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Protecting America's Intellectual Property:

A Legislative History of the Pro IP Act of 2008

Volume 3

Document Numbers 37–45

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INTERNATIONAL IPR REPORT CARD—ASSESSING U.S. GOVERNMENT AND INDUSTRY EFFORTS TO ENHANCE CHINESE AND RUSSIAN ENFORCEMENT OF INTELLECTUAL PROPERTY RIGHTS

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

DECEMBER 7, 2005

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INTERNATIONAL IPR REPORT CARD—ASSESSING U.S. GOVERNMENT AND INDUSTRY EFFORTS TO ENHANCE CHINESE AND RUSSIAN ENFORCEMENT OF INTELLECTUAL PROPERTY RIGHTS

WEDNESDAY, DECEMBER 7, 2005

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

The Subcommittee met, pursuant to notice, at 10:17 a.m., in Room 2141, Rayburn House Office Building, the Honorable Lamar Smith (Chairman of the Subcommittee) presiding.

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

I'm going to recognize myself for an opening statement, then the Ranking Member, Mr. Berman of California, for an opening statement. Then I want to represent the gentleman from California, Mr. Issa, for comments, as well, because he is the author of a resolution that was approved on the House floor recently to deal with the subject at hand.

I also want to compliment the gentleman from California, Mr. Issa, because I believe, with the exception of the Chairman and the Ranking Member, that he has the best attendance record on this Subcommittee of anyone. And that is both appreciated and will be remembered. I'll recognize myself for an opening statement.

The evidence continues to show that the government of the People's Republic of China is engaged in a long-term effort to steal sensitive and proprietary technologies from U.S. industry. Last week, Federal judges in Los Angeles ordered Chi Mak, an electrical engineer who worked as a defense contractor, and his brother Tai Mak, who also is in the Chinese military, to be held without bond in a case prosecutors believe could be among the most damaging cases of Chinese technology spying.

In court papers, Chi Mak has reportedly admitted passing restricted data for 22 years—including sensitive information on the DBX destroyer, the Aegis weapons system, and a U.S. study that reveals the methods to be used by U.S. warship personnel to continue operating after being attacked—to Chinese military intelligence handlers.

This kind of technology spying and theft of intellectual property pose serious threats to our country's long-term economic and na-

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tional security interests. No two governments are more adept at exploiting U.S. weaknesses in protecting technology than the governments of China and the Russian Federation.

U.S. policy is motivated by a sincere desire to encourage these governments to respect individual rights, including the right to profit from the legitimate use and licensing of intellectual property rights. Our hope is that the Chinese and Russian governments will ultimately develop into reliable and dependable allies in the fight to protect intellectual property rights. Yet that hope must be grounded in reality, and not motivated by wishful thinking.

Unfortunately, there is little in the present record to indicate a sincere desire by the political leadership of these nations to respect the rights of U.S. intellectual property owners. In numerous international and bilateral agreements, China and Russia assume the duty to provide adequate and effective enforcement of intellectual property rights in return for the United States and other nations lowering trade barriers to their goods. The political leadership of each nation has prospered by being permitted to reap the benefits of international trade, without being held accountable for their own commitments.

Their record stands in stark contrast to the countless assurances, guarantees, and commitments to honor their obligations that have been made to the most senior officials of the United States Government.

One of the most offensive examples of intransigence was reported in the December 1st edition of the Moscow Times. In an article entitled, "Envoy: Licensed DVDs Cost Too Much," Alexander Kotenkov, who is President Putin's representative in the Russian Parliament's upper chamber, stated at a conference "devoted to the fight against piracy" that he often purchased illegally-made discs for plane trips, paying the equivalent of $3.12 for a DVD that contains five or six films.

President Putin's representative went on to blame copyright owners for piracy, by stating that Russian citizens are not at fault for being unable to buy licensed discs, because the costs of legitimate discs are too high.

I am confident, in connection with any future consideration of Russian accession to the WTO, the United States Congress will consider the extension of permanent normal trade relations with Russia. In the absence of a real, sustained, and verifiable commitment by the highest levels of the Russian government to protect the legitimate rights of intellectual property owners, I will continue to oppose U.S. support for the extension of PNTR and for Russia's admission to the WTO.

I have no intention of watching while Russia becomes the next China; a result that I am concerned could ultimately lead to an erosion of U.S. public support for the WTO and the rules-based trading system that it was intended to implement.

Our witnesses today will bring the Subcommittee up to date on the developments that have transpired since May 17, when this Subcommittee held back-to-back hearings on Chinese and Russian IP theft.

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

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Mr. BERMAN. Thank you very much, Mr. Chairman, for scheduling this hearing on international intellectual property piracy. I actually hope the Subcommittee can institutionalize the practice of having at least one hearing a year that focuses on international trade and products protected by intellectual property rights.

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

Because of the massive copyright piracy that occurs daily in China and Russia, the sales of black market goods cause an annual loss of revenue to American creators that is truly staggering. According to the International Intellectual Property Alliance, piracy rates in the copyright industries range from a low of 70 percent to a high of 95 percent. And American industries annually lose over $2½ billion in China, and almost $2 billion in Russia.

But it is not only the copyright industries, entertainment, software, book publishing, etcetera, that suffer. We could probably have an entire hearing only on counterfeiting of motorcycle parts, purses, and pharmaceuticals. No industry is immune from the endemic intellectual property violations occurring in these two countries.

The problem in both China and Russia is similar. While the laws may be on the books, actual enforcement of those laws is sorely lacking. Few criminal prosecutions have taken place, and even fewer sentences have been meted out. There's currently no true deterrent for the pirates. In fact, piracy has become the foundation for new businesses that export these black market goods.

The one effective tool the current Administration has to incentivize the Chinese government to address its piracy problem is pursuing a WTO case. At the last hearing on this issue, the USTR testified that they were, "committed to ensure that China is compliant with its obligations. And we will take WTO action if, in consultation with you and with our industry, we determine that this is the most effective way to fix the problem that we are resolved to fix."

When I asked whether 6 months would be a reasonable time frame to reach a conclusion, the answer was that it could be. So here we are, 6 months later, and I'm looking forward to an update from that office.

Furthermore, have additional avenues for mitigating the effect of piracy in China been explored by the current Administration? Currently, the Chinese government engages in vast restrictions on market access for American copyrighted goods. They restrict the number of American films that can be shown, and severely curtail the right of our companies to do business in their country. These barriers make the impact of piracy that much greater, and virtually impossible for our companies to counteract piracy.

With Russia, there is still some leverage, because they have not joined WTO yet. I took note of the Chairman's comments in his opening statement on this subject.

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A number of months ago, I, along with a number of other Democrats, wrote Ambassador Portman advising him. And these were Democrats who were inclined—on a number of occasions

have been willing to support free trade agreements. We wrote a letter to Ambassador Portman, advising him that in order to obtain our support for any future trade agreement, we would have to be assured that the lesson taught from allowing China to join the WTO without provision for adequate enforcement against intellectual property violations has been learned.

In fact, just last week, IIPA submitted comments for the Special 301 Out-of-Cycle review on Russia. It's not encouraging news: "In short, Russia is not complying with its commitments to provide adequate and effective copyright protection and enforcement."

Furthermore, the House in a bipartisan vote—I believe that was the gentleman from California, Mr. Issa's resolution—recognized Russia's failure to adequately protect intellectual property, and cautioned that without change they are at risk of losing GSP benefits and accession to the WTO.

The last time, we discussed the complexity of denying GSP benefits to a country, a process which requires consultation of most agencies within the Executive Branch. It's clear that in Congress we all agree that this situation is quite outrageous, and that a country that flagrantly violates American intellectual property rights should not receive GSP duty-free benefits. So I ask, since the last hearing, has there been any movement on the status of Russia's GSP benefits?

If motivated, these countries can protect intellectual property rights. When piracy hurts the Chinese interests, the Chinese government has been motivated to step in. When knock-offs of the Beijing summer 2008 game logos on T-shirts were being sold, the markets were quickly cleared. In short, China can deal with this problem, if it has the political will, and when it has the political will.

In Russia, it seems incredible that the Russian government actually controls the facilities and land on which many of these pirate optical disc plants operate. How can it simply do nothing to shut down the plants operating on these government-run installations?

I'm looking forward to hearing from the witnesses to learn what benchmarks or time lines have been established to help guide a decision on a WTO case against China, the withdrawal of GSP duty-free benefits from Russia, and whether Russia is aware that they will be denied admission to the exclusive WTO club unless the piracy problem is addressed. I'm looking forward to hearing about other steps that are being taken to protect American creativity. Thank you, Mr. Chairman.

Mr. SMITH OF TEXAS. Thank you, Mr. Berman. The gentleman from California, Mr. Issa, is recognized for his comments.

Mr. ISSA. Thank you, Mr. Chairman and Ranking Member Berman. Thank you for your leadership in seeing that the resolution, which had to be pushed through the Ways and Means Committee, saw the floor, and certainly showed the Administration, in addition to the Russians, that we are determined not to make the same mistake we made with China.

I, personally, voted in support of the Permanent Normalized Trade; and obviously, it led to WTO admission for China. That is

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a vote that I deeply regret. I'm a dyed-in-the-wool free-trader; but free trade is about fair trade.

Briefly, I wanted to echo some of the comments that the Ranking Member and the Chairman made, which are if you have countries which believe, support, and in fact participate in theft, it doesn't matter what their justification is. The truth is that Russia and China hide under the theory that they cannot afford—that they are poor countries; they cannot afford to pay that, as was said in the opening statements. The fact is, Russia has become the number-two, soon to be the number-one seller into Europe of counterfeit goods.

Obviously, Russia believes that Europe can also not afford—Luxembourg, with a per-capita GDP similar to the United States, cannot afford—to pay a fair price, unless of course Russia is making a profit on it.

There is no question that this behavior is part of a culture in the old Soviet Union and the still technically communist China, that intellectual property is not real property, and that in fact it is a right of the state. That attitude and the legislation and the enforcement have to be changed.

I believe that with the Chairman's leadership, that we can continue to echo the message to the Administration, Trade Representative here today, that we shall not, under any basis, allow for accession to the WTO—which I do have to disagree with the Ranking Member slightly. I'd like to say it was exclusive, but with over 140 members, the truth is Russia stands out by its absence as a country prohibited—rightfully so—prohibited from entering this no longer so exclusive club because of their action. Their action is reprehensible.

And I'll close with this. Less than 6 months ago, I was in Russia; and I've been assured by a group that was there over the break, it's still the same. If you can drive the main streets of Moscow and see them offering MPEG-4, MP-3, formats for movies and for music that are not offered from the makers in their original form, on the main streets in large neon signs—and of course, offering an opportunity to buy "Star Wars" long before it was out on DVD—it is very clear that they are unapologetic for their theft of intellectual property.

And as Mr. Berman, I believe, noted, also, they don't have a problem at all stealing other property from us in the defense industry, and in fact in every area of manufacturing. And I thank the Chairman and the Ranking Member.

Mr. BERMAN. Would the gentleman yield?

Mr. ISSA. I'd be glad to yield.

Mr. BERMAN. On the issue of the exclusivity, it reminds me of the Groucho Marx line: "Why would you want to get in any club that would take you?"

Mr. ISSA. "That would have you as a Member." Absolutely. And with that, I yield back.

Mr. SMITH OF TEXAS. Thank you, Mr. Issa. It's nice of us to have a united front up here.

Before we hear from the witnesses, I'd like to ask you to stand and be sworn in.

[Witnesses sworn.]

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Mr. SMITH OF TEXAS. Please be seated. Our first witness is Chris Israel, who serves as the Coordinator for International Intellectual Property Enforcement. Mr. Israel was appointed to this newly created position, which is housed at the U.S. Department of Commerce, in July 2005, by President George W. Bush. In this capacity, Mr. Israel is tasked with coordinating and leveraging the resources of the Federal Government to improve the protection of U.S. intellectual property at home and abroad.

Before accepting his current position, Mr. Israel served in a variety of assignments at the Department of Commerce, many of which focused on advancing U.S. innovation and technology leadership.

I am told that today's testimony will mark the first time that Mr. Israel has testified before a Committee of Congress since accepting his new responsibilities.

His ability to ensure the development of a sustainable and comprehensive national and international enforcement policy for the protection of U.S.-based intellectual property rights is of vital and continuing interest to this Subcommittee.

Mr. Israel received his BA from the University of Kansas, and his MBA from the George Washington University.

Our second witness is Victoria Espinel, who is the [Acting] Assistant U.S. Trade Representative for Intellectual Property in the Office of the United States Trade Representative. In that capacity, Ms. Espinel serves as the principal U.S. trade negotiator on intellectual property.

Ms. Espinel's office chairs the intra-agency committee that conducts the annual Special 301 Review of international protection of intellectual property rights. The latest report was published on April 29, 2005. Subsequent to its publication, Ms. Espinel appeared before the Subcommittee to deliver testimony on the subjects of intellectual property theft in China and Russia. She will be providing this Subcommittee with an update on developments, as well as a status report on the substantial challenges that remain.

Ms. Espinel holds an LLM from the London School of Economics, a JD from Georgetown University, and a BS in foreign service from Georgetown University's School of Foreign Service.

Our third witness is Eric H. Smith, who serves as the President of the International Intellectual Property Alliance, a private-sector coalition of seven U.S. trade associations which is based in Washington, D.C. IIPA represents over 1,900 companies that produce and distribute materials protected by copyright laws throughout the world. A founder of IIPA, Mr. Smith frequently serves as the principal representative of the copyright industries in WTO, TRIPS, and Free Trade Agreement negotiations.

Mr. Smith has a JD from the University of California at Berkeley, a BA from Stanford, and an MA from the School of Advanced International Studies at Johns Hopkins.

Our final witness is Joan Borsten, who is President of Films by Jove, Inc., a California-based production and distribution company that acquired worldwide rights to much of the animation library of Moscow's—is it Soyuzmultfilm?—Studio in 1992.

Ms. Borsten received her BA in comparative literature from the University of California at Berkeley, and her MS in bilingual education at USC.

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Welcome to you all. We have witness statements from all of the witnesses on this panel. Without objection, their complete testimony will be made a part of the record.

As you all know, we trust that you will limit your testimony to 5 minutes; which we look forward to. And Mr. Israel, we will begin with you.

TESTIMONY OF CHRIS ISRAEL, COORDINATOR FOR INTERNATIONAL INTELLECTUAL PROPERTY ENFORCEMENT, U.S. DEPARTMENT OF COMMERCE

Mr. ISRAEL. Thank you, Mr. Chairman. Chairman Smith, Ranking Member Berman, and Members of the Committee, I'm pleased to be able to be here today to join you and my counterparts on this panel to discuss the challenge of international intellectual property rights enforcement.

I want to first thank the Committee for their continued support and leadership on issues concerning the protection of intellectual property. I look forward to the opportunity to work together to ensure that the heart of America's thriving innovation economy, its intellectual property, is effectively protected around the world.

Combating piracy and counterfeiting is a top priority for the Bush Administration. President Bush has consistently raised IP enforcement with foreign leaders; placed it on the agenda of the G8; and made it a key part of the recent U.S./EU summit. He has also discussed our ongoing concerns with leaders of critical markets such as China and Russia. In addition, he has directed his Administration to address the issue actively, aggressively, and with a results-oriented approach.

The reasons IP enforcement is a priority for this Administration are very clear. Few issues are as important to the current and future economic strength of the United States as our ability to create and protect intellectual property.

Enforcement of intellectual property also carries great consequence for the health and safety of consumers around the world, because fake goods don't just hurt business; they hurt people.

Finally, the theft of American intellectual property strikes at the heart of one of our greatest comparative advantages: our innovative capacity.

The Office of International Intellectual Property Enforcement is located at the Department of Commerce, and I report to Secretary Gutierrez. We also work under the leadership of the White House, and we have been met with tremendous cooperation from all Federal agencies that contribute to our overall IP enforcement efforts.

A very critical element of our overall coordination is the Strategy Targeting Organized Piracy, the STOP Initiative, launched by the Bush Administration in October 2004. This initiative brings together USTR, Commerce, Justice, Homeland Security, and the State Department. STOP has yielded tangible results and received attention around the world.

The STOP Initiative and our new Office of International Intellectual Property Enforcement allows us to deliver a clear message: The United States takes the issue of intellectual property enforcement very seriously; we are leveraging all of our resources to ad-

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dress it; and we have very high expectations of all of our global trading partners.

As this Committee clearly understands, the problem of global piracy and counterfeiting exists in many industries and countries, and demands continuous attention. With finite resources and seemingly infinite concerns, how we focus our efforts is critical.

The Bush Administration is focused on six key priorities. First, we are working to empower America's innovators. Through specific tools and broad education efforts, we are getting the word out to American businesses that they must be aggressive and proactive in protecting their rights.

Secondly, we are focused on preventing counterfeit and fake goods from penetrating our borders. This means casting a wider net, utilizing technology, and working with our trading partners to share information.

Third, we are working to prevent fake and counterfeit goods from corrupting legitimate supply chains. We have worked closely with the Coalition Against Counterfeiting and Piracy to develop voluntary guidelines companies can use to ensure their supply and distribution chains are free of counterfeits.

Fourth, U.S. law enforcement is leading efforts to dismantle criminal enterprises around the world that steal intellectual property. The Justice Department has pursued numerous operations targeting criminal organizations involved in online piracy and trafficking in counterfeit goods.

Fifth, we are working with our trading partners to build international support for IP enforcement. Through the Joint Committee for Commerce and Trade, the JCCT, for example, we have worked extensively with China to address rampant IP concerns. And just last week, we reached an agreement to work much more closely with the European Union to combat global piracy.

Lastly, we are educating other governments about intellectual property rights and how important IPR is to the global economy. To date, over 100 IPR enforcement projects and 290 IPR technical assistance projects have been conducted around the world.

Mr. Chairman, the Bush Administration is committed to stopping intellectual property theft and providing businesses with the tools they need to flourish in a global economy. As I work to coordinate the U.S. Government's efforts, and with your continued support and the partnership of this Committee, we will be able to do even more on behalf of American innovators, researchers, entrepreneurs, artists, and workers.

We must take advantage of the opportunity to work together to better protect the knowledge industries of today, so that we may continue to see the innovations and growth of tomorrow. Thank you, Mr. Chairman.

[The prepared statement of Mr. Israel follows:]

PREPARED STATEMENT OF CHRIS ISRAEL

Chairman Smith, Ranking Member Berman and members of the Committee, I am pleased to join you today to discuss the challenge of international intellectual property rights enforcement.

I want to thank the Committee for its continued support and leadership on issues concerning the protection of intellectual property. I look forward to the opportunity

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to work together to ensure that the heart of America's innovation economy, its intellectual property, is effectively protected around the world.

The Bush Administration is keenly aware of the significance of IP protection for American businesses, workers, entrepreneurs and innovators. It is estimated that IP theft costs U.S. businesses approximately $250 billion annually and results in the loss of hundreds of thousands of American jobs. Combating piracy and counterfeiting is a top priority for this Administration. This prioritization is evident in the leadership shown by President Bush. He has consistently raised IP enforcement with foreign leaders, placed the issue on the agenda of the G8 and made it a key part of the recent U.S./EU summit. He has also discussed our ongoing concerns with leaders of critical markets such as China and Russia. He has directed his Administration to address this issue actively, aggressively and with a results-oriented approach.

I appreciate the opportunity to discuss this leadership, to address our efforts to maximize the Federal government's role in protecting American intellectual property and to share our results-oriented strategy.

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LEADERSHIP AND PRIORITIZATION

The reasons for the Administration's leadership on IP enforcement and for its prioritization are clear.

First, few issues are as important to the current and future economic strength of the United States as our ability to create and protect intellectual property. U.S. IP industries account for over half of all U.S. exports. They represent 40% of our economic growth and employ 18 million Americans who earn 40% more than the average U.S. wage, and a recent study valued U.S. intellectual property at approximately $5 trillion—or about half of U.S. GDP. Quite simply, our ability to ensure a secure and reliable environment for intellectual property around the world is critical to the strength and continued expansion of the U.S. economy.

The enforcement of intellectual property rights also carries great consequence for the health and safety of consumers around the world. The World Health Organization estimates that 10% of all pharmaceuticals available worldwide are counterfeit. The U.S. Federal Aviation Administration estimates that 2% of airline parts installed each year are fake—or about 520,000 parts. And we have seen counterfeit circuit breakers that overheat and explode, brake linings made of wood chips and cardboard, and fake power cords. In the world of today's sophisticated criminal IP operations, if a product can be easily counterfeited, has an immediate demand and provides a good profit margin it will be copied. Consumer safety and product quality are concerns obviously not on the minds of global IP thieves.

Finally, the theft of American intellectual property strikes at the heart of one of our greatest comparative advantages—our innovative capacity. Through the applied talents of American inventors, researchers, entrepreneurs, artists and workers we have developed the most dynamic and sophisticated economy the world has ever seen.

And I truly believe the world is a much better place due to these efforts. We have delivered life-saving drugs and products that make people more productive. We have developed entirely new industries and set loose the imaginative power of entrepreneurs everywhere. And, we set trends and market best-of-class products to nearly every country in the world.

We value our heritage of innovation and exploration—it is not only part of our history; it is the key to our future.

