on computer and intellectual property crime. CCIPS attorneys prosecute cybercrime and intellectual property cases; advise and train local, state, and federal prosecutors and investigators in network attacks, computer search and seizure, and IP law; coordinate international enforcement and outreach efforts to combat intellectual property and computer crime worldwide; and comment upon and propose legislation. For example, CCIPS attorneys worked with Congress, including Members of this Committee, in 1997 to improve IP enforcement through the legislative amendments made by the "No Electronic Theft" (NET) Act. Those amendments extended federal criminal copyright law to unlawful large-scale reproduction and distribution of copyrighted works even when the thieves do not make a profit. In 1999, CCIPS prosecutors obtained the first convictions after trial under the Economic Espionage Act of 1996, a criminal statute that protects trade secrets. CCIPS also worked with the U.S. Sentencing Commission in 2001 to amend the sentencing guidelines to provide substantial sentences for copyright infringement.

With the deeply appreciated support of Congress, we have significantly increased the size of the Computer Crime and Intellectual Property Section in the past eighteen months, which is allowing us to devote additional resources to address piracy both here and abroad. Intellectual property protection is an important part of my portfolio, and a core responsibility of CCIPS. Moreover, for the first time, CCIPS has a Deputy Chief whose sole responsibility is to oversee and manage the attorneys in the Section dedicated to IP enforcement. At present, there are ten CCIPS attorneys working full-time on the IP program. The attorneys of CCIPS are developing a focused and aggressive long-term plan to combat the growing threat of piracy. They are developing and implementing the Departments overall anti-piracy strategy, assisting AUSAs in the prosecution of intellectual property crimes, and reaching out to international counterparts to ensure a more effective world-wide response to intellectual property theft. Working in concert, CCIPS, the CTC Network, and the CHIP Units create a formidable, multi-pronged approach to prosecuting intellectual property crimes. We are already beginning to see the positive results of their efforts.

SIGNIFICANT PROSECUTORIAL ACCOMPLISHMENTS:

In the past few years we have achieved many significant prosecutorial victories against IP pirates. I would like to take just a few minutes to highlight some of our most recent accomplishments.

Operation Buccaneer:

The Computer Crime and Intellectual Property Section, working with the CHIP Unit for the Eastern District of Virginia and the United States Customs Service, continues to investigate and prosecute a massive international copyright piracy conspiracy code-named "Operation Buccaneer." This undercover investigation culminated in the simultaneous execution of more than 70 searches worldwide in December 2001, including searches in Australia, Finland, Sweden, Norway, and the United Kingdom. It was the largest Internet software piracy investigation and prosecution ever undertaken, and the first to reach across international borders to achieve coordinated enforcement action against domestic and foreign targets. The investigation targeted multiple top-tier, highly organized and sophisticated international piracy or "warez" groups that specialized in "cracking" the copyright protection on software, movie, game and music titles and distributing tens of thousands of those titles over the Internet. I will discuss their organized criminal operations in more detail shortly.

As a result of Operation Buccaneer, as of today, *twenty* U.S. defendants have been convicted of felony copyright offenses, sixteen of those in the Eastern District of Virginia. Nine defendants have received prison sentences of between 33 to 46 months, the longest sentences ever imposed for Internet copyright piracy. Six defendants are awaiting trial in the United Kingdom, and I can assure you with virtual certainty that more prosecutions will be brought in the U.S. as this investigation progresses. In both its scope and outcome, Operation Buccaneer is the most significant Internet piracy case ever brought, and it has sent a strong deterrent message which continues to resonate throughout the copyright piracy community.

United States *v.* Mynaf:

On February 13, 2003, a California man, Mohsin Mynaf was sentenced in the Eastern District of California to 24 months in federal prison for multiple violations relating to copyright, including Digital Millennium Copyright Act violations, criminal copyright infringement, and trafficking in counterfeit labels. Mynaf operated a videocassette reproduction center which produced counterfeit movie videocassettes, which he would then sell at various locations throughout California. In addition to 24 months in federal prison, Mynaf must also pay in excess of $200,000 in restitution. Three other individuals have also been convicted of aiding and abetting Mynaf in his illegal activity and are awaiting sentencing. This case was successfully prosecuted by a CTC in the U.S. Attorneys Office in Sacramento, California.

Operation Decrypt:

On February 11, 2003, in the Central District of California, as part of a year-long investigation known as Operation Decrypt, 17 individuals were indicted for their roles in developing sophisticated software and hardware used to steal satellite television signals. One of the individuals has already pled guilty and admitted to being responsible for nearly $15 million in losses to the victim companies. An additional nine defendants have also agreed to plead guilty to various crimes as a result of their involvement. The defendants in these cases used online chat rooms to exchange information and techniques on how to defeat the sophisticated security protections utilized by satellite entertainment companies. In October of 2002, search warrants were executed in seven states as part of this operation. Operation Decrypt is being prosecuted by an attorney with the CHIP Unit for the Central District of California, located in Los Angeles.

United States *v.* Ke Pei Ma, et. al:

On February 26, 2003, in a joint operation between federal and local law enforcement in New York City, four arrests were made and six people were charged (two remain fugitives) in conjunction with an investigation of the illegal distribution of Symantec and Microsoft software. At the time of the arrests, over $9 million worth of counterfeit software was seized from distribution centers in the New York area. The defendants are believed to have distributed thousands of copies of counterfeit software and received an estimated $15 million over two years in return for the pirated products. In a single two-month period, the defendants received nearly $2 million dollars as a result of their illegal activity. This case was prosecuted by attorneys in the CHIP Unit in the Eastern District of New York.

United States *v.* Rocci:

Beginning on February 25, 2003, the Computer Crime and Intellectual Property Section, working with the CHIP Unit for the Eastern District of Virginia, engaged in a ground-breaking and highly-successful public education effort as part of a conviction originally obtained in December of 2002. In December, David Rocci of Virginia, pled guilty to conspiring with others to traffic in illegal circumvention devices

in violation of the Digital Millennium Copyright Act. Rocci was the owner and operator of the most prominent publicly-accessible web site on the Internet dedicated to providing information about the "warez" scene and copyright infringement, *www.iSONEWS.com.* Rocci used his web site as the exclusive medium to conduct the illegal sale of circumvention devices known as "mod chips," which defeat security protections in the Microsoft Xbox and allow unlimited play of pirated games on the gaming console. As a condition of his guilty plea, Rocci transferred his domain name and website to the United States. Upon taking control of the domain name late last month, the United States replaced iSONEWS.com with a new web page providing information about U.S. v. Rocci, as well as a general anti-piracy message outlining the potential criminal consequences for engaging in illegal piracy. (A copy of the website is attached to this testimony.) This case marks the first time that the United States has assumed control of an active domain name in an intellectual property case. In the first three days, the new law enforcement site received over 238,000 hits from Internet users worldwide. As of March 11, the two week mark, the site received over 550,000 hits. The Department feels a strong sense of responsibility to educate the public about the need to respect intellectual property rights and will look for additional opportunities like this to build upon successful prosecutions of those who willfully violate those rights.

Mr. Chairman, as you can see, the Department of Justice is actively pursuing intellectual property criminals engaged in a wide array of illegal activity, and we are doing so using all of the various statutes at our disposal. Our efforts are beginning to pay off, and we are having success in our battle with global piracy. But we are not resting on our laurels and are aware that there is much work to be done. We remain committed to this effort and will build on our success by continuing to prosecute piracy aggressively.

ORGANIZED CRIMINAL ACTIVITY AND PIRACY:

As a result of cases such as those I have just mentioned, law enforcement today has a deeper and more sophisticated understanding of piracy than it has ever had before. Piracy is a continually evolving crime. Traditionally, piracy operations were small, often run by individuals or a loose collection of people trying to make a quick buck in what has been perceived to be a fairly "risk-free" criminal enterprise. However, in recent years, that has changed. Piracy is now big business: a world-wide, multi-billion dollar illicit economy which robs legitimate industries and creators of income, while driving up costs for consumers.

It is against this backdrop that criminal organizations are playing a more prominent—and dangerous—role in piracy around the globe. Organized criminal activity, in many forms, is clearly a factor in global piracy today. Today, I will talk about two different, yet equally troubling, types of organized criminal activity that are emerging globally: organized on-line piracy groups and traditional organized crime syndicates operating from Asia or Eastern Europe.

ORGANIZED ON-LINE PIRACY GROUPS:

One aspect of piracy—practically non-existent as recently as twenty years ago—is online or Internet piracy. The Internet has changed the landscape of intellectual property crimes in many ways. Piracy over the Internet poses significant challenges for law enforcement. It is harder to detect than traditional means of piracy, and it costs the pirates virtually nothing to operate, while generating countless perfect digital copies of music, movies, software and games in just a fraction of the time it would take to generate the copies manually. Even when we successfully remove the source of digital piracy, any copies previously distributed remain on the Internet and can spawn a whole new generation of pirated products with little more than a few strokes on a keyboard.

As mentioned, until recently, on-line piracy was believed to be high-return, low-risk endeavor by many in the piracy community. Now, however, through a number of high-profile enforcement actions, the Department is making it clear to members of the online piracy community that their activities may have dire consequences for them. In addition to Operation Buccaneer, attorneys from the Department, along with the Federal Bureau of Investigation, have effectively prosecuted online pirates in other cases, such as the "Pirates with Attitude" and "Fastlane" prosecutions in Illinois, and two ongoing prosecutions, "Operation Bandwidth" in Nevada and "Operation Digital Piratez" in New Hampshire. We are committed to continuing to disrupt the online piracy community. The word is out: the Department of Justice will pursue online pirates and will put them in jail.

The Department has learned a great deal about the online piracy community. First and foremost, it is dominated by a handful of highly structured, security con-

scious groups which exist solely to engage in piracy online. These organized criminal groups are frequently referred to as "warez" groups. While warez groups are a relatively new phenomenon, they are responsible for placing a massive number of pirated movies, music, games and software into circulation each year, and represent a significant and growing threat to intellectual property rights around the globe.

The leading international warez groups compete against each other to attain a reputation as the fastest, highest quality, free providers of pirated computer software, including utility and application software, PC and console games, and movies. These groups specialize in being the *first* to release new pirated software to the warez community for unauthorized reproduction and distribution. The groups prosecuted as part of Operation Buccaneer were among the most notorious organized online piracy groups in the warez scene.

These criminal organizations are extremely security conscious, utilizing state-of-the-art technology to attempt to shield their illegal activity from victim companies and from law enforcement. They are also highly organized, structured to maximize their manpower and technological know-how to fully and efficiently support their illegal activity.

Like legitimate companies, "top-tier" warez groups have clear hierarchies and divisions of labor. Rank and position within warez groups are based on a variety of factors, including special skills, length and quality of service to the group, and reputation within the warez scene. A typical group—which can consist of people all over the world who may know each other only through their screen names—will consist of one or possibly two leaders, two or three high level individuals known as "Council," twelve to fifteen Staff members, and a general Membership comprising anywhere from twenty to eighty individuals. The Leader has ultimate authority over all aspects of the group and its activities. Council members are primarily responsible for the group's day-to-day operations, including preparation of new releases, recruitment, and security issues. Staff members are typically the most active individuals in preparing a group's new releases for distribution, or in maintaining the group's "File Transfer Protocol" (FTP) sites from which the pirated software is distributed. Finally, the general Members contribute to the group in a variety of ways, including acting as occasional suppliers of new software, hosting the groups FTP servers, or providing hardware (e.g., laptops, hard drives, routers, other computer equipment) to other group members for use in their warez activities. The more work someone does for the group, the higher up the organization that person will move, and the greater the access that person will have to pirated products.

While there are countless similarities, two factors distinguish warez groups from traditional organized crime syndicates. First, warez groups conduct their illegal operations in the cyber world as opposed to the physical world. Second, and perhaps most startling, warez groups typically do not engage in piracy for monetary gain. In fact, in some quarters of the warez scene, pirates who engage in "for profit" operations are held in contempt and criticized.

Despite the fact that warez groups typically do not profit directly, it would be a grave mistake to dismiss their conduct as harmless or unimportant. On the contrary, warez groups pose a growing and significant threat to intellectual property rights holders around the world. It is generally agreed that most of the pirated movies, music, games and software available on the Internet come from these high-level warez groups. Further, they are the source for much of the pirated products which filter their way down to less sophisticated, but more widely used, distribution mechanisms such as peer-to-peer networks. For example, a warez group dedicated to music piracy will obtain unauthorized advance copies of songs and albums and distribute those advance copies to the warez scene. Within days, or frequently within just a few hours, the warez music release filters down to public "Internet Relay Chat" (IRC) channels and peer-to-peer networks—often weeks before its commercial release date. The availability of MP3 files on the Internet in advance of legitimate CD's being made publicly available results in a direct injury to the artists and to the recording industry.

While the pirates who steal and distribute copyrighted works do not profit monetarily, the consequences to the victim company are just as dire as if they did. For many victim companies, particularly smaller companies whose livelihood depends upon the success of only one or two products, irreversible damage occurs the moment the pirated digital copy hits the Internet.

Any consideration of organized crime and IP must include top-level warez release groups. While we recognize that our efforts must address all aspects of online and hard-good piracy, including the pursuit of those involved in the lower tiers of the Internet distribution chain, the Department will continue to devote significant resources to pursuing warez groups.

TRADITIONAL ORGANIZED CRIME AND INTELLECTUAL PROPERTY.

Another emerging concern is the fact that traditional organized crime syndicates appear to be playing a dominant role in the production and distribution of certain types of hard goods piracy, such as optical disks. This problem seems particularly prevalent in Asia and parts of the former Soviet Union. Unlike warez groups, the goal of these organized crime groups is to make as much money as they can.

The continued emergence of organized crime poses substantial challenges for law enforcement. Highly organized criminal syndicates frequently have significant resources to devote to their illegal operations, thus increasing the scope and sophistication of their criminal activity. Further, by nature, these syndicates control international distribution channels which allow them to move massive quantities of pirated goods, as well as other illicit goods, throughout the world.

As one might expect, these groups do not hesitate to threaten or injure those who attempt to interfere with their illegal operations. Industry representatives in Asia report that they have been threatened and their property has been vandalized by members of these syndicates when their anti-piracy efforts strike too near the illegal operation. Government officials have also been threatened. These criminal syndicates are a formidable foe, but one that must be dealt with to truly attack the problem of intellectual property theft.

Throughout Asia, organized crime groups operate assembly lines and factories that generate literally millions of pirated optical discs. These groups pirate a full range of products ranging from music to software to movies to video games. Anything that can be reproduced onto an optical disk and sold around the globe is available. There is also anecdotal evidence that syndicates are moving their production operations onto boats sitting in international waters to avoid law enforcement.

Recently, an attorney from the Computer Crime and Intellectual Property Section visited Kuala Lumpur, Malaysia to conduct law enforcement training for Malaysian prosecutors and agents. According to Malaysian officials with whom he spoke, many, if not most, of the optical disk production facilities in Malaysia are owned and operated by organized crime syndicates, specifically very wealthy and powerful criminal gangs or "triads" from Taiwan which control a significant number of facilities not just in Malaysia but across Asia generally.

The reach of organized crime appears to extend beyond the production of optical disks into the distribution chain. While in Malaysia, that same CCIPS attorney visited an open air market, similar to ones found in large cities around the world, which offered a myriad of pirated products. While touring the market, our attorney learned that many vendors offer their goods on tables covered in brightly colored cloths which indicate that vendors affiliation with a specific criminal syndicate. One vendor may use a red cloth to show his affiliation with one criminal gang, while his neighbor offers his wares on a blue cloth signifying his affiliation with another criminal gang.

Of course, this problem is not limited to Malaysia, but occurs in other parts of the world such as in parts of the former Soviet Union. Additionally, many organized piracy groups from Asia use South America, most notably Paraguay, as a transshipment point for pirated products. Industry groups have reported that organized crime from Taiwan and other parts of the world control much of the distribution of optical disks into Latin America through Ciudad del Este.

It is also true that the pirated goods produced by organized crime syndicates enter into and are distributed throughout the United States. There is ample evidence, for example, that Taiwanese triad members import into the United States massive amounts of counterfeit software and other counterfeit products, such as "remarked" computer chips. The reach of these organized crime operations is undeniably global in scope.

Of course, developing more and better intelligence about these organized crime groups and their operations is just the first step in what will be a long and potentially difficult process of targeting this type of activity. Because most of these syndicates operate outside the United States, we must rely on foreign governments for much of the enforcement efforts in this area. The importance of international cooperation cannot be overstated. If a government lacks the will or the expertise to enforce IP laws, organized crime will continue to proliferate with impunity. Even in countries that have the will and expertise to fight back, a lack of investigative resources, inadequate laws, a judicial system that will not impose serious sentences, or corruption can grind IP enforcement to a halt.

The Department of Justice is committed to being a constructive part of the United States government's international IP outreach efforts. In particular, we are focusing our resources on those foreign nations which face surmountable difficulties in the investigation and prosecution of IP crimes. We are pleased to be working with other

United States agencies, such as the Patent and Trademark Office, the State Department and the U.S. Trade Representative, to ensure that foreign nations are committed to building sound and lasting IP enforcement regimes.

The Justice Department will continue to work closely with investigative agencies, especially the Federal Bureau of Investigations and the United States Customs Service, to develop additional intelligence sources and information in order to enhance our ability to respond to the growing threat of organized crime from Asia and other parts of the world. This is a serious and emerging threat that victimizes American rights holders, costs companies hundreds of millions of dollars, and damages our nation's economy. There is no easy solution. The task at hand requires a concerted effort on the part of industry, government and law enforcement. The Department stands ready to do its part.

TERRORISM AND PIRACY

Finally, Mr. Chairman, I want to close by briefly discussing terrorism. Earlier I noted that organized crime syndicates are frequently engaged in many types of illicit enterprises, including supporting terrorist activities. On this point, I want to be crystal clear. Stopping terrorism is the single highest priority of the Department of Justice. We are constantly examining possible links between traditional crimes and terrorism, and we will continue to do so. All components of the Justice Department, including CCIPS, the Counterterrorism Section, and the Organized Crime and Racketeering Section, will do everything within their power to make sure that intellectual property piracy does not become a vehicle for financing or supporting acts of terror.

CONCLUSION

On behalf of the Department of Justice, I want to thank you again for inviting me to testify today. We thank you for your support over the years and reaffirm our commitment to continuing to work with Congress to address the significant problem of piracy. I will be happy to answer any questions that you might have.

U.S. Department of Justice

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DEFENDANT INDICTED IN CONNECTION WITH OPERATING ILLEGAL INTERNET SOFTWARE PIRACY GROUP

ALEXANDRIA, Va.– United States Attorney Paul J. McNulty and Michael Chertoff, Assistant Attorney General for the Criminal Division, announced today the indictment of Hew Raymond Griffiths, of Bateau Bay, Australia, on charges related to his leadership of one of the oldest organized software piracy groups on the Internet. The Department of Justice also announced that it intends to seek his extradition in the coming weeks.

A federal grand jury charged Griffiths, 40, with one count of conspiracy to commit criminal copyright infringement and one count of criminal copyright infringement. If convicted on both counts, the defendant could receive a maximum sentence of ten years in federal prison and a $500,000 fine.

The indictment charges Griffiths, known by his screen nickname as "Bandido," with being co-leader of Drink Or Die, an illegal internet software piracy group founded in Russia in 1993. The Internet software piracy (or warez) group expanded internationally throughout the 1990's.

During the three years prior to its dismantlement by federal law enforcement in December 2001, the group is estimated to have caused the illegal reproduction and distribution of more than $50 million worth of pirated software, movies, games and music.

"Griffiths thought he was beyond the reach of U.S. law enforcement," said U.S. Attorney Paul McNulty. "He will be proved wrong. We will seek formal extradition from Australia in the coming weeks, but for now, the message should be clear: no matter who you are or where you live, if you steal the intellectual property rights of individuals and businesses, we will not stop at our borders to find you and bring you to justice."

"The internet makes this type of law enforcement cooperation across international borders essential," said Michael Chertoff, Assistant Attorney General for the Criminal Division. "The indictment of Hew Raymond Griffiths shows that international cooperation can result in effective criminal enforcement on a global scale."

"While combating terrorism is our top priority, agents with the Bureau of Immigration and Customs Enforcement will continue to vigorously pursue those who use the Internet to commit crimes," said Michael Garcia, Assistant Secretary for Immigration and Customs Enforcement at the U.S. Department of Homeland Security. "Operation Buccaneer clearly demonstrates federal law enforcement's resolve to stop cyber pirates and prosecute them to the fullest extent of the law."

According to the indictment, Griffiths oversaw all the illegal operations of Drink Or Die, a warez group that specialized in "cracking" (i.e., removing or circumventing embedded copyright protections) software and then distributing the "cracked" versions to the warez scene. Members stockpiled illegal software at huge Internet computer storage sites commonly referred to as "FTP sites." They were filled with tens of thousands of individual software, game, movie and music titles worth millions of dollars. The group used encryption and an array of other sophisticated technological security measures to hide their activities from law enforcement.

In December 1999, the defendant granted an interview to an online news source proclaiming he ran Drink or Die's day-to-day operations and controlled access to more than 20 warez FTP sites worldwide. He gave this warning to others engaged in Internet software piracy:

> "I hope more people start to realize that we play a dangerous game. . . when you play with fire, you can indeed get burnt. . . . and prison is not a nice thing guys."

Griffiths' indictment is the latest action arising from the joint U.S. Customs/Department of Justice investigation known as "Operation Buccaneer", the largest international online copyright piracy investigation ever conducted by federal law enforcement. To date, 20 defendants have been convicted in the U.S. on charges of felony copyright infringement, 16 of those in the Eastern District of Virginia. Ten defendants were sentenced to terms of imprisonment of between 33 and 46 months, the longest sentences ever imposed for online software piracy. Six additional defendants are currently awaiting trial in the United Kingdom. Spin-off investigations and prosecutions are ongoing in the U.S., Finland, Norway and Sweden. Federal officials credited the assistance of the Australian Federal Police in identifying Griffiths and executing searches at his residence in Australia.

Prosecuting the case for the United States are Assistant United States Attorney Robert Wiechering; Michael DuBose, Senior Counsel, Computer Crime & Intellectual Property Section (CCIPS), and Michael O'Leary, Deputy Chief, CCIPS.

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03-156

[iSONEWS] - Microsoft Internet Explorer provided by U.S. Department of Justice

File Edit View Favorites Tools Help

Back Search Favorites History

the iSO News is now the property of the United States government.

The domain and web site were surrendered to U.S. law enforcement pursuant to a federal prosecution and felony plea agreement for conspiracy to violate criminal copyright laws.

David Rocci, a.k.a "krazy8," pled guilty in the United States District Court for the Eastern District of Virginia on December 19, 2002, to conspiring with others to violate federal copyright laws by illegally importing, marketing, and selling modification, or "mod," chips. Mod chips illegally circumvent built-in security protections and allow individuals to play pirated games on game consoles, such as the Microsoft Xbox and the Sony Playstation2. Rocci and his co-conspirators used www.iSONEWS.com as the exclusive outlet to market and sell their mod chips to individuals in the illegal warez scene. As a result, the iSONEWS website is now the property of the United States government. Individuals involved in this conduct face up to five years in federal prison and a fine of $500,000 for each count charged. To learn more about *United States v. Rocci*, click here.

Piracy is the unauthorized, willful reproduction or distribution of copyrighted material, such as software, movies, music, and games. People who distribute pirated works over the Internet via IRC, FTP sites, web sites, or file-sharing networks, and people who download or reproduce pirated works are risking criminal prosecution. Piracy is a crime even when the works are distributed over the Internet for free or where the conduct does not involve monetary gain, such as the trading of pirated products for other pirated products.

The Department of Justice and federal law enforcement will continue to investigate and prosecute individuals and groups that violate the federal criminal copyright laws at home and abroad. For more information on these and other federal anti-piracy investigations, visit www.cybercrime.gov.

Start [iSONEWS] - Microsoft ... 12:13 PM

Mr. SMITH. Okay. Thank you, Mr. Malcolm.

Mr. LaMagna.

STATEMENT OF RICH LAMAGNA, SENIOR MANAGER—WORLDWIDE INVESTIGATIONS, MICROSOFT

Mr. LAMAGNA. Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to testify on this important topic. Let me assure you it will not be in Cantonese or Mandarin. [Laughter.]

Mr. LAMAGNA. My testimony will focus on software counterfeiting, the manufacture and sale of pirated CD-ROMs and physical components. This sophisticated form of piracy is dominated by organized criminal enterprises that produce billions of dollars in counterfeit software.

For most of its history, the software industry has battled against piracy. Despite these efforts, software piracy remains a serious problem throughout the world, accounting for one quarter of the software used in the United States and 40 percent of the software used worldwide. In some regions, piracy rates approach 90 percent.

Our industry loses almost $11 billion each year from software counterfeiting and other forms of piracy. Annual seizures of counterfeit Microsoft products exceed $1.7 billion. Over the next 5 years, software piracy will cost the U.S. economy more than 175,000 jobs and $1.6 billion in tax revenues.

Software counterfeiters go to great lengths to make pirated software look genuine in an effort to deceive the consumer and maximize illicit profits. Here is an example of counterfeit Office

Mr. SMITH. Thank you, Mr. LaMagna.

Mr. Valenti.

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

Mr. VALENTI. Thank you, Mr. Chairman, Mr. Berman, and Members of the Committee.

Before I begin, I want to introduce a gifted young independent filmmaker from Britain, whose blockbuster film, "Bend It Like Beckham," is proving very popular in Europe. But, alas, it's been hijacked all over the world, and here it is avalanching this country. And guess what? Her film doesn't come out yet in the United States for another week.

Ms. Gurinder Chadha. Stand up. I want them to see you.

Because in the words of Peter Finch in the movie "Network," she's mad as hell, and she's not going to take it anymore. [Laughter.]

Mr. SMITH. Thank you for being here.

Mr. VALENTI. Let me do my little show and tell. Hope you can see the screen over there. Beginning in 1998, Mr. Chairman, we had zero seizures of counterfeit DVDs in this country. And now, you can see in the year 2002 over 7 million.

Now here is a major trading and piracy. A major motion picture was released in the United States November the 22nd last year. Two days before, in a press screening, it was camcorded and then ran like a wire through all of Asia and Malaysia, Indonesia, Thailand, Beijing, Hong Kong, and so forth. And by the time this picture opened, it had been stolen all over the world.

The major centers of DVD counterfeit production are Malaysia, Thailand, Taiwan, China, Philippines, and now Russia. Now here's a map of Russia. There are about 26 pirate factories in Russia, and guess what? Six of them are on land owned by the Russian government.

They're now beginning—it moved over and avalanched Central and Eastern Europe and now are invading the European Union, which is the largest international market for our movie.

This next slide shows you how ingenious these dudes are all over the world. These are criminal elements. A raid of a DVD factory revealed an underground tunnel, where a meter-wide little electric car transported the counterfeit DVDs from their factories into a house several hundred yards away.

Our surveillance team thought it was mighty strange that no material was being shipped out of the factory until we did a raid. The enforcement team broke through the roof and then rappelled down in the place before they could destroy the evidence and found this underground tunnel.

As you can see in this next slide how ingenious they are and how much money they spend to do this because it's much more profitable being in the pirating business today than in the drug trade. Much less risk, as Mr. Malcolm and this Microsoft executive pointed out. You can make a lot more money with a lot less risk than being in drugs.

Next slide is a—this is very ingenious. This is a submersible barge. It's a submarine barge. It has no propulsion. Fishing boats—when it gets underwater, fishing boats tow it. And if somebody wants to raid the fishing boat, they immediately cut the line to the submersible barge and then locate it by GPS positioning. So they can go back later and pick it up.

This next slide shows you what's in that damned barge—174,000 counterfeit DVDs were found when we made this raid. They have very ingenious methods of smuggling. Shipping containers, cars with hidden compartments, stacks of DVDs in bags of asphalt, concealed cavities in stacks of cardboard. You name it, they do it.

Now this looks like an innocent—next slide is an innocent, pristine, pure little blank DVD. But guess what, you pull back the cover, and underneath, you have a pirated DVD. The DVDs go from—they're using DHL and FedEx. And by the way, both of those express services have been cooperating fully with us.

We found in one raid that we found 418 parcels, and you can believe this, and we had 10,000 pirated DVDs in there. Now these DVDs will go all over the world, but mainly to Australia, the Middle East, Europe, and the United States. And that's pretty much all over the world.

And finally, piracy and guns go hand in hand. This is an organized crime enterprise, Mr. Chairman. This is a sniper rifle, M–16, heavy weapons, as well as cocaine was there. Wherever we go, we find this connection.

The Customs Service, in their bulletin of November 2, 2002, said there was a definite connection between organized crime and terrorists. This is where the connection is. A lot of terrorists are being funded by this illegal merchandise.

I think Attorney General Malcolm has been absolutely wonderful and sturdy in making sure that in this country we are really on top of these and making it clear that this is going to be a high-risk, low-reward business. But, alas, that's not so abroad.

I hope these remarks charm you greatly, but I think I'll stop at this point. Thank you, sir.

[The prepared statement of Mr. Valenti follows:]

PREPARED STATEMENT OF JACK VALENTI

America's crown jewels—its intellectual property—are being looted. Organized, violent, international criminal groups are getting rich from the high gain/low risk business of stealing America's copyrighted works. We don't know to what end the profits from these criminal enterprises are put. US industry alone will never have the tools to penetrate these groups or to trace the nefarious paths to which those profits are put. For these reasons it is entirely suitable and necessary that the Subcommittee on Courts, the Internet and Intellectual Property of the House of Representative's Committee on the Judiciary hold this hearing and illuminate the nature of the problems and the effect on the copyright industries (consisting of movies, TV programs, home videos, books, music, computer games and software).

THE ECONOMIC WORTH OF THE COPYRIGHT INDUSTRIES

The copyright industries were responsible in 2001 for some five percent of the GDP of the nation. Over the past quarter century, these industries' share of GDP grew more than twice as fast as the remainder of the economy. They earn more international revenues than automobiles and auto parts, more than aircraft, more than agriculture. The copyright industries are creating *new* jobs at three times the rate of the rest of the economy. The movie industry alone has a *surplus* balance of trade with every single country in the world. No other American industry can make

that statement. And all this comes at a time when the U.S. is suffering from some $400 billion in trade deficits.

DIGITAL PIRACY: THE DELIVERY DREAM, THE PIRACY NIGHTMARE

It would be a serious mistake to take our past successes for granted. While piracy has been a sad fact illuminating our lives since the blossoming of the home video entertainment business a quarter century ago, the forms of digital piracy we now face raise serious, new challenges that we need your help in addressing.

I must admit, with all appropriate modesty, that we had become fairly good at combating the old forms of analog video tape piracy. With the help of our government and international trade agreements, such as the World Trade Organization's Agreement on Trade Related Intellectual Property, most countries have adopted modern copyright laws. We had been seeing declining loss rates in many of the traditional centers of piracy. Despite our successes, we were losing close to $3 billion dollars a year.

And then the world changed. Digital technologies, which offer so much in terms of enhanced clarity of image and sound, and exciting new ways to deliver high quality entertainment directly to people's homes, also gave birth to serious new forms of piracy.

By now, I presume that all of you have heard of our concerns about Internet piracy—and I assure you, that dialogue will continue. The mysterious magic of being able, with a simple click of a mouse, to send a full-length movie hurtling with the speed of light to any part of the planet, is a marketing dream and an anti-piracy nightmare. Ask the music industry how Internet piracy can devastate an industry's bottom line. As computer modem speeds accelerate and broadband access spreads across the United States and around the world, more people are gaining the ability to download full length motion pictures quickly. The threat to the motion picture industry from Internet piracy is growing.

Internet piracy is not the only digital threat we face. Today, I'd like to focus on another form of digital piracy—widespread piracy of optical discs—CDs, Video CDs, DVDs, and recordable versions like CD-Rs and DVD-Rs. The piracy of DVDs and other optical media products is dominated by organized crime and increasingly threatens our international markets, which account for 40 percent of revenues earned by the filmed entertainment industry. Indeed, all industries that rely on intellectual property protection, including the music and video game industries, are facing huge losses from optical disc piracy, especially in international markets. Microsoft products are another favorite target for the pirates.

The motion picture industry seized over 7 million pirate DVDs worldwide last year. DVD piracy didn't exist for our industry as recently as 1999.

"DIE ANOTHER DAY:" AN EXAMPLE OF PIRATES IN ACTION

The damage from pirated DVDs is enormous. DVD piracy erodes our home video revenues, but also corrodes revenues from our international theatrical business. Pirate DVDs often enter the market months before the release of legitimate DVDs—often before a movie is released into the theaters. Let me give you just one example. MGM's latest James Bond film, *Die Another Day*, was released theatrically in major cinemas in the United States on November 22. The first pirate copy, camcorded from a press screening in the United States, showed up in pirated DVD format in Malaysia on November 21. By the 28th, only six days after its US theatrical release, every major market in Asia was already infected with pirate copies of *Die Another Day*. In Taiwan, theatrical release wasn't scheduled until February 1 to coincide with Chinese New Years holidays—normally a big period for cinema sales in that part of the world. The pirates had nine full weeks to sell our products in pirated form before the film was legitimately released in theaters.

A SNAPSHOT OF OPTICAL DISC PIRACY AROUND THE WORLD

The problem of large-scale pirate optical disc production began in China in the mid-90s. When China cut off the export of piratical discs in the late 1990s, the pirates packed up their equipment and relocated to more hospitable areas where enforcement was lax or absent. Now we are seeing major problems with DVD production in Malaysia, Thailand, Taiwan, Philippines, and Indonesia. Pakistan, Bangladesh, Ukraine, and elsewhere in Central Europe are host to factories replicating pirate copies of music CDs. The music industry's problems today are always a danger sign for us, since pirates often start with music and then move on to movies, video games and other products.

In the past year, we have also witnessed a major surge of large-scale factory production of DVDs in Russia. Today there are at least 26 optical plants in Russia, in-

cluding at least five that specialize in the production of DVDs. The number and overall capacity of these plants has more than doubled in the past two years. Nine of these plants are located on property owned by the Russian Government.

Pirate DVDs have devastated the local market in Russia. Pirate DVDs have so saturated the Russian market that the pirates have resorted to selling them on the streets *by the kilo*. Pirate DVDs are sold everywhere—at street markets, in kiosks, in retail stores and over the Internet.

Those 26 plants in Russia currently have capacity to replicate about 300 million DVDs and CDs a year; legitimate demand in Russia is approximately 18 million units. This excess capacity points to the fact that the Russian pirates are targeting export markets—OUR export markets. Piracy in Russia poses a major threat to revenues across Europe. In 2002 MPA's anti-piracy operations seized pirate Russian DVDs in markets across Central and Eastern Europe. In July a raid at a retail market in Poland turned up over 4000 copies of pirate discs from Russia. Those discs contained 15 different language tracks—from Finnish and Swedish to Greek and Turkish, Dutch, Danish, to Indian and Arabic. If bold actions aren't taken quickly to shut down this piracy, American sales of copyrighted works to Western Europe—our most lucrative market in the world—will be demolished by these pirated imports from Russia. The time to act is now before these criminals further build out their distribution networks and alliances throughout Central and Western Europe.

Even before large-scale factory production has been brought under control, we are now seeing the rapid growth of local burning of movies and other forms of copyrighted content onto blank recordable media—CD-Rs and DVD-Rs. This kind of piracy is more dispersed geographically, since the piracy takes place in medium to small "labs" with banks of CD burners, but is often still highly organized. The retail markets in Taiwan are filled with this kind of pirate product; not coincidentally, Taiwan is one of the world's largest producers and exporters of blank optical discs, fueling this problem around the world.

THE ORGANIZED CRIME CONNECTION

Several U.S. government agencies are bringing attention to the link between organized crime and copyright piracy. The Federal Bureau of Investigation's website home page states the following:

> *"Unlike criminals who engage in other types of criminal activity, those who commit IP crimes can not easily be categorized. Counterfeiters, software pirates, and trade secret thieves are as different as the intellectual property they counterfeit, steal, and sell. In general, software pirates have an acute interest in computers and by extension, the Internet. Many counterfeiters hail from foreign countries, such as South Korea, Vietnam, or Russia. They are frequently organized in a loosely knit network of importers and distributors who use connections in China, Southeast Asia, or Latin America to have their counterfeit and imitation products made inexpensively by grossly underpaid laborers. There is also strong evidence that organized criminal groups have moved into IP crime and that they are using the profits generated from these crimes to facilitate other illegal activities. There are a number of reasons for the dramatic increase in IP crime in recent years. First, many forms of IP can be produced with minimal start-up costs making IP crimes accessible to large numbers of people; second international enforcement of IP laws is virtually nonexistent; and finally, domestic enforcement of IP laws has been inadequate and consequently the level of deterrence has been inadequate."*

The link between piracy and organized crime has been widely accepted by the European Commission, which recently organized a forum to address the prevention of organized crime and included a discussion of piracy and counterfeiting. Interpol has also acknowledged the link with organized crime and established the Interpol Intellectual Property Crime Action Group. Many national enforcement authorities, from the United Kingdom to Australia have recognized that piracy and organized crime go hand in hand.