And this future—a future of innovation, exploration and growth that benefits the entire world—rests on a basic, inherent respect for intellectual property rights and a system that protects them.

The Bush Administration's effort to provide a secure and predictable global environment for intellectual property is driven by a commitment to foster U.S. economic growth, to secure the safety and health of consumers everywhere, and an abiding respect for the great American innovative spirit that has driven our nation since its founding and will determine our future.

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ORGANIZATION AND EFFECTIVE ENGAGEMENT

This is my first opportunity to testify as the Coordinator for International Intellectual Property Enforcement, and I appreciate the chance to discuss how the Administration is working to focus and leverage our vast capabilities and resources.

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The Office of International Intellectual Property Coordination is located at the Department of Commerce, and I report to Commerce Secretary Carlos Gutierrez. We also work under the leadership of the White House, and our efforts thus far have met with tremendous cooperation from the all federal agencies that contribute to our IP enforcement efforts.

Reinforcing the commitment and collaboration that exists within this interagency process is the fact that a senior Justice Department official is currently serving as the Deputy Coordinator for International Intellectual Property Coordination and Customs and Border Protection and the Patent and Trademark Office have both provided detailees to support our efforts.

A critical element in our overall coordination is the Strategy Targeting Organized Piracy (STOP) Initiative launched by the Bush Administration in October 2004. STOP has built an expansive interagency process that provides the foundation and focus for all of our efforts. This initiative is led by the White House and brings together USTR, the Department of Commerce, the Department of Justice, the Department of Homeland Security and the State Department. STOP is an attempt to play offense in the global fight against piracy and counterfeiting. The agencies involved have identified ways to empower U.S. businesses to better protect their IP, increase efforts to seize counterfeit goods at our borders, pursue criminal enterprises involved in piracy and counterfeiting, found innovative ways to work with U.S. industry, and aggressively engaged our trading partners to join our efforts.

STOP has yielded tangible results (Fact Sheet is submitted for the record), maintained the commitment of senior Administration officials, institutionalized an unprecedented level of coordination within the federal government and received attention around the world. The message that the STOP Initiative, and indeed our new Office of International Intellectual Property Enforcement, allows us to deliver is—the United States takes the issue of IP enforcement very seriously, we are leveraging all of our resources to address it and we have high expectations of all of our global trading partners.

In addition to the infrastructure put in place by the STOP Initiative and reinforced by the Office of International Intellectual Property Enforcement, the Administration will seek a reinvigorated role for the National Intellectual Property Law Enforcement Coordination Council (NIPLECC). NIPLECC is tasked with coordinating domestic and international intellectual property law enforcement in order to ensure the effective and efficient enforcement of intellectual property in the United States and worldwide. NIPLECC has made a number of valuable contributions since its creation in 1999 including the development of a comprehensive database that includes all recent IP law enforcement training provided by the U.S. government to developing and least developed nations as well as delivering legislative suggestions to improve domestic IP laws related to enforcement. However, there is unmet potential and in my role as Director of NIPLECC I look forward to working with this Committee to ensure that we are maximizing the capabilities of NIPLECC. To begin this effort, I can report that we will conduct a meeting of all NIPLECC members in January. This will be the most comprehensive NIPLECC meeting since its inception in 1999.

NIPLECC can play a vital role in our effort by bringing together the leaders of the key operational entities within the federal government that are responsible for IP enforcement. By establishing priorities and objectives at a senior level we will reinforce our day-to-day activities and ensure that all of the agencies critical to the federal government's IP enforcement efforts are closely coordinated and committed to a common results-oriented agenda. In addition to the existing NIPLECC structure—which is comprised of the Department of Justice (Assistant Attorney General of the Criminal Division), the Commerce Department (Under Secretary for Intellectual Property and Director of the Patent and Trademark Office and Under Secretary for International Trade), the Office of the U.S. Trade Representative (Deputy USTR), the Department of Homeland Security (Commissioner of Customs and Border Protection) and the State Department (Under Secretary for Economics, Business and Agricultural Affairs).

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STRATEGY AND FOCUS

As this Committee clearly understands, the problem of global piracy and counterfeiting confronts many industries, exists in many countries and demands continuous attention. With finite resources and seemingly infinite concerns, how we focus our efforts is crucial. I appreciate this opportunity to share with you the key areas which make up the Administration's overall Strategy for Targeting Organized Piracy.

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First, we are working to **empower America's innovators to secure and enforce their rights at home and abroad.** Our efforts to provide new federal services and assistance include:

- A hotline (1–866–999–HALT) to counsel businesses on how to protect their IP.
- A website *(www.stopfakes.gov)* and brochure, to provide information and guidance to right holders on how to register and protect their IP in markets around the world.
- "IP toolkits" to guide businesses through securing and enforcing their rights in key markets around the world. Available at the *www.stopfakes.gov* website, toolkits for China, Russia, Mexico, Korea and Taiwan are downloadable.
- Extensive education campaigns across the country to teach small and medium sized enterprises how to secure and protect their rights and where to turn for federal resources and assistance. These seminars have occurred in 20 states and more are planned in 2006.
- An online recordation tool for rights holders to record their trademarks and copyrights with Customs and Border Protection.
- We have launched a China Intellectual Property Rights (IPR) Advisory Program in conjunction with the American Bar Association, the National Association of Manufacturers and the American Chamber of Commerce in China to provide legal counsel for SMEs to protect and enforce their IPR in China.
- Training for U.S. embassy personnel to be effective first responders to IPR issues in order to identify problems abroad and assist rights holders before fakes enter the market and/or supply chain.

Next, we need to increase our efforts to **stop fake and counterfeit goods at America's borders.** This means:

- Casting a wider, tighter net on counterfeit and pirated goods by implementing new risk assessment models and technologies to stop counterfeit goods at our borders.
- Working with trading partners to share information and improve our capabilities to assess and anticipate risks. We have seen results of this effort with the European Union. At the U.S./EU Economic Ministerial last week, leaders of both governments committed to expand information sharing of customs data. Follow-up work on this commitment has already begun.

We need to **build international support and rules to stem the flow of fake and counterfeit goods and keep them out of global supply chains.** Our efforts here include:

- Commissioning a study by the Organization for Economic Cooperation and Development on the impact of global counterfeiting and piracy.
- Conducting outreach to Canada, the European Commission, France, Germany, Hong Kong, Japan, Korea, Mexico, Singapore and the United Kingdom laying the basis for increasing cooperation on IP enforcement. Outreach to other like-minded countries is underway.
- Facilitating the transfer of IP criminals to justice in America by revising and modernizing mutual legal assistance treaties and extradition treaties with Finland, Sweden, Belgium, Spain, the UK and Luxembourg. Additional treaties are under negotiation.
- Conducting post-entry audits to identify companies vulnerable to IP violations and working with them to correct their faulty business practices.
- Working closely with U.S. industry—namely, the Coalition Against Counterfeiting and Piracy, a U.S. Chamber of Commerce and National Association of Manufacturers led association—on the "No Trade in Fakes" program to develop voluntary guidelines companies can use to ensure their supply and distribution chains are free of counterfeits.

Law enforcement must play a leading role in **dismantling criminal enterprises that steal intellectual property.** We have:

- Pursued numerous operations targeting criminal organizations involved in online piracy and trafficking in counterfeit goods. We have indicted the four leaders of one of the largest counterfeit goods operations ever uncovered in New England—broke up a scheme to sell more than 30,000 luxury goods—including handbags, wallets, sunglasses, coats, shoes, and necklaces, and found the materials to manufacture at least 20,000 more counterfeit items.

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- Led Operation Site Down, an international online piracy investigation involving more than 90 searches in twelve countries. Such cases have led to numerous arrests and convictions around the globe, seizure of millions of dollars worth of pirated products and the dismantling of criminal operations.
- Led Operation Ocean Crossing, a joint U.S. and Chinese law enforcement action that disrupted an organization trafficking in counterfeit pharmaceuticals. The action resulted in arrests in China and the United States and the capture of hundreds of thousands of fake pharmaceuticals.
- Executed measures to maximize law enforcement's ability to pursue perpetrators of IPR crimes. For example, we increased from 5 to 18 the total number of Computer Hacking and Intellectual Property Units in U.S. Attorneys' Offices across the country. This increased to 229 (one in each federal district) the number of specially trained prosecutors available to focus on IP and high-tech crimes.
- Proposed the *Intellectual Property Protection Act of 2005* to strengthen criminal intellectual property protection, toughen penalties for repeat copyright criminals, and add critical investigative tools for both criminal and civil enforcement authorities.

We must **reach out to our trading partners and build international support.** U.S. leadership is critical and we are active on a number of fronts:

- We have obtained endorsement of increased protection for IP in multilateral forums such as the G–8 and Asia-Pacific Economic Cooperation forum, and bilateral venues with the European Union and China.
- The past year has resulted in particularly strong commitments from China in a variety of fora. Within the Joint Committee on Commerce and Trade (JCCT) the Chinese have committed to, among other things, address the proliferation of illegal software within government and state-owned enterprises, increase criminal prosecutions for IP violations, enhance cooperation with U.S. law enforcement and join the WIPO Internet Treaties. We have already seen movement on a number of these commitments. Notably, Attorney General Gonzales laid the groundwork for expanded law enforcement cooperation on IP cases during a recent trip to China and China recently sent a delegation to the United States to discuss the steps necessary to accede to the WIPO Internet Treaties. In addition, USTR has recently invoked a procedure under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights to make a formal request for China to provide detailed information regarding their IP enforcement regime. The Japanese and Swiss governments also delivered similar requests to China for enforcement data under the same WTO provision.
- Noting the interest this Committee showed in increased cooperation with the European Union and Japan at its hearing in May, I would like to point to two significant developments. Just last week, Secretary Gutierrez reached an agreement with European leaders to significantly expand the cooperation between the United States and EU to address global piracy through stepped-up commitment to enforcement and information sharing.
- We are increasing the number of U.S. IP attaches abroad in our embassies located in China, India, Brazil and Russia, who will assist U.S. businesses, advocate U.S. intellectual property policy and conduct IPR training.

Finally, we must **educate other governments about intellectual property rights:**

- The United States has conducted numerous training and capacity building programs working with foreign judges and law enforcement officials from around the world to improve criminal and civil IPR protection. So far, we have conducted over 100 IPR enforcement projects and 290 IPR technical-assistance projects around the world, producing real results in IP protection and enforcement.
- We have established a Global Intellectual Property Academy to consolidate and expand intellectual property training programs for foreign judges, enforcement officials, and relevant administrators.

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Mr. Chairman, the Bush Administration is committed to stopping intellectual property theft and providing businesses the tools they need to flourish in the global economy. As I work to coordinate the U.S. government's intellectual property en-

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forcement efforts, and with your continued support and the partnership of this Committee, we will be able to do even more to provide American businesses and innovators with the protection they need. America's intellectual property is important not just for her national security, but it is also a necessary component in ensuring continued U.S. economic growth and technological leadership. We must take advantage of the opportunity to work together to better protect the knowledge industries of today so that we may continue to see the innovations of tomorrow. Thank you very much.

Mr. SMITH OF TEXAS. Thank you, Mr. Israel.

Ms. Espinel.

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

Ms. ESPINEL. Thank you. Chairman Smith, Ranking Member Berman, and Members of the Committee, thank you for the opportunity to address the important issue of the international protection and enforcement of intellectual property.

Stopping counterfeiting and piracy and protecting our right-holders is a top priority of this Administration and of USTR. My remarks will focus on China and Russia but, time permitting, I would also like to provide you with a brief overview of our other activities to fight counterfeiting and piracy.

Turning to China, the protection and enforcement of IP remains a top issue in our bilateral trade relationship with China. It is an issue that has been raised at the highest levels of government with the Chinese by both Ambassador Portman and by President Bush.

As you know, each year USTR issues a Special 301 Report that catalogues the IP problems of the world's worst offenders. In 2004, because of our level of concern at China's continued lack of progress, USTR initiated a more intensive review of China's IP regime, known as an Out-of-Cycle Review.

On April 29th, USTR reported the results of that review. I described the results of the review and the actions we announced that we would take in my earlier testimony. Today, I would like to update you on the progress that has been made since then on the actions that we set out in the 301 Report.

First, we committed to investigate potential WTO dispute settlement cases. In the 301 Report, we announced that we would be working closely with our industry, with a view toward WTO dispute settlement. Cases at the WTO require extensive research and data collection.

We have been working closely with our industry to develop the information, and have, for example, sent a USTR legal team to China to meet with industry enforcement experts on the ground. We anticipate that those industries that have been working closely with us will continue to do so.

We appreciate greatly the Chairman's support of this partnership. Our time table for determining whether or not a WTO case against China is the most effective approach is dependent on the effectiveness of these efforts.

Second, we elevated China to the Priority Watch List, as an indication of our significant level of concern.

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Third, we pledged to intensify work to the JCCT IPR Working Group. Since April, we have had three meetings of the JCCT, and have seen progress at these meetings.

My complete testimony sets out a number of commitments made by China at the July JCCT following the experts' meeting in May, and our elevation of China to the Priority Watch List. I will highlight a few of them.

China agreed, among other things:

To increase criminal prosecutions;

To reduce exports of infringing goods;

To establish an IPR ombudsman in the Chinese Embassy to assist small- and medium-sized companies in particular;

To join the WIPO Internet treaties in 2006; and

To clarify some deficiencies in the judicial interpretations.

Since July, in order to move these commitments forward, China has done several things, including: Making a proposal for customs cooperation;

They have explained to us their process to ensure legal use of software by the government;

They have sent us Internet regulations in order to come into compliance with the WIPO Internet treaties, and have committed to work with us on them;

They have told us that the IPR specialist to help small- and medium-sized businesses will be in Washington by the end of this year; and

They have been working on regulations that transfer administrative cases over to the criminal process, as part of the effort to increase criminal prosecutions.

We have also seen some increased enforcement, particularly against counterfeiting; for example, in this year's Mountain Eagle campaign. But we have made clear to China that we need sustained enforcement and that annual enforcement campaigns will not be sufficient.

Fourth, I would like to highlight the TRIPS Transparency Provision commitment that we made. We announced that we would be filing a formal request under article 63 of the TRIPS Agreement, and we did so on October 26. This request seeks additional information on China's IP enforcement efforts.

In an example of our work to enhance international cooperation, we were joined by Japan and Switzerland, who submitted simultaneous similar requests. These requests seek detailed information from China on its reported IPR enforcement efforts.

China's response to these requests, anticipated in early 2006, will be a test of whether it is serious about resolving the rampant IP infringement throughout its country.

Turning to Russia, enforcement in both the copyright and trademark sectors continues to be a significant problem in Russia. As a result, Russia is designated as a Priority Watch List country in the Special 301 Report, and an Out-of-Cycle Review is being conducted this year to monitor progress. We are also continuing inter-agency review of a petition filed by the U.S. copyright industries to withdraw some or all of Russia's GSP benefits.

USTR and other agencies have been, and will continue to be, very engaged with the Russian government at all levels to develop

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an effective intellectual property regime and strengthen enforcement in Russia. Intellectual property has been raised as a priority issue by Ambassador Portman and by President Bush.

We are working on IP issues in Russia and on a number of fronts, including in the context of Russia's WTO accession negotiations. We have made it clear to the Russian government that progress on intellectual property will be necessary in order to complete the accession process.

Our work has brought about some improvements; particularly with respect to the content of Russia's laws. But enforcement of these laws is critical. We have seen some recent indications of progress, and we are monitoring to see whether or not Russia sustains and increases these efforts. We will continue to push, and have made clear to Russia that we need concrete results.

USTR has a number of other tools at our disposal. I would like to give a very brief overview of these. As you know——

Mr. SMITH OF TEXAS. Ms. Espinel, I'm afraid your time has expired.

Ms. ESPINEL. All right.

Mr. SMITH OF TEXAS. Now, we'll look forward to hearing the rest of your testimony when we ask you questions, if that's all right.

Ms. ESPINEL. Thank you.

[The prepared statement of Ms. Espinel follows:]

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PREPARED STATEMENT OF VICTORIA ESPINEL

TESTIMONY OF

VICTORIA ESPINEL

ASSISTANT U.S. TRADE REPRESENTATIVE (ACTING)

BEFORE THE

SUBCOMMITTEE ON COURTS, THE INTERNET

AND INTELLECTUAL PROPERTY

December 7, 2005

Chairman Smith, Ranking Member Berman and members of the Committee, thank you for the opportunity to address the important issue of international protection and enforcement of intellectual property rights (IPR).

As you are aware, protecting IPR is one of the most complex issues of our trade agenda. Since the advent of the Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) nearly 10 years ago, globalization and new technologies have made it easier for thieves to steal, copy and sell everything from auto parts, medicines and sports equipment to intangible products that could be downloaded online such as software, music and films. While, there have been some signs of improvement this past year, much work remains to be done.

Stopping counterfeiting and piracy and protecting our right holders is a top priority of this Administration. Ambassador Portman has made clear that IPR protection is a major priority for USTR. As a key component for U.S. economic growth and job creation, intellectual property protection supports the livelihood of so many American employers and employees in every region of the country. It is also a consumer health and safety concern when cheap imitation and unregulated goods are used, often unknown to consumers, to repair mechanical products, treat sicknesses or serve as protective gear in sports events, among other daily activities.
My remarks will focus on China and Russia, but also provide an overview of our other activities.

China

The protection and enforcement of IPR remains a top issue in our bilateral trade relationship. It is an issue that has been raised at the highest levels of government with the Chinese by Ambassador Portman, most recently during his visit to China last month, and by President Bush during meetings with Chinese President Hu in both September and November. These meetings produced a statement commitment from President Hu on the need to "protect the legitimate rights and interests of all international intellectual property rights owners, including those in the United States," and was a welcome indication that China recognizes the seriousness of our concerns.

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The Special 301 Out-of-Cycle Review

Each year, USTR issues the "Special 301" Report cataloging the IPR problems of the world's worst offenders – a list that contains dozens of countries. China is a regular member of this list. In 2004, because of our level of concern at China's continued lack of progress with respect to enforcing intellectual property rights, USTR initiated a more intensive review of China's IPR regime, known as an "Out-of-Cycle" Review.

On April 29, USTR reported the results of that review. We concluded that China's efforts to had significant gaps particularly in deterring rampant piracy and counterfeiting. We announced four new actions we would take to address these concerns:

1. Investigate potential WTO dispute settlement cases

In order to evaluate whether the United States should file a complaint against China in the WTO's dispute settlement process, USTR works closely with industry to gather detailed information on potential cases. Cases at the WTO require extensive research and data collection and are subject to an appeals process. The resources required to collect information on potential cases must come from industry, and some companies, including those represented on this panel today, have been working diligently to produce an accurate account of IP enforcement in China.

We appreciate greatly the Chairman's support of this public-private partnership in requesting additional resources from industry at our last hearing on this issue. China does not share the same level of transparency regarding enforcement actions as the United States, and collecting information is a resource-intensive and time consuming process. Our timetable for determining whether or not a WTO case against China is warranted is dependent on the effectiveness of these efforts.

2. Elevate China to the Priority Watch List in the 2005 Special 301 Report

China's placement on the Priority Watch List (PWL) indicates our significant level of concern that particular problems exist in that country with respect to IPR protection, enforcement and market access. This ranking sends a global signal to our trading partners and to companies seeking to do business in China. It also sends a strong message to China that these concerns have to be addressed.

3. Intensify requests through the JCCT IPR Working Group

Since April, we have held two meetings of the U.S.-China Joint Commission on Commerce and Trade (JCCT) Working Group Intellectual Property Rights involving senior levels of government as well as expert-to-expert exchanges between U.S. and Chinese IPR officials from all relevant policy and law enforcement agencies. These meetings, held May 25-27 and November 8-9, have proven invaluable at producing a common understanding of the

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problems and issues plaguing our IPR trade relationship, and establishing the linkages necessary to resolve them.

Cooperation through the working group meetings has led to a number of commitments by senior level Chinese officials, most notably at the July JCCT meeting where China agreed, among other things, to: (1) increase criminal prosecutions for IPR violations relative to the total number of IPR administrative enforcement cases, (2) reduce exports of infringing goods by issuing regulations to ensure the timely transfer of cases for criminal investigation, (3) improve national police coordination by establishing a leading group in the Ministry of Public Security responsible for overall research, planning and coordination of all IPR criminal enforcement to ensure a focused and coordinated nationwide enforcement effort, (4) enhance cooperation on law enforcement matters with the United States by immediately establishing a bilateral IPR law enforcement working group focusing on the reduction of cross-border infringement activities, (5) expand an ongoing initiative to aggressively counter piracy of movies and audio-visual products, (6) ensure that all central, provincial and local government offices are using only licensed software by the end of 2005 and that state-owned enterprises are using only licensed software in 2006, (7) fight software end-user piracy by declaring that it is considered to constitute "harm to the public interest" and therefore is subject to administrative penalties nationwide, (8) establish an IPR ombudsman in the Chinese embassy in Washington to assist U.S. companies, particularly small- and medium-sized companies, experiencing IPR problems, (9) rid trade fairs of fake goods, (10) join the WIPO Internet-related treaties in 2006, and (11) clarify the December 2004 Judicial Interpretation to make clear that its criminal thresholds apply to sound recordings and that exporters are subject to independent criminal liability.

4. TRIPS Transparency Provision

On October 26, we filed a formal request under Article 63.3 of the TRIPS Agreement to seek information on China's intellectual property enforcement efforts. In an example of our work to enhance international cooperation on this issue, we were joined by Japan and Switzerland, who submitted simultaneous similar requests. These transparency requests seek detailed information from China on its reported IPR enforcement efforts. China's response to these requests, anticipated in early 2006, will be a test of whether it is serious about resolving the rampant IPR infringement found throughout its country.

Other Efforts

As a means of encouraging greater public-private sector dialogue on IPR matters, we have also been working to support activities of other agencies. These efforts are too numerous to list today, but I want to mention in particular the State Department series of Ambassador's Roundtables that bring U.S. and Chinese government officials together to discuss the most pressing IPR matters of the day with industry representatives. These dialogues have proven useful at promoting dialogue and a degree of transparency into China's IPR regime.

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Russia

Enforcement in both the copyright and trademark sectors continues to be a significant problem in Russia. As a result, Russia was designated a PWL country in the Special 301 Report and an Out of Cycle Review for Russia is being conducted this year to monitor progress. We are also continuing interagency review of a petition filed by the U.S. copyright industries to withdraw some or all of Russia's GSP benefits. A GSP hearing was held on November 30th at which members of the US copyright industries testified in support of their position to withdraw some or all of Russia's benefits. USTR is considering this GSP petition.

USTR Efforts

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

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

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

Russia must undertake stronger enforcement measures. Actions also need to be directed to improve its border protection measures, and to impose effective criminal penalties. In addition, Russia needs effective optical disc plant inspection and enforcement mechanisms, including to shut down the plants and destroy the equipment used, and a concerted effort to combat internet piracy if it is to begin to address our concerns.

In the past few months, the Russian government has demonstrated an increasing understanding of the seriousness of the IPR piracy problem in Russia. For example, Russia has launched a new enforcement initiative with raids on production facilities in restricted areas, retail sweeps, and the

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opening of a case against a pirate Internet music site. We are monitoring the situation to see whether Russia sustains this effort.

We are pushing hard on each of these elements. We have seen some recent indications of progress but will continue to push and have made clear that we need concrete results.

Other USTR Activities - Tools and Measures to Combat Piracy and Strengthen Enforcement

USTR has taken a comprehensive, multi-faceted approach to address the complexity of IPR theft occurring across the globe. We have been vigorously employing all tools and resources at our disposal to bring pressure to bear on countries to reform their intellectual property regimes, and we will continue to do so.

Special 301/Section 301

As we do in April of each year, USTR issued the Special 301 Report cataloging the IPR problems in dozens of countries worldwide. A country's ranking in the report sends a message to the world and potential investors about a country's commitment to IPR protection. The Special 301 has been a successful in encouraging countries to institute reforms or come forward with reform proposals to avoid elevation on the list. For example:

- Korea – After elevating Korea to PWL last year, Korea took significant steps this year to strengthen protection and enforcement of IPR such as, introducing legislation that will explicitly protect sound recordings transmitted over the Internet (using both peer-to-peer and web casting services); implementing regulations to address film piracy; and increasing enforcement activities against institutions using illegal software.

- Taiwan – In response to our out-of-cycle review last year, Taiwan's legislature approved a number of amendments to its copyright law that provide greater protection for copyrighted works and increase penalties for infringers. In addition, Taiwan authorities made permanent an IPR-specific task force that has increased the frequency and effectiveness of raids against manufacturers, distributors, and sellers of pirated products.

Mention in the Special 301 Report sometimes compels authorities to take immediate enforcement action. For example, Pakistan undertook significant IPR enforcement actions Immediately after last year's 301 report in which it was placed on the Priority Watch List. Specifically, Pakistan shut down, six well known plants that had been churning out millions of pirated optical disks and instituted surprise raids to check the plants on an ongoing basis. We are monitoring to ensure that the plants stay clean. As another example of progress motivated by the Special 301 report, in an effort to improve its standing on the 301 list, the Philippines recently passed legislation on optical discs, and we are currently monitoring the enforcement of that law through an out-of-cycle review

Trade Agreements

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Our FTAs contain comprehensive obligations on civil, criminal and customs enforcement. For example, provisions that provide for tighter border controls, and expeditious *ex parte* searches to gather evidence, higher damage awards, deterrent criminal sanctions and increased authority for criminal enforcement. As a result, we have made implementation process of our FTAs a priority on par with their development and negotiation.

In the past year, we have worked closely with Australia and Singapore to ensure that their implementing legislation meets their FTA obligations to protect and enforce IPR. Currently, we are working closely with Morocco, Bahran and CAFTA on similar efforts, and have added action plans for the implementation of FTAs in our current negotiations. We will continue to work closely with our trading partners and our industry on implementation of the FTAs.

Since the Bipartisan Trade Promotion Authority Act of 2002, we have completed and received Congressional approval of FTAs with Australia, Chile, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Morocco, Nicaragua and Singapore, have concluded negotiations with Bahrain and Oman, and have launched FTA negotiations with several more countries - Panama, Thailand, Colombia, Ecuador and Peru , the United Arab Emirates, and the South African Customs Union countries). We will remain vigilant – with support and cooperation from our embassies and industry – to quickly respond to concerns over the possible lack of compliance or enforcement of FTA obligations that may arise in the future.

WTO

Protection and enforcement of IPR is an issue we raise in every WTO accession negotiation. For example, with respect to Ukraine's accession to the WTO, we have been working with the Ukrainian Government on numerous IPR issues, including the implementation of its new optical disc legislation passed last summer, stopping the export and import of pirated and counterfeit products from and into Ukraine, and improving protection of pharmaceutical test data from unfair commercial use. Ukraine has demonstrated significant commitment to improving it IPR regime, in the context of our negotiations on WTO accession as well as in order to improve its standing on the 301 list and to restore its GSP benefits.

Preference Programs

USTR also administers the Generalized System of Preferences (GSP) program and other tariff preference programs. The "carrot" of preserving GSP benefits is an effective incentive for countries to protect IPR. In fact, the filing of a GSP review petition or the initiation of a GSP review has in some cases produced positive results. For example, in response to an extended GSP review of Brazil this past year, the Government of Brazil adopted a new National Action Plan to enforce copyrights and reduce piracy. The Brazilian Government appears to be moving in the right direction and is now committing significant fiscal and personnel resources to anti-piracy efforts. The recent efforts to integrate the enforcement efforts and informational exchange channels of the Federal Police, Federal Highway Patrol, and Internal Revenue Service, are evidence that the Plan is being implemented. Over the past two months hundreds of thousands

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of pirated products have been seized and destroyed, and dozens of individuals have been arrested.

The Strategy Targeting Organized Piracy (STOP!) Initiative

In April and June, USTR led a delegation represented by most of the federal agencies participating in STOP! on an international outreach effort to explore how to increase cooperation to combat the growing global trade in pirated and counterfeit goods. The delegation met with counterparts in Asia (Singapore, Hong Kong, Japan, and Korea) and Europe (Germany, the European Commission, France, and the United Kingdom), and also met with Canada and Mexico in Washington, as well as with representatives of the private sector. In addition to providing a unified message concerning United States efforts to enforce against international IPR theft, the delegation put forward a series of proposals for increasing cooperation with our trading partners. In the coming months, outreach will continue to other like-minded countries.

The STOP! initiative is yielding results. It has brought new forms of federal assistance to American companies across the country, increased law enforcement resources to stop pirates and counterfeiters, and developed an international law enforcement network to increase criminal enforcement abroad. STOP! objectives have also been endorsed in numerous multilateral fora including the G-8, Organization for Economic Cooperation and Development, and the Asia-Pacific Economic Cooperation (APEC) to address issues ranging from improved enforcement to public awareness to commercial supply chain integrity.

Efforts to translate the APEC endorsements into a package of deliverables that improve IPR enforcement are underway. Leading this effort is the U.S., Japan, Korea sponsored APEC Anti-Counterfeiting and Piracy Initiative which was joined by Japan and Korea and endorsed by at the recent APEC Economic Leaders on November 18th and 19th.. This initiative includes a series of model guidelines to help member economies develop appropriate domestic measures to reduce trade in counterfeit and pirated goods and online piracy, and increase cooperation to strengthen capacity building activities that will aid in to fight against this illicit trade.

Conclusion

Dealing with the problem of counterfeiting and piracy requires a comprehensive, intensive and sustained effort. Stopping this illicit trade requires a comprehensive, intensive and sustained effort. We recognize there are many challenges to overcome. We will press forward with the tools and resources provided us in addressing these concerns with the goal of improving the situation for American owners of IPRs worldwide. We have made progress, but enormous challenges remain. We will continue to work with other federal agencies, coordinate with our stakeholders and reach out to our trade partners to develop mechanisms to comprehensively combat IPR theft through all means at our disposal. Stopping the trade in fakes and making the environment more welcoming to our right holders is a top priority.

I look forward to working with you and your staffs to continue to devise solutions for dealing with this critical matter.

Thank you.

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Mr. SMITH OF TEXAS. Thank you.
Mr. Smith.

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

Mr. SMITH. Mr. Chairman, Mr. Berman, Members of the Subcommittee, the IIPA is a coalition of seven trade associations representing now over 1,900 U.S. copyright-based companies. Thank you once again for the opportunity to appear here to review the record of China and Russia on enforcing their copyright laws to reduce among the highest piracy rates in the world.

I'm afraid anything I add here won't even approach the eloquence with which the Chairman and the Ranking Member and Mr. Issa described the endemic piracy problems that we face in these two countries. We reported to you last May that our situation in both these countries was dire, at best. Our industries were losing at least $2½ billion a year in China, $1.7 billion in Russia; piracy rates were 90 percent in China, and between 70 and 90 percent in Russia, depending on the sector involved.

You've asked us to give you a report card on progress over the last 6 months. We regret to report that there has been negligible progress in China, and the situation in Russia has actually gotten worse. Neither country has yet found the political will to act.

Let me turn first to China. In my written statement, we outline what has happened—or more accurately, not happened—in the last 6 months. Some report that the government is showing greater awareness of piracy and is being more cooperative. This is progress; no question. But have the Chinese authorities commenced a barrage of criminal cases against pirates? No.

Have they sought to provide greater market access? China is the most closed market in the world to copyright-based industries. The answer again is, no. In fact, the U.S. Government in the last JCCT round was told flat-out, no, there would be no market liberalization in these sectors.

In my written testimony, and Ms. Espinel's as well, we detail what happened at the July 2005 JCCT meeting. There was some progress made, but, in our view, most were in the nature of future commitments; not what we really seek, a report on specific actions being taken to "significantly reduce IPR infringements."

We are continually frustrated by the lack of transparency in the Chinese enforcement system. One of the reasons that USTR went to the article 63 process at the TRIPS Council was to, hopefully, get a real understanding of how the Chinese system works by getting meaningful facts about all the vast numbers of cases they cite to us.

At the recent IPR Working Group meeting in November in Beijing, it was reported to us that the Ministry of Public Security provided statistics on some of its enforcement actions. They sound impressive, but there was no report on how many copyright cases were brought, how many persons were convicted for piracy of U.S. copyrighted works, or what penalties were meted out.

We have no alternative but to conclude that the number of cases brought was very close to zero. And to the best of our knowledge, there have only been two convictions for piracy of U.S. copyrighted works under article 217 of the criminal law since China joined the WTO, and none that we are aware of in the last 6 months.

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Our view is that China's failure to bring criminal cases against copyright piracy on a commercial scale—the TRIPS standard—puts it in violation of its obligations under the WTO TRIPS Agreement. We also believe that China's criminal law, on its face, is in violation of TRIPS.

Not being able to do business in the Chinese market is deeply frustrating to our companies. It is inexcusable that China continues to permit the wholesale theft of U.S. intellectual property, the key export of our country, while continuing to enjoy the benefits of our open market for Chinese goods—so open that China enjoyed a $162 billion surplus with us in 2004. As we noted earlier, this is an issue of political will, and we have not seen it yet.

Turning to Russia, a market which has deteriorated for us in the last 6 months, some salient facts:

In the last 6 months, Russia has added at least eight—and by some accounts, more—optical disc plants to the 34 we reported last May. Nine of these plants—and maybe up to 18—are located on the facilities of the Russian government, as was described. Pirate optical discs forensically sourced from Russia have been found in 27 countries.

We have asked the Russian government to inspect these factories, seize pirate products, seize the equipment used in these infringements, and prosecute the plant owners; while imposing deterrent penalties that would place every Russian plant owner and their associates in real jeopardy. This has just not happened.

In recent weeks, the Russian authorities reported taking nine raids against OD plants. This is positive, but the results are telling. Much of the seized material ended up back on the streets. No equipment was seized. We believe that most of these plants continue to operate. This has been the typical situation in 2004, and so far in 2005.

We know that over the years a few people employed by these plants were prosecuted and convicted. But virtually all have received suspended sentences. There is simply no deterrence in the Russian system, and until there is the political will to change that, we cannot expect much change.

Fortunately, we have ample tools to help Russia, hopefully, find that political will to enforce the law. In passing House Congressional Resolution 230 by a near unanimous bipartisan vote in the House of Representatives on November 9—thanks to Mr. Issa and all of you—the Administration has been delivered a clear message: Until Russia takes effective enforcement action to reduce this piracy, it should not be admitted to the WTO and receive the trade benefits accorded WTO members. We cannot make the same mistake that was made with China: permitting Russia to enter the WTO without undertaking meaningful and WTO/TRIPS compatible enforcement.

It has also sent a clear message that Russia should not be eligible for over $600 million—that's January to September 2005—in GSP benefits. IIPA's GSP petition is 5 years old. It has not been acted on, and piracy has gotten worse in Russia. IIPA just testified at another GSP hearing looking into Russia's eligibility. We asked again for benefits to be withdrawn. It's now time to act, and for the Administration to remove these benefits.

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The U.S. Government also has huge leverage under Special 301. IIPA has recommended that Russia be designed a Priority Foreign Country, after the ongoing Out-of-Cycle Review. If no actions are taken, Special 301 permits the levying of retaliatory sanctions against such named country.

We cannot allow Russia to continue to feel invulnerable, at the same time as they do nothing to halt massive theft of our intellectual property.

Thank you again, Mr. Chairman, for showing such a great and abiding interest in nurturing the creative and innovative individuals and industries that have become so important to our culture, our technological future, our economic growth, and to job creation. I'd be pleased to answer any questions. Thank you.

[The prepared statement of Mr. Smith follows:]

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PREPARED STATEMENT OF ERIC H. SMITH

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Written Statement

of

Eric H. Smith
President, International Intellectual Property Alliance (IIPA)

before the

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

"International IPR Report Card – Assessing U.S. Government and Industry Efforts to Enhance Chinese and Russian Enforcement of Intellectual Property Rights"

December 7, 2005

Mr. Chairman, Ranking Member Berman and other distinguished Committee members, IIPA and its seven trade association members thank you again for the opportunity to appear today to review the record of China and Russia on enforcement of their copyright laws against wholesale, massive piracy, both within their domestic markets and for export. Last May, IIPA testified before this Subcommittee and provided a report on the dire situation that our industries face in these two countries.

We applaud you, Mr. Chairman, for holding this hearing to permit the U.S. government and affected U.S. industries to update that May report. It is vitally important that both these countries are fully aware of Congress' views on this topic which so vitally affects the U.S economy and U.S. jobs.

IIPA represents the U.S. copyright industries. Its seven member trade associations consist of over 1,900 U.S. companies, accounting for millions of U.S. jobs. The copyright industries, in 2002, contributed over $625 billion to the GDP, or 6% of the U.S. economy and almost 5.5 million jobs or 4% of U.S. employment. These companies and the individual creators that work with them are critically dependent on having strong copyright laws in place around the world and having those laws effectively enforced. On average, the copyright industries generate over 50% of their revenue from outside the U.S., contributing over $89 billion in exports and foreign sales to the U.S. economy, with a surplus balance of trade of $33 billion. Given the

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overwhelming global demand for the products of America's creative industries, all these numbers would be significantly higher if our trading partners, including both China and Russia, were to significantly reduce piracy rates by enforcing their copyright and related laws vigorously.

Is it realistic to expect countries like China and Russia to "significantly reduce piracy levels"[1] in the near term?

Mr. Chairman, before embarking on our update of the piracy situation in these two countries, I wanted to address, as a preliminary matter, a commonly-heard charge that because China and Russia are "developing" countries (or in the case of Russia, an "economy in transition"), because they are vast in size and because available law enforcement resources are sparse and untrained, that we are simply asking too much of these countries to improve significantly and quickly their performance in the fight against piracy.

The answer to this charge is indeed an easy one—if China and Russia are not in a position to meet their international legal obligations in the area of IPR protection, they should not be a party to international trade agreements that provide such obligations and corresponding benefits. Our members are acutely aware of the realities of the situation in both countries. We are not politicians, we are businessmen, and our mission is to achieve the possible, not to demonstrate failure. Even given these resource constraints (which exist in virtually all countries, by the way) it is realistic to expect these countries to be able to reduce piracy levels significantly in the short term – indeed in both cases it should have happened by now.

Most of our members have vast experience fighting piracy in developing countries around the world. Their businesses critically depend on creating legitimate markets in these countries. While the nature of piracy keeps changing, as technology advances and as organized criminals become more adept at avoiding law enforcement, we can cite you at least two examples where piracy rates were significantly reduced and these examples provide the lessons and the template for how China and Russia can do so as well – but only if those governments have the political will to make it happen. These examples come from my own experience of working with the U.S. government, our members and these countries over the last 20 years.

In South Korea in the mid to late 80's, piracy levels were estimated – and we will use the recording and film/video industries as the example – at over 80% of the market. By the mid-90s, the rates for those sectors had been reduced to 10% to 15%. Similarly, in Taiwan, known for years as the counterfeit and piracy capital of the world, piracy rates were similar to, if not worse than, those in South Korea. By 1997-1998, the rates had been similarly reduced to 10-15% of the market in these sectors.

We acknowledge that these countries/territories are smaller than China and Russia, but we submit that the key is reducing piracy in the major cities and here the size of the market is not particularly relevant. What is critically relevant in our judgment, and what turned the tide in South Korea and Taiwan, were:

[1] A commitment made by China's Vice Premier Wu Yi at the 2004 JCCT meeting.

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1. The regular application of criminal remedies and high penalties on pirates. We submit that it is not necessary to prosecute thousands of people and to use massive enforcement resources. What is key is that the government sends the message to its people through exemplary prosecutions that create a domestic environment that significantly raises the risk to pirates that they are in serious jeopardy. This is the nature of "deterrence." After all, piracy is an economic, not an emotional crime, and responds rather directly to criminals' assessment of the risk of remaining in the piracy business. The key is that these criminal remedies work to take the potential of vast profits out of the equation, that penalties are stiffer than the money that can be made. We recognize in some ways that this is an oversimplification but we also submit that it "works."

2. Undertaking enforcement actions in close cooperation with right holders and using scarce enforcement resources to move up the pirate value chain. Of course, raiding activities at *all levels – retail, distribution, and manufacturing – is critical and the activity must* be constant. These are not ingredients wholly missing in China and Russia. What is missing is the consistent, close cooperation with right holders and a fully transparent enforcement system. Moreover, corruption at many levels of that system is a tremendous obstacle. It is also a myth that dealing with piracy requires massive resources not available in these countries. This is simply not the case. What is key is the "smart" application of the resources available to target, prosecute and punish with a view to creating deterrence.

3. A zero-tolerance policy toward corruption in the system is also critical. We have seen that the Chinese are able, where they have had the political will in a particular area, to work through this problem and bring corrupt officials to justice. We have not seen this in Russia – the political will does not seem to be there. What we have not seen in either country, which we did see during the periods cited in South Korea and Taiwan, is that high level law enforcement officials were willing to ensure that this economic crime – IPR theft -- was given priority and that corruption was not tolerated. The leadership had decided that dealing with this issue was in its interest and a high priority and this filtered down to law enforcement. To date, this has not happened in either China or Russia. Indeed, dealing with piracy as an economic crime, with appropriate prosecutions and deterrent penalties, is a decision that does not appear to have yet been taken in either country.

4. A country must have open market access to legitimate product. Governments cannot permit pirates unfettered access to their markets while restricting the ability of legitimate companies to compete. Both Taiwan and Korea had substantially reduced all significant barriers to the entry of legitimate product allowing right holders to satisfy the demand with legitimate product. While this is not as critical a problem in Russia (though bureaucratic barriers remain a significant problem), the issue is so acute in China that, even if China were to do everything noted above, U.S. industry might still not see any significant benefit.

Again, in seeking not to oversimplify a complex issue, we must note that piracy rates in both South Korea and Taiwan for audio and video product did not stay at this low level. New

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problems must constantly be addressed. In the case of Taiwan it was an unfettered growth in optical disc production capacity and the territory's failure to prevent its takeover by organized crime after 1997-98. While Taiwan appears to have gotten a handle on this new issue, it is now faced with the new challenge of Internet piracy and faces some ongoing problems with book piracy and illegal commercial photocopying. South Korea did not go through the pirate optical disc production phase but did withdraw for a while from aggressive criminal enforcement and is now facing massive Internet piracy, as the country with the highest broadband penetration in the world.