The Secretary of State for Northern Ireland, the Rt. Hon. Dr. John REID, last year announced the Serious & Organised Crime Threat Assessment & Strategy. He identified as immediate priority areas of criminality: (1) Armed Robbery; (2) Counterfeit Goods—Intellectual Property Crime; (3) Tobacco and fuel smuggling; and (4) Drug Dealing.

CASE EXAMPLES OF ORGANIZED CRIME

Pirate factories go to great lengths to conceal and harden their operations. One raid in October 2001, near Bangkok, revealed an underground tunnel linking a fac-

tory to a residential house. Pirate products were moved out of the factory on a meter-wide, specially installed electric rail system that ended under the kitchen sink of a near-by home. The products were trucked away from the back of the house, effectively hiding the movement of pirated goods out of the factory.

The pirates employ sophisticated security systems, such as hardened front doors and surveillance cameras, to delay entry by enforcement officials into the factories. These security devices give the pirates the 10–15 minutes they need to destroy the evidence of their crimes in vats of acid kept specifically for this purpose. Local police have been forced to adopt equally sophisticated responses. In the raid on a factory in Thailand the police, accompanied by our anti-piracy enforcement team, broke through the roof of the factory and rappelled down ropes in order to maintain the element of surprise.

SOPHISTICATED SMUGGLING

The pirates also use highly sophisticated smuggling methods. Macau Marine Police, working with Hong Kong Customs, intercepted two submerged, un-powered, purpose-built "submarines" in two, separate raids in April and May 1999. These submarines were towed behind fishing boats and had ballast and compressed air tanks that enabled the sub to be raised and lowered. If enforcement officials intercepted the fishing vessel, the tow line could be cut, the barge's location marked with GPS positioning, and later recovered when the coast was clear. In these cases, however, the authorities, relying on sophisticated intelligence, knew what they were looking for and were able to recover 174,000 pirate optical discs in one seizure and 73,000 in the second. These cases demonstrate the scale and level of sophistication that criminal syndicates employ to evade detection. Traditionally, such methods have been reserved for the smuggling of drugs and other contraband, including firearms.

Pirates use other ingenious methods to smuggle their products. The International Federation of the Phonographic Industries, in a raid with Polish Customs last year, intercepted a car suspected of transporting pirate CDs from Russia. When the authorities removed the car's fender, they found a hidden compartment full of pirated CDs. MPA has found hidden compartments in shipping containers, stacks of DVDs concealed in bags of asphalt, and ingenious concealed cavities in what appeared to be stacks of flattened cardboard boxes.

Sometimes the pirates try to ship pirated products by disguising them as legal products. A law enforcement official in Australia thought he had a shipment of blank DVDs—until he pealed back the label on one of the copies—and uncovered a shipment of pirated copies of the film "Ali."

With the cooperation of major express mail delivery services, we have made progress in cutting down the shipment of pirated DVDs from Malaysia. In a major raid last July in Penang, Malaysia, we discovered 418 separate parcels containing about 10,000 pirate DVDS destined for Australia, the Middle East, Europe and even the United States.

VIOLENCE AND INTIMIDATION

Pirates also employ violence and intimidation. A raid on a street market in Malaysia last summer turned into a riot. A vehicle driven by the pirates rammed the van transporting the Malaysian enforcement officials and MPA's anti-piracy investigators to the raid. Bat wielding pirates attacked the enforcement team. Only after the Malaysian enforcement officials fired their weapons into the air did the crowd disperse.

Pirates have directly threatened Government leaders. Last year, the President of the Municipal Council in a city in Malaysia received a personal death threat along with a threat that his daughter would be raped if the crackdown on illegal VCD traders continued. The Minister of Domestic Trade and Consumer Affairs in Malaysia also received a personal death threat.

In the Netherlands two years ago, our local program helped smash a sophisticated and violent criminal organization that was distributing compilation pirate optical discs under the HiteXplosion and MovieBox labels. The discs contained monthly compilations of interactive games, movies and music. Two of the pirates had organized the torture of two associates for under-reporting their sales of pirated CDs and DVDs. The two were subsequently sentenced to four and a half year prison terms on charges of extortion and accessory to kidnapping and attempted assault.

In the UK, there is increasing evidence that Chinese crime gangs control much of the pirate DVD business in London and the South East. Illegal immigrants have, it appears, been pressed into selling pirate DVDs by Chinese human traffickers (known as Snakeheads) to pay off family debts to the gangs.

GOVERNMENTS NOTE LINKS TO TERRORISM

Mr. Chairman, let me commend to your attention an article by Kathleen Millar in the November 2002 issue of *U.S. Customs Today* entitled "Financing Terror: Profits from Counterfeit Goods Pay for Attacks." With your permission, I would like to enter this article into the record. The article outlines the "close connections between transnational crime and terrorism." It states that the participants at the 1st International Conference on IPR hosted by Interpol in Lyon, France in 2001 "all agreed the evidence was indisputable: a lucrative trafficking in counterfeit and pirate products—music, movies, seed patents, software, tee-shirts, Nikes, knock-off CDs and 'fake drugs' accounts for much of the money the international terrorist network depends on to feed its operations." The article concludes that "The new link between commercial-scale piracy and counterfeiting has redirected public attention in 2002, and law enforcement agencies like Customs and Interpol are going after the organized crime syndicates in charge of what was too often viewed as a 'victimless crime.' September 11 changed the way Americans look at the world. It also changed the way American law enforcement looks at Intellectual Property crimes."

The Police Service of Northern Ireland's (PSNI) Anti-Counterfeiting and Racketeering Unit also reports that paramilitary organizations in Northern Ireland regard counterfeiting as their preferred fund-raising option. According to the PSNI, these paramilitary groups last year made specific threats against officers involved in anti-piracy raids at Newtownards Market after PSNI officers had seized over £50,000 worth of counterfeit goods, including DVDs.

AN APPEAL FOR ASSISTANCE

To deal with this kind of organized crime, MPAA and our fellow copyright associations, need the help of governments—both here and abroad. It is simply not possible for a private sector organization to penetrate this kind of organized, criminal endeavor without the help of governments. Governments need to dedicate the same kinds of legal tools to fighting piracy that they bring to other kinds of organized crime: money laundering statutes, surveillance techniques, and organized crime laws.

We also need your help to let foreign government officials whom you meet here or when you are abroad, know that inaction is not an option in the fight against piracy. The continued vitality of the copyright industries, one of America's signature industries, is at stake.

We need our enforcement agencies to help train and work with foreign enforcement agencies to stem the flow of piracy across borders.

We also need the continued assistance of all the agencies that make up the "country team" at American embassies abroad. Ambassadors and their staff from State and Commerce have done outstanding jobs in offices from Moscow to Taipei in helping press for better laws and better enforcement. They help deliver the message that failure to address these high levels of crime has consequences for our bilateral relationships. The traditional enforcement agencies—Customs and legal attaches—are also playing an important role in some countries in engaging their counterparts in dialogue, in improving coordination among enforcement agencies around the world, and in training foreign law enforcement in all aspects of fighting organized crime—including copyright theft.

Recently negotiated trade agreements are playing a crucial role in raising the standards of copyright law and enforcement around the world. The Office of the US Trade Representative has done an excellent job in the newly negotiated FTAs with Chile and Singapore incorporating provisions that raise the standards for copyright protection to the level of US laws and help provide the tools we need to combat this menace. The agreements also help open markets—and the more open the market, the less the incentive for piracy. I hope I can encourage you to support these Free Trade Agreements when they come before Congress later this year.

ENTERTAINMENT INDUSTRY COALITION FOR FREE TRADE

I'm pleased to announce that in recognition and support of the value of trade agreements in helping to move our international agenda forward, we will be launching at noon today an Entertainment Industry Coalition for Free Trade. This coalition brings together a wide range of entertainment industries and associations—films, music, entertainment software, theater owners, and television programmers. We hope that many of you can join us at noon today as we launch this Coalition whose main objective is to spread the word that trade matters to our industries.

IN CONCLUSION

Large, violent, highly organized criminal groups are getting rich from the theft of America's copyrighted products. Only when governments around the world effectively bring to bear the full powers of the state against these criminals can we expect to make progress. Only when industry and governments join forces to fight these organized groups will we succeed in protecting one of the jewels in America's trade crown. A singular truth exists in the movie industry: "If you can't protect what you own, you don't own anything."

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Financing Terror

Profits from counterfeit goods pay for attacks

By Kathleen Millar, *Public Affairs Specialist, Office of Public Affairs*

Anti-terrorist organizations in the U.S. and abroad are homing in on the close connections between transnational crime and terrorism. Before 9/11, law enforcement defined both as strategic threats but tended to approach each problem separately, constructing one set of responses to criminal activities-like money laundering, IPR violations, and drug trafficking-and devising other tactics to combat terrorism.

Today, in a post-9/11 environment, agencies like Customs and Interpol understand that the international underworld is a breeding ground for terrorism, providing groups like al Qaeda, Hammas, Hezbollah, and the Irish Republican Army (IRA) with funds generated by illegal scams, and with opportunities to launder millions in terrorist dollars. Behind the army of hijackers, suicide bombers, and terrorist gunmen stands an even greater number of "company men"-criminal entrepreneurs and financiers in suits who understand the best way to bankroll Armageddon is through the capitalist system.

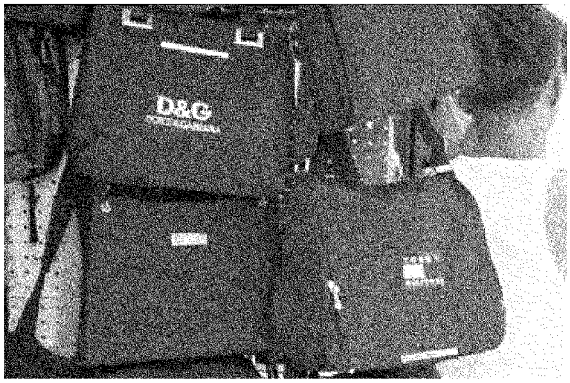

Photo Credit: James Tourtellotte

Counterfeit "designer bags" can generate profits

Fat Harold's Carolina Cruisin' fundraiser

30 athletes, 117 medals at the International Law Enforcement Games

Retirees: Still on the job

Personnel and payroll self-service available 24/7

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for terrorists.

They run what look like legitimate businesses, travel to "business meetings" in Frankfurt, Amsterdam, and New York, and pay fictional "employees" with money that feeds and houses terrorist cells. They run computer manufacturing plants and noodle shops, sell "designer clothes" and "bargain-basement" CDs. They invest, pay taxes, give to charity, and fly like trapeze artists between one international venture and another. The endgame, however, is not to buy a bigger house or send the kids to an Ivy League school - it's to blow up a building, to hijack a jet, to unleash a plague, and to kill thousands of innocent civilians.

Interpol and Customs join forces against IPR violations

Financing terrorism is a topic that Customs and Interpol are taking seriously. Last year, soon after the attacks on New York and Washington, Interpol hosted the 1st International Conference on IPR in Lyon, France. Enforcement and security experts outlined the relationships between global commerce and global crime - instances in which profits from counterfeit merchandise funded terrorist activities - and participants agreed that Interpol needed to create a Group of Experts on International Property Crime.

Interpol hosted the first meeting of the multi-agency, IP Advisory Group on July 23. The group met again on October 3, and law enforcement officials from U.S. Customs, Finnish Customs, Ireland, Northern Ireland, and the Royal Canadian Mounted Police joined forces with the corporate community to hammer out concrete responses on an international scale. The World Intellectual Property Organization, the Motion Picture Association, the International Anti-Counterfeiting Coalition, Procter and Gamble, the World Customs Organization, the Pharmaceutical Security Institute, the International Federation of Phonographic Industry, the Global Anti-Counterfeiting Group, the European Union, and REACT Services (UK) all had representatives at the table.

"Our objective," says Erik Madsen, a crime intelligence officer with Interpol, "was to raise awareness, to create a strategic plan to fight this kind of crime, and to take action."

In the end, all agreed the evidence was indisputable: a lucrative trafficking in counterfeit and pirated products -

music, movies, seed patents, software, tee-shirts, Nikes, knock-off CDs, and "fake drugs" - accounts for much of the money the international terrorist network depends on to feed its operations.

New York's Joint Terrorist Taskforce reported a counterfeit T-shirt ring had used sales profits to subsidize the bombing of the World Trade Center in 1993. In 1999, an International Chamber of Commerce official reported the IRA was financing its operations by selling pirated videos, including a copy of "the Lion King." In 2000, a naturalized Paraguayan citizen born in Lebanon was charged with selling millions in counterfeit software out of a headquarters operation in the notorious piracy haven of Ciudad del Este; allegedly, the proceeds went to the militant Islamic group Hezbollah. Last year, Microsoft officials based in London charged counterfeiters were using the Internet to sell pirated software, an effort they described as one designed to support drug running and terrorism.

Losses from counterfeiting and piracy outstrip 9/11 impact on airlines

For years, legitimate manufacturers have cited huge financial losses, the run-off from IPR violations, as a primary reason to pass tough IPR legislation and enforce anti-counterfeiting laws. What policy-makers sometimes failed to note was the sheer enormity of those losses. After 9/11, leaders in both the public and private sectors described the loss to the U.S. airline industry as "catastrophic." While the airline industry accounts for about 10 percent of the nation's gross domestic product, copyright industries generate more foreign sales and exports than the aircraft and aircraft parts industries combined.

The new link between commercial-scale piracy and counterfeiting has redirected public attention in 2002, and law enforcement agencies like Customs and Interpol are going after the organized crime syndicates in charge of what was too often viewed as a "victimless crime." September 11 changed the way Americans look at the world. It also changed the way American law enforcement looks at Intellectual Property crimes.

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Mr. SMITH. Thank you, Mr. Valenti.
Ms. Vidov.

STATEMENT OF JOAN BORSTEN VIDOV, PRESIDENT, FILMS BY JOVE, INC.

Ms. VIDOV. Chairman Smith, Congressman Berman, and other distinguished Members of the Subcommittee, I want to thank you for the invitation to appear here today.

I am president of a U.S. small business which has encountered extraordinary difficulties as licensee of Russian intellectual property. I am here to describe these difficulties because our experience illuminates the links between copyright piracy in Russia and organized crime.

As my testimony will show, the organization behind Russian copyright piracy is the government itself, directed at the highest level by the Ministry of Culture. What fits the definition of organized crime more than a foreign government conspiring to steal the property of a small U.S. business? That is the worst kind of organized crime by the most powerful possible organization.

Eleven years ago, my company signed a contract with Russia's premier animation studio, Soyuzmultfilm, to restore and market a large library of over 100—or 1,000 animated films produced during the Soviet era. We invested millions of dollars to acquire, repair, restore, and distribute these works.

Together with our partner, Mikhail Baryshnikov, we made the animation accessible for the first time to a greater worldwide audience by creating dubbed version with actors such as Charlton Heston in English, Catherine Deneuve in French, and Julio Iglesias in Spanish.

Seven years after we signed our contract, when our investment was showing a profit, officials of the Russian Ministry of Culture began a campaign to retroactively void our contract. In '99, they set up in Moscow a dummy corporation with the same name as our contracting partner and claimed that their new company was the true copyright holder back in 1992.

Thus began a protracted series of suits and countersuits in the Russian courts between the animation studio that had licensed the rights to us and the Ministry of Culture. During this period, Films by Jove suffered financial losses because the ministry prohibited the Russian State Film Archive from supplying us with films for which we had the rights.

After our Russian licenser won a series of decisions and appeals against the Ministry of Culture, the ministry resorted to manipulating the courts. The chief justice of the Russian commercial court was instructed at an ex parte meeting to "protect State interests." As a result, all lower court rulings that had gone against the ministry were vacated.

Films by Jove successfully defended its copyright in the U.S. courts. In August 2001, the U.S. Federal court for the Eastern District of New York held that Films by Jove had licensed the rights to the animation library from the proper rights holder. The dummy corporation was a party to the case and agreed to be bound by the judge's ruling.

Despite this, the Ministry of Culture has been flouting the U.S. decision for more than a year. For example, ministry officials have been sending letters via Russian embassies to broadcasters with whom we are negotiating, informing them—falsely—that only licenses issued by the dummy corporation are legitimate and implying that my company does not have the right to contract out the animation.

Ministry employees have been showing up at international sales expos, announcing that we are pirates and thieves and trying to sell our own product. In Japan and Korea, our distributors have been terrorized by a Soviet expatriate acting on instructions from the ministry and insisting that all royalties be paid to him instead of to us.

Most recently, the Ministry of Culture tried to make arrangements to have the American Film Institute screen the same animated films that were the subject of the Federal court decision. Fortunately, the AFI discovered in time that the ministry did not hold rights to these works.

The Ministry of Culture's campaign against my company has not been stopped by the intervention of U.S. Government officials. You, Congressman Berman, together with Congressmen Weldon and Waxman, sent two letters to the deputy prime minister in charge of the Ministry of Culture. In November, the U.S. ambassador to Russia, Alexander Vershbow, met personally with the minister of culture about our case.

The U.S. trade representative, the Commerce Department, the staff at the U.S. embassy in Moscow have repeatedly raised this matter with the minister of economic development and trade. What is the motivation between this relentless harassment that has damaged my company's reputation, deceived our trading partners, and interfered with our international sales?

We believe that part of the answer is that the ministry aims to establish a government monopoly that will funnel money directly into the pockets of top ministry officials from two major cash streams—revenues from the sale of Soviet era films, including animation, and Russian box office receipts from American movies that bring in hundreds of millions of dollars.

The Ministry of Culture has already created the new organization that will consolidate this monopoly. It is called Roskinoprokat, or the Russian film distribution. One of its publicly stated goals is to control imports of U.S. blockbusters, and it plans to open—I've got that much more.

Mr. SMITH. Okay.

Ms. VIDOV. And it plans to open offices in Los Angeles this summer. Roskinoprokat is a monolithic throwback to a Soviet-style command economy, and it is difficult to reconcile with Russia's claims to be a modern market economy.

I'd like to close my testimony by reminding you that the attempted theft of intellectual property by the Russian government officials is not limited to film, music, and software. For example, my colleague, Gary Johnson, who is here with us today, has submitted testimony about the company he heads, Sawyer Research Product.

Like Films by Jove, his company's success caught the eye of a Russian official—in his case, a local governor—who again, on the basis of "state interests," obtained Russian court rulings that stripped Gary's company of its physical plant, equipment, and trade secrets.

Proprietary blueprints developed by another small firm, American Capital Systems, are in danger of being exploited without compensation because the company refused to pay a bribe demanded by an official of the Russian Ministry of Finance. Congressman Weiner, who represents ACS, is submitting testimony in connection with that case.

And in closing, I want to thank the Subcommittee for giving me the opportunity to testify today. I'll be happy to answer any of your questions.