Both China and Russia continually try to excuse their lack of effective enforcement against piracy by citing at every turn that they need still more time and that they are "developing" countries. Frankly, we in industry know that these are mere excuses – neither country has made the political decisions that would allow them to significantly reduce piracy – decisions that other countries have made and the results are evident.

Now let's turn to an update on copyright piracy in China and Russia, keeping these points in mind.

China

Conclusion: There has been some minor incremental progress but no significant reduction in piracy levels, either domestically or for export

In our May testimony we laid out for the Subcommittee the issues faced by each of the copyright industries. We noted that losses in 2004 amounted to a staggering $2.5 billion and that piracy rates continued to hover around 90% of the market. I refer the Subcommittee back to that testimony because none of those basic issues have changed in the last six months. In what follows we detail what new has happened in China that affects the copyright industries.

Since the May hearing before this Subcommittee, there have been

(a) a number of bilateral engagements between the U.S. and China, including a July 11 meeting of, and "outcomes" from, the JCCT;
(b) the announcement of another special enforcement period, on Internet piracy, to last through February, 2006;
(c) the finalization of regulations governing the liability of ISPs with respect to Internet infringements;
(d) the issuance of draft guidelines (not yet final) for the transfer of cases from the administrative enforcement system to the criminal system, following on the December 2004 "Judicial Interpretations" by the Supreme People's Court revising the thresholds that must be met before an IPR violation becomes a criminal offense;
(e) the completion of the 4th Transitional Review Mechanism (TRM) in the TRIPS Council;
(f) the submission of the U.S. government's request for enforcement information under TRIPS Article 63.3, as announced in USTR's Special 301 decision;

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(g) two Roundtables conducted in Beijing and Shanghai by U.S. Ambassador Randt in early November, and
(h) a November meeting of the IPR Working Group (set up within the JCCT framework) involving representatives from law enforcement on the Chinese side.

These new meetings and initiatives were viewed by the U.S. government and by most elements of the private sector as positive signs of an increasing awareness of the importance of IPR enforcement to China.

In the second (July 2005) meeting of the reconstituted JCCT, the "outcomes" document reflected some positive developments. However, in general all were further "commitments" (not unimportant but of which we have seen many over the last ten years which have not borne fruit), rather than reflections of enforcement actions taken on the ground. Some of these key developments included:

(a) an agreement to increase criminal prosecutions, including the above mentioned promulgation of guidelines to refer criminal cases;
(b) promises of increased cooperation by law enforcement agencies at every level;
(c) the announcement of an MOU with the Motion Picture Association which committed China to crack down on any DVDs or VCDs that were in the market before their release in the legitimate home video market in China;
(d) clarification that sound recordings were covered by the new Supreme People's Court "Judicial Interpretations";
(e) in what is regarded as a most promising development, a statement that end-user software piracy (a massive problem in China) constitutes "harm to the public interest" making it subject to nationwide administrative enforcement, that such piracy is even a criminal offense "in appropriate circumstances," and that the government will complete legalization of government software use at the central, provincial and local levels by year-end and will begin legalizing software use in "state-owned enterprises" in 2006; and
(g) in a critical move for the software industry, the Chinese government agreed to "delay" issuing draft regulations that would have required government ministries to purchase only Chinese software.

The report card to date on these JCCT "outcomes" is positive in some areas. A document was later released clarifying that sound recording are covered by the JIs, cooperation has appeared to improve among enforcement bodies, the software procurement regulations have not been promulgated (though little progress has been made to date on Chinese adherence to the WTO Agreement on Government Procurement), and there has been some incremental progress in enforcement under the new MOU. However, on the most critical issues that we have with China, namely significantly increased enforcement, the jury remains out on enforcement against end-user piracy and on increased criminal enforcement generally.

The Supreme People's Procuratorate and the Ministry of Public Security have accepted comments (including from IIPA) on their draft referral guidelines and the National Copyright Administration and the State Council have accepted two sets of comments (also from IIPA and some of its members) on the new Internet Regulations, but neither have been finalized and issued.

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However, we applaud the Chinese government for opening up both these processes to the foreign private sector. Such transparency is essential to any enforcement system working effectively.

As promised in the Special 301 announcement, USTR submitted its TRIPS Article 63.3 request to the Chinese government at the TRIPS Council. IIPA was greatly pleased that this request was joined by Japan and Switzerland. The Chinese government's initial reaction to this request was reportedly very negative but we hope that that China will eventually comply and provide the information necessary for the U.S. government and industry to understand better and evaluate the effectiveness of the Chinese enforcement system.

With respect to the 4th annual Transitional Review Mechanism (TRM) on whether China is meeting its WTO obligations in the IPR area, the Chinese response was, again, to avoid the tough questions and generally to remain unresponsive to legitimate requests for information from the U.S. and other WTO members.

Some of this litany represents the incremental progress mentioned above but, as noted, on the most critical issue: is China significantly increasing copyright piracy prosecutions under its Criminal Law and the new JIs, the answer is still that they have not.

In the November IPR Working Group, set up under the JCCT, Ministry of Public Security officials provided statistics on their most recent enforcement crack-down, called Mountain Eagle, and on enforcement generally.

The Ministry reported that from November 2004 to September 2005, it had brought 2,963 criminal cases, and concluded 2,589. There was no breakdown of whether these were trademark counterfeiting cases only or included all IPR categories (we suspect they involve only trademark cases). 4,900 criminals were penalized (no further statistics on penalties were given). Out of all these reported cases initiated, only 55 involved foreign firms and 36 were U.S. companies – all that were mentioned were companies that owned trademarks subject to counterfeiting. We do not believe any of these were copyright cases.

Indeed, to this date, we know of only two criminal cases prosecuted and concluded IN *THE LAST FOUR YEARS (since China joined the WTO)* under the criminal piracy provision, Article 217, involving a U.S. copyrighted work.[2]

[2] The Chinese government has reported to the IPR Working Group and to others increased referrals of administrative cases to the criminal system, but have provided no information on whether these involved U.S. copyrights. We know of one case involving U.S. videogames which was transferred to the criminal authorities, but as often happens, the accused disappeared and the case is in abeyance. It is unclear at this point whether any significant increase in referrals will occur before the referral guidelines mentioned above have been finalized, published and distributed.

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In the copyright area, the Ministry reported that in 2004 it seized 21 "illegal" OD lines (presumably from "underground" plants that did not have proper operating licenses).[3] No information was given whether anyone involved with these seized lines was ever prosecuted. In 2005 through September, the number of seized lines was put at 15. It seems, therefore, that there has been minimal improvement on this front. No other information was provided.

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

Without a massive increase in criminal enforcement, piracy rates will likely remain at current levels

It has been one and a half years since the Chinese government promised the U.S. government significantly increased criminal enforcement. To date the copyright industry cannot yet report any significant movement in this area. The promise inherent in the lowered thresholds in the December 2004 "Judicial Interpretations" – after the passage of one year – appears not to have made any difference in the number of cases brought nor the penalties imposed.

IIPA said in its May testimony, and we repeat here: Until the Chinese government *musters the political will to prosecute piracy as a criminal act, we will not see a significant long* term shift downward in the piracy rate. The administrative enforcement system does not provide the deterrence that is necessary to force pirates out of this illegal business.

The copyright industries continue to be hampered by onerous market access restrictions and the Chinese government has made no moves to remedy the problem.

As we reported in May, there is a direct relationship between piracy and China's severe market access restrictions on the copyright industries. The plain fact is that U.S. copyright products have almost total access to the Chinese market, in **pirate** copies with **billions of dollars being earned by pirates**, not by the rightful owners of that product.

[3] In May, we reported that there were 83 "licensed" OD factories. Many of these also produce massive quantities of pirate product, both for the domestic market and for export. In the October 24, 2005 submission by China to the TRIPS Council in the TRM proceeding (IP/C/W/460, 11 November 2005), it was noted that China claimed to have "inspected and confiscated" 167 million illegal audio and video products and pirate copies, apparently in calendar year 2004. Again, there was no breakdown between pornographic product and infringing copies, and no information on the quantity that represented the works of U S. right holders.

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Efforts in the July 2005 JCCT meetings to seek redress from the Chinese government on this front met with total resistance – the Chinese government made crystal clear that they had no intention of opening up their market further to copyrighted products beyond their minimal commitments in the WTO.[4]

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

Actions to be taken by the Chinese government

In our May testimony we also set out the actions that the Chinese government must take if it is to bring its enforcement regime into compliance with its TRIPS obligations. Those action items have changed little. China must:

- Significantly liberalize and implement its market access and investment rules, including and in addition to those already made in the WTO, and improve the overall business climate in China to permit effective operations by all copyright industries. This should continue to be a major objective in the JCCT.
- Immediately commence criminal prosecutions (the passage of an entire year with no action is inexcusable) using both the monetary and new copy thresholds and carry these forward promptly to impose deterrent penalties. The Economic Crime Division of the Public Security Bureau should be made responsible for all criminal copyright enforcement and be provided sufficient resources and training to very substantially increase criminal enforcement under the new Judicial Interpretations. Amendments should be made to those Interpretations to further lower thresholds, to provide that the method of valuation should include the value of finished and semi-finished products and infringing components, and otherwise pave the way for greater criminal enforcement.
- Ensure that foreign copyright holders and their trade associations are given the full details of actions by enforcement agencies and the transparency necessary to effectively engage China's anti-piracy claims.
- Under the leadership of Vice Premier Wu Yi, constitute a single interagency authority at the national and provincial/local levels to undertake administrative enforcement against piracy of all works. This authority would have the would have the full authority to administer fines and to refer cases to the Ministry of Public Security and the Supreme People's Procuratorate for criminal prosecution, under referral guidelines that are equal to or better than the Judicial Interpretations. Such authority must have the full backing of the Party Central Committee and the State Council. Far greater resources must be

[4] Or, in the case of the book publishing sector, possibly even living up to the WTO commitments it has made. There are serious questions as to whether China has fulfilled its WTO accession commitments to open distribution and trading rights to foreign book publishers.

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provided to this enforcement authority. All administrative enforcement, and enforcement by Customs at the border, must be significantly strengthened.[5]

- Adopt a final set of regulations governing protection and enforcement on the Internet, including the liability of Internet Service Providers, which follow the recommendations made in IIPA's Special 301 submission and recommendations made by IIPA directly to NCA and the State Council, including effective "notice and takedown" mechanisms and without unreasonable administrative evidentiary burdens. Establish within this single interagency authority described above special units (at the national, provincial and local levels), whose purpose is to enforce the law and these new regulations against piracy on the Internet.
- Amend the Criminal Law to comply with the TRIPS Article 61 requirement to make criminal all acts of "copyright piracy on a commercial scale." These must include infringing acts not currently covered, such as end-user software piracy and Internet offenses conducted without a profit motive. Also amend the Criminal Code provisions requiring proof of a sale, to require instead proof of commercial intent, such as possession with the intent to distribute.
- Significantly increase administrative penalties/remedies, including shop closures, and monetary fines, impose them at deterrent levels, and publicize the outcome of cases.
- Take immediate action against illegal use of copyrighted materials on university campuses, including at on-campus textbook centers.
- Permit foreign companies and trade associations to undertake anti-piracy investigations on the same basis as local companies and trade associations.
- Through amended copyright legislation or regulations, correct the deficiencies in China's implementation of the WCT and WPPT, and ratify the two treaties by mid-2006, as promised.
- Significantly ease evidentiary burdens in civil cases, including establishing a presumption with respect to subsistence and ownership of copyright and, ideally, permitting use of a U.S. copyright certificate, and ensure that evidentiary requirements are consistently applied by judges and are available in a transparent manner to litigants.
- Require government agencies to certify software legalization, allocate sufficient resources at every government level specifically earmarked for procurement of legal copies of software, and establish transparent mechanisms to audit and verify government legalization, including increases in legitimate software sales.

The copyright industries are continuing to work closely with USTR to prepare the necessary elements of a WTO case if China does not significantly improve its enforcement system in the next months. That work has progressed since your last hearing in May, but no decision to bring such a case has been made.

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

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Russia

In May, when my colleague Eric Schwartz, testified for the IIPA on the problems our members confront in Russia, he noted that the piracy problem in Russia was the worst it has been in our experience since the fall of the Soviet Union. Piracy of all copyright materials – motion pictures, records and music, business and entertainment software, and books – is at levels ranging from a low of about 66% to a high of 87% – totally unacceptable for a country and economy the size and sophistication of Russia.

Unfortunately, in the six months since that testimony, the problem has gotten even worse.

Six months ago we testified that there were 34 known optical disc plants. Last month the Russian government acknowledged that there are now 42 such plants and our members' report that in the past two weeks that number has grown to between 46 and 48 plants. These plants are, in essence, unregulated with only a handful subject to inspections or the seizure of material, and none have been the subject of the imposition of effective criminal enforcement for commercial piracy.

Let me re-iterate and summarize some of the statistics from our testimony in May of this year. A more complete overview of our issues was included in our filing last week with the Office of the U.S. Trade Representative as part of an Out-of-Cycle review of Russia's IPR regime. We attach a copy of that filing.

Scope and nature of the piracy problem in Russia

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

The number of optical disc (i.e., CD and/or DVD) plants in Russia has more than doubled in just the last three years. There are a total of 80 known operational production lines, and reports that that number may be closer to 120 lines. Production capacity has nearly tripled as criminal operations have encountered little hindrance in expanding their activities.

Even more troubling, IIPA is aware of nine production plants located on the facilities of the Russian government, so-called restricted access regime enterprises (although the Russian government has publicly acknowledged that there may be as many as 18 such plants).

Russia's annual manufacturing capacity now stands conservatively at over 370 million CDs and additionally over 150 million DVDs, despite the fact that the demand for legitimate discs is unlikely to exceed 80 million in all formats (including an estimated current demand for legitimate DVDs at around 10 million discs per year). Thus, Russian pirates are clearly producing material for export markets which hurt the copyright industries' competitiveness in

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third country markets. Russian-produced optical discs (CDs) have been positively identified in at least 27 countries. So, the harm illegal Russian plants are doing far exceeds the Russian marketplace.

Forensic evidence indicates that at least 24 of the plants are known to be producing pirate product. Of course, without proper surprise inspection procedures in place, there is no way of knowing for certain the size and scope of what all the plants are producing.

In 2004, there were eight actions taken by the Russian government against the optical disc ("OD") CD/DVD plants, including raids and seizures of illegal materials according to our industry, and Russian government, reports.

In recent weeks as many as nine additional raids have been run. The raids are obviously a positive step.....but, the outcome of the raids this year, as in 2004, are telling:

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

Second, the optical disc plants that were raided in 2004 and 2005, including the most recent raids, remain intact, and in almost all cases, in operation after those raids. In some cases, truckloads of illegal material were seized from the same plants by Russian government enforcement officials – and still these same plants remain in operation. And in no case, was the equipment used to make illegal material ever confiscated or destroyed. It is a telling signal of Russia's indifference to the problem that the equipment used in the commission of these offenses remains in the possession of the wrongdoers.

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

The Russian government's legacy of failed commitments

In May, we characterized the performance of the Russian government over the past decade as representing a legacy of failed commitments on obligations to the United States and the broader international community. We outlined in that testimony the list of these failed commitments. Just this week, one senior Russian official (in President Putin's office) at an IPR enforcement seminar acknowledged his own purchases of illegal material in Russia because pirated materials were "sold at a better price" than legitimate material. Of course, since most of the pirate product produced in Russia is exported, this so-called "price argument" – not even true in the domestic market – is irrelevant.

In sum, six months after testifying before this subcommittee, there is little that IIPA can report that is positive.

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Yes, there have been stepped up plant raids, but so far, the outcome is the same – the plants are not being shuttered (with the exception of a few plant owners moving locations), no equipment used in production is being seized, and there are no criminal convictions taken against plant operators. And, if the attitude of the Russian government can be best summarized by a presidential official about his desire to purchase illegal material, the time has come for the U.S. government to act decisively.

IIPA's recommendations to the U.S. government

IIPA believes that after nine years on the Priority Watch List, it is time for the U.S. government to take a different approach to Russia's inability or unwillingness to act.

We have several times over the past few years offered the Russian government suggested "steps" necessary to improve enforcement (see our Out-of-Cycle filing attached for our most recent recommendations).

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

1. Condition Russia's entry into the World Trade Organization (WTO) on meaningful copyright law enforcement;
2. Designate Russia as a Priority Foreign Country (PFC) after the on-going out of cycle review by USTR.; and
3. Deny Russia's eligibility for Generalized System of Preferences (GSP) duty-free trade benefits.

We also note that the House of Representatives sent its own strong message to the Government of Russia that Russia is not presently in compliance with its WTO/TRIPS obligations and is not eligible for GSP benefits. On November 16, 2005 by a vote of 421-2, the House of Representatives passed H. Con. Res. 230, which IIPA strongly applauds and appreciates.

Condition Russia's entry into the World Trade Organization (WTO) on meaningful progress in enforcing its copyright laws

The Russian IPR regime is not in compliance with WTO/TRIPS obligations, especially pertaining to enforcement. As a consequence, the U.S. government should not assent to Russia's accession into the World Trade Organization until its copyright regime, both legislative and enforcement, is brought into compliance with these WTO/TRIPS obligations.

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

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The U.S. can and should condition Russia's entry into the WTO on Russia making positive and meaningful enforcement progress – for example, by licensing and inspecting all the known 42 (or 48) optical disc plants, closing those engaged in illegal activities including the seizure and/or destruction of the equipment used to make illegal material, and criminally prosecuting those involved in this commercial illegal activity as well as ensuring imposition of deterrent (not suspended) sentences.

Designate Russia as a Priority Foreign Country (PFC) when the current "Out-of-Cycle" review is complete

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

The situation has gotten significantly worse, not better, in the past few years. IIPA recommended in February 2005, and continues to recommend as part of the out-of-cycle review, that it is time to designate Russia a Priority Foreign Country to force Russia to properly enforce its laws or face the consequence of trade sanctions.

Remove Russia's eligibility for Generalized System of Preferences (GSP) benefits

In August of 2000, IIPA filed a petition asking the U.S. government to open an investigation into Russia's practices and outlining a variety of ways in which Russia failed (and continues to fail) to meet the GSP criterion of providing adequate and effective protection for intellectual property. That petition was accepted by the U.S. government on January 10, 2001. IIPA has since testified three times before the U.S. government GSP interagency committee – this November 2005 (and in March 2001 and September 2003) -- and submitted extensive materials and briefs.

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

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

* * *

Mr. Chairman, we are grateful for your support and for the support of the members of this Subcommittee, in May and now, to work with industry and the Administration to ensure that the

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progress (or in the case of these two countries, lack of progress) is fully monitored and Congress, along with the Administration, can consider what appropriate action to take.

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ATTACHMENT

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE®

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December 2, 2005

Via electronic submission: FR0528@ustr.gov
Sybia Harrison
Special Assistant to the Section 301 Committee
Office of the U.S. Trade Representative
1724 F Street, NW
Washington, DC 20508

Re: Special 301 Out-of-Cycle Review: Russia

To the Section 301 Committee:

Attached are the International Intellectual Property Alliance (IIPA) comments regarding the Special 301 Out-of-Cycle Review of the Russian Federation.

Sincerely,

Eric J. Schwartz
Vice President and Special Counsel
International Intellectual Property Alliance

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Out-of-Cycle Review Submission of the
International Intellectual Property Alliance
Regarding the Intellectual Property Rights Practices of the Russian Federation

December 2, 2005

The International Intellectual Property Alliance (IIPA) appreciates the opportunity to provide these comments and to summarize the very serious copyright enforcement issues confronting our members in Russia. In short, the government of Russia is not complying with its bilateral or multilateral commitments to provide adequate and effective copyright protection and enforcement.

In our view, the Section 301 Committee should designate Russia as a Priority Foreign Country and begin an immediate review of the necessary trade sanctions to force Russia to improve its IPR regime.

In addition, IIPA believes the GSP Subcommittee should terminate its current investigation with a finding that Russia is not complying with the eligibility requirements for GSP benefits, and should remove Russia's eligibility to participate until such time as it has achieved adequate and effective protection of intellectual property rights (IPR) as contemplated by the GSP statute.

Last, Russia should not be permitted to accede to the WTO until Russia fully complies with the WTO obligations for IPR protection and enforcement.

For nine straight years, Russia has been on the Priority Watch List while the number of optical disc plants producing illegal material and exporting it abroad has grown exponentially—from 2 plants in 1996 to over 42 today. The fact that Russia has run raids at a handful of plants in October and November 2005 is a positive step, but it can hardly qualify as rising to the level of needed enforcement. Effective enforcement means that illegal plants are closed and plant operators convicted and sentenced. That, to date, has not occurred.

It has been almost five years since the IIPA GSP petition was first filed, and over four years since the U.S. government accepted the petition, which as a threshold matter, acknowledged Russia's shortcomings under the GSP program.

The U.S. government has, in effect, given the Russian government many years to address IPR protection and enforcement concerns, and the Russians have repeatedly failed to meet their commitments to do so. We believe the U.S. government should immediately designate Russia as a Priority Foreign Country, and should revoke Russia's eligibility from the GSP program.