[The prepared statement of Ms. Vidov follows:]

PREPARED STATEMENT OF JOAN P. BORSTEN VIDOV

Chairman Smith, Congressman Berman and other distinguished members of the subcommittee, I want to thank you for the invitation to appear before the Subcommittee today. I come to you as president of a small business that invested in Russia and is in danger of having its investment expropriated without compensation. I also come to you as the representative of a group of small businesses who have suffered a similar fate in Russia.

As a victim of Russia's weak enforcement of intellectual property rights, I come to you with a warning that Russia's disrespect for IP rights is on the increase due to the difference between stated policy and what certain government officials unofficially condone in practice. Even as Russia moves toward membership in the WTO, systematic copyright violations and collusion between government officials and pirates both continue unabated.

Finally, I come to you as a victim of a breakdown of separation of powers between Russia's executive and judicial branches: from the highest federal courts to the smallest regional courts, judges make ill-founded rulings when government officials often with private agendas exert pressure on courts in the name of "protection of state interests."

So as you can see, I have a number of issues to discuss, but here at the outset let me make clear that my comments do not purport to make any linkage between piracy and organized crime and terrorism. Others more qualified may speak directly to those precise issues, but the purpose of my testimony today is to outline my experience with intellectual property rights violations in Russia. To demonstrate why this matters to the U.S. Congress, I would like to highlight the following points and the impact they have on our bilateral commercial relationship:

I. IPR violations in Russia hurt U.S. investors
II. The use of "state interests" and illegal ex-parte meetings hinder legitimate judicial reform efforts in Russia
III. Russia disregards U.S. and international arbitration court decisions
IV. The U.S. government must play an important role in addressing Russian IPR violations in the United States

In my conclusion, I will present several recommendations to Congress on steps that can be taken to address these issues.

I. IPR VIOLATIONS IN RUSSIA HURT U.S. INVESTORS

The International Intellectual Property Alliance (IIPA) 2003 report on Russia cites losses to U.S. copyright holders of $1 billion a year, making Russia one of the worst violators of U.S. intellectual property rights.

The majority of my testimony will be dedicated to IPR violations in the entertainment industry (e.g., films, CDs, videocassettes, DVDs, electronic games, etc.). But there is another, equally important area impacted by IPR violations—technology transfer. I would like to share an example with you. My colleague, Gary Johnson, is President of Sawyer Research Products. (Gary is in the audience today, has submitted separate testimony for the record, and is happy to answer any questions.) Sawyer is a global leader in the business and technology of single crystal piezo-

electric materials, especially quartz, which is second only to the production of silicon in the ranking of crystal materials used in electronics.

In 1994, Sawyer became a shareholder of Quartz Glass Plant in the Vladimir region of Russia. The plant's success, in large measure the result of utilizing Sawyer's world-class technology in a neglected facility in the heart of Russia, caught the eye of the local governor who waved the "protection of state interests" flag. Shortly following a court decision favorable to their ends, private parties closely linked to the local administration deployed a private security force to block Sawyer from its own plant, despite the fact that Sawyer had not exhausted the appeals process and litigation continued. Sawyer technology now is available to a nearby plant still under state ownership, as well as to the private parties continuing to occupy the object of Sawyer's investment.

The Sawyer example highlights the devastating impact IPR violations have on U.S. small businesses investing in Russia. I would like to emphasize this point, because, unlike our larger counterparts, SMEs do not have the financial or human resources necessary to devote to the extensive legal proceedings resulting from IPR violations in Russia.

Films By Jove case

Now I would like to provide my personal experience with IPR/copyright violations in Russia.

I have been an executive in the U.S. motion picture industry for over 15 years, and am currently president and co-owner of the Los Angeles-based film production and distribution company, Films By Jove. Eleven years ago, in May 1992, we signed a contract with Russia's leading animation studio to restore and market a large body of Soviet-era animated films. For your background, during the Soviet era, this type of animation had been sold for peanuts, by the kilo, or just given as a bonus to companies buying a large package of Soviet feature films.

Today the Russian animation we distribute can be seen in theaters and on television all over the world, and is available on videocassettes and DVD in thousands of retail outlets in North America, South America, Europe, and Asia. Together with our partner Mikhail Baryshnikov, we gave the old animation new cachet by revoicing it in English with actors such as Jessica Lange, Martin Sheen and Charlton Heston. We revoiced in French with actors like Catherine Deneuve, and in Spanish with Julio Iglesias. Together with the prestigious art book publisher Harry N. Abrams, we published the only book of Russian fairy tales currently in print in the United States, handsomely illustrated with cells from the animation.

We are proud to have contributed to the safeguarding and promotion of Russia's rich artistic heritage. We accomplished this by investing millions of dollars to acquire, repair, restore, and distribute these films, making them accessible for the first time to the general public outside the former USSR. The Soviets had freely "borrowed" Western literature and music to make some of the best animated films—a bad habit that did not end after the USSR signed its first intellectual property convention in 1973. So we also had to plead and cajole representatives of these writers and musicians to license us the rights necessary to keep these films alive.

In 1999, seven years after we licensed the animation library, when the investment in restoring the animated films first showed a profit for the Russian animation studio and for my company, the Russian State Film Committee (later absorbed into the Ministry of Culture) commenced a legal and political campaign to retroactively void our contract. This effort began when the State Film Committee set up in Moscow a shell corporation with the same name as the Russian studio from which we had licensed the animation rights. Ministry of Culture officials claimed that this new company, established in 1999, was the true copyright holder back in 1992, instead of the entity with whom we had contracted. Hence, they claimed, our contract was void retroactively.

Thus began a protracted series of suits and countersuits, decisions and appeals in Russian courts between the animation studio that had licensed the rights to us and the Ministry of Culture. During this period, Films By Jove suffered financial losses because the Ministry of Culture prohibited the Russian State Film Archives from supplying us with films for which we had the rights. Such interference with our normal business operations became part of an organized campaign to deny our property rights.

Throughout this time, Ministry of Culture officials significantly damaged my company's interests by sending letters via Russian embassies to broadcasters with whom we were negotiating—informing them, falsely, that only licenses issued by the dummy corporation were legitimate and implying that Films By Jove could not therefore contract out the rights. These misleading statements have deceived our trade partners, interfered with our commercial activities, and caused us serious fi-

nancial losses due to damage to our reputation and lost sales. Furthermore, the letters from the Ministry blatantly misrepresent the fact that Films By Jove has successfully defended its copyright in the U.S. courts. The studio with which Films by Jove contracted in 1992 was also successful in the Russian court system, only to have the decisions overturned in the name of "state interests."

The unrelenting and organized efforts by Russian government officials to annul the contractual rights of Films By Jove, and to destroy our investment, have already come to the attention of the U.S. Congress. In 2002, two letters concerning our case were sent to Russian government officials jointly signed by Congressman Berman, Congressman Waxman and Congressman Weldon, including the following points:

1. Officials of the Russian government "appear to have inappropriately influenced the decisions of the Russian courts in violation of the constitutional separation of powers between the two branches of government";
2. Such efforts directly harm the long-term investment of Films By Jove; and
3. The Ministry of Culture does not appear to be committed to safeguarding the rights of American investors, contrary to President Putin's repeated statements pledging that investors will be guaranteed a level playing field, adherence to the rule of law, an independent judiciary, and no government interference in private commercial contracts.

In response, Congressmen Berman, Waxman and Weldon received a letter from the Russian Ambassador to the U.S. questioning the reference to Films By Jove as an investor. Apparently the Russians destroyed evidence of our wire transfers and payments to the studio (assuming U.S. banks do not keep records) because, according to the Russian Ambassador, the Russian company received no payments from the U.S. party to the contract.

In addition to the assistance we received from the U.S. Congress regarding our case, U.S. Ambassador to Russia Alexander Vershbow and the staff at the U.S. Embassy have also raised our case repeatedly with the Minister of Economic Development and Trade. Ambassador Vershbow met personally with the Minister of Culture last November and explained that we are ready to conduct negotiations aimed at reaching an amicable and transparent solution based on the rule of law.

In spite of repeated assurances that our concerns would be addressed, a new full-scale campaign was mounted at an international television sales expo in France last fall to advise all buyers that we were "pirates" and "thieves," that all new contracts had to be signed with them, and that any contracts previously signed with our company were null and void. The state-studio's brochures specifically advertised the titles we legally acquired, paid for, and into which we invested significant amounts of money for restoration and revoicing in order to make them sellable to international broadcasters.

To address this situation, we had recourse to a French court decision that we had won in 1996 against Sovexportfilm, another state-owned Russian company that we caught pirating in the early 1990s (it too enjoys Ministry of Culture support). On the basis of that decision, a French magistrate ordered his bailiff to shut down the Russian sales booth at Cannes in order to gather evidence about the shell company's commercial activities that violated our intellectual property rights. The director of the shell company and his deputy both told the French bailiff that they worked for the Russian Ministry of Culture.

The Russian Ministry of Culture is now in the process of liquidating the studio with which we signed our agreement, showing no concern at all for the livelihoods and pensions of the 300 shareholders, most long-term employees of the animation studio.

IPR violations and expropriation—to what end?

It appears that part of the impetus for these copyright violations is the Ministry's goal to establish a Soviet-type structure to funnel profits directly into the pockets of the film industry's leadership. Currently, a state-owned entity, "Roskinoprokat," is seeking to control all phases of the Russian feature film industry, from buying Kodak stock, to duplicating films for video and DVD, to producing Russian films, dubbing others into Russian, and controlling all cinema houses in Russia. All of the film studios have had to become state companies. Most have already had their libraries of films made during the USSR extracted from the production arms.

This desire to control all is what led the Ministry of Culture to destroy the successor of the studio with which we signed our contract. The expropriation of our property rights under this contract was another well-orchestrated step toward concentrating in the same hands all of the animation rights.

You will hear more about Roskinoprokat in the coming years because, as they openly state in interview after interview in Russia, the biggest plum is rights to distribute U.S. studio films, which generate the biggest profits in Russia. More than 100 modern movie theatres operate in Russia today, a number expected to triple in the next five years, with revenues predicted to reach $100 million. Post-Soviet Russian films constitute only about 3 percent of the screen repertory and average $200,000 at the box office. By contrast, American movies have proven to be very popular and very lucrative, grossing an average of $2.8 million at the Russian box office.

The Minister of Culture and his Deputy have made clear that their goal is to consolidate everything into one big government-owned company. Roskinoprokat recently announced plans to open offices in Los Angeles this summer and is already hiring staff. One of their associates told me earlier this week that they believe it is only a "matter of time" before the major studios "succumb." The result will surely be a nightmare even worse than Sovexportfilm's monopoly on importing foreign films into the Soviet Union.

II. THE USE OF "STATE INTERESTS" AND ILLEGAL EX-PARTE MEETINGS HINDER LEGITIMATE JUDICIAL REFORM EFFORTS IN RUSSIA

The importance of "state interests" in the application of law and administrative process in Russia raises critical separation of powers issues. In the Soviet tradition, courts and administrative powers, including enforcement agencies, pursue a mission related to state interests. They do not follow the Western norms of fair adjudication of law according to the facts and transparent procedures to implement rulings and otherwise conduct administrative process. In the Russian environment, state prosecutors operating under control of the executive branch define "state interests" in many judicial proceedings. Their very presence in a case frequently creates outcomes consistent with their objectives, rather than with the law and facts.

We unfortunately have experienced the illegitimate use of ex-parte meetings in court decisions. At the same time that the Russian Ministry of Culture was challenging our copyright in U.S. court, it was continuing in Russian courts to challenge the legitimacy of the animation studio that had contracted with us. After six rulings against the Ministry of Culture in the Russian courts, Ministry officials invited the Chief Justice of the Supreme Arbitrazh (or Commercial) Court to send a representative to a secret but well-documented "consultation" at the offices of Deputy Prime Minister Matviyenko. The purpose of the meeting was to secure for the new government-owned studio rights that belonged by law to the studio with which we signed our contract. No one from our side was invited of course, and such ex-parte meetings are against the law.

Attending the meeting on behalf of the government was Minister of Culture Shvidkoy, two of his deputy ministers, a Ministry of Culture lawyer, a representative of the State Property Ministry, two representatives of the State Prosecutor's Office, the director of the Russian patent bureau Rospatent, representatives of the Presidential Administration, director of the state-owned studio, and the chairman of Roskinoprokat.

This ex-parte meeting resulted in one cassation court decision and one Supreme Arbitrazh (Commercial) Court decision that together vacated all lower court rulings that had previously been decided against the Ministry of Culture. The effect of these decisions was that the properly registered successor of the company from which we gained our license was de-registered. It should be noted that in his declaration to the U.S. Federal Court, which I have submitted for the record, the respected Russian jurist Sergei Pashin concluded that the Supreme Arbitrazh Court decision was clearly inconsistent with both Soviet and Russian law and prior decisions made by the same court about the same matter, and that it had all of the markings of what is known in Russia as a "state ordered decision."

III. RUSSIA DISREGARDS U.S. AND INTERNATIONAL ARBITRATION COURT DECISIONS

One of our contractual obligations was to defend the Russian studio's copyright against pirates in our distribution territory, which included the United States. In August 2000, while we were engaged in a lawsuit against a convicted felon for copyright violation in the U.S. Federal Court for the Eastern District of New York, the shell corporation set up by the Russian Ministry of Culture joined the suit as a third party on the side of the felon. Their objective in joining the suit against us in U.S. court was to attempt to gain a ruling that Films By Jove was not the legitimate copyright holder of the animation. The Ministry was thus tenacious in its organized campaign to undermine my company's rights, and we were unexpectedly burdened with enormous legal expenses in the effort to defend ourselves.

As it turned out, the Russian Ministry of Culture allied itself with the losing party in the U.S. district court: Films By Jove won the case. The felon with whom the Ministry had allied itself was arrested in December 2000 and subsequently pleaded guilty to pirating the intellectual property of the Motion Picture Association of America and the Recording Industry of America using master tapes and optical cassettes illegally manufactured in Russia. The Ministry's support for this convicted felon has never wavered.

On a related note, I also want to strongly urge the U.S. government and members of the international community to address Russia's failure to observe the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. As several of my small business colleagues will tell you, Russian bailiffs do not enforce foreign arbitral decisions, even when ordered to do so by the Russian Supreme Court. I would be happy to provide examples of these cases if you so desire.

IV. THE U.S. GOVERNMENT MUST PLAY AN IMPORTANT ROLE IN ADDRESSING RUSSIAN IPR VIOLATIONS IN THE UNITED STATES

Russian IPR violations not only impact our business in Russia, they affect our business in the U.S. and in other countries. The losses I referenced earlier from the IIPA report on Russia do not include the massive additional losses caused by the import into the U.S., Germany and Israel—all countries with major populations of wealthy Russian immigrants—of illegally manufactured videos CDs, DVDs and software.

In the U.S., our government plays an important role in addressing IPR violations. For example, in December 2000 when the FBI arrested a Brighton Beach video pirate for piracy of the MPAA and RIA—the same one we sued in U.S. Federal Court—they confiscated truckloads of master cassettes and CDs imported from Russia. Unfortunately the pirate's arrest only resulted in a momentary lull in the violations of Russian and U.S. intellectual property by the Russian émigré community—and for that we have to look to our own legal system.

The pirate, Joseph Berov, opened his bootleg video business while on federal probation for importing Russian women into the U.S. for the purpose of indentured servitude. Yet two years after his arrest by the FBI and one year after he pleaded guilty, Mr. Berov has yet to be sentenced by the U.S. Federal Court for the Eastern District of New York. In the interim, he has opened two new superstores and resumed importing illegal video CDs from Russia. The message to his partners at the Ministry of Culture and the local émigré community is that "crime pays."

Other examples of Russian IPR violations in the U.S. include the Ministry of Culture's attempt last week to present the American Film Institute (AFI) with an animation program that violates both our license and the August 2001 U.S. Federal Court decision that we won. The same program included feature film rights that were legally licensed to legitimate U.S. distributors by the very Russian studios the Ministry agrees are the legal copyright holders. The AFI was vigilant and thus averted a major scandal. Two years ago, the American Cinematheque was less vigilant, and, with the Ministry of Culture, organized a tour of films without the consent of the legitimate producer (Mosfilm) of the films. The copyright holder was not consulted, not paid, and not even acknowledged.

Conclusion

I would like to close my testimony today by offering the following recommendations to the U.S. government, in order to address IPR violations in Russia:

- To continue to hold hearings such as this to raise awareness of IPR violations. In particular, these hearings should examine critical points of influence and leverage to curb Russian copyright violations. They should investigate the official role of Russian government agencies in IP piracy. They should consider why the state company Roskinoprokat, a self-proclaimed "child" of the Ministry of Culture, is being allowed to open an office in the U.S. and conduct commercial activity; and whether Roskinoprokat will be protected by the same sovereign immunity afforded the Ministry.
- To work with your colleagues in the U.S. Executive Branch (State Department, Commerce Department, USTR, etc.) to identify appropriate costs that could be imposed on Russia as a result of the disregard for the rule of law (treaty violations, expropriation cases, etc.);
- To support U.S. funding for rule-of-law initiatives in Russia, especially in the area of enforcement; and,
- To work with your counterparts in the Russian Congress ("Duma") to get a commitment to resolving these violations and disputes.

I want to thank the Subcommittee for giving me the opportunity to testify today, and I will be happy to answer any of your questions.

Congress of the United States
Washington, DC 20515

March 15, 2002

The Honorable Valentina Ivanovna Matviyenko
Deputy Prime Minister
2 Krasnopresnenskaya nab.
103274 Moscow
Russian Federation

By Fax

Dear Deputy Prime Minister Matviyenko:

In 1992, Films by Jove (FBJ), a California-based film distribution company, signed a legally binding contract with the Russian studio Soyuzmultfilm (SMF), the holder of a copyright for a library of Soviet-era animation, to distribute these animation films outside of the former Soviet Union. At the time, SMF was in the process of being converted from state ownership to private ownership. The contract between FBJ and SMF applies California law to the relationship.

FBJ invested over $4 million to restore, dub, and otherwise enhance the Soviet animation in order to make it accessible to the West, making a great contribution to Russian culture by successfully marketing and popularizing your heritage abroad. However, once the animation film project started to generate revenue for FBJ and SMF, Russian officials began efforts to retroactively void the FBJ contract. This issue has already been adjudicated in favor of FBJ by the United States District Court for the Eastern District of New York, which found that the 1992 agreement between FBJ and SMF was valid.

Regrettably, persuasive documents indicate that in the ongoing commercial dispute between the original SMF (with which FBJ has the contract) and a second state-owned Soyuzmultfilm incorporated in 1999, the Ministry of Culture -- together with the Office of the Prosecutor General – appear to have inappropriately influenced the decisions of the Russian Arbitrazh Courts, including the High Arbitrazh Court, to favor the state-owned entity. These efforts, which have been justified by some officials as "protection of state interest," violate the constitutional separation of powers between the two branches of government, and directly harm the long-term investment of FBJ.

FBJ recently obtained a copy of a November 9, 2001 letter from Deputy Minister of Culture A. A. Golutva to the Embassies of the Russian Federation, in which Mr. Golutva falsely states that "all attempts to dispute legality of the existence and activity of the state-owned Soyuzmultfilm Studio in the courts were not crowned with success." He also instructs the Embassies to circulate information that "any usage of both films and trademark of Soyuzmultfilm, including usage in accordance with agreements concluded with lease enterprise Film Studio SMF or with other persons not authorized by state-owned Soyuzmultfilm Studio, are illegal." This letter has been used to undermine FBJ's credibility as a legitimate copyright holder

and has caused substantive material damage to FBJ. We are alarmed because this appears to demonstrate that top officials at the Ministry of Culture are not committed to safeguarding the rights of American investors.

In addition, at a time when the U.S. and the Russian Federation are working together to curb piracy of American intellectual property in Russia, we are deeply concerned that the Ministry of Culture has allied itself in U.S. Federal Court with Joseph Berov, who previously pleaded guilty to importing women from the former Soviet Union into the United States for the purpose of indentured servitude, and who recently pleaded guilty to pirating the intellectual property of the Motion Picture Association of America (MPAA) and the Recording Industry of America (RIAA). Mr. Berov pirated the MPAA and RIAA using master tapes and optical cassettes illegally manufactured in Russia.

We consider the activities of the Russian officials connected to the case, including Culture Minister Mikhail Shvidkoy, contrary to President Vladimir V. Putin's repeated statements urging new foreign investment in Russia. President Putin has requested the U.S. government to encourage American investors to take a new look at Russia, pledging that under his administration investors will be guaranteed a level playing field, adherence to the rule of law, an independent judiciary, and no government interference in third party contracts.

In the near future we may propose Congressional hearings on intellectual property protections in Russia and the FBJ case. Such hearings could have an impact on the U.S. government's support for new investment in Russia, Russia's membership in the World Trade Organization, as well as the ability of the new Russian government-owned company Roskinoprokat to license distribution rights to major American films, a goal publicly articulated by Mr. Golutva. It appears that many of the Russian officials involved in Roskinoprokat are the same who are trying to illegally cancel the FBJ contract and damage that company's investment.

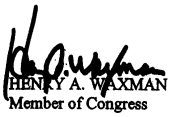
Ms. Deputy Prime Minister, we have no doubt that you are committed to the protection of foreign investors' rights and the development of Russia's business ties with the U.S. and the world. Unfortunately, it appears to us that some ministers and deputy ministers under your purview may have inappropriate personal and financial interests in the outcome of the cases and in the cancellation of the FBJ contract.

We therefore urge you instruct the Ministry of Culture, and specifically Mssrs. Shvidkoy and Golutva, to recognize the lawful ownership of the distribution rights of the Soviet-era animation by FBJ, and meet with the U.S. Embassy officials and representatives of FBJ to discuss the formal conclusion of this conflict in the fashion satisfactory to the American investor.

Sincerely,

HOWARD L. BERMAN
Member of Congress

CURT WELDON
Member of Congress


HENRY A. WAXMAN
Member of Congress

cc: Minster of Culture Mikhail Shvidkoy

Congress of the United States

Washington, DC 20515

May 21, 2002

The Honorable Valentina Ivanovna Matviyenko
Deputy Prime Minister
2 Krasnopresnenskaya nab.
103274 Moscow
Russian Federation

Dear Deputy Prime Minister Matviyenko:

On March 15, 2002 we wrote to you about inappropriate and apparently illegal efforts by the Ministry of Culture to retroactively cancel the legitimate and long-term investment of the American company Films by Jove (FBJ). To date we have not received a response.

FBJ has informed us that representatives of the Unitary Soyuzmultfilm (SMF) did meet with them at the Cannes TV Market on April 15 and reached an agreement by which the two companies could work in the future. This agreement included the Unitary SMF's recognition of FBJ's long-term contract – an assurance that would also be required from the Ministry of Culture. However, since returning to Moscow other parties in the Ministry of Culture's legal department have apparently blocked the Unitary SMF's ability to conclude the agreement.

In addition, FBJ informs us that Unitary SMF Director Ernst A. Rahimov, upon learning that the Unitary SMF had lost the U.S. Federal Court case in New York, stated that the Unitary SMF had never agreed to become a party in the case, and had never given any lawyer the authority to represent the Unitary SMF. He apparently also stated that the copyright to films produced during the USSR belongs to the studios, the same position taken by Mosfilm and Lenfilm when they filed a suit in the same U.S. Federal Court on May 1, 2002. The lawyer allegedly representing the Unitary SMF before Judge Trager has based his entire case on the Unitary SMF's "position" that copyrights belong to the state.

These events create an impression that some individuals in the Ministry of Culture are apparently providing misleading information to the U.S. Federal Court which is antithetical to Russian law, President Putin's decree No. 309 of April 4, 2001, and the Unitary SMF's own legal position. This undermines Russia's ability to distribute its cultural treasures in the United States and other parts of the world, and

Presidential Decrees, editing Bills and drafts of Presidential Decrees, and for the approval of the drafts of Decrees and Presidential Orders, for the submission of proposals to implement the Constitutional Authority granted to the President of the Russian Federation (for instance, the right to veto). Pashin participated in the preparation of the currently effective Federal Constitutional Law enacted on April 28, 1995, entitled "On Arbitrazh Courts in the Russian Federation", and also participated in the preparation of Arbitrazh Procedural Code of the Russian Federation of May 5, 1995, and also of norms included in 1993 Constitution of the Russian Federation, which are related to the justice system. In addition, Pashin was responsible for examining documents received from the Ministry of Justice of the Russian Federation pertaining to the nominees for the posts of judges, submitting his opinion to the Presidential Appointment Committee, preparing drafts of Presidential Decrees. The Judicial Reform Department was responsible for establishing new institutions of legal procedure, for instance, for the establishment of jury court procedures, for summarizing legal practice and promoting professional training among judges. To ensure professional training among judges Pashin organized a group of over 200 judges and sent them to the United States, Great Britain and Austria for an exchange visit.

15. In 1995-1996 S.A. Pashin was employed as Deputy Head of the Legal Department of the State Duma and Federal Council of the Russian Federation. Pashin was responsible for preparing models for decrees for States members of the CIS.

16. In 1996-2001 S.A. Pashin retained the position of the Federal Judge of the Moscow Municipal Court.

The Development of the Legal System

17. Pashin is one of the authors of the Judicial Reform Concept in the R.S.F.S.R., approved by the Supreme Council of the R.S.F.S.R on the introduction of as the of the R.S.F.S.R. President B.N. Yeltsin on October 24, 1991.

18. He was the sole author of the first law in the history of Russia "The Constitutional Court of the R.S.F.S.R" (approved in the author's version in 1991).

19. He was the primary author of the law "The Status of Judges in the Russian Federation" (adopted in 1992).

20. He led the working group on the development of the legal system and the jury system and was the author of the procedural aspects (the law was passed in 1993).

21. He headed the working group on the development of draft Federal constitutional law "The Court System in the Russian Federation" (Adopted in 1996).

22. In the last three instances, S.A. Pashin was appointed the representative in Parliament of the President of the Russian Federation, who in turn proposed laws to the Supreme Council of the Russian Federation as his legislative prerogative and after the dissolution of the Council to the State Duma of the Federal Council of the Russian Federation.

Awards

23. For his significant part in the development of the Judicial Reform Conception in the R.S.F.S.R, S.A. Pashin was honored with the Order of the President of the Russian Federation and awarded the honorary title of "Honorary Attorney of the R.S.F.S.R" (1992).

24. For his public service S.A. Pashin was awarded the prize "For the Protection of Human Rights" and the title of Authorized Official Protecting Human Rights in the Russian Federation (1999).

Public Service

25. S.A. Pashin took part in the legal defense of the Center "Judicial and Legal Reform", Center for the Promotion of Criminal Justice, the Taganrog Society for the Protection of Human Rights, he is also a member of the Independent Expert and Legal Council and of the Moscow Helsinki Group.

CONTENT OF THE OPINION

The December 18, 2001 Decision of the High Arbitrazh Court of the Russian Federation

26. In its December 18, 2001 decision, the Presidium of the High Arbitrazh Court of the Russian Federation ("High Arbitrazh Court") stated that the Joint Stock Company "Kinostudio "Soyuzmultfilm" into which the lease enterprise "Kinostudiya mul'tiplikatsionnykh fil'mov" was converted, "is not the successor of rights of the state enterprise "Kinostudio "Soyuzmultfilm" because 'The leased property complex..., was not privatized, and with the creation of the joint stock company it has remained state property. ...With the expiration of the lease agreement term, the plaintiff had no longer any legal grounds for using rights and property that were obtained under this agreement."

27. In making its ruling the High Arbitrazh Court also stated that, "...not a state enterprise but an independent legal entity - such as an organization of lessees created by a labor collective of a state enterprise - is converted into a lease enterprise."

28. In making said statement the High Arbitrazh Court tried to make it appear as if the state enterprise did not transform into the lease enterprise. The statement that an organization of lessees created by a labor collective, not a state enterprise, is converted into a lease enterprise might be interpreted to mean that the involvement of an

organization of lessees somehow affects the undeniable fact that the state enterprise transformed into the lease enterprise.

29. An organization of lessees is merely the workers of the lease enterprise. Said parties execute documents authorizing the transformation. It is a merely ministerial middle step in the transformation from state enterprise to lease enterprise. It does not affect the fact that the state enterprise transformed into the lease enterprise and the state enterprise ceased to exist thereafter. Tens of thousands of state enterprises have been transformed in the same manner.

30. The High Arbitrazh Court used an unprecedented and illogical judicial construction because the lease enterprise could not have inherited any assets from the organization of lessees because it was created by the collective for the sole purpose of signing the agreement with Goskino. All rights that the lease enterprise inherited would have been inherited from the state enterprise.

31. Said statement and the High Arbitrazh's glaring failure to explain the fate of the State Enterprise over ten years (after the Lease Enterprise was created) raise questions regarding the integrity of said decision.

32. The analysis of the legislation from the end of 1989 leaves no room for doubt that: First, the State Enterprise SMF was transformed into the lease Enterprise SMF according to the wishes of the general conference on signing a lease contract dated

Dec 20, 1989 between Goskino (lessor) and the collective of the Studio (lessee) followed by the State Registration on December 14, 1990.

33. Secondly, at that moment the State Enterprise lost its quality as a juridical person and ceased to exist.

34. The law of the Russian Federation ("RF") of December 25, 1990 on Enterprises and Entrepreneurship states that an enterprise can be created by the resolution of the labor collective of a state enterprise (Part 1, Article 33 of the Law) into the organizational and legal form of a Lease Enterprise (Part 1, Article 15 of the Law). When the transformation of a state enterprise into "another legal and organization form" happens, the enterprise ceases to exist (Part 1, Article 37 of the Law); "all the property rights as well as obligations of the previous enterprise will go to the newly formed enterprise" (Part 8, Article 37 of the Law).

35. After the transformation into a Lease Enterprise the State Enterprise cannot exist, neither as an Enterprise or another juridical person. After the transformation, it ceases to be an independent commercial entity producing a product or providing services or labor, which means it does not fall within the definition of an enterprise contained in Part 1, Article 4 of the Law of the RSFSR of December 25, 1990. At that exact moment it also loses all the qualities of the juridical person established by Article 23 of the Civil Code of the Russian Federation of 1964, i.e. ownership of defined

property, ability on its behalf to acquire rights and fulfill obligations, be a party to court arbitration or third party mediation court.

36. The position of the High Arbitrazh Court in its December 18, 2001 decision appears to be inconsistent with the position that the courts of general jurisdiction as well as the High Arbitrazh Court itself have previously taken about related questions. For instance, when considering the complaints of employees fired at the time of transfer of a state enterprise into lease enterprise by the labor collective, the courts of general jurisdiction of different levels concluded that in such cases, the reorganization of such enterprises took place in the form of transformation from one organizational legal form into another. As a result the former employees of such former state enterprises had the right to continue labor relations with the newly formed lease enterprise (note Bulletin of the Supreme Court of the Russian Federation No 12, 1993 signed by Judge A.K. Gavrilin titled "Court decisions overturning termination decisions made by the management of private and reorganized enterprises.")

37. In the decision of the High Arbitrazh Court of January 23, 2001 No. 5527/00, signed by the same judge who signed the December 18, 2001 decision, the court stated unequivocally that the state enterprise for design, remodeling and construction "Mosoblremstroy" transformed into a lease enterprise PPRS "Mosoblremstroy." In that case the law was implemented according to its actual meaning. The Court stated that the state enterprise, not the organization of lessees, was transformed into a lease enterprise.

It its decision of December 18, 2001 the High Arbitrazh Court inexplicably took a different position.

38. This hurried change by the High Arbitrazh Court of its own legal position leads one to think there was a distortion in this case of the legal framework in favor of the interests of the organs of executive power. In Russia this phenomena is called "an ordered judicial decision."

39. In view of the foregoing, the legality of the December 18, 2001 decision of the High Arbitrazh Court appears doubtful. Omissions by the High Arbitrazh Court, as well as use by the court of illogical and entangled judicial constructions, resulted in a decision which allowed the organs of the executive branch to interpret this decision in any manner they deemed fit which would be for the purpose of protecting what is specifically understood to be "state interest."

Specific understanding of the "state interest" by a Russian court.

40. The way a "state interest" is understood in Russia's highest bodies of state power, is seen from the copy of an office memo addressed to one of the executives of the High Arbitrazh Court, A. A. Arifullin, written by the Senior consultant of the Administration of Generalization of Judicial Practice E. A. Lyubichev who was present at the March 30, 2001 consultation meeting at offices of the Deputy Chairman of the

Russian Federation Government V.I. Matvienko. A copy of said memo is annexed to the Declaration of Larissa Riabchenko as Exhibit 1.[1]

41. At the meeting, "a wish was expressed about the necessity by all state bodies to secure the protection of interests of the Russian Federation (the Federal State Unitarian Enterprise "Kinostudio "Soyuzmultfilm")." As it is seen from the preamble and the remainder of the text of the decision made at the March 30, 2001 consultation meeting at the offices of the Deputy Chairman of the Russian Federation Government, V.I. Matvienko, annexed to the declaration of Larissa Riabchenko as Exhibit 2, the securing of a state interest is linked to the securing of the activity of the FSUE "Kinostudio "Soyuzmultfilm." Thus, the state interest was linked by governmental organs of Russia with the interests of a federal state unitary enterprise which, according to Law is only one of many equal subjects of commercial activity.

42. According to Part 2, Art. 8 of the Russian Federation Constitution, "Russian Federation recognizes and equally protects private, state, municipal, and other forms of property." The Federal Constitutional Law of April 28, 1995, "On Arbitrazh Courts in the Russian Federation," among the basic principles of the activity of Arbitrazh courts points out "the equality of organizations and civilians before the law and the court" (Art. 6.) "Justice in an Arbitrazh court is performed

[1] I am informed that this document along with the document annexed as Exhibit 3 to the declaration of Larissa Riabchenko (an actual photocopy later obtained from Goskomimushchesvo of the RF) were found in the supervisory court file by Larissa N. Riabchenko and Ms. Riabchenko was not allowed to make photocopies therefrom. Pursuant to the 1995 Russian law, Ms. Riabchenko should not have been denied permission to photocopy documents from said file.

based upon the equality before the law irrespective of location, subordination, and the form of property," says Art. 6 of the Arbitrazh Procedural Code of the Russian Federation. Item 1 of the Decree of the Plenary Session of the High Arbitrazh Court No. 8 of February 25, 1998, "On some issues of the practice of resolution of disputes concerned with protection of property right and other material rights," says that "...The rights of ownership, use and disposal of their property of all property owners are subject to court protection in equal manner."

Violation of the principle of independence of judicial power

43. The participation of a representative of the highest level body of judicial power "in resolution of economic disputes and other issues in consideration by arbitrazh courts" (Art. 127 of the Russian Federation Constitution) in a consultation meeting organized at the highest level body of executive power, in order to discuss, in particular, the specific issues being considered by arbitrazh courts in a specific case and to develop recommendations to the General Prosecutor's Office of the Russian Federation and the High Arbitrazh Court (Items 6 and 7 of the decision of the consultation meeting at the Deputy Chairman of the Russian Federation Government V. I. Matvienko), makes doubtful the impartiality of both the High Arbitrazh Court and lower arbitrazh courts, in their consideration of cases in question, and is an unlawful form of "collaboration" between the bodies of judicial and executive power, and it violates the principle of division of authorities proclaimed in Article 10 of the Russian Federation Constitution.

44. A High Arbitrazh Court representative's participation in such a consultation meeting violates Provisions of Part 1, Art. 5 of the Federal Constitutional Law of December 31, 1996, "On Legal System of the Russian Federation," which states that "Courts perform judicial power independently, not dependent of anyone's will...".

45. Part 4, Art. 3 of the Code of Honor of the Russian Federation Judge (approved by the 2nd All-Russian Congress of Judges and adopted by the Council of Judges of the Russian Federation on October 21, 1993) allows judges to enter into contact in some form, including through intermediaries from the cabinet of judges, "with bodies of legislative and executive power or their officials, regarding issues of law, the legal system, or performance of justice but during such contacts no pressure can be exerted on a judge in relation to his performance of his professional duties and doubts do not rise regarding his impartiality." Violation of the code of judges' ethics is a misdemeanor that entails, pursuant to Art. 121 of the RF Law of June 26, 1992, "the Status of Judges in the Russian Federation," legal accountability including the termination of judiciary powers.

Exertion of Influence on Performance of Justice

46. In this case, the Chairman and other judges of the High Arbitrazh Court appear to have been pressured by the Deputy Chairman of the Russian Federation

Government. The exerted pressure exhibited by Item 7 of the decision of the consultation meeting on March 30, 2001 at the office of the Deputy Chairman of the Russian Federation Government, at which Senior Consultant of the High Arbitrazh Court's Administration of Generalization of Judicial Practice E. A. Lyubichev was given an "assignment" for High Arbitrazh Court Chairman V. A. Yakovlev (the same judge who rendered the December 18, 2001 decision). The suggested "assignment" was that Chief Justice Yakovlev should "carry out, in procedural forms established by law, court supervision over the cases in consideration by Arbitrazh Courts of Moscow and Moscow Circuit re: the appeals of the FSUE "Kinostudio "Soyuzmultfilm," the Moscow Region Prosecutor's Office, and the JSC "Kinostudio "Soyuzmultfilm." These measures are placed in the context of efforts by the bodies of executive power (Ministry of Culture of the Russian Federation, Ministry of Property of the Russian Federation, the Department of the Russian Agency for Patents and Trademarks "Rospatent", the General Prosecutor's Office of the Russian Federation) "to secure the activity of the FSUE," as if the High Arbitrazh Court was treated, not as the independent body of judicial power that it is supposed to be, but as if it was some mid-level department, one of, as it is said in the preamble to the decision, "the interested state organizations."