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Regarding GSP eligibility, Russia is not nearly providing the mandated "adequate and effective protection" in accordance with sections 502(b) and 502(c) of the 1974 Trade Act (the intellectual property provisions in the GSP statute found at 19 U.S.C. §§ 2462(b) and (c)). The U.S. suspension of all of Russia's GSP benefits should remain in effect until Russia meets a series of U.S. proposed IPR performance standards on copyright enforcement. We offer suggestions below on what these enforcement standards should look like; in short, steps that Russia must take to begin to provide effective enforcement.

The IIPA represents associations and companies that have a significant economic interest in the adequate and effective protection of copyrights in Russia. Specifically, the IIPA is a private sector coalition formed in 1984 to represent the U.S. copyright-based industries in bilateral and multilateral efforts to improve international protection of copyrighted materials. The IIPA is comprised of seven trade associations: the Association of American Publishers (AAP), the Independent Film & Television Alliance (IFTA), the Business Software Alliance (BSA), the Entertainment Software Association (ESA), the Motion Picture Association of America (MPAA), the National Music Publishers' Association (NMPA), and the Recording Industry Association of America (RIAA).

These member associations represent over 1,900 U.S. companies producing and distributing materials protected by copyright laws throughout the world – theatrical films, television programs, home videos and DVDs; musical records, CDs, and audiocassettes; musical compositions; all types of computer software including business applications software and entertainment software (such as videogame CDs and cartridges, personal computer CD-ROMs, and multimedia products); and textbooks, tradebooks, reference and professional publications and journals (in both electronic and print media). The copyright-based industries are a vibrant force in the American economy.[1]

Simply stated, Russia's current copyright piracy problem is enormous—it is one of the worst piracy problems of any country in the world, second only to China. Piracy of all copyright materials – motion pictures, records and music, business and entertainment software, and books – is at levels ranging from a low of about 66% to a high of 87% – levels totally unacceptable for a country and economy of the size and sophistication of Russia. Moreover, exports of infringing products from Russia are eroding the copyright industry's legitimate businesses in third country markets.

Inadequate copyright laws and ineffective anti-piracy enforcement adversely affect employment, market development, job creation and revenues both in the United States and abroad. With many of these U.S. companies increasingly relying on foreign licensing and sales revenues, piracy has become a major impediment to continued revenue growth and has become the major market access barrier for the copyright industries.

[1] According to Copyright Industries in the U.S. Economy: The 2004 Report, prepared for the IIPA by Economists, Inc., the U.S. "core" copyright industries accounted for an estimated 6% of U.S. Gross Domestic Product (GDP), or $626.6 billion, and employed 4% of U.S. workers in 2002 (according to the latest data available through that year), or 5.48 million persons. IIPA's report is available at: http://www.iipa.com/copyright_us_economy.html.

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In August 2000, the IIPA filed a petition with the U.S. government to initiate a review of Russia's eligibility to participate in the GSP program due to its failure to provide adequate effective copyright protection for U.S. copyright owners, as required by Sections 502(b) and 502(c) of the 1974 Trade Act.[2] Hearings were held in March 2001 and October 2003 in Washington, D.C. at which the IIPA testified. The situation in Russia has gotten significantly worse since the IIPA petition was initially filed, and even since the 2003 hearings. There were only 10 optical disc plants in Russia at the time of our original submission in 2000. By 2003, that number had climbed to 26 plants. At present, there are no fewer than 42 optical disc plants operating in Russia, the great majority of which are involved in the production of infringing materials, and their export to a wide variety of third country markets. It is a matter of the highest importance that Russia undertakes clear, immediate, and unambiguous improvement in its enforcement copyright regime, especially including immediate steps to curtail the production and export of pirate optical discs.

II. Inadequate and Ineffective Copyright Enforcement in Russia

Russia's current legal framework for copyright protection is inadequate, ineffective, and in need of many reforms. However, the legal reforms are of secondary importance to the need for Russia to immediately enforce its IPR laws under its existing legal regime. In short, Russia is not doing nearly enough to meet its bilateral or multinational obligations for comprehensive effective enforcement.

Without question, the most serious threat to the copyright industries in Russia is the explosive growth of optical media (i.e., CD and/or DVD) production facilities and distribution systems that are currently operating unabated. Today, the number of optical disc plants in Russia is at least 42 plants (a number acknowledged by the Russian government and with very recent reports that there may be as many as 46 plants), including thirteen dedicated DVD plants. There are more than 80 known operational production lines (with reports that there may be as many as 120 lines). Production capacity has nearly tripled in the past few years as criminal operations have encountered little hindrance in expanding their activities. Even more troubling, the IIPA is aware of nine production plants located on the facilities of the Russian government, so-called restricted access regime enterprises (although the Russian government has publicly acknowledged that there may be as many as 18 such plants). Forensic evidence links at least 24 of the 42 plants to the production of pirate product. Of course, without proper surprise inspection procedures in place, there is no way of knowing for certain the size and scope of what the plants are producing.

Moreover, Russia's annual manufacturing capacity now stands conservatively at over 370 million CDs and more than 150 million DVDs, despite the fact that the demand for legitimate discs is unlikely to exceed 80 million in all formats (including an estimated current demand for legitimate DVDs at around 10 million discs per year). Thus, Russian pirates are clearly producing material for export markets which hurt the copyright industries' competitiveness in third country markets. Russian-produced optical discs (CDs) have been positively identified in at least 27 countries.

[2] See 19 U.S.C. §§ 2462(b) and (c).

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The immediate cessation of illegal production using existing law is the number one priority for the copyright industries, along with the adoption of a comprehensive optical media regulatory and enforcement scheme. This step should include the withdrawal of licenses for all plants engaged in illegal conduct, and especially for those operating on government property which can be undertaken swiftly.

The Russian government touts its "success" by noting plant raids in 2004 and 2005. In 2004, there were eight actions taken by the Russian government against the optical disc ("OD") CD/DVD plants, including raids and seizures of illegal materials according to our industry, and Russian government reports. In September and October the Russian government undertook a series of additional raids (reportedly as many as nine), including the seizure of thousands of copies of illegal product. The raids are obviously a positive step. But, the end-results of the earlier raids are telling, and underscore the significant amount of work Russia must undertake to meet the GSP eligibility criteria:

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

Second, it would appear that virtually all of the optical disc plants that were raided in 2004 and 2005 remain in operation after those raids. A recent raid in mid-November 2005 on the Roff plant in Odintsovo, near Moscow, has led to a suspension of a license while a criminal prosecution proceeds. This was the first such suspension (by the new Federal Service charged with compliance with licensing regulations). In the case of several plants raided in 2004, truckloads of illegal material were seized weeks later from the same plants by Russian government enforcement officials – and still these same plants remain in operation and their licenses have not been suspended by the Ministry of Culture (i.e., the Federal Licensing Service – Rosokhrankultura).

Third, the plant owners remain unscathed by the criminal justice system. A few plant employees have been convicted – after extensive delays in criminal investigations – but virtually all received suspended sentences. Consequently, there is no deterrence to continuing to conduct commercial piracy in Russia at present.

Years of inaction have allowed the optical disc problem to mushroom. The existence and location of the plants (including as noted, some on land leased from the government) have been known for many years to the Russian authorities, yet little or no meaningful action has been undertaken. The Government of Russia has taken some positive steps, including passage in 2004 of much-needed copyright amendments, and some raids, but the fact remains that these are too few and far between, and they have thus far done little to stem the rising tide of pirate production.

The record industry has been involved in 24 cases against optical disc plants in the past two years. Twenty-one of those 24 cases remain without a resolution – that is, no prosecutions of the operators of illegal CD plants have been initiated, as investigations have dragged on. In

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the other three cases, the pirate CDs were destroyed, but no deterrent sentences were handed down. The only exception to this pattern (which has been true for years) was in June 2002 when the Disc Press MSK plant (raided in September 1999) was finally closed and a Zelenograd court handed down 4-year prison sentences to two operators of the plant. In February 2004, there was a one-year conditional sentence given to a manager of the Zelenograd plant which was raided in December 2002, resulting in the seizure of 234,493 pirate CDs (over 59,000 were music CDs). The more typical case is that of the Synograph plant, raided in October 2000. There was a four year criminal investigation aimed at the director of the plant; a court hearing was supposed to be undertaken this year, but the plant is still in operation.

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

To solve this problem, Russia must undertake vigorous criminal enforcement backed by the highest political officials in the government, since much of the piracy is undertaken by organized criminal syndicates. For example, according to the Entertainment Software Association (ESA), Russian organized crime syndicate pirates of videogame material are so well-entrenched that they "label" their product. The Motion Picture Association of America (MPAA) reports that DVDs are being locally produced in seven or eight foreign languages, not including Russian, indicating that the organized crime syndicates are producing these DVDs strictly for export. Markets that have been negatively impacted by imports of pirate Russian DVDs include: Poland, Estonia, Finland, Ukraine, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Germany, Israel, the United Kingdom, and Turkey.

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

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

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

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

IIPA urges the U.S. government to continue to insist on the adoption of a more effective licensing scheme, including one that links criminal sanctions and plant closures to noncompliance. That is why the U.S. government and the IIPA have sought the adoption of legal reforms to provide a more comprehensive enforcement authority. Over four years ago, the U.S. government provided the Russian government with a proposal for a comprehensive optical disc regulatory regime to address this problem, including tough enforcement provisions to control import, export, and the manufacture of optical discs and related raw materials and equipment. To date, the Russian government has not moved to adopt a comprehensive regulatory regime for optical disc replication.

During the past several years, the Russian government has run raids against some optical disc plants and warehouses. But as noted, these measures fall far short of an effective and comprehensive program to halt the widespread production and distribution of piratical optical discs.

Linked with the optical disc production problem is the need for the enactment and enforcement of effective border measures to stop the export and import of illegal material. Russia is a major transshipment point for illegal product. Coupled with illegal production from Russia, border enforcement to stop the shipment of illegal material to the other 25-plus countries receiving this material is thus another priority for the copyright industries. President Putin signed a new Customs Code that went into force on January 1, 2004, providing for measures to prevent the trade of counterfeit goods across borders. Unfortunately, the law failed to provide for *ex officio* enforcement authority. Consequently, even if customs officers discover shipments of obviously infringing products, they are not able to act on their own authority. Instead they are limited to act only in those cases where rightsholders have filed written applications to suspend the release of suspect goods.

The only way to combat the organized crime syndicates engaged in optical disc production and distribution, as well as the other forms of piracy that they conduct, is by effective criminal enforcement. Unfortunately, the criminal enforcement system in Russia is the weakest

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link in the Russian copyright regime. This deficiency has resulted in extraordinarily high piracy levels and trade losses. The federal police and the IP unit in the Ministry of the Interior have generally been cooperative in running raids against major pirates. At the retail level, however, anti-piracy actions must be conducted by municipal authorities (even though the criminal police have the authority—they just do not use it), and in these cases pirates are subject to administrative, not criminal, remedies that have proven ineffective.

Thus, the major shortcoming is the failure by the Russian legal system to use its existing criminal law provisions to impose deterrent penalties. Any street raid and/or small administrative fine imposed pales in comparison to the size and scale of the criminal activity. In general, swift criminal prosecutions do not follow raids. Prosecutors continue to drop cases without a justifiable reason (or, citing a lack of public interest). When cases are prosecuted, the penalties imposed are not at deterrent levels. Prison sentences are usually suspended. According to the Russian authorities, in 2005 only eight non-suspended prison sentences were imposed on IP infringers. There have been exceptions, of course, but as a result of the light sentencing, many police and prosecutors are discouraged from investigating and prosecuting offenders.

As a result of these enforcement failures, there are very high estimated piracy levels in all copyright sectors accompanied by massive financial losses. The piracy levels reported by the copyright industries are as follows: the recording industry is at 66%; the motion picture industry is at 80% (and likely over 90% for DVD piracy); the software industry is at 87% for business software and 73% for entertainment software; and the book publishing industry reports high levels of piracy, although current statistics are unavailable.

In sum, Russia is not providing adequate and effective enforcement as required by its bilateral and multilateral obligations to the United States.

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

In addition, existing efforts by certain industries to offer low cost Russian editions have not had the effect of reducing local piracy rates. The record industry, for example, is already manufacturing locally, and sells legitimate copies for an average price of $6.00 to $8.00 U.S. dollars—a price that is extremely low not just in relation to prices for music elsewhere, but also with respect to other consumer goods sold in Russia. The motion picture industry is also replicating DVDs locally and has considerably reduced the prices of legitimate product to below $10 in many cases. It is not the price of legitimate product that is creating opportunities for piracy—it is the opportunity for easy profits that has brought criminal enterprises into this business, and Russia should stop offering such excuses for its continuing inaction.

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

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

Steps the Russian Government Can Take to Properly Enforce IPR Crimes – Focusing on Optical Disc Piracy

There are several critical steps that the Russian government could take immediately to effectively confront its optical disc and related piracy problems:

1. Inspect, on a regular, unannounced and continuous basis, each of the 42 known OD plants, and immediately close and seize the machinery used to produce pirate product (some of these steps require additional legislative or regulatory measures);
2. Announce, from the office of the President, that fighting copyright piracy is a priority for the country and law enforcement authorities, and instruct the Inter-Ministerial Commission, headed by the Prime Minister, to deliver reports every three months to the President on what steps have been taken to address the problem. Also, it is imperative to establish a central coordinating body for law enforcement authorities with wide powers, derived directly from the President, to combine the efforts of the Economic Crime Police, the Police of Street Order, Police Investigators (who investigate major cases from the beginning to trial) and Department K (the New Technologies Police);
3. Adopt in the Supreme Court a decree setting forth sentencing guidelines for judges—advising the courts to impose deterrent penal sanctions as provided under the penal code as amended (Article 146). We also recommend amending Article 146 to a minimum penalty of six years, not the current penalty of five years (since only penalties of six or more years are treated as "serious" crimes);
4. Immediately take down websites offering infringing copyright materials, such as allofmp3.com, and criminally prosecute those responsible;
5. Improve border enforcement, including the import of machinery used to produce illegal product and the export of large shipments of that product abroad;
6. Initiate investigations into and criminal prosecutions of organized criminal syndicates that control piracy operations in Russia (including operations that export pirate material to markets outside Russia);

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7. Introduce, either via executive order or legislation, the necessary modifications of the optical disc licensing regime so that it clearly provides more effective control over the operations of the plants, including the granting of licenses to legal plants and withdrawing and sanctioning of illegal plants; stricter controls on the importation of polycarbonate and machinery; mandatory seizure and destruction of machinery used to produce pirate materials; and the introduction of criminal penalties for the owners of such plants. In addition, any plant licensing regime (including current law) should extend in scope to the operators of telecine machines and mastering laboratories used to pirate audiovisual works; and
8. Take action to undo the situation in St. Petersburg where legitimate video and DVD markets have been effectively lost due to the activities of a collective management organization known as the Association of Collective Management of the Authors' Rights (which falsely claims to represent MPA member companies and which incredibly, enjoys the support and protection of local officials, and requires, in violation of federal law, the application of a pirate hologram on all products sold with its license).

A full list of enforcement and legal reforms necessary in Russia were detailed in our Special 301 Report of February 2005.

III. Inadequate and Ineffective Copyright Protection in Russia

The Russian legal regime remains inadequate and ineffective in many key areas.

The most egregious short-coming is the failure to properly address the optical media problem with comprehensive legislative and regulatory reforms. In 1996, the IIPA first identified optical disc plant production as a problem and suggested the need for an enforcement "action plan" to address this problem, including legislative reforms. Two optical disc ("OD") plants were identified in the IIPA's February 1996 Special 301 Report. As noted, there are now 42 OD plants, and still Russia has failed to even consider legislation to provide proper plant licensing, inspection and criminal penalties for violators. At all levels of the Russian government there have been promises to address this problem (starting in 1999) including a pledge, never met, in 2002 to issue an "action plan"— but to date, there has been virtually no comprehensive action taken against the plants, no comprehensive plan of action issued by the Russian government, and no legislative reforms on this point have even been introduced. There *is no excuse for why the Russian government has been unable to properly license and inspect all* the known (now 42) plants, and to close and repeal (i.e., cancel) the licenses of those engaged in illegal production and distribution, as well as to criminally prosecute the plant owners and operators.

As one example of the failure to regulate the plants: late in 2004, in bilateral talks with the U.S. government and IIPA, the Russian government promised it would "meet with the 18 plants" (their figure) on restricted access (i.e., military) property to ascertain the legal or illegal status of their production, and to report back to the U.S. government. The meeting, scheduled for December, was cancelled and never rescheduled. The reason: the Russian government confessed it was unable to determine all the owners of the plants from its records (because of its

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inadequate licensing law) and therefore could not identify with whom the government needed to meet.

The Russian government must also introduce, and then implement with proper enforcement, effective measures against camcording motion pictures in Russian theaters so that infringers cannot claim to be making private copies for their personal use. At present, Russian pirates are obtaining high-grade pirate copies of movies by duplicating films in the projection booths of theaters, by making telecine copies of stolen or borrowed theatrical prints on their way to local theaters, and by camcording from local theater screens.

A short list of the other failed commitments relating to legal reforms includes:

Never properly implementing *ex parte* search provisions nor incorporating them into the Civil Procedure Code; (enacted in 2003).

Not providing police and prosecutors with the proper authority to confiscate illegal material nor *ex officio* authority to commence criminal investigations (the 1996 Criminal Procedure Code requires rightholders to formally press charges to commence investigations in some instances); and

Not fully implementing the 2003 amendment to the Criminal Code which fixed the grave harm threshold problem (i.e., it is unclear if it is working properly as it is not being utilized).

IV. Russia's WTO Accession

Russia's WTO accession negotiations are at a critical juncture. We believe that accession candidates must ensure that they have met in full their WTO obligations prior to accession, including ensuring that their copyright laws and enforcement systems comply with the substantive and enforcement provisions of the WTO/TRIPS Agreement. The Russian IPR regime is nowhere close to compliance with the WTO TRIPs obligations. As a consequence, the U.S. government should not assent to Russia's accession into the World Trade Organization until its copyright regime, both legislative and enforcement related, is brought into compliance with the WTO TRIPS obligations

IIPA urges USTR and the U.S. government as a whole to continue using the WTO accession process to encourage movement in Russia toward effective implementation of the TRIPS obligations as a member of the international trading community. We note, however, that such attention in the WTO sphere must not be undertaken at the expense of holding Russia accountable to its current multilateral and bilateral IPR obligations to the U.S. under the GSP trade program.

V. Estimated Trade Losses Due to Copyright Piracy in Russia

Below is a chart tracking the estimated trade losses due to copyright piracy and their estimated piracy levels in Russia. Data for this chart is provided to IIPA by its member associations. The methodology, which is basically the same used when we filed our 2000

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petition, is available on the IIPA website.[3] The IIPA estimates that the copyright industry lost over $1.7 billion due to piracy last year, and over $6 billion in the last five years in Russia.

RUSSIAN FEDERATION
Estimated Trade Losses Due to Copyright Piracy
(in millions of U.S. dollars)
and Levels of Piracy: 2000-2004

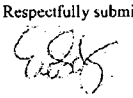
INDUSTRY	2004		2003		2002		2001		2000	
	Loss	Level	Loss	Level	Loss	Level	Loss	Level	Loss	Level
Motion Pictures	275.0	80%	275.0	75%	250.0	80%	250.0	80%	250.0	90%
Records & Music	411.9	66%	405.0	64%	371.9	66%	285.0	64%	250.0	70%
Business Software[4]	600.0	87%	704.0	87%	370.0	89%	90.6	87%	89.0	88%
Entertainment Software[5]	255.8	73%	NA	80%	NA	90%	173.6	90%	NA	94%
Books	42.0	NA	40.0	NA	40.0	NA	48.0	NA	48.0	NA
TOTALS	1784.7		1424.0		1031.9		847.2		637.0	

VI. Conclusion and Request for Action

Copyright law and enforcement in Russia clearly fails to conform to the "adequate and effective protection" standard demanded of our trading partners. Russia has been placed on the Priority Watch List for 9 straight years while the number of optical disc plants grew from 2 in 1996 to at least 42 today. Russia is failing to comply with our GSP eligibility rules. For too many years, Russia has been on-notice that it must take appropriate action to meet its "part of the bargain" in receiving these unilateral trade benefits. So far, its part of the bargain has not been met.

IIPA believes that the U.S. government should immediately designate Russia a Priority Foreign Country, and should suspend Russia's eligibility to participate in this trade program given its overall enforcement deficiencies and its lack of compliance with the requirements of the GSP program.

Respectfully submitted,



Eric J. Schwartz
Vice President and Special Counsel
International Intellectual Property Alliance

[3] The methodology used by IIPA member associations to calculate these estimated piracy levels and losses is described in IIPA's 2005 Special 301 submission, and is available on the IIPA website at www.iipa.com/pdf/2005spec301methodology.pdf.

[4] BSA's 2004 statistics represent the U.S. publishers' share of software piracy losses in Russia, and follow the methodology compiled in the Second Annual BSA/IDC Global Software Piracy Study (May 2005), available at http://www.bsa.org/global/study/. These figures cover, in addition to business applications software, computer applications such as operating systems, consumer applications such as PC gaming, personal finance, and reference software.

[5] ESA's reported dollar figures reflect the value of pirate product present in the marketplace as distinguished from definitive industry "losses." The methodology used by the ESA is further described in Appendix B of IIPA's 2005 Special 301 report (see link above).