47. Such actions by the Deputy Chairman of the Russian Federation Government conflict with the provisions of Part 1, Article 120 of the Russian Federation Constitution, Part 2, Article 1 of the Federal Constitutional Law of December 31, 1996 "On Legal System of the Russian Federation," Article 6 of Federal Constitutional Law of

April 28, 1995 "On Arbitrazh Courts in the Russian Federation" which declare independence of the bodies of judiciary power from the bodies of executive powers.

Replacement of the Judiciary Supervision by Administrative Control

48. Another telling fact is also included as part of Item 7 of the decision of the consultation meeting of March 30, 2001 which presses the Chairman of the High Arbitrazh Court to perform improper actions. According to Art. 127 of the Russian Federation Constitution, Articles 9, 10, 15, 20 of the Federal Constitutional Law of April 28, 1995 "On Arbitrazh Courts in the Russian Federation," neither the Chairman of the High Arbitrazh Court, nor any other official of the said court, is endowed the right to carry out "court supervision over cases in consideration by Arbitrazh Courts of Moscow and Moscow Circuit," because such actions are deemed as unlawful interference into the court's activity (Part 5, Article 5 of the Federal Constitutional Law of December 31, 1996 "On the Legal System of the Russian Federation.") Bringing forth the protest as a matter of supervision and consideration of a case as a matter of supervision at the High Arbitrazh Court are solely possible upon the completion of court proceedings in the lower courts and only after the lower courts decisions take effect.

49. It is clear that in this case the term "'court supervision" acted as a euphemism for the concept of "control" which is confirmed by the use of the word "control" in the office memo of the High Court Senior consultant E. A. Lyubichev (Exhibit A) when he writes that at the consultation meeting at the Deputy Chairman of the Russian Federation Government "a wish was expressed about... the reinforcement of control on behalf of the General Prosecutor's Office and the High Arbitrazh Court of the Russian Federation over the decisions of the said courts."

The Potential Effectiveness of Interference by a High-Level Official of the Russian Government into Court Activity

50. All arbitration courts without exception acting on the Russian Federation territory (including those called arbitration courts for regions, krais, and other subjects of the Russian Federation) belong to the category of federal courts that act within the framework of the centralized court system under the jurisdiction of the Higher Arbitrazh Court. All Arbitrazh courts judges are appointed in Moscow. "The courts are financed only from federal budget..." (Article 124 of the Russian Federation Constitution). Similarly the court system of the general jurisdiction is structured, in which only the lowest level, the justice of the Peace, is not considered federal, yet is it still supported by the federal budget.

51. In consideration of economic disputes, no priority should be given to the state and those in possession of its property. Pursuant to Part 2, Article 8 of the Russian

Federation Constitution, "Russian Federation equally recognizes and protects private, state, municipal, and other property forms." The Federal Constitutional Law of April 28, 1995 "On Arbitrazh Courts in the Russian Federation" among the fundamental principles of the arbitrazh court activities names "the equality of organizations and citizens before the law and court" (Article 6.) "Justice in the arbitrazh court is implemented on the basis of equality of organizations before the law and the court regardless of the location, subordination, and property form," says Article 6 of the current Arbitrazh Procedural Code of the Russian Federation. Item 1 of the Decree of the Plenary Session of the Higher Arbitrazh Court of the Russian Federation No. 8 of February 25, 1998 "On some issues of the practice of resolution of disputes concerned with protection of property right and other material rights," says that "...The rights of ownership, use and disposal of their property of all property owners are subject to court protection in equal manner."

52. But in fact, there are reasons to presume that, especially after the suspension of court reform in 1995-1996, the courts began in some cases to pursue goals others than those in interest of the law, and adopted an orientation to the priority protection of narrowly understood state interests. From the Soviet period, the term of "telephone law" has been preserved. There are several reasons for it.

53. Arbitrazh courts were formed after the adoption of the R.S.F.S.R. Law of June 4, 1991, "On Arbitrazh Court" on the basis of the so-called State Arbitrazh of R.S.F.S.R. which was designed to resolve administratively (not judicially) disputes between socialist enterprises, with an implied objective of the priority guarding of the

Soviet State's interests and protection of "all-nation" (which again is the state's) property. The chairmen of arbitrazh courts, their deputies, and other judges for the most part were formerly employed as state arbitrators and have up to the present time preserved their former orientation.

54. The following fact could not but leave an imprint on the judges' minds which is that until August 7, 2000, the tasks of civil legal proceedings were recognized as the protection "of the Socialist economic system and Socialist property" (Part 1, Article 2 of the R.S.F.S.R. Civil Procedural Code), and judges were instructed to resolve "civil cases based on law, in accordance with the socialist sense of justice" (Article 7 of the R.S.F.S.R. Civil Procedural Code).

55. The current generation of Russian lawyers who have influential posts in the bodies of executive authority and non-prestigious court duties, have been raised in the spirit of the Soviet law, permeated by the idea of priority of state interest and will and state property over that of private property. The expression "private property" was risky to use for a career in social sciences even during "Perestroika" of 1985-1990. Until August 7, 2000, the tasks of civil legal proceedings were recognized as the protection of the Soviet social system, "socialist economic system and socialist property" (Part 1, Article 2 of the R.S.F.S.R. Civil Procedural Code, and judges and jurors were instructed to resolve "civil cases based on law, in accordance with the socialist sense of justice" (Article 7 of the R.S.F.S.R. Civil Procedural Code). This state approach is perpetuated by judges without any outside interference into their activity, simply by inertia.

56. According to Articles 44 and 46 of the Federal Constitutional Law of April 28, 1995, "On Arbitrazh Courts in the Russian Federation," Articles 30 and 33 of the Federal Constitutional Law of December 31, 1996, "On Legal System of the Russian Federation," the procurement of the activity of the whole system of Arbitrazh courts is placed upon the High Arbitrazh Court which depends on the Russian Federation Government for its allotment of budget items concerned with funding of the Arbitrazh courts.

57. The funding and procurement of Russian courts since 1917, has never been sufficiently adequate. In 1995-2000 the courts received from federal budgets the sums that covered no more than 30-40% of their expenses. In 2001, for the first time in the post-Soviet period, half of the budget request of the court system was satisfied. Court chairmen, including the heads of the Supreme Court of the Russian Federation and the Higher Arbitrazh Court, are interested in maintaining friendly relations with the authorities, especially because the judges and the staff of the aforementioned higher courts, while being on a relatively modest salary, receive far greater benefits (such as company cars, summer houses, low cost vacations at resorts, service in Kremlin hospitals and clinics for themselves and their families, clothing at special tailor's shops, passes to the exclusive cafeteria on Ilyinka street, and apartments) from the hands of the officials of the Russian Federation President's Administration.

58. Court chairmen appointed to this post for life have enormous power over regular judges and they use that power extensively in selecting their staff or forcing judges who do not compromise with their conscience, to leave or be laid off on defamatory grounds; and in arbitrarily distributing the cases. The court chairmen determine whether a judge is promoted, whether his family moves from a dorm to a separate apartment in the near future, whether he takes his vacation in the summer or winter.

59. Not by chance among the proposals to revive court reform, discussed today in Russia, that much thought is given to the following: improving courts funding, renovating court buildings (700 of which have been deemed dangerous because of possible collapse), limiting the term of court chairmancy for a judge to five years, introducing into the judges collegium judges who resolve issues of termination of judges' authorities and representatives of public rights activists.

Based on the aforementioned, I come to the following *conclusion*:

60. There are solid grounds to conclude that the ruling of the High Arbitrazh Court No. 8137/00 of December 18, 2001 was made in violation of the principle of the

lateral Investment Treaty does not address intellectual property protection specifically, its protections against discriminatory treatment, uncompensated expropriation, and submission of disputes to international arbitration would benefit U.S. investors who have had their investments in Russian, including intellectual property, confiscated or treated in a discriminatory fashion.

5. **U.S. copyright-based industries should review their price structures and, if possible, lower them to meet competition from pirated sources. At present, pirated music CDs sell for $2–3 each in Russia and licensed CDs cost $15. With average monthly incomes throughout Russia in the $100–150 range, the substantial price differential between pirated and licensed works is a huge factor supporting the demand for pirated works.**

Though I believe that these steps, if taken, will result in a substantial improvement in the protection of foreign intellectual property in Russia, it would be naïve to assume that this situation will improve dramatically overnight. Instilling a respect for the rights of intellectual property owners is only a subset of the larger problem of instilling a respect for the rule of law in Russia. This larger task will involve overcoming a thousand years of experience and habit.

International and domestic efforts to encourage a respect for the rule of law in Russia have met with mixed success at best, which should not be surprising. Fashioning a new legal culture, one that is not premised on deference to authority and a profound distrust of the state, is no easy matter. Most international technical assistance programs have focused on encouraging a respect for the rule of law at the grassroots level. While this is important and ultimately indispensable, I think it is unlikely by itself to succeed. In Russian society, courts, police, government officials, and ordinary citizens take their cues from the top. As long as senior government officials ignore the rule of law, other members of society will ignore it as well. That is why I believe the most effective policy the U.S. government can pursue is to take the specific steps suggested above and, in a broader sense, encourage the leaders of the Russian government to act themselves in a lawful manner—in a way that shows that they respect the law.

Perhaps the most constructive policy that President Putin could undertake would be to initiate a government campaign to remove corrupt government officials and those who interfere in the workings of the courts and other judicial agencies, and to curtail the power of the oligarchs and criminal organizations. It is only when President Putin and his senior officials model a respect for the law themselves that others in Russian society will take the rule of law seriously.

Again, I would like to thank the Subcommittee for the opportunity to discuss this important issue.

Table 1
RUSSIA
ESTIMATED TRADE LOSSES DUE TO PIRACY[1]
(in millions of U.S. dollars)
and LEVELS OF PIRACY: 1995–2002

INDUSTRY	*2002*		*2001*		*2000*		*1999*		*1998*		*1997*		*1996*		*1995*	
	Loss	*Level*	*Loss*	*Level*	*Loss*	*Level*	*Loss*	*Level*	*Loss*	*Level*	*Loss*	*Level*	*Loss*	*Level*	*Loss*	*Level*
Motion Pictures	250.0	80%	250.0	80%	250.0	90%	250.0	90%	312.0	85%	312.0	85%	312.0	95%	312.0	99%
Sound Recordings/ Musical Compositions	371.9	66%	285.0	64%	250.0	70%	200.0	70%	170.0	75%	165.0	65%	170.0	70%	180.0	73%
Computer Programs: Business Applications	93.9	87%	90.6	87%	89.0	88%	134.5	89%	196.1	92%	174.5	89%	298.2	91%	216.9	94%
Computer Programs: Entertainment Software	NA	90%	173.6	90%	NA	94%	241.1	95%	240.8	97%	225.8	95%	223.0	93%	189.9	91%
Books	40.0	NA	48.0	NA	48.0	NA	48.0	NA	45.0	NA	45.0	NA	45.0	NA	45.0	NA
TOTALS	**755.8**		**847.2**		**637.0**		**873.6**		**963.9**		**922.3**		**1048.2**		**943.8**	

[1] International Intellectual Property Alliance, *2000 Special 301 Report* (2000), at 138, and *2003 Special 301 Report* (2003), at 249. These reports are available on the IIPA's website, www.iipa.com..

PREPARED STATEMENT OF TIMOTHY P. TRAINER

The International AntiCounterfeiting Coalition (IACC) would like to thank the distinguished members of the Subcommittee for the opportunity to offer its views with respect to the links between intellectual property theft and organized crime and terrorism.

The IACC is a Washington, D.C.-based non-profit organization devoted solely to combating product counterfeiting and piracy. Formed in 1978, today it is comprised of a cross section of business and industry—from autos, apparel, luxury goods, and pharmaceuticals, to food, software and entertainment—the IACC's members' combined annual revenues exceed $650 billion. The touchstone of the IACC's mission is to combat counterfeiting and piracy by promoting laws, regulations and directives designed to render the theft of intellectual property undesirable and unprofitable. The IACC serves as an umbrella organization, offering anticounterfeiting programs designed to increase protection for patents, trademarks, copyrights, service marks, trade dress and trade secrets.

Critical to the IACC's purpose is its belief that acts of counterfeiting create severe public health and safety hazards, as well as economic harm. The IACC supports government actions that will ultimately result in increased enforcement, lead to the prosecution of intellectual property infringers, and create a strong deterrent to counterfeiters and pirates. In pursuing its mission, the IACC provides law enforcement officials with information and training to identify counterfeit and pirate products and in the methods of product security to prevent the infringement of its members' intellectual property rights.

In an effort to create conditions under which its members' intellectual property rights are safe from illegal copying, infringement and other forms of theft, the IACC engages in substantive dialogue with governments and intergovernmental organizations worldwide. In pursuing its mission, the IACC provides law enforcement officials with information and training to identify counterfeit and pirate products and in the methods of product security to prevent the infringement of its members' valuable intellectual property rights.

SCOPE OF INTELLECTUAL PROPERTY THEFT

There are no product lines, corporations, or consumers that escape the counterfeiters' and/or pirates' reach. Dangerous counterfeit products have appeared in retail stores across the United States. Organized crime is increasingly attracted by counterfeiting's high profits and relatively low criminal penalties. In addition, the manufacture, distribution and sale of counterfeit goods rob local economies of precious tax revenues, and costs Americans jobs.

Many pirate and counterfeit goods are not as visible as you might think. Many people think of the counterfeits and pirated products purely in terms of street vendors' products—music CDs, sunglasses, t-shirts, hats, cosmetics, cell phone covers, handbags and watches—bearing easily recognizable and known names and logos. But, on a different level, product counterfeiters and pirates are trading on names and logos often associated with things such as razor blades, shampoos, pharmaceuticals, foods, hand tools, auto parts, light bulbs, film, skin lotions, laundry detergent, band-aids, insecticides, batteries, cigarettes and practically anything else that bears a name that consumers are familiar with in the market place. Very few products, if any, are beyond the reach of skilled counterfeiters.

PUBLIC HEALTH AND SAFETY DANGERS

Of particular concern to IACC members and consumers is the increasing availability of fakes that present severe health and safety risks. For example, the World Health Organization estimates that counterfeit drugs account for ten percent of all pharmaceuticals. That number can rise to as high as sixty percent (60%) in developing countries.[1] In another case, and according to a federal indictment made public in May 2002, U.S. Customs officials seized 59,000 bottles of counterfeit vodka in a Massachusetts warehouse. The fake vodka had been imported from a former Soviet

[1] The Engineer, Fighting the Fakers, at 16 (April 26, 2002); Phillippe Broussard, Dangerous Fakes, World Press Review, v44, n1, p36 (1) (January 1999). According to the Shenzhen Evening News (a government owned newspaper), approximately 192,000 people died in China in 2001 because of fake drugs. China's Killer Headache: Fake Pharmaceuticals, Washington Post, August 30, 2002. The same article goes onto to state that, since 2001, Johnson & Johnson has established 38 criminal cases against different factories that copied its products in China.

republic.[2] In Estonia in 2001, illicit vodka containing methyl alcohol killed 60 people.[3] The problems, however, do not end with pharmaceuticals and alcohol.

In the 1990's, a major shampoo manufacturer was forced to place half-page advertisements in at least 27 national newspapers informing the general public that counterfeit versions of its shampoo were available in retail stores. Of particular concern to the manufacturer was the fact that the fake shampoo may have contained bacteria, risking infection in users with weakened immune systems.[4] Even more disturbing was the case where the operational life of counterfeit bearing seal spacers removed from a United Airlines plane were found to be only 600 hours—the genuine parts had an operational life of 20,000 hours. The fake parts came complete with fake boxes, labels and paperwork and were only discovered because of a very alert maintenance technician.[5] Finally, counterfeit-labeled infant formula found its way onto shelves in grocery stores in 16 states.[6]

For more examples relating to threats to the public health and safety, please refer to the attached document containing a list of relevant public source news articles and government reports compiled by the IACC.

LINKS TO ORGANIZED CRIME AND TERRORISM

In addition to the public safety issues, the IACC has spent years tracking the increasing influx of organized crime and terrorists into the lucrative under world of product counterfeiting and copyright piracy. These notorious organizations operate vast networks of counterfeit product distribution channels, and are often heavily involved in other criminal activity such as drug trafficking or money laundering.

Low risk of prosecution and enormous profit potential have made criminal counterfeiting an attractive enterprise for organized crime groups. Congress itself recognized organized crime's increasing role in the theft of intellectual property when it made both trademark counterfeiting and copyright piracy violations predicate acts under the federal RICO statute (see 18 U.S.C. § 1961). The federal money laundering statutes (18 U.S.C. δ§ 1956–57) similarly include trademark counterfeiting and copyright piracy violations as crimes that constitute the type of "specified unlawful activity" necessary for convictions under these statutes.

Recently, ties have also been established between counterfeiting and piracy and terrorist organizations that use the sale of fake and unauthorized goods to raise funds and launder money. Indeed, the United States Customs Service has explicitly stated that there is a link between terrorist organizations and intellectual property theft.[7] In addition, Operation Green Quest—a multi-agency task force established by the Treasury Department and aimed at identifying and dismantling the terrorist financial infrastructure—has specifically recognized counterfeit merchandise schemes as a source of terrorist funding.[8]

The attached list of public source news articles compiled by the IACC helps to detail, in alarming fashion, the extent of the connections between intellectual property

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[2] Thanassis Cambanis, Fancy Labels, Cheap Vodka Don't Mix, The Boston Globe, May 2, 2002, at B1.

[3] The Engineer, Fighting the Fakers, at 16 (April 26, 2002).

[4] Henry Gilgoff, Counterfeit: Rip-offs of Popular Products Victimize Both Consumers and Manufacturers, Newsday, August 27, 1995. Fake toothpaste has also found its way into drug stores. Colgate Warns People Against Fake Toothpaste, Austin American Statesman, August 12, 1996.

[5] Billy Stern, Warning! Bogus Parts Have Turned Up in Commercial Jets. Where's the FAA?, Business Week, June 10, 1996, at 90.