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Mr. SMITH OF TEXAS. Thank you, Mr. Smith. I have to observe that I noticed, Mr. Smith and Ms. Borsten, that you both went to Berkeley. And it's just nice to see two graduates of Berkeley in favor of any kind of property rights; particularly intellectual property rights. [Laughter.]

And that's not really a slight, but goes more to the reputation perhaps of one of the best institutions in the country.

Ms. Borsten.

TESTIMONY OF JOAN BORSTEN, PRESIDENT, FILMS BY JOVE, INC.

Ms. BORSTEN. Chairman Smith, Congressman Berman, and other distinguished Members of the Subcommittee, I want to thank you for the invitation to appear before you again.

Despite three U.S. Federal Court decisions in our favor, my company, Films by Jove, continues to be threatened with the loss of our investment by the Russian government. In May 1992, Films by Jove acquired rights to distribute internationally an award-winning library of more than 1,200 Soviet animated films. Most of these films were little known outside the former Eastern Bloc. Our contract required that we restore and reformat the films for the international market, and that we pay our Russian partners significant acquisition fees and profits.

Our success drew the attention of the Russian Federation officials, who wanted to bring the lucrative business that we developed under their own control. In 1999, the Russian government deliberately formed a new state-owned animation studio with the same name as the studio from which we had licensed the rights back in 1992.

In 2000, this state-owned studio, backed by the ministry of culture, joined forces against us as a third party in a lawsuit we had initiated in the New York Federal Court to end illegal video duplication by a major Russian-American video pirate, a convicted felon. The new studio told Judge David Trager that it was the sole legitimate copyright holder of the animated films, and that we were the pirates.

In August 2001, Judge Trager concluded that we had signed our 1992 contract with the only possible copyright holder of the animated films. The following year, the Russian studio requested that Judge Trager reconsider his ruling, on the basis of a new decision by Russia's highest commercial court. That ruling cancelled, without explanation, certain lower court decisions on which Judge Trager had relied.

To counter this step, we presented the court with a confidential document which provided details of a secret meeting at the Kremlin about securing the animation rights for the new studio. The secret meeting was attended by a representative of the office of the chief justice. It was also attended by the Minister of Culture, his two deputies and their lawyer, representatives of the State Property Ministry, the State Prosecutor's Office, the Russian Patent Bureau, the presidential administration, and the director of the new state-owned studio. At the meeting, the Deputy Prime Minister assigned the chief justice the task of making sure the courts ruled in favor of the state.

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The last time I testified, we were still waiting for Judge Trager's decision. In April 2003, he denied their request for consideration, writing, "It is apparent that the High Arbitrazh Court's decision was strongly influenced, if not coerced, by the efforts of various Russian government officials seeking to promote state interests." Under these circumstances, the high court's decision is entitled to no deference.

Nine months later, the Prime Minister of Russia signed a directive retroactively amending the 1999 directive that had created the new state-owned studio, now to include animation copyrights. According to both Soviet and post-Soviet laws, the state did not have those copyrights to give, either in 1999 or in 2003.

The state-owned studio again petitioned Judge Trager for reconsideration. In their brief, attorneys for the state-owned studio warned Judge Trager that the Prime Minister's directive "strongly suggests that the Russian government is concerned about what has happened in this U.S. court."

In November 2004, Judge Trager again declined reconsideration, writing, "It would contradict the very principles at the foundation of the separation of powers doctrine to allow a foreign state to engage in activities that the United States courts would not tolerate from the U.S. Legislature."

The pirates settled. The state studio did not appeal. But the Russian government continued its efforts against us. Indeed, their recent actions have been most contradictory. One moment, they propose settlement; and the next moment, they resume obstructionism and hostility.

In October this year, we signed a memorandum of understanding, by which the new studio recognized our 1992 contract and its amendments. One month later, the Russian side suddenly began to demand additional documents in what we fear might turn out to be a renewed challenge to our rights.

We've recommended numerous times to the Russian government that if it is so important for the animation library to be controlled by a Russian state-owned organization, they should come to the negotiating table and buy us out of our contract.

Despite the difficulties that I have outlined, since Judge Trager's decision there has been progress in building protection for intellectual property rights of U.S. investors in Russia. It is now quite possible that in the future U.S. companies harmed by Russian non-enforcement of their intellectual properties will be able to use U.S. courts to obtain redress of their grievances. Recently, both the Second Circuit and the Colorado Supreme Court reversed lower court decisions that had found the Russian courts to be adequate alternative forums for property disputes.

I urge this Committee and Congress not to underestimate the ruthlessness and implacability of Russian efforts to undermine property rights, especially intellectual property rights.

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

[The prepared statement of Ms. Borsten follows:]

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PREPARED STATEMENT OF JOAN BORSTEN

Testimony to the Subcommittee on Courts, The Internet and Intellectual Property
Committee on the Judiciary
U.S. House of Representatives
December 8, 2005

Joan P. Borsten
President, Films by Jove, Inc.

"International IPR Report Card –Assessing U.S. Government and Industry Efforts to Enhance Chinese and Russian Enforcement of Intellectual Property Rights

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. Since my previous testimony almost three years ago, Russian disrespect for intellectual property rights has not abated. On the contrary, Russian piracy has increasingly involved government officials.

Despite three US Federal Court decisions in our favor over the last three years, my company, Films by Jove, continues to be threatened with the loss of our investment because of new efforts by the Russian government to expropriate our rights without compensation.

I would like to provide some details of these developments to you today.

My testimony will highlight two points:

I. IPR violations sponsored by the Russian government hurt U.S. investors and the credibility of the Russian legal system has been undermined by Kremlin pressure on judges.
II. Russia continues to disregard U.S. court decisions on IPR.

Despite this perhaps gloomy picture, I will go on to point out several hopeful developments in US jurisprudence that will help US investors to protect their intellectual property rights against Russian government interference. In my conclusion, I will recommend several steps that can be taken by the US Government to build on this progress.

I. IPR Violations Sponsored by the Russian Government Hurt U.S. Investors

The Case of ***Films by Jove***

My company's most recent experiences are as follows:

In May 1992, Films by Jove acquired rights to distribute internationally an award winning library of more than 1,200 Soviet animated films. Most of these films were little known

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outside the former Eastern Bloc. Our contract required that we restore and reformat the films for the international market, and that we pay our Russian partner significant acquisition fees and profits. Our success in promoting Russian animation around the world drew the attention of Russian Federation officials who wanted to bring the lucrative business that we developed under their own control.

In December 1998 we filed suit in the New York Federal Court to end illegal video duplication by a major Russian-American video pirate, a convicted felon. Then, in 1999, the Russian government deliberately formed a new state-owned animation studio with the same name as the studio from which we had licensed the rights back in 1992. In 2000 this state-owned studio, backed by the Ministry of Culture, joined forces against us as a third party in the ongoing suit. The new studio told the judge that it was the sole legitimate copyright holder of the animated films, and that *we* were the pirates. In August 2001, US Federal Judge David Trager disagreed with their claim. He concluded that we had signed our 1992 contract with the only possible legitimate copyright holder of the animated films.

In March 2002, the Russian state-owned entity requested that Judge Trager reconsider his ruling on the basis of a new decision by Russia's highest commercial court -- the Supreme Arbitrazh Court. That ruling cancelled without explanation certain lower court decisions on which Judge Trager had relied.

To counter this step, we presented the court with a confidential document that we had obtained, providing details of a secret meeting at the Kremlin at which the Deputy Prime Minister of the Russian Federation instructed the Chief Justice to control the court. The stated purpose of the meeting was to co-ordinate the efforts of various state organizations which had failed (until then) to secure the copyrights for the new state-owned studio. The secret meeting was attended by the following officials: a representative of the Office of the Chief Justice; the Minister of Culture; two Deputy Ministers of Culture; 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; the director of the new state-owned studio; and the chairman of a new state-owned film distribution agency.

Three weeks after that *ex parte* meeting, a cassation court ordered that the properly registered successor of the company from which we gained our license be de-registered. Nine months after the *ex parte* meeting, the Chief Justice of the Supreme Arbitrazh Court issued a decision which had been drafted for him by the Deputy State Prosecutor. We were able to obtain copies of the draft decision and of the judge's final decision. Comparison of the two revealed that the judge's final ruling repeated the prosecutor's draft word for word. That decision vacated without discussion two lower court rulings that had gone against the State.

In April 2003 Judge Trager denied the request for reconsideration, writing:

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> "It is...apparent that the High Arbitrazh Court's December 18, 2001 decision was strongly influenced, if not coerced, by the efforts of various Russian government officials seeking to promote "state interests." Under these circumstances the High Court's decision is entitled to no deference.
>
> "If the High Court's clearly erroneous decision impacted only the rights of Russian parties, this court might, nevertheless, defer to the High Court's arbitrary departure from what appears to have been the consensus understanding of the...legislation. However, insofar as this ruling affects the rights of a non-Russian party, Films by Jove, which invested over three million dollars in acquiring the copyright license for Soyuzmultfilm Studio's films, and developing the commercial value of these copyrights, the sudden shift in Russian law effected by the High court decision, which operates to deprive an American corporation of its substantial investment, is simply *unconscionable* (our emphasis added). For these reasons this court will not defer to the conclusions articulated in the High Court's December 18, 2001 decision."

In December 2003, the Prime Minister of Russia signed a directive retroactively amending the 1999 directive that had created the new state-owned studio, and giving the animation copyrights to the new studio, even though -- according to both Soviet and post-Soviet laws -- the State did not have them to give. On the basis of this new directive, the newly created state-owned studio moved again for reconsideration in March 2004.

In their brief, attorneys for the state-owned studio warned Judge Trager that the Prime Minister's directive "strongly suggests that the Russian Government is concerned about what has occurred in this [US court's] action...."

Fortunately, Judge Trager was not intimidated. His reply was a resolute defense of the separation of powers. In November 2004 he rejected the second motion for reconsideration, stating: "It would contradict the very principles at the foundation of the separation of the powers doctrine to allow a foreign state...to engage in activities that the United States courts would not tolerate from the US legislature."

Having lost three times, the newly-created studio and their co-defendant, the Russian-American pirate, were preparing to appeal to the 2nd circuit when events took an unexpected turn. The pirate's Russian-American wife, now the owner of his business, declared her intention to run a lawful operation. She settled with us, paid a mutually agreed upon sum, cut off financial support to the new studio's lawyers, and withdrew from the appeal process. The appeal was dismissed after the new studio failed to file the necessary papers with the U.S. 2nd circuit.

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II. Russia Continues to Disregard US Court Decisions on IPR

Despite three decisions against them in US Federal Court, the Russian government has continued its efforts against us. Indeed, their recent actions have been most contradictory: one moment they propose settlement, and the next moment they resume their obstructionism and hostility. For example, as a condition of entering the New York Federal Court case in August 2000, the new state studio agreed to be bound by Judge Trager's decision. Nevertheless, after the 2003 decision, the state-owned studio together with the Ministry of Culture and Ministry of State Property planned to file suit against us in Moscow in an attempt to gain a bogus legal instrument that could be used to disrupt our sales, if not in the US, then overseas.

The inconsistent pattern of the Russians in their dealings with us continues to this day. In April this year, the state-owned studio proposed a truce, and in October we signed a memorandum of understanding by which the new studio recognized our 1992 contract and its amendments. In November, however, the Russian side suddenly began to demand additional documents from us in what we fear might turn out to be a renewed challenge to our rights.

Needless to say, these on-again-off-again tactics have been a severe drain on our finances. We are obliged to pay continuing legal fees out of our operating expenses, while our Russian adversaries draw on the limitless resources of their country's national budget.

We have recommended numerous times to the Russian government -- and we repeat now publicly -- that if it is so important for the animation library to be controlled by Russians, they should come to the negotiating table and buy us out of our contract.

We have negotiated in good faith. So far, the Russians have not.

MEETING THIS CHALLENGE

The Trager Decision Has Laid a Foundation for Future Action

Despite the difficulties that I have outlined, there has been progress in building protection for the intellectual property rights of US investors in Russia. Judge Trager's rulings laid a firm foundation for such protection. Indeed, Judge Trager's decisions represent an historic turning point in US jurisprudence. The judge was the first to formally recognize that Russian state-sponsored corruption constitutes a threat against which US property interests must be protected. (The US Federal court decisions about the animation library can be found at www.russiananimation.com/legal.)

Directly or indirectly, the Trager ruling has raised the red flag domestically for judges who hear cases involving the Russian court system. The 2nd circuit recently reversed a New

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York federal court decision which had found Russia to be an adequate alternative forum for a property dispute between Norex Petroleum and among others, the Russian oil company TNK. In another property rights case, the Colorado Supreme Court recently vacated and remanded two lower court decisions that found Russia to be an adequate alternative forum for a case against the Russian oil company Lukoil.

The Trager decision has also been cited in a report prepared for the Parliamentary Assembly of the Council of Europe (that report concerned cases brought by the Russian Prosecutor General against Mikhail Khodorkovsky, Platon Lebedev, and Alexei Pichugin).

The Trager decision may have an impact on Russian courts, in a curious manner: for several years Russian pirates have tried to use the corrupt Russian courts to win spurious financial awards against US copyright holders. The pirates sought these awards apparently hoping to enforce them in the US and the UK. The Trager decision may strengthen US companies against such tactics.

Furthermore, it is quite possible that US companies harmed by Russian non-enforcement of their intellectual property rights will begin using the US courts to obtain redress of their grievances. This could become a deterrent to Russian state-sponsored piracy.

The US Government Can Move To Protect US Investors' Rights through Existing International Agreements

In addition to the courts, the US Government has, in my view, an important role to play in building protections for US investors against Russian IPR violations. A major area for US action will be in holding Russia to its obligations in three key international agreements:

First, Russia is signatory to the United Nation's New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. This convention obligates Russia to enforce awards of international arbitration courts. However, many American small businesses, such as Kola River and Euro Asian Investment Holding, who obtained judgments in Stockholm and London for property expropriated by the Russians in the late 1990's, have been unable to have their judgments enforced. Even though Russian judges – including the Chief Justice of the Russian Supreme Court -- have acknowledged Russia's international duty to uphold arbitration decisions under the convention, Russian bailiffs have failed to act, or have been ordered not to.

Second, Russia is a signatory to the European Convention on Human Rights. The articles and conventions are therefore part and parcel of Russian law, as is the case law from the European Court of Human Rights which hears hundreds of cases each year brought each year by individuals and legal entities who believes their rights have been violated by the courts of the member states. With regard to property rights, the European Court of Human Rights (ECHR) has ruled consistently that executive interference in the judicial process is a violation of the Convention, as is expropriation without compensation, non-enforcement of

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final judicial decisions by State bodies, and actions of state-bodies that contribute to a violation.

Third, Russia is a signatory to the Berne Convention under which thousands of Russian and Soviet works that were formerly in the public domain in the US became eligible for the restoration of copyrights. Despite widespread publicity by the US copyright office on the procedures for regaining copyrights, the Ministry of Culture apparently never advised any of their constituents in the former Soviet film industry that such an opportunity was available. Similarly, Russian producers of new works have apparently never been advised by the Ministry that they have only 90 days from first cinema, television or DVD exhibition in Russia to register the title with the Library of Congress. As a result Russian-American video pirates take advantage of this ignorance to distribute bootleg copies. They escape having to pay statutory damages or legal fees to the rightful owners once the 90 day registration period has expired.

RECOMMENDATIONS

I would like to close my testimony today by offering the following recommendations on ways the US Government could help address IPR violations in Russia:

- I urge this committee and the Congress not to underestimate the ruthlessness and implacability of Russian efforts to undermine property rights, especially intellectual property rights.

- I encourage you to take notice of the new directions in US laws which have laid a firm foundation for more effective enforcement of US property rights in the Russian Federation. I urge the US Government to keep US companies informed -- through appropriate agencies and public information channels -- of Russian predatory practices and of the growing body of US law which can be used against such practices.

- I would like to see the US Government work more closely with the Council of Europe to protect US property interests in Russia. US companies, particularly small and medium-sized enterprises, should be aware that American legal entities that believe their civil rights have been violated by the Russian courts are entitled to bring their cases to the European Court of Human Rights.

- I believe the US public and private sectors should cultivate as allies filmmakers in the re-born Russian movie industry who can learn and benefit from US efforts to protect their intellectual property here, in the face of massive piracy in the Russian-American community. Together with them we can build a lobby for IPR protection in Russia. Towards that goal, I support U.S. funding for rule-of-law initiatives in Russia, especially in the area of enforcement; without functioning courts, there will be no civil society in Russia.

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- I urge you 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 continue investigate the official role of Russian government agencies in IP piracy.

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.

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Mr. SMITH OF TEXAS. Thank you, Ms. Borsten.

Mr. Israel, let me direct my first comment to you. And that is, I think it is worthy of emphasizing a couple of figures that you used in your prepared testimony. And in fact, I've used similar figures when I've made speeches on this subject, as well.

The first is that the United States intellectual property industries account for over half of all U.S. exports, and represent 40 percent of our economic growth. The figure I've been using is actually 30 percent, and I just wondered what your source was for the 40, which I like better.

Mr. ISRAEL. Thank you, Mr. Chairman. I'd be happy to provide you the specific footnote to that. I believe that's a study that was done by the U.S. Federal Reserve that looked at economic growth, I think in the latter half of the 1990's. But on the 40-percent number, I'd be happy to follow up to you and the Committee on that.

Mr. SMITH OF TEXAS. Okay. Great, if you would. And would you do the same in regard to the estimated IP theft cost to United States businesses of approximately $250 billion annually? And of course, the result in hundreds of thousands of lost American jobs, I'm familiar with that. But the $250 billion figure I think is, again, eye-catching, and if you could give us the source on that, as well.

Mr. ISRAEL. I will certainly do it.

Mr. SMITH OF TEXAS. Ms. Espinel, let me direct most of my questions to you today, just because of your position. You say in your testimony that we are working on IPR issues in the context of Russia's WTO accession negotiations. We have continuing concerns that Russia's current IPR regime does not meet WTO requirements.

I assume today you would oppose the entry of Russia into the World Trade Organization, based upon its current record; would you not?

Ms. ESPINEL. I would certainly say that Russia needs to make considerable progress——

Mr. SMITH OF TEXAS. Okay, but they're not——

Ms. ESPINEL [continuing]. As we, including Ambassador Portman, have made clear.

Mr. SMITH OF TEXAS. You would not consider them in sufficient compliance today to recommend their entry into WTO?

Ms. ESPINEL. We believe more progress needs to be made.

Mr. SMITH OF TEXAS. I'm sorry?

Ms. ESPINEL. We believe more progress needs to be made.

Mr. SMITH OF TEXAS. Okay. Do you have any ideas when that progress would be sufficient to justify their consideration?

Ms. ESPINEL. I suppose a lot of that depends on Russia. I mean, we're working very hard on the accession negotiation, obviously, but we've made it very clear to them that we need a good agreement, in order to be able to complete the process.

Mr. SMITH OF TEXAS. Mr. Smith in his testimony raised, or made three recommendations, and let me follow up on two of them. They overlap what I was going to ask you about. He says that IIPA believes that after 9 years on the Priority Watch List, it is time for the United States Government to take a different approach to Russia's inability or unwillingness to act. In this case, recommendation, designate Russia as a Priority Foreign Country, after the on-

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going Out-of-Cycle Review by USTR. Why would you not so designate Russia?

Ms. ESPINEL. Well, we would consider using all of the options that we have against Russia. I think we would consider not so designating Russia if we believed that progress is being made, or if we believed that designating Russia as a PFC would not be the most effective way to achieve what we want to achieve, which is progress in Russia.

Mr. SMITH OF TEXAS. The other recommendation was to deny Russia's eligibility to Generalized System of Preference duty free trade benefits. When will that decision be made?

Ms. ESPINEL. There is an ongoing review of GSP, which the USTR is taking very seriously. There was a hearing actually——

Mr. SMITH OF TEXAS. Is there a deadline for when that review will be complete?

Ms. ESPINEL. The general GSP deadline, the regular GSP deadline is June 30th for decisions. That doesn't necessarily, though, have to be Russia's deadline. There could be a decision made earlier than that.

Mr. SMITH OF TEXAS. That's good news. June 30th, or perhaps before.

Ms. ESPINEL. We would certainly anticipate that a decision would be made by June, at the latest.

Mr. SMITH OF TEXAS. June 30th at the latest? Okay. Good. And a question on China. If we are not using existing WTO trade dispute mechanisms against China, which is widely perceived as among the worst global IPR offenders, then of what value are the WTO mechanisms?

Ms. ESPINEL. Well, I would say I think even the threat of WTO dispute settlement, of which China is well aware, is an effective tool.

Mr. SMITH OF TEXAS. Well, the threats, both to China and Russia, just don't seem to be manifested in much of a change in their conduct. And so I think it's going to require tougher actions on your part, on the part of our Government, if we are going to get the results that we want.

Ms. ESPINEL. I think we would certainly agree that there is an enormous amount of work that remains to be done. We have seen some recent indications of progress with China and with Russia. Although with Russia I would like to emphasize that those signs of progress are truly very, very recent; so obviously, it's going to be critical to see if Russia has the ability to not just sustain that, but actually increase it significantly.

With respect to WTO settlement, their dispute settlement specifically with China, as you know, it is something that we are working quite closely with our industry to develop our WTO options. And as I said before, if we, in consultation with our industry and in consultation with you and the rest of Congress, believe that's the most effective way to address the problem, we will move forward.

Mr. SMITH OF TEXAS. Okay. I would guess you would get widespread support by Congress to take some strong actions. Thank you, Ms. Espinel.

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

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Mr. BERMAN. Well, thank you very much, Mr. Chairman. First, Mr. Israel and Ms. Espinel, you've heard Ms. Borsten, the story of her saga in dealing with the Russians and their sale of these copyrights and then their refusal to acknowledge it, their creation of an entity to continue to produce them.

I'm wondering if, following this hearing, you or your offices—I think Commerce only because commercial attaches in our embassy in Moscow; the Trade Representative, because of your ongoing dialogue—in addition to the broader issues, help the Russians understand the importance of this specific issue in terms of at least a good example of how they respect copyrights and contracts. Would you be willing to have your offices follow up in pursuing that?

Mr. ISRAEL. Certainly, Congressman. And my understanding is that Films by Jove has worked with the U.S. Embassy in Russia.

Mr. BERMAN. Yes.

Mr. ISRAEL. Previously, I know Ambassador Vershbow was personally engaged, and commercial offices in Russia have been engaged, as well. We're certainly happy to take onboard recent activity and any developing needs that the company may have for U.S. engagement, and do any follow-up we can.

Mr. BERMAN. Great.

Ms. ESPINEL. As would USTR.

Mr. BERMAN. Good. This issue about progress is being made, on China, they made a number of commitments: increased criminal prosecutions for IPR violations, relative to the total number of IPR administrative enforcement cases. They agreed to do that. Have they?

Ms. ESPINEL. In order to do that—Well, one of the steps that they need in order to do that is to have regulations in place that will transfer cases that are put into the administrative system, about which we have serious concerns that it's not sufficiently deterrent——

Mr. BERMAN. Are those regulations in place?

Ms. ESPINEL. Those regulations are in process. They have drafted them. We are reviewing them. They are moving forward on them.

Mr. BERMAN. Reduce exports of infringing goods by issuing regulations to ensure the timely transfer of cases. That's what you're referring to for criminal investigation?

Ms. ESPINEL. There are several regulations that China is in the process of drafting as a result of the commitments in the JCCT, including with respect to transfer of administrative cases to the criminal process, export regulations, and Internet regulations in order to come into compliance with the WIPO Internet treaties.

Mr. BERMAN. And at this particular point, none of these regulations are in place?

Ms. ESPINEL. None of these regulations are yet in place.

Mr. BERMAN. Improve national police coordination by establishing a leading group in the ministry of public security responsible for overall research, planning, and coordination of all IPR criminal enforcement, to ensure a nationwide enforcement effort. Have they created such a group in the ministry of public security?

Ms. ESPINEL. I believe that has been concluded.

Mr. BERMAN. Four, enhance cooperation on law enforcement matters with U.S. by establishing a bilateral IPR law enforcement

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working group focusing on the reduction of cross-border infringement activities. Has that been done?

Ms. ESPINEL. Yes.

Mr. BERMAN. Expand an ongoing initiative to aggressively counter piracy of movies and audiovisual products.

Ms. ESPINEL. Yes.

Mr. BERMAN. It's been——

Ms. ESPINEL. It has. I should note, I suppose, that they have been some mixed results from that. There's been some very good results. The results of the campaign in Beijing were not as strong as we would have liked to have seen. The results in Shanghai and, I believe, Shenjin [ph] were actually quite positive.

But again, I would like to emphasize China—whatever signs of progress there we consider to be, obviously, good, but nascent. I mean, what is critical is that they sustain them.

Mr. BERMAN. Do you have benchmarks in mind for determining whether the progress is real and meaningful and substantial? I sound like we're talking about Iraq, but I'm not. We're talking about in terms of dealing with the problem of piracy.

In a percentage context, a reduction, or in an absolute number context, do you have some kind of benchmarks in mind for deciding whether or not there is enough progress to justify continuing not to bring a WTO case?

Ms. ESPINEL. Well, I guess, in my view, there are two categories of benchmarks. One is the specific commitments that China has made to us, and whether or not they follow through on those in terms of, for example, improving their legislation, or putting certain processes in place. And the second would be——

Mr. BERMAN. What about——

Ms. ESPINEL [continuing]. Results in terms of actually seeing piracy and counterfeiting reduce; whether that's measured by increased sales of our products, or measured by industry's assessment of the piracy rates falling. But I would say both of those, I think, are important components to measure progress.

Mr. BERMAN. And on the latter, what have you seen so far, on the quantified benchmarks, the reduction in piracy, the increase in acquisition of legal goods?

Ms. ESPINEL. I'm not aware that industry has done an overall survey since the last time I was before this testimony [sic], so I don't have any new figures or statistics to cite.

Mr. BERMAN. Well, Mr. Smith, if you apply that quantifiable standard, what would you say about China at this point?

Mr. SMITH. Well, for 2004, at least, the piracy rate went down a small notch in the recording industry, but stayed pretty constant for everything else. And we don't expect much of a change in 2005, simply because we haven't seen in our area the kind of criminal enforcement that the Chinese have been promising for a long time now. We just haven't seen it.

Mr. BERMAN. Well, I think my time has expired, Mr. Chairman.

Mr. SMITH OF TEXAS. The gentleman's time has in fact expired. And the gentleman from California, Mr. Schiff, is recognized for his questions.

Mr. SCHIFF. Thank you, Mr. Chairman. And really, the question I had is the question that Howard concluded with.

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But I'd like to see if I can get a few more specifics on it, because I think, both with respect to China and Russia and for our own purposes, unless there are clear expectations expressed to China and Russia about what we would like to see happen—in Russia's case vis-á-vis WTO and GSP; in China's case, whether there is an actual case filed in the WTO—my guess is, from my limited meetings with Chinese officials both there and here, they'll continue to tread water as long as they feel they can tread water. It won't injure the trading relationship.

And I think the same is true of Russia. Unless they have clear benchmarks of what we expect, I don't think things are going to change appreciably. But I do think that if we set out clear benchmarks of what we expect, that we might get a change.

And I know that you've asked the industry to go about doing the documentation to prepare for a WTO case. And I'm sure that will be useful; although the facts seem to be pretty overwhelming. If you can't make a WTO case in China, you can't make a WTO case anywhere.

And it seems to me that this is really designed by time, to tread water a little bit. But again, I think unless we have a clear set of benchmarks of what we expect—And it might be measured in terms of reduction of piracy. I don't know that it can be measured in the sense of increased sales of our products. That, although a desirable metric, doesn't seem like a legitimate metric, in terms of their piracy problems.

But what more specific and quantifiable things either have you asked for, or can you ask for, where China can be given the very clear alternatives of "Meet these expectations, or we'll support a WTO case," or in Russia's case, their accession? What are the clear metrics that either you have offered or that we can now offer?

Ms. ESPINEL. Well, first, I would say that I absolutely agree with you, that I think having clear benchmarks or a clear path forward is critical for China, Russia and, frankly, for all the countries where we're facing this challenge, so they have a clear understanding of what we think is necessary in order for them to address that.

With China and Russia, we have done that, I think, both at what I would describe as the macro level and a micro level. I mean, we've made clear to China and Russia that we need to see improvements and that improvements will be measured by seeing the piracy rates come down.

We have, in addition to that, given them very detailed lists of either improvements in legislation, administrative processes, other very detailed improvements they need to make to their overall system in order to make their system more effective. And we will be measuring progress both by decrease in piracy rates and by their ability to move forward on the very specific action items that we've given both of them.

Mr. SCHIFF. Can you share with us—the Chairman asked what the deadline was for determination on the GSP issue. It's June 30th; it has to be decided by June 30th. Is that——

Ms. ESPINEL. That is the general deadline for the GSP review processes that are outstanding. That's not specific to ISP, just specific to the GSP review process as a whole.

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Mr. SCHIFF. So on or before that point, you'll have to make a decision about whether to try to revoke GSP status. Can you let us know what criteria you've enumerated with the Russians, so that we can hold you accountable and that we can together hold the Russians accountable?

Because as we get closer to June 30th, there may be a decision made to wait till the next June 30th; which is a decision of sorts that we've made, I guess, over several years, because we haven't taken action in this area. But it would be useful, I think, for us and for the Russians to know precisely what we expect of them.

My impression, again, with respect to China—and it's probably similar to Russia—is that if we merely talk about improvement, they will give us a very good presentation about all the ways they've improved; and yet, at the bottom line, the piracy won't have changed very much.

So either today or in written form, I'd really like to see what specifically we expect to take place before June 30th with respect to Russia, what specifically we expect China to accomplish in terms of number of criminal prosecutions or whatever standard is the right standard to use, so that we can encourage, foster, push a WTO case or any other kind of enforcement action, so that we can get concrete results. I invite any of you to respond to that.

Mr. ISRAEL. Congressman, I would add one insight based on something you brought up in the initial part of your question to Victoria; which is the sales of U.S. goods and services into these markets, I think, is a very critical piece of evidence we need to review and we need to look at. And it's something that working with industry is the key vehicle that's going to present those types of results.

When we talk to the Chinese about bringing their government infrastructure into an environment where they use legitimate and legal software, I think the most effective determinant of their progress on that, or one of the most effective determinants, is: are leading American software companies who are actively looking to get into that market having better results?

The fact that the Chinese market is the second leading market, the second largest market for PCs in the world, but the 25th largest market for software in the world, obviously tells us that in between two and 25 there's a lot of piracy going on.

So I do think it's important. And one thing we're trying to focus on doing is work with U.S. industry to get some indicators from them.

Mr. SCHIFF. And I don't disagree with that. What I mean is that I don't know that we can tell China that, unless we sell "X" amount of products, we're going to bring a WTO case for infringement. I don't know we can show that causal effect. But I do think we ought to maximize our pressure to open the markets in China, for exactly the reason you mentioned.

Ms. ESPINEL. If I could just add to the specifics, particularly with respect to Russia, in terms of benchmarks that we're looking for, one thing that we've made very clear to Russia is that they have a massive optical disc piracy problem, and that we need to see the plants shut. But in addition to that, we need to see the equipment

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seized and destroyed, so the plants can't reopen. There are raids and prosecutions, but we need to see people actually be put in jail.

There does seem to be—again, this is recent—greater cooperation on the law enforcement side. It may be that the prosecutors are the weakest link in this system at this point in time. But I think both on the OD plants—on the optical disc plants—and on tackling the Internet piracy problem that Russia has, those are two key items that we have made quite clear to Russia we see as priority issues that they have to get addressed.

Mr. SCHIFF. Thank you.

Mr. SMITH OF TEXAS. Thank you, Mr. Schiff.

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

Mr. ISSA. Thank you, Mr. Chairman. I sit on the International Relations Committee, in addition to the Judiciary Committee and, oddly enough, the Government Reform Committee. And all three of our Committees are looking at and trying to deal with: What do we do with two nations, both former classic Stalinist dictatorships, that seem to have absolutely no real intent, beyond passing laws, but intent to enforce those laws when it comes to intellectual property, when it comes, to be honest, with not spying on us and not taking not just intellectual property in the sense of DVDs and CDs, but technology to do just about anything to improve their economy?

And I always want to be careful when I suggest this, but I want to liken back to the Cold War. During the Cold War, we held these two—China as it is today obviously, and the old Soviet Union, but substantially the Moscow government—we held them to be totalitarian dictatorships. And because we held them to be totalitarian dictatorships, we held them responsible for any and all actions that occurred within their government structure and within anything that might be called a private sector. Any person granted the ability to leave their country, their ships, including their maritime commercial ships, we held them all responsible.

Isn't it true that, particularly with Putin's step away from a free market, that Russia now is looking much more like a government that central control is certainly possible, if not always executed; and in the case of China, there's substantially no difference in the organization that we dealt with in the Cold War, a strong central government with strong regional governments, but all of which reported back, in the case of China, to the political structure of the Communist Party?

If that's true, and I believe it is, shouldn't we view the Cold War tactic of simply saying to their governments, "We hold you responsible, and any failure will be considered to be a willful act," and a failure to make these changes, or substantial progress on these changes, in a timely fashion, should result in an appropriate raising on an economic basis of the curtain that we so long were viewing in front of us and between us? Mr. Israel, I guess we'll start with you.

Mr. ISRAEL. Thank you, Congressman. I think, you know, the historical contexts that come into play with these two countries in particular certainly have to be considered. And I know the entire Federal Government—the Administration, as well as Congress—

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consider these components when you think about how to address the issues going forward.

I do think, in addition to some of the things you laid out, one key factor to consider is the significant current presence and potential presence and desired presence of U.S. business and industry working in these markets. These are, as you're well aware, sir, of course, very large and lucrative markets, particularly in the case of China, with very large U.S. investments there.

So I do think the posture that the United States takes toward these two countries has, obviously, evolved and changed a good deal over the most recent years, as the trading relationship has become extremely intertwined and complex between the countries.

And I do think we are looking. And I believe that in the coordination model that we're trying to develop we are looking to make sure that across the entire U.S. Federal Government the relationships that we have with these two countries, when given an opportunity to stress the significance of intellectual property rights, what it means, not in terms of how these two countries view it, but how in terms the United States views it and, indeed, most of the industrialized, sophisticated economies of the world view intellectual property.

One thing that I think is a bit of a piece of leverage with both Russia and China is they desire to be viewed on the world stage as sophisticated global economies.

Mr. ISSA. Market economies.

Mr. ISRAEL. Market economies, to use the common term that we hear quite a bit from both. And their leaders desire that. And we have stressed that there is a certain pattern of behavior; there's rules of law; there's ways you engage in a global economy that fit the norms of the modern economy. And I do think that's something we need to continue to stress with both these countries.

And I do think it's an evolving set of relationships, clearly. And there are new rules and new processes we're engaging in and trying to use every opportunity we have across all the relationship venues with these two countries to stress the priorities that we have; IPR being nearly first on every one of those lists.

Mr. ISSA. So in order to focus the answers, because I don't want to monopolize the time, the question really, though, is the government-to-government relationship; not as a market economy to market economy where we say, "Make your best efforts, but we understand you have an independent judiciary, an independent legislature, an independent business climate," all of which really doesn't exist in China. And I've traveled and done business in China extensively for over 20 years, and now traveled to Russia and looked at the changing Russia. These are not market economies.

Business-to-business, I understand. Government-to-government, should we hold these governments responsible? And if so, should that message become the obvious message, which is, "We don't want to hear about best efforts; we expect your government to perform the same as when, during the Cold War, we said if your submarine drifts outside its zone, we will consider it a provocative action, not an accident, because we expect you to keep your government activities and your fishing boats that used to prowl the West Coast—we expect you to make sure that they obey international

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law." So the question really is government-to-government. Ms. Espinel?

Ms. ESPINEL. Well, I guess, to me, the question you ask is: Isn't this really a matter of political will, high-level political will?

Mr. ISSA. Exactly.

Ms. ESPINEL. And I would agree with you. And I think we understand that with both Russia and China it is critical that this come from the highest level of their political structure in order to be effective. We have, therefore, raised it at our own highest levels of political structure, including by President Bush.

I'd like to note, in case you aren't aware, that the meetings, I think, with the top levels of all the Federal agencies and President Bush have produced a statement from President Hu of China, saying that he understands the need to protect the legitimate rights and interests of our right-holders, and that this is something China intends to do.

I'd also like to note that our understanding is in August of this year, for what I believe is the first time, President Putin actually intervened on this issue and sent a very strong message to his inter-ministerial that this is something that needed to be addressed. And I think that is a primary reason why we have in fact seen some recent progress in the last few weeks, because that message is coming from the very top of their political structure now. So I would agree with you that it's critical that it be addressed at that level.

Mr. ISSA. Thank you, Mr. Chairman. I'd ask unanimous consent for the others to respond in writing.

Mr. SMITH OF TEXAS. Without objection, would you complete the response in writing, then?

[The statements follow:]

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WRITTEN RESPONSE TO QUESTION POSED BY REPRESENTATIVE ISSA FROM THE HONORABLE CHRIS ISRAEL, COORDINATOR FOR INTERNATIONAL INTELLECTUAL PROPERTY ENFORCMENT, U.S. DEPARTMENT OF COMMERCE



UNITED STATES DEPARTMENT OF COMMERCE
Office of the Coordinator for
International Intellectual Property Enforcement
Washington, D.C. 20230

January 11, 2006

The Honorable Lamar Smith
U.S. House of Representatives
H2-362 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Smith:

It was a pleasure to testify before your Subcommittee during the hearing on "The International IPR Report Card - Assessing U.S. Government and Industry Efforts to Enhance Chinese and Russian Enforcement of Intellectual Property Rights." During that hearing, Rep. Darrell Issa requested that I answer a question for the record. His question and my response are below:

> *"Should we hold these governments responsible (for IP enforcement)? And if so, should that message become the obvious message, which is, "We don't want to hear about best efforts ... we expect you to make sure that they obey international law."*

I would certainly agree with Congressman Issa's proposition that we hold governments directly responsible for real and tangible results in protecting intellectual property and adhering to international agreements that they are a party to.

Leaders in China and Russia must know that the United States places a very high priority on IP protection. The Administration has repeatedly communicated this to leaders in both countries – including conversations between President Bush and Presidents Hu and Putin.

We have seen leaders in China and Russia increase their efforts to address piracy and counterfeiting. For instance in China, both President Hu and Premier Wen have made recent summit-level commitments regarding intellectual property enforcement. Vice Premier Wu Yi assumed a leadership role on the issue at the 2004 Joint Commission on Commerce and Trade meeting, when she committed to reducing the incidence of piracy in China. In September of 2004, she also convened a national telephonic/video conference on intellectual property in order to initiate a one-year campaign to improve intellectual property protection. Additional high-ranking officials who have spoken out on IPR are noted below. [1]

[1] Chen Zhili, State Councilor in charge of science and technology and education; Bo Xilai, Minister of Commerce; Ma, Xiuhong, Vice Minister of Commerce; Zhang Zhigang, former Vice Minister of Commerce and Head of MORO; Tian Lipu, Commissioner of State Intellectual Property Office; Wang Jingchuan, former Commissioner of SIPO; Xu Guanhua, Minister of Science and Technology; Li Dongsheng, Vice Minister of SAIC; Shi Zongyuan, Commissioner of the Press and Publications Administration and National Copyright Administration, Yan Xiaohong, Deputy Commissioner of PPA and NCA, Zhu Lilan, Vice Chairman of NPC Standing Committee and Chairwoman of China Association of Invention; and Lu Yongxiang, Vice Chairman of NPC Standing Committee and former President of Chinese Academy of Science.

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There have also been several significant policy enactments addressing intellectual property. The 11th five year program contains multiple references to "self innovation", a National IPR Strategy is under way, a National Patent Strategy has reportedly been developed and nearly every Chinese ministry has IPR action plans or programs. In addition, many local governments have IPR action plans.

In Russia, President Putin has directed his inter-ministerial to address IP enforcement. In addition, Russian Minister of Economic Development and Trade German Gref has recently made strong public statements indicating the need for Russia to protect IP in order to promote their own economic growth. Likewise, Russian Minister of Education and Science Andrey Fursenko has made similar statements to senior U.S. officials.

As the president of the G8 in 2006, Russia also has a tremendous opportunity to demonstrate leadership and results on IP enforcement this year.

Our efforts and expectations certainly extend beyond conversations and best efforts however. The most significant indication of progress will continue to be results. Whether it is delivering on the JCCT commitment to eliminate government use of pirated software in China, or a significant reduction in the number of optical disc (OD) plants engaged in piracy in Russia, the Administration will continue to focus on results and hold our trading partners and their leaders accountable for delivering them.

I appreciate your leadership and commitment to combating international fakes and counterfeits. I can assure you that the Administration shares this commitment and is working to ensure that we are leveraging all of our resources and capabilities to protect American IP. If you or other committee members have any further questions, please contact me or Stephen Replogle, Office of Legislative and Intergovernmental Affairs, at (202) 482-3663.

Sincerely,

Chris Israel

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WRITTEN RESPONSE TO QUESTION POSED BY REPRESENTATIVE ISSA FROM MR. ERIC SMITH, PRESIDENT, INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE (IIPA)

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January 12, 2006

Response of Eric H. Smith
President, International Intellectual Property Alliance (IIPA)
to question posed by Congressman Issa re China and Russia and their international legal obligations

At the December 7, 2005 oversight hearing on International IPR Report Card – Assessing U.S. Government and Industry Efforts to Enhance Chinese and Russian Enforcement of Intellectual property Rights before the Subcommittee on Courts, the Internet and Intellectual Property, Committee on the Judiciary, Congressman Issa asked for the response of members of the witness panel on what U.S. and industry expectations should be with respect to Russia and China's compliance with their international obligations to enforce their IPR laws.

Ms. Espinel responded to Congressman Issa's observations and question by stating that the issue is really "a matter of political will, high-level political will." Congressman Issa agreed that this was a key issue. Ms. Espinel then noted the meetings of President Bush with President Hu of China at which he recognized the "need to protect the legitimate right and interests of our [U.S.] right holders..." (draft transcript p. 61) and the "intervention" of President Putin with his inter-ministerial IPR committee on enforcement issues. She then added that "it's critical that it be addressed at that level" [e.g., the Presidential level].