[6] See Marian Burros, F.D.A. Target: Baby Formula, N.Y. Times, September 6, 1995; 142 Cong. Rec. 5776 (House). More recently, in 1999, the Food and Drug Administration (FDA) issued a warning regarding counterfeit cans of infant formula for infants allergic to milk protein. The warning came after some of the illicit product had already been purchased. The FDA warning stated that infants who ingested the counterfeit formula could experience fevers, skin rashes or severe allergic reactions. FDA Warns About Infant Formula Fraudulently Labeled as Nutramigen in Southern California, HHS NEWS (U.S. Department of Health and Human Services), P99–23, October 8, 1999. See also Fugitive Who Sold Counterfeit Baby Formula Convicted of Federal Criminal Charges, Department of Justice (Press Release), August 9, 2002, available at http://www.cybercrime/gov/mostafaConvict.htm (discussing the conviction of Mohamad Mostafa on charges involving a conspiracy to sell counterfeit infant formula; the defendant was also in the country illegally and upon indictment in 1995 fled to Canada where he was arrested in 2001).

[7] See Kathleen Millar, Financing Terror, Profits from Counterfeit Goods Pay for Attacks, U.S. Customs Today, November 2002, available at http://www.customs.gov/custoday/nov2002/index.htm; Moving Up on the Outside, it's IPR Seizures, U.S. Customs Today, May 2002, available at http://www.customs.gov/xp/CustomsToday/2002/May/ost.xml; NBC News Miami Affiliate interview of U.S. Customs Agent (broadcast February 4, 2003)(tape of broadcast on file with the IACC).

[8] See Green Quest, Finding the Missing Piece of the Terrorist Puzzle, available at http://www.customs.ustreas.gov/xp/cgov/enforcement/investigative—priorities/greenquest.xml.

theft and organized criminal and/or terrorist groups and their potential devastating impact to both the American citizenry and economy. Consider just a few examples from that list:

(1) In February 2003, federal prosecutors in Brooklyn, N.Y. charged six men with importing up to 35 million counterfeit cigarettes from China into the United States. The men were accused of importing the fake cigarettes, then selling them through a tax free business located at an upstate New York Indian reservation and also through the website *http://www.smokecheap.com.* The cigarettes were allegedly imported into the United States in 5 separate shipments through New Jersey ports over a two tear period. The charging documents stated that the counterfeiters hid the cigarettes in shipping containers behind kitchen pots. According to the prosecutors, the men were under investigation in Europe for cigarette smuggling. Two of the defendants were also charged with importing counterfeit batteries from China via Lithuania.[9]

(2) In 1996, the FBI confiscated 100,000 counterfeit T-shirts bearing fake and unauthorized Nike "swoosh" and/or Olympic logos that were intended to be sold at the 1996 Summer Olympic Games. The operation generated millions of dollars and was run by the followers of Sheik Omar Abdel Rahman—a blind cleric who was sentenced to 240 years in prison for plotting to bomb New York City landmarks. Authorities seized three floors worth of illicit merchandise, stacked seven feet high.[10]

(3) There have been recent media accounts reporting a link between the terrorist organization Al Qaeda and the trafficking of counterfeit goods. An investigation, involving several countries, into a shipment of fake goods from Dubai to Copenhagen, Denmark, suggests that Al Qaeda itself may be funding itself by trafficking in counterfeit goods. Danish customs, using sophisticated risk analysis software, examined one of the containers on board and discovered that it contained over one thousand crates full of counterfeit shampoos, creams, cologne and perfume. The goods were ultimately bound for the United Kingdom. The United Kingdom later revealed that the sender of the counterfeit goods was a member of Al Qaeda. This connection was later confirmed by the European Commission's Customs Coordination Office. The intelligence services of three countries—Denmark, the United Kingdom and the United States—were, according to the same report, involved in investigating the matter.[11]

(4) On January 16, 2003 William Haskell Farmer entered a guilty plea to trafficking in a massive counterfeit clothing operation. (The guilty plea was conditional upon an appeal to the United States Court of Appeals for the Fourth Circuit). According to the United States prosecutor, the scheme involved approximately $7 million in knock off T-shirts and sweat shirts. Farmer sold the shirts to 191 stores throughout the country. United States Customs agents seized over 300,000 fake items from Farmer's home and warehouse (the house was a two-story home with a swimming pool and two car garage). Farmer agreed to forfeit over $500,000 in cash and cashier's checks, eight vehicles, (including two Mercedes Benzs and a 1998 Corvette), and two cargo trailers. The cash had been seized in 1998 when Farmer's home was searched. The majority of the money was in $50 and $100 bills. There was $6,000 worth of change in the garage.[12]

(5) Police in the Chinatown section of New York City uncovered a stash of fake watches, handbags, sunglasses and wallets worth over $125 million that were hidden in a building that contained secret tunnels, trapdoors and vaults. Ten people were arrested.[13]

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[9] See William Glaberson, 6 Are Charged With Selling Millions of Counterfeit Marlboros, The New York Times, February 21, 2003, at sec. B, pg. 3; John Marzulli, Fake Marlboro Men Busted in Smuggling Ring, Daily News (New York), February 21, 2003, at 37.

[10] See John Mintz & Douglas Farah, Small Scams Probed for Terror Ties, Washington Post, August 12, 2002, at A1.

[11] Al-Qa'idah Trading in Fake Branded Goods, BBC Monitoring Reports (September 11, 2002); Lenore Taylor, Big Business Targets Terrorist Pirates, Australian Financial Review, January 29, 2003, at 9.

[12] Clif LeBlanc, Huge Fake Clothing Ring Cracked, Upstate Man Pleads Guilty to Running $7 Million Scam, The State (South Carolina), January 18, 2003, at A1; South Carolina Man Pleads Guilty to Trafficking Clothing with Counterfeit Trademarks, Department of Justice Press Release, January 16, 2003, available at http://www.cybercrime.gov/farmerPlea.htm.

[13] Erika Martinez & Marsha Kranes, Knockoffs Knocked Out, New York Post (May 10, 2002).

(6) In November 2001, US federal authorities made their largest seizure ever of counterfeit computer software in connection with the arrest of the individuals. The seizure of nearly 31,000 copies of phony software was valued at approximately $100 million (US). The software originated in Taiwan and was encased in counterfeit packaging (including holographs and registration codes) and also came with manuals. Federal authorities were alerted to the shipment when a member of a criminal syndicate operating between Taiwan and Los Angeles allegedly attempted to bribe an undercover agent who was posing as a U.S. Customs official. Seized in connection with the arrests were a forty foot shipping container containing counterfeit computer software and packaging material, two forty foot containers filled with 85,000 cartons of counterfeit cigarettes (i.e., 17 million cigarettes). A second search warrant executed in connection with the investigation resulted in the seizure of 21 cartons of counterfeit end user license agreements, manuals, bar codes, adhesive labels and registration cards.[14]

These are just a few examples. For more stories about the well documented links between intellectual property theft and organized crime and terrorism, please refer to the attached document containing a list of relevant public source news articles and government reports compiled by the IACC.

The IACC believes that the best deterrent to counterfeiting and piracy is criminal penalties that result in actual imprisonment. Based on this policy, the IACC has led efforts that resulted in the passage of the 1984 Trademark Act that established federal criminal sanctions for trademark counterfeiting,[15] the Anticounterfeiting Consumer Protection Act of 1996 that increased civil penalties and provided U.S. Customs with the authority to assess administrative fines against those that import counterfeit products,[16] and the establishment of specific criminal provisions for trademark counterfeiting in 31 states and the District of Columbia. By providing federal and state law enforcement officials with the jurisdiction to prosecute counterfeiters, and U.S. Customs with the discretion to penalize known importers of counterfeit merchandise, the IACC has sought to promote a comprehensive enforcement system to stop illegal goods at the borders, punish manufacturers and distributors of counterfeit products in interstate commerce, and address counterfeiting at the retail level within the states, counties and cities where it is most prevalent.

Recent world events have caused federal and state government officials to correctly reevaluate the mission priorities of law enforcement personnel to address national security issues. As pointed out above, the IACC is concerned that the low risk, high-profit nature of counterfeiting and piracy has and will continue to attract the attention of organized crime and terrorist groups looking to fund their operations. The IACC and its members look forward to working with Congress, law enforcement and the new Department of Homeland Security to identify and eliminate links between counterfeiting and the funding of terrorist groups that may arise in the course of protecting U.S. economic interests and intellectual property rights.

CONCLUSION

On behalf of the IACC, I thank the Members of the Subcommittee for providing me with the opportunity to present this written testimony and, based on the documented links I have presented herein, urge the United States Government to investigate more aggressively the links between all types of intellectual property theft and organized criminal and terrorist groups.

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[14] Taiwan Fears US Blacklist After Fake Software Haul, The Strait Times (Singapore), November 19, 2001, at A3; U. S Customs Seizes $100 Million in Pirated Computer Software, Biggest Case in U.S. History, Department of Justice Press Release, November 16, 2001, available at http://www.cybercrime.gov/operationwhitehorse.htm.

[15] See 18 U.S.C. § 2320.

[16] See 19 U.S.C. § 1526(f).

ATTACHMENT

FACTS ON FAKES

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Introduction

Mr. James Moody, former chief of the Federal Bureau of Investigation's Organized Crime/Drug Operations Division declared that counterfeiting would become "the crime of the 21st century."
-- *George W. Abbott. Jr. and Lee S. Sporn, Trademark Counterfeiting § 1.01 (2001).*

The DOJ's own prosecution guidelines for intellectual property offenses contain the following pertinent passage:

> *The importance of intellectual property to the national economy, and the scale of intellectual property theft, led the Department of Justice to designate intellectual property crime as a "priority" for federal law enforcement. As the U.S. Attorneys' Manual recognizes, "from time to time the Department establishes national investigative and prosecutorial priorities. These priorities are designed to focus Federal law enforcement efforts on those matters within the Federal jurisdiction that are most deserving of Federal attention and are most likely to be handled effectively at the Federal level." U.S. Attorneys' Manual 9-27.230(B)(1) (comment).*
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> *Intellectual property crimes were formally designated a "priority" by Deputy Attorney General Eric Holder on July 23, 1999. Deputy Attorney General Eric Holder, Remarks at Press Conference Announcing the Intellectual Property Rights Initiative (Jul. 23, 1999)(http://www.cybercrime.gov/dagipini.html). In announcing the Intellectual Property Rights Initiative, Deputy Attorney General Holder stated that the Department of Justice, the Federal Bureau of Investigation and the United States Customs Service had concluded that they must make investigating and prosecuting intellectual property crime "a major law enforcement priority." In making the announcement, he noted that:*
>
> > *[a]s the world moves from the Industrial Age to the Information Age, the United States' economy is increasingly dependent on the production and distribution of intellectual property. Currently, the U.S. leads the world in the creation and export of intellectual property and IP-related products.*
>
> *Deputy Attorney General Holder also observed that "[a]t the same time that our information economy is soaring, so is intellectual property theft." Since intellectual property theft undermines the federally established copyright and trademark systems, it is especially appropriate that investigation and prosecution of these crimes be a federal law enforcement priority.*

-- United States Department of Justice Prosecuting Intellectual Property Crimes Manual http://www.usdoj.gov/criminal/cybercrime/ipmanual/96ipma.htm#V1.A.1.a. (Section six of this manual is entitled: Charging and Other Strategy Considerations for Infringement Cases). The manual was drafted by the Computer Crime and Intellectual Property Section (CCIPS) of the Department of Justice and the entire manual can be accessed at http://www.usdoj.gov/criminal/cybercrime/ipmanual.htm.

Economic Impact of Counterfeiting

The size and scope of product counterfeiting has skyrocketed in recent years. The United States economy is losing millions of dollars in tax revenue and tens of thousands of jobs because of the manufacture, distribution and sale of counterfeit goods. This decrease in revenue results in fewer schools, hospitals, police, roads, etc. The actions of counterfeiters also make it harder for legitimate retailers to compete in the marketplace. Counterfeiting results in decreased retail sales and lost jobs as honest intellectual property owners are forced to cut back work forces because of decreased sales. Counterfeiters are not innocent little con artists or isolated street peddlers simply trying to make a few extra dollars. The truth is they steal from the corporations, steal from the community, steal from the consumers they deceive and are only concerned with lining their own pockets.

(1) The Business Software Alliance estimates the cost of software piracy alone to be about $12 billion a year.

(2) The International Chamber of Commerce estimates that seven percent of the world trade is in counterfeit goods and that the counterfeit market is worth $ 350 billion. George W. Abbott, Jr. and Lee S. Sporn, *Trademark Counterfeiting* § 1.03[A][2] (2001).

(3) In 1982 the International Trade Commission estimated counterfeiting and piracy losses at 5.5 billion. In 1996, that number stood at $200 billion. (Bank robberies, by contrast, involve less than $50 million per year, but seem to garner more public attention and more law enforcement resources). -- *S. Rep. No. 104-177, 104th Cong., 1st Sess. 1-2 (1995);* George W. Abbott, Jr. and Lee S. Sporn, *Trademark Counterfeiting* § 1.03[A][2] (2001).

(4) Counterfeit automobile parts, like brake pads, cost the auto industry alone over $12 billion dollars in lost sales. If these losses were eliminated the auto industry could hire 200,000 additional workers. George W. Abbott, Jr. and Lee S. Sporn, *Trademark Counterfeiting* § 1.03[A][2] (2001); Richard C. Noble, *From Brakes to Plugs to Engines, Counterfeiters Produce, Push Parts,* Flint J., September 3, 1995; H.R. Rep. No. 104-556 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1074, 1075.

(5) Lost tax revenue costs New York City alone approximately $350 million a year in lost revenue -- *Joseph Scott, He Is the Fashion Police, New York, March 6, 1995, at 38.* According to a 1993 Business Wire release, product counterfeiting is believed to cost

California $7.5 billion a year and 25, 000 jobs. In Michigan, a piracy rate of 14.7% translates into $64.7 million in retail losses and $34.9 million in lost tax revenue. *BSA Seeks to Sink Software Pirates,* Grand Rapids Business Journal, vol. 20, No. 18, pg. 3 (May 6, 2002).

Organized Crime/Terrorism & Counterfeiting – Examples

Low risk of prosecution and enormous profit potential have made criminal counterfeiting an attractive enterprise for organized crime groups. Congress recognized organize crime's increasing role in the theft of intellectual property when it made trademark counterfeiting and copyright piracy predicate acts under the federal RICO statute (see 18 U.S.C. § 1961). Recently, ties have been established between counterfeiting and terrorist organizations who use the sale of fake goods to raise and launder money. Consider these facts about the presence of organized criminal and terrorist groups in the underground counterfeiting and piracy markets:

(1) Operation Green Quest -- a multi-agency task force established by the Treasury Department and aimed at identifying, disrupting and dismantling the terrorist financial infrastructure and sources of funding -- has specifically recognized counterfeit merchandise schemes as a source of terrorist funding. *Green Quest, Finding the Missing Piece of the Terrorist Puzzle,* available at http://www.customs.ustreas.gov/xp/cgov/enforcement/investigative_priorities/greenquest.xml.

(2) In February 2003, federal prosecutors in Brooklyn, NY charged six men with importing up to 35 million counterfeit cigarettes from China into the United States. The men were accused of importing the fake cigarettes, then selling them through a tax free business located at an upstate New York Indian reservation and also through the website http://www.smokecheap.com. The cigarettes were allegedly imported into the United States in 5 separate shipments through New Jersey ports over a two tear period. The charging documents stated that the counterfeiters hid the cigarettes in shipping containers behind kitchen pots. According to the prosecutors, the men were under investigation in Europe for cigarette smuggling. Two of the defendants were also charged with importing counterfeit batteries from China via Lithuania. William Glaberson, *6 Are Charged With Selling Millions of Counterfeit Marlboros,* The New York Times, February 21, 2003, at sec. B, pg. 3; John Marzulli, *Fake Marlboro Men Busted in Smuggling Ring,* Daily News (New York), February 21, 2003, at 37.

(3) On February 28, 2003, Mohamad Hammoud was sentenced to 155 years in prison for helping to lead a cigarette smuggling operation that sent money to Hezbollah. *Ringleader Gets Maximum Sentence in Scheme to Help Hezbollah,* available at http://www.foxnews.com/story/0,2933,79909,00.html.

(4) In the Philippines, underground CD production lines are often heavily secured sites equipped with hidden cameras for early detection and surveillance purposes. Syndicates move the equipment in piece by piece to avoid detection. Dave L. Llorito, *Loose Rules Make CD Pirates Feel at Home Here,* The Manila Times (January 2, 2003)(a three part article); *Lax Rules Give CD Pirates a New Home in the Philippines,* The Straits Times (January 6, 2003).

(5) There have been recent media accounts reporting a link between the terrorist organization Al Qaeda and the trafficking of counterfeit goods. An investigation, involving several countries, into a shipment of fake goods from Dubai to Copenhagen, Denmark, suggest that Al Qaeda itself may be funding itself by trafficking in counterfeit goods. Danish customs, using sophisticated risk analysis software, examined one of the containers on board and discovered that it contained over one thousand crates full of counterfeit shampoos, creams, cologne and perfume. The goods were ultimately bound for the United Kingdom. The United Kingdom later revealed that the sender of the counterfeit goods was a member of Al Qaeda. This connection was later confirmed by the European Commission's Customs Coordination Office. The intelligence services of three countries -- Denmark, the United Kingdom and the United States -- were, according to the same report, involved in investigating the matter. -- *Al-Qa'idah Trading in Fake Branded Goods,* BBC Monitoring Reports (September 11, 2002); Lenore Taylor, *Big Business Targets Terrorist Pirates,* Australian Financial Review, January 29, 2003, at 9.

(6) On January 16, 2003 William Haskell Farmer entered a guilty plea to trafficking in a massive counterfeit clothing operation. (The guilty plea was conditional upon an appeal to the United States Court of Appeals for the Fourth Circuit). According to the United States prosecutor, the scheme involved approximately $7 million in knock off T-shirts and sweat shirts. Farmer sold the shirts to 191 stores throughout the country. United States Customs agents seized over 300,000 fake items from the Farmer's home and warehouse (the house was a two-story home with a swimming pool and two car garage). Farmer agreed to forfeit over $500,000 in cash and cashier's checks, eight vehicles, (including two Mercedes Benzs and a 1998 Corvette), and two cargo trailers. The cash had been seized in 1998 when Farmer's home was searched. The majority of the money was in $50 and $100 bills. There was $6,000 worth of change in the garage. Clif LeBlanc, *Huge Fake Clothing Ring Cracked, Upstate Man Pleads Guilty to Running $7 Million Scam,* The State (South Carolina), January 18, 2003, at A1; *South Carolina Man Pleads Guilty to Trafficking Clothing with Counterfeit Trademarks*, Department of Justice Press Release, January 16, 2003, *available at* http://www.cybercrime.gov/farmerPlea.htm.