IIPA fully agrees with this response. In both Russia and China, the "political will" to enforce the law against massive piracy must come from this level of government, given the nature of these governments. So IIPA welcomes the intervention of President Putin and the statements of President Hu. Without direct intervention by President Putin in Russia and by President Hu and the Politboro in China, IIPA does not believe there can be any significant reduction in piracy levels in either country in the near term.

While this is certainly the case, it must be pointed out again that, in the case of China, it is now a WTO member and has an unambiguous international "legal obligation" to enforce its law in compliance with its TRIPS/WTO commitments. That government has failed to meet that obligation which it had at the moment it was admitted to the WTO. The Chinese political leadership, at this highest-level, has made welcome statements, including the most recent one by President Hu, about the importance of intellectual property protection, but such statements must be followed (and this is what takes the "political will, not just statements) by direct and effective action to prosecute pirates and impose deterrent penalties. The industry has identified this as the critical failure of China in meeting its TRIPS obligations and while there has been some progress in organizing the Chinese government enforcement machinery to take such actions, the "political will" to take the specific actions needed to come into TRIPS compliance is still not evident in China. China should not be permitted to shirk its responsibilities to take such action immediately and bring its enforcement regime into compliance with these solemn commitments it has made to the U.S. and to all WTO members.

While Russia is not yet a WTO member, it is in the final stages of the accession process. "Intervention" by President Putin must extend to "ordering" the appropriate authorities to close pirate OD

aap BSA. Independent Film & Television Alliance NMPA

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factories found to be pirating U.S. product, to prosecute the owners of these plants who are blatantly violating Russia's existing law, AND to follow up to see that the authorities actually complete this process. IIPA had stated in its written testimony that this and certain other measures must be done before Russia is allowed to join the WTO. Furthermore, Russia now fails to meet the criterion on IPR enforcement contained in the GSP statutory conditions for receiving duty-free trade benefits. Congress has made clear that such blatant disregard of the intellectual property rights of U.S. right holders should not be rewarded by offering such valuable unilateral trade benefits. The U.S. could bolster Russia's "political will" by removing such benefits until that country comes into compliance both with this GSP criterion and with its future WTO obligations.

We thank the Chairman and all members of the Subcommittee, including Congressman Issa, for giving IIPA the opportunity to respond further on these critical issues and for holding this important hearing.

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WRITTEN RESPONSE TO QUESTION POSED BY REPRESENTATIVE ISSA FROM MS. JOAN BORSTEN, PRESIDENT, FILMS BY JOVE, INC.

FILMS BY JOVE INC
23852 Pacific Coast Hwy. #308
Malibu, CA 90265

20 January 2006

Representative Darrell Issa
House of Representative
Judiciary Committee
IP Subcommitee

RE: Subcommittee hearing on December 10, 2005

Dear Representative Issa:

First of all, let me congratulate you on passage by both the House and Senate of your sense of the Congress resolution which states that the Russian Federation must protect intellectual property rights. The resolution is much appreciated and long overdue.

In response to the main question you posed to witnesses during the subcommittee hearings, my response is follows:

There is no separate "market economy"-based private sector in Russia today, and the presumption should therefore be, as you suggest, that the Russian Government is responsible for IPR violations. We believe that amelioration of this very serious problem is a matter for diplomatic, government to government level relations.

Here are some examples, from our personal experience:

- When we licensed the animation library in 1992, we discovered that a significant number of the best films were based on underlying western literature and music which the Soviet Studio had never acquired. While it is true that some of this intellectual property was "borrowed" before the USSR signed its first international copyright convention in 1973, it was also true that some of the films were made post-73. In order to "save" these films we had to buy the underlying rights from those western rights holders who were willing to cooperate.

- For 70 years the USSR had a state monopoly on foreign trade. In the field of film, this was exercised by state company called Sovexportfilm. During the USSR they had stockpiled copies of thousands of Russian feature films and animated films in bunkers around the world. . During perestroika new economic legislation cancelled Soviexportfilm's monopoly status. The Studios which had made the films --and which by law owned the copyrights – were given the right to control the destiny of the films, i.e. to distribute them domestically and internationally. Despite this the state company Sovexportfilm blatantly ignored the new economic laws. They continued to sell. Goskino (the Soviet/Russian State Film Committee) either looked the other way or openly supported them against the Studios. We had to take Sovexportfilm to court in France, and threaten them with court in Germany, to stop the piracy.

- In December 1998 our company Films by Jove sued for IPR violations what it thought was a private citizen, Joseph Berov. Imagine FBJ's surprise when in October 1999 the Russian government created a new state-owned Studio, which joined the lawsuit as a third party plaintiff on the side of Mr. Berov in August 2000. As Judge Trager's decisions make clear, our principal adversary in the case was the Russian Government: not only the Ministry of Culture, but the Prime Minister's Office and Russia's highest commercial court (the High Arbitrazh Court).

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- The Ministry of Culture has regularly asked the Russian Foreign Ministry in writing to have embassy staff block our company from selling animation in various countries of Europe and Asia. This constitutes official interference in American trade at the most fundamental level

- In the last six years, most of the valuable Soviet Film libraries have been confiscated/re-nationalized by the Russian Government. As copyrights for the thousands of films made during the USSR belong by law to the Studios, not the State, the Studios could have become Joint Stock Companies. The shares would have been owned by the same Studio employees who made the films during the USSR, or their heirs. Instead the Ministry of Culture required the Studios to be turned into state-owned companies called Federal State Unitary Enterprises (FSUE). The FSUE then splits off its valuable library, which becomes a share holding company of the "closed" type. The main shareholders are usually large banks, but film industry insiders have little doubt that standing behind the banks are government officials. As all studio general directors were employees of the Ministry of Culture, he/she would have been summarily terminated for opposing the plan, and in fact some were. Only one Studio still controls its own library.

- No "private sector" DVD pirate in Russia could operate on such a vast scale and in such volumes without the participation of, and cooperation with Russian authorities.

- When I addressed the committee three years ago, I described how the Russian government had set up a state owned company called Roskinoprokat to re-nationalize distribution of feature films in cinemas. In order to open a Los Angeles office, Roskinoprokat described themselves to the US film industry (in their English-language publicity materials) as a "private enterprise."

From the times of the Czar, through the USSR, and until today, the Russian people have produced some of the world's most intellectual property – literature, music, cinema, art. Nonetheless, disregard for intellectual property rights in Russia is historic. From Soviet times, despite domestic laws and international treaties, those governing the Russian people have exhibited no serious respect for intellectual property rights. This official attitude, of course, has influenced the beliefs and behavior of those governed. Until and unless the official attitude changes, intellectual property rights of Russians and non-Russians will not be respected.

I hope this brief response was helpful.

Sincerely,

Joan Borsten

Mr. SMITH OF TEXAS. Thank you, Mr. Issa.

The gentlewoman from California, Ms. Waters, is recognized for her questions.

Ms. WATERS. Thank you very much, Mr. Chairman, and Members. I'm beginning to recognize that this problem of piracy and counterfeit items, etcetera, is much larger than I even thought it was.

First, let me just say that, whether you are on Fifth Avenue in New York in front of Sak's Fifth Avenue or Cartier's, where the knockoff goods are being sold out of bags by immigrants around the clock, or you are in most of the communities—and particularly low-

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income communities—across the country, knockoffs have replaced, basically, the retail industry in many of these communities.

And not only do you have people selling on the streets; you have these huge swap meets that are bringing in the knockoffs from Korea and China and other places, I guess. So when you go to festivals around the country, whether it's in Florida, New York, etcetera, they're selling thousands of Louis Vuitton purses and all the other items that most of us know about.

Now, I can simply speculate that we have been very lenient with China and some of our other trading partners. And I do not think they take us seriously.

I'm pleased to hear about this new, strong relationship we have with Russia, and the fact that they are supposedly shutting down plants and breaking up these operations. But I guess I'd like to ask whomever would like to answer, what evidence do you have that Russia or China is willing to shut down plants, have criminal penalties, and to destroy equipment, etcetera; whether we're talking about in the simple retail industry, or with computer software, or any of the other areas of concern that we have about intellectual properties?

Mr. SMITH. If I might take a crack at that, just to respond to the first part of your statement, in this country, clearly, we have piracy, and you described it. But it's a very small percentage of our overall market. It exists. There's no way you're going to get rid of it.

But if you go to China and Russia, we're not talking about 3 and 4 percent piracy rates, we're talking about 90 percent piracy rates. And we're talking huge criminal syndicates that produce this product. It's a problem of a totally different order.

With respect to Russia and the closing of the plants, in fact, just recently they raided nine plants. And in my testimony, I noted that that's progress. They raided them. But the problem is——

Ms. WATERS. And what happened?

Mr. SMITH. The problem is that product went out the door. They didn't seize the equipment. Historically, there have been virtually no prosecutions of plant owners. There's been one conviction of a plant owner in the last 5 years. This latest set of raids doesn't give us great comfort that there's been significant change.

And Ms. Espinel is absolutely right, President Putin did make that statement. And perhaps we will see something. But President Putin and the Russian government have made a lot of statements over the last years, and we haven't seen the action. And we're, frankly, quite frustrated. And it's a lot of promises and no convictions, no real action that is going to have a significant, on-the-ground market impact for our industries.

Ms. WATERS. May I quickly ask, how has this discussion taken form or shape in the WTO?

Ms. ESPINEL. I'll speak to that. I just want to emphasize, or underscore, the remarks made by Mr. Smith. We do see the recent raids of the OD plants as progress, but we have made quite clear to Russia that we need follow-up; we need the equipment to be seized and destroyed; we need the plants to be shut down permanently; we need to see people put in jail.

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In terms of the WTO process, right now we and other countries are negotiating with Russia the terms of their WTO accession, and there is an office at USTR that handles those negotiations. We are in the process of doing our bilateral market access negotiations with Russia. When those are completed, there will then be a multilateral process to negotiate the rules of the WTO accession.

Ms. WATERS. Thank you, Mr. Chairman.

Mr. SMITH OF TEXAS. Thank you, Ms. Waters; appreciate those questions.

Thank you all for your testimony today. It's been very helpful. Obviously, this is an issue we're going to continue to monitor closely. But we appreciate your responses today.

And Mr. Israel, you more than survived your first appearance before Congress as a witness.

I thank you all again. We stand adjourned.

[Whereupon, at 11:33 a.m., the Subcommittee was adjourned.]

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APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

STATEMENT OF THE HONORABLE HOWARD BERMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND RANKING MEMBER, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY

Mr. Chairman,

Thank you for scheduling this hearing on international intellectual property piracy. I hope this subcommittee can institutionalize the practice of having at least one hearing a year that focuses on international trade in products protected by intellectual property rights. By consistently bringing attention to the rampant piracy problem occurring abroad, we can begin to help the millions of creative people in this country who earn their living from intellectual property.

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

Because of the massive copyright piracy that occurs daily in China and Russia, the sales of black-market goods cause an annual loss of revenue to American creators that is truly staggering. According to the International Intellectual Property Alliance, piracy rates in the copyright industries range from a low of 70 percent to a high of 95 percent and American industries annually lose over 2.5 billion dollars in China and almost two billion dollars in Russia. But it is not only the copyright industries - entertainment, software, book publishing that suffer. We could probably have an entire hearing only on counterfeiting of motorcycle parts, purses and pharmaceuticals. No industry is immune from the endemic intellectual property violations occurring in these countries.

The problem in both China and Russia is similar - while the laws may be on the books, actual enforcement of those laws is sorely lacking. Few criminal prosecutions have taken place and even fewer sentences have been meted out. There is currently no true deterrent for the pirates. In fact, piracy has become the foundation for new businesses that export these black market goods.

The one effective tool the current administration has to incentivize the Chinese government to address its piracy problem is pursuing a WTO case. At the last hearing on this issue, the USTR testified that they were "committed to ensure that China is compliant with its obligations. And we will take WTO action if, in consultation with you and with our industry, we determine that this is the most effective way to fix the problem that we are resolved to fix." When I asked whether 6 months would be a reasonable time frame to reach a conclusion, the answer was that it could be. So here we are 6 months later - I am looking forward to an update.

Furthermore, have additional avenues for mitigating the effect of piracy in China been explored by the current administration? Currently, the Chinese government engages in vast restrictions on market access for American copyrighted goods. They restrict the number of American films that can be shown and severely curtails the right of our companies to do business in their country. These barriers make the impact of piracy that much greater and virtually impossible for our companies to counteract piracy.

With Russia there is still some leverage because they have not joined WTO yet. A number of months ago I, along with a number of New Democrats, wrote Ambassador Portman advising him that in order to obtain our support for any future trade agreement we would have to be assured that the lesson taught from allowing China to join the WTO without provision for adequate enforcement against intellectual property violations, has been learned. In fact, just last week IIPA submitted comments for the Special 301 out of cycle review on Russia. It is not encouraging news.

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"In short, Russia is not complying with its commitments to provide adequate and effective copyright protection and enforcement." Furthermore, the House, in a bipartisan vote (H. Con. Res. 230) recognized Russia's failure to adequately protect intellectual property and cautioned that without change they are at risk of losing GSP benefits and accession to the WTO.

Last time, we discussed the complexity of denying GSP benefits to a country - a process which requires consultation of most agencies within the Executive branch. It is clear that in Congress, we all agree that this situation is quite outrageous and that a country that flagrantly violates American intellectual property rights should not receive GSP duty-free benefits. So, I ask—since the last hearing has there been any movement on the status of Russia's GSP benefits?

If motivated, these countries can protect intellectual property rights. When piracy hurts the Chinese interests, the Chinese government has been motivated to step in. When knockoffs of the Beijing Summer 2008 games logos on T-shirts were being sold, the markets were quickly cleared. In short China can deal with this problem if it has the political will. In Russia, it seems incredible that the Russian government actually controls the facilities and land on which many of these pirate optical disk plants operate. How can it simply do nothing to shut down the plants operating on these government- run installations?

I am looking forward to hearing from the witnesses to learn what benchmarks or timelines have been established to help guide a decision on a WTO case against China, the withdrawal of GSP duty free benefits from Russia, and whether Russia is aware that they will be denied admission to the exclusive WTO club unless the piracy problem is addressed. I am looking forward to hearing about other steps that are being taken to protect American creativity.

STATEMENT OF THE HONORABLE BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. Chairman, thank you for holding this important oversight hearing on intellectual property theft in China and Russia.

In China, an estimated 95% of motion pictures and 90% of business software are pirated. In Russia, 80% of all motion pictures and 87% of business software are pirated. Considering that the core copyright industries account for 6% of U.S. GDP and the total copyright industries account for approximately 12% of U.S. GDP, it is clear that America's businesses are facing a serious problem. In fact, the FBI estimates that U.S. businesses lose between $200–250 billion a year to counterfeit goods.

Recently, China and Russia have received attention for intellectual property rights violations within their borders. For example, in April, the Office of the United States Trade Representative released its "Special 301" report, and elevated China to the "priority watch list" due to its failure to protect intellectual property rights.

We must make sure that *each* nation recognizes that piracy is a global problem. The growth of piracy among organized crime rings is illustrative of its global scope. The combination of enormous profits and practically nonexistent punishments by many foreign governments makes copyright piracy an attractive cash cow for organized crime syndicates. Often specializing in optical disc and business software piracy, these crime rings are capable of coordinating multi-million dollar efforts across multiple national borders. We must meet this type of highly organized piracy with highly organized coordination and enforcement efforts.

Another disturbing trend is the growing willingness of many foreign governments to condone the use of, and even use, pirated materials. At its best, government sets the standards for the protection of rights. At its worst, government encourages and even participates in the breach of those rights.

A recent article in The Moscow Times reported that the co-chairman of the public advisory board for the Russia Against Counterfeiting movement has said that until DVD's and CD's become more affordable, he and the majority of Russians would opt for pirated music and movies. This type of behavior from those responsible for reducing piracy is unacceptable. Now is the time for each country in the international community to choose which path it will take with regard to intellectual property rights.

We all must realize that copyright piracy and counterfeiting are serious problems that do not merely affect private companies' bottom lines in the short term. They also discourage investment and innovation in the long term, which will eventually lead to fewer consumer choices - a repercussion that affects entire societies and economies. Governments must work together to reward creators and punish thieves.

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Recent treaties, such as the TRIPS agreement, provide the legal framework for member countries to aggressively enforce their copyright laws. Article 61 of the TRIPS agreement specifically requires member countries to establish criminal procedures and penalties to be applied in cases of copyright piracy. The WTO provides trade dispute mechanisms and these tools can be used to pressure countries into compliance with existing agreements. In addition, countries like Russia wishing to enter the WTO should establish that they are committed to enforcing intellectual property rights.

We already have many tools to combat international piracy. Now we must put these tools to work. The United States must lead by example and rigorously enforce our copyright piracy statutes. However, we must also work with the international community to encourage other countries to do the same. Only when we coordinate our efforts to combat piracy will we see substantial results.

I look forward to hearing the testimony of our expert witnesses about how best the United States can help enforce intellectual property rights in countries that have not yet proven their commitment to enforcing intellectual property violations.

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NEWS ARTICLE BY THE HONORABLE LAMAR SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND CHAIRMAN, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY: "DEFENSE CONTRATOR HELD IN SPY CASE," FROM THE NOVEMBER 30, 2005 EDITION OF THE WASHINGTON TIMES

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The Washington Times
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Defense contractor held in spy case

By Bill Gertz
THE WASHINGTON TIMES
Published November 30, 2005

A defense contractor charged with failing to register as a Chinese agent admitted passing data on U.S. Navy arms technology to China for 22 years, including information on next-generation destroyers, an aircraft carrier catapult and the Aegis weapons system, according to new court papers in the case.

Two federal judges in Los Angeles on Monday reversed earlier rulings and ordered the contractor and his brother held without bond. The rulings followed testimony from FBI agents in the case.

Court papers released Monday, including a detention motion filed by Assistant U.S. Attorney Gregory Staples, also identified the Chinese military intelligence handler who received the information from defense contractor Chi Mak and his brother Tai Mak, who also is in the Chinese military.

The court documents shed new light on what U.S. intelligence officials say will be one of the most damaging cases of Chinese technology spying on U.S. weapons, even though the information compromised was not secret.

According to court papers, Chi Mak, an electrical engineer who worked on more than 200 Navy contracts, told investigators two days after his Oct. 30 arrest that he had been sending sensitive but unclassified documents on weapons research to China since 1983.

According to the papers, Chi Mak admitted passing to China information on:

•Direct current-to-direct current (DDC) converters for submarines.

•A 5,000-amp direct current hybrid circuit breaker for submarines.

•Electro-Magnetic Aircraft Launch System (EMALS), a new system to launch aircraft from carriers using magnets instead of steam.

•The power distribution system for the Aegis weapons system and its Spy-1 radar, used on the Navy's most advanced guided missile destroyers and cruisers.

•A study that reveals the methods used by U.S. warship personnel to continue operating after being attacked. Officials said the paper is a blueprint for attacking and disabling warships.

•Modifications and Additions to Reactor Facility (MARF), a nuclear reactor located at the Navy's Knolls Atomic Power Laboratory that's used for testing prototype nuclear reactors. Investigators found a detailed, hand-drawn map of that facility in Chi Mak's house.

Prosecutors argued in court that Chi Mak planned to retire to China in March and thus posed a flight risk.

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U.S. District Judge Cormac J. Carney, who ordered Chi Mak to be held without bond, dismissed a defense lawyer's claim that the charges were exaggerated. "You're talking about billions of dollars of technology that puts our country at serious risk," he said.

Investigators found data on the DDX destroyer program on encrypted files carried by Tai Mak, a Phoenix television engineer, when he was arrested along with his wife Oct. 28 at Los Angeles International Airport as they prepared to travel to China. The documents were labeled "proprietary" and "restricted," the court papers stated.

Chi Mak and his wife also were arrested Oct. 23 and initially charged with theft of government property and conspiracy. The charges against Chi Mak, his wife and Tai Mak were later reduced to failing to register as government agents. Tai Mak's wife was charged in a separate indictment with running a marriage fraud business.

According to the papers, Chi Mak, who was recently fired from his defense contractor job at Power Paragon, initially traveled to Hong Kong and gave the stolen information to his brother. Tai Mak then passed it to Pu Pei-Liang, identified by the FBI and the Naval Criminal Investigative Service (NCIS) as a research fellow at the Center for Asia Pacific Studies (CAPS) at Zhongshan University in Guangzhou, China. Later, Tai Mak served as the courier for the data.

During an intercepted telephone call to Mr. Pu on Oct. 19, Chi Mak stated he was part of the "Red Flower of North America," the code name that the FBI thinks was used to identify the spy ring.

The NCIS said the center in Guangzhou is run by the Chinese military and conducts operational research for it, including acquiring U.S. Navy technology.

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NEWS ARTICLE BY THE HONORABLE LAMAR SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND CHAIRMAN, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY: "ENVOY: LICENSED DVDS COST TOO MUCH," FROM THE DECEMBER 1, 2005 EDITION OF THE MOSCOW TIMES

Envoy: Licensed DVDs Cost Too Much