(7) Counterfeit operations in Paraguay tri-border region may have been used to raise money to support terrorist operations and groups. *Feds Track Counterfeit Goods Sales,* available at: http://abcnews.go.com/wire/US/ap20021024_151.html. (October 24, 2002); Kathleen Millar, *Financing Terror,* U.S. Customs Service Monthly Newsletter, November 2002, available at http://www.customs.gov/custoday/nov2002/index.htm; Larry Rother, *South America Region Under Watch for Signs of Terrorists,* The New York

Times, December 15, 2002, at 32; Sebastian Junger, *Terrorism's New Geography,* Vanity Fair, December 2002. The first article cited states:

> *"Federal authorities have several investigations under way examining evidence suggesting that Hezbollah, Hamas and other terror networks might be selling counterfeit products to pay for their worldwide activities. . . . FBI, Customs Service and other agencies are investigating the sale of stolen or counterfeit computer software, T-shirts and handbags that are suspected of benefiting terrorist networks. Officials said the schemes span the globe from Paraguay to Pakistan .... U.S. officials said there is particular concern that a region in South America famous for counterfeit products may have ties to terrorism. The region near the borders of Paraguay, Brazil and Argentina has a large Arab population. Law enforcement officials said they are investigating multimillion-dollar counterfeit software operations based in Ciudad Del Este, in eastern Paraguay, that are believed to have diverted money to Middle Eastern groups with ties to terrorism. Some of the suspects are of Lebanese origin and were arrested by Paraguayan authorities based on information from the U.S. government, the officials said."*

(8) A 52 year old woman was one of four people arrested in November 2001 after being suspected of operating a piracy ring that imported close to $100 million in fake software and computer products from Taiwan. The woman was recently sentenced to nine years in prison and ordered to pay $11 million in restitution to two software companies. *Woman Must Pay $11m in Software,* http://www.cnn.com/2002/TECH/biztech/11/25/counterfeit.software.ap/index.html, November 25, 2002.

(9) According to some media reports, the FBI had compiled strong evidence that the 1993 terrorists financed their activities with counterfeit textile sales from a store on Broadway. James Nurton, *Why Counterfeiting is Not So Harmless,* Managing Intellectual Property, September 2002, at 43; *Feds Track Counterfeit Goods Sales,* at http://abcnews.go.com/wire/US/ap20021024_151.html (October 24, 2002)(noting that testimony before a Senate Judiciary Committee in 1995 confirmed this fact). In 1996, *Business Week* reported that that the FBI had investigated the link between counterfeit merchandise sales in New York and the terrorists who bombed the World Trade Center in 1993. Willy Stern, *Why Counterfeit Goods May Kill,* Business Week, September 2, 1996, at 6.

(10) According to the private investigator conducting the search, a raid of a souvenir shop in mid-town Manhattan led to the seizure of a suitcase full of counterfeit watches and the discovery of flight manuals for Boeing 767s, some containing handwritten notes in Arabic. A similar raid on a counterfeit handbag shop in New York uncovered faxes relating to the purchase of bridge inspection equipment. Two weeks after the raid on the handbag shop, police in New Jersey were investigating an assault on a Lebanese member of an organized crime syndicate. During a search of the man's apartment, authorities

found fake drivers' licenses and lists of suspected Al Qaeda terrorists – including the names of some workers in the handbag shop that had been raided. James Nurton, *Why Counterfeiting is Not So Harmless,* Managing Intellectual Property, September 2002, at 43.

(11) Paramilitary groups in Northern Ireland funded their terrorist activities through the sale of pirate products, including the sale of the Lion King. -- Kathleen Millar, *Financing Terror,* U.S. Customs Service Monthly Newsletter, November 2002, available at http://www.customs.gov/custoday/nov2002/index.htm; Nick Somerlad, *Two Arrested After Police Find Explosives,* Press Association, December 20, 2000.

(12) In July 2002, three individuals were arrested when police stumbled upon 5,000 fake Rolex watches and Mount Blanc pens and $1 million in cash during a raid of a Flushing (Queens), New York home in connection with a drug operation. Prosecutors stated that the defendants used the sale of counterfeit items to launder drug money. Scott Shifrel, *3 Charged in Money Laundering,* Daily News (New York), July 11, 2002, at 4.

(13) Recovered Al Qaida terrorist training manuals revealed that the organization recommends the sale of fake goods as one means to raise funds to support terrorist operations. John von Radowitz, *Fake Internet Goods 'Linked to Terrorists',* Press Association, June 25, 2002. This same article noted that Hezbollah traffics in counterfeit pharmaceuticals. John von Radowitz, *Fake Internet Goods 'Linked to Terrorists',* Press Association, June 25, 2002.

(14) The Basque terrorist group ETA in southern Spain is involved in the sale of counterfeit clothes and handbags. John von Radowitz, *Fake Internet Goods 'Linked to Terrorists',* Press Association, June 25, 2002.

(14) Police in the Chinatown section of New York City uncovered a stash of fake watches, handbags, sunglasses and wallets worth over $125 million that were hidden in a building that contained secret tunnels, trapdoors and vaults. Ten people were arrested. – Erika Martinez & Marsha Kranes, *Knockoffs Knocked Out,* New York Post (May 10, 2002).

(15) In February 2002, John Sankus Jr., 28, of Philadelphia, was sentenced to 46 months in prison leading an international piracy ring responsible for copying and distributing software, games and movies. Sankus headed an international software piracy group called DrinkorDie , which was comprised of about sixty members from numerous countries including the United States, Australia, Norway, Finland and the UK. The group's biggest claim to fame was distributing copies of Windows 95 two weeks before the official release of the operating system. Federal agents conducted raids at Duke University and MIT in connection with DrinkorDie's activities. Some of the computers seized in the operation contained more than one terabyte of hacked software (which is equal to 700,000 floppy disks). - - Josh White, *Pa. Man Admits Internet Conspiracy,* Washington Post, at B02, (February 28, 2002).

(16) On December 14, 2001, Mark Dipadova (who used three aliases) was sentenced to 24 months in prison and three years of supervised release and ordered to pay over $135,000 in restitution for operating websites through which he sold counterfeit goods. Dipadova and his partner shipped over 10,000 packages, both domestically and internationally and had been sued civilly by trademark holders. At his sentencing hearing, Dipadova admitted to posting a link on one of his websites to an audio recording of a radio interview in which he stated that he was aware that his actions were illegal but that he refused to stop because he was making too much money. *Defendant Who Operated Fakegifts.com Sentenced,* Department of Justice Press release, December 17, 2001, *available at* http://www.cybercrime.gov/DipadovaSent.htm.

(17) In November 2001, US federal authorities made their largest seizure ever of counterfeit computer software in connection with the arrest of the individuals. The seizure of nearly 31,000 copies of phony software was valued at approximately $100 million (US). The software originated in Taiwan and was encased in counterfeit packaging (including holographs and registration codes) and also came with manuals. Federal authorities were alerted to the shipment when a member of a criminal syndicate operating between Taiwan and Los Angeles allegedly attempted to bribe an undercover agent who was posing as a U.S. Customs official. Seized in connection with the arrests were a forty foot shipping container containing counterfeit computer software and packaging material, two forty foot containers filled with 85,000 cartons of counterfeit cigarettes (i.e., 17 million cigarettes). A second search warrant executed in connection with the investigation resulted in the seizure of 21 cartons of counterfeit end user license agreements, manuals, bar codes, adhesive labels and registration cards. *Taiwan Fears US Blacklist After Fake Software Haul*, The Strait Times (Singapore), November 19, 2001, at A3; *U. S Customs Seizes $100 Million in Pirated Computer Software. Biggest Case in U.S. History,* Department of Justice Press Release, November 16, 2001, *available at* http://www.cybercrime.gov/operationwhitehorse.htm.

(18) The speed and brazenness of Italian counterfeiting groups was demonstrated the summer of 2001 when burglars broke into the headquarters of a prominent Italian luxury goods/apparel producer. An investigation of the incident revealed that the only items missing as a result of the break-in were samples of the designer's 2002 men's spring/summer collection. It is now assumed that counterfeiters stole the samples to copy them before the genuine products made it to market. The sale of fake leather goods alone in Italy is estimated at $1.4 billion. Robert Galbraith, Luxury Groups Battle a Wave of Counterfeit Goods, *The International Herald Tribune*, p. 12 (September 29, 2001).

(19) In November 2001, a Cocoa Florida businessman was convicted of conspiracy to distribute and possession of cocaine and crack cocaine, trafficking in counterfeit merchandise and carjacking. When he was arrested police seized $150,000 in cash and truckloads of counterfeit clothing. -- John Tuohy, *Testimony from Felons Help Convict Cocoa Man.* Florida Today, (November 27, 2001).

(20) In 1996, the FBI confiscated 100,000 counterfeit T-shirts bearing fake and unauthorized Nike "swoosh" and/or Olympic logos that were intended to be sold at the

1996 summer Olympic games in 1996. The operation generated millions of dollars and was run by the followers of Sheik Omar Abdel Rahman – a blind cleric who was sentenced to 240 years in prison for plotting to bomb New York City landmarks. -- John Mintz & Douglas Farah, *Small Scams Probed for Terror Ties,* Washington Post, August 12, 2002, at A1. Authorities seized three floors worth of illicit merchandise, stacked seven feet high.

(21) In 1993, law enforcement officials in New York raided a large warehouse in New York and discovered numerous fake handbags. What was unusual was what they found sewn into the lining of the handbags. The ring of drug smugglers would smuggle in the drugs this way, sell the drugs and then sell the bags. Essentially, they used contraband to hide other contraband. George W. Abbott, Jr. and Lee S. Sporn, *Trademark Counterfeiting* § 1.03[B] (2001); S. Rep. 104-177. 104th Cong., 1st Sess. (1995).

Health & Safety Concerns/Dangers

"Perhaps most troubling is the widespread threat counterfeiting poses to public health and safety. Few Americans truly appreciate the significance, scope or consequences for this crime."

Senator Orrin G. Hatch (R-UT)
Chairman, Senate Judiciary Committee
Press Conference, August 9, 1995

(1) A survey conducted by the Nigerian Institute of Pharmaceutical Research revealed that 80 percent of drugs in the major pharmacy stores in Lagos, Nigeria were fake or counterfeit. *Nigeria Reaffirms Efforts to Eliminate Fake Drugs,* Xinhua General News Service, February 13, 2003.

(2) According to the Shenzhen Evening News (a government owned newspaper), approximately 192,000 people died in China in 2001 because of fake drugs. *China's Killer Headache: Fake Pharmaceuticals,* Washington Post, August 30, 2002. The same article goes onto to state that, since 2001, Johnson & Johnson has established 38 criminal cases against different factories that copied its products in China.

(3) Diet pills imported into Japan (from China) were blamed for at least four deaths and 160 cases of illness. Dozens of people were suffering from liver disorders. -- *Chinese Diet Pill Casualties Mount,* http://www.cnn.com/2002/WORLD/asiapcf/east/07/21/japan.pills/index.html, July 21, 2002.

(4) According to a federal indictment made public in 2002, U.S. Customs officials seized 59,000 bottles of counterfeit vodka in a Massachusetts warehouse. It had been imported from a former Soviet republic. Thanassis Cambanis, *Fancy Labels, Cheap Vodka Don't Mix,* The Boston Globe, May 2, 2002, at B1.

(5) In August 2002, Bell Helicopter sued two aircraft maintenance and repair companies for trademark counterfeiting. -- James E. Swickard (editor), *Bell Helicopter is Suing Two Companies Specializing in Aircraft Maintenance and Repair,* Business & Commercial Aviation, Vol. 91, No. 2, p. 33 (Intelligence Section)(August 2002).

(6) In New York it was discovered that a 16 year old liver transplant recipient had received eight weeks worth of injections of a counterfeit drug (Epogen) to treat his anemia and raise the child's red blood cell count. The treatments, instead of improving the boy's condition, caused excruciating aches and spasms. The vials used for the injections were supposed to contain 40,000 units of the drug, instead the counterfeit version contained only 2,000 units. Other counterfeit lots were found in Texas. --- Ridgely Ochs, *Sounding Alarm on Counterfeit Drugs; FDA Investigating Recent of Fake Drug Cases,* New York Newsday, at 6 (June 12, 2002).

(7) Other counterfeit drug cases include a meningitis vaccine made of tap water, birth control pills made of wheat flour, and paracetamol syrup made of industrial solvents. The Engineer, *Fighting the Fakers,* April 26, 2002, at 16; House Report of the Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, *Prescription Drug Diversion and Counterfeiting,* July 10, 1985, at 23 (referring to a scam involving counterfeit birth control pills).

(8) In 2002, a New York County district attorney charged seven people and five companies in the US, China and India with selling counterfeit Viagra over the Internet. Undercover officers purchased over 25,000 pills. Some pills were smuggled into the U.S. in stereo speakers and stuffed toys. One supplier told the agents that he could supply 2.5 million tablets a month. Counterfeits hit market within two weeks. – *U.S. Officials Arrest Viagra Counterfeiters,* Scrip, May 22, 2002; Ridgely Ochs, *Sounding Alarm on Counterfeit Drugs; FDA Investigating Recent of Fake Drug Cases,* New York Newsday, at 6 (June 12, 2002).

(9) In 2001, illicit vodka containing methyl alcohol killed 60 people in Estonia. The Engineer, *Fighting the Fakers,* at 16 (April 26, 2002).

(10) Counterfeit version of the AIDS drug circulated in the US in late 2000; the drug was not effective and caused skin irritations. -- The Engineer, *Fighting the Fakers,* April 26, 2002, at 16; Jim Shamp, *Glaxo Sends Out Warning About AIDS Drug.* The Herald-Sun, May 14, 2002 (discussing a case of counterfeit labels applied to the wrong type of AIDS drug).

(11) Seventeen people in the US died between May 1999 and January 2000 after taking a powerful, but counterfeit, antibiotic. The Engineer, *Fighting the Fakers,* at 16 (April 26, 2002).

(12) World Health Organization estimates that counterfeit drugs account for ten percent of all pharmaceuticals. That number can rise to as high as 60% in developing

countries. The Engineer, *Fighting the Fakers,* at 16 (April 26, 2002); Phillippe Broussard, *Dangerous Fakes,* World Press Review, v44, n1, p36 (1) (January 1999).

(13) An August 2001 news article reported a host of actions by the Saudi Arabian Ministry of Commerce against distributors attempting to sell potentially unhealthy products. Among the unhealthy products seized were 7,000 bottles of imitation Vaseline and related fake creams found while investigating cosmetic shops. A November 2001 raid at a counterfeit factory in Jeddah resulted in the seizure of 10,000 packets of jelly, 650,000 packets of macaroni, 12,000 bottles of perfume, and 5,000 brake pads. The factory employed 120 workers who were involved in producing fake cardboard cartons, cans and bottles.

(14) Over 100 children died in Nigeria in 1990 after taking cough syrup that was actually antifreeze. Phillippe Broussard, *Dangerous Fakes,* World Press Review, v44, n1, p36 (1) (January 1999).

(15) Counterfeit versions of infant formula were found on the shelves of grocery stores in 16 different states. Marian Burros, *F.D.A. Target: Baby Formula,* N.Y. Times, September 6, 1995; 142 Cong. Rec. 5776 (House). More recently, in 1999, the Food and Drug Administration (FDA) issued a warning regarding counterfeit cans of infant formula for infants allergic to milk protein. The warning came after some of the illicit product had already been purchased. The FDA warning stated that infants who ingested the counterfeit formula could experience fevers, skin rashes or severe allergic reactions. *FDA Warns About Infant Formula Fraudulently Labeled as Nutramigen in Southern California,* HHS NEWS (U.S. Department of Health and Human Services), P99-23, October 8, 1999. *See also Fugitive Who Sold Counterfeit Baby Formula Convicted of Federal Criminal Charges,* Department of Justice (Press Release), August 9, 2002, *available at* http://www.cybercrime/gov/mostafaConvict.htm (discussing the conviction of Mohamad Mostafa on charges involving a conspiracy to sell counterfeit infant formula; the defendant was also in the country illegally and upon indictment in 1995 fled to Canada where he was arrested in 2001).

(16) One counterfeiter in California filled genuine Coke bottles with his own soda like beverage and offered them for sale as genuine Coca-Cola. *United States v. Petrosian,* 126 F.3d 1232 (9th Cir. 1997).

(17) Counterfeit parts have been discovered in helicopters sold to NATO, in jet engines, bridge joints, and fasteners in areas of nuclear facilities responsible for preventing the meltdown of the reactor itself. H.R. Rep. 104-556 (1996).

(18) In the mid 1990s a major shampoo producer was forced to place newspaper ads in over 25 papers to warn consumers to the presence of fake shampoos that contained unsafe levels of bacteria. Henry Gilgoff, *Counterfeit: Rip-offs of Popular Products Victimize Both Consumers and Manufacturers,* Newsday, August 27, 1995. Fake toothpaste has also found its way into drug stores. *Colgate Warns People Against Fake Toothpaste,* Austin American Statesman, August 12, 1996.

(19) A Norwegian plane crash in 1989 that killed 55 people resulted, in part, from substandard shear bolts and sleeves of an unknown origin. *55 Killed in Crash of Norwegian Plane, None Aboard Survive as Craft Plunges into Sea Near Denmark,* L.A. Times, September 9, 1989, at 4 (cited and discussed in Robert W. Luedeman, *Flying Underground: The Trade in Bootleg Aircraft Parts,* 62 J. Air L. & Comm. 9396-100 (August/September 1996).

(20) The FAA estimates that 2% of the 26 million airline parts installed each year are counterfeit (that equals 520,000 parts). Billy Stern, *Warning! Bogus Parts Have Turned Up in Commercial Jets. Where's the FAA?,* Business Week, June 10, 1996, at 90.

(21) The operational life of counterfeit bearing seal spacers removed from a United Airlines plane were found to be 600 hours - - the genuine parts had an operational life of 20,000 hours - - the fake parts came complete with fake boxes, labels and paperwork and were only discovered because of a vigilant airline mechanic. In another case, Delta Airlines discovered that an engine mount cone-bolt, (a device which actually fastens the engine to the plane), on one of its planes was actually counterfeit. Billy Stern, *Warning! Bogus Parts Have Turned Up in Commercial Jets. Where's the FAA?,* Business Week, June 10, 1996, at 90.

(22) In 1987, seven children died when the bus they were riding in flipped over. The brakes that were just installed on the bus bore a well-known trademark. Further examination, however, showed they were made of sawdust. *A System Approach to the Counterfeit Problem. Genuine or Bogus: How Can You Tell?,* ASTM Standardization News, April 1990, at 38.

(23) In a federal case in California the court determined the defendant sold counterfeit helicopter parts that caused several helicopters to crash resulting in injuries and death. S. Rep. No. 98-526 at 4 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3627, 3630-31.

(24) One million counterfeit birth control pills caused internal bleeding in women. S. Rep. No. 98-526 at 4 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3627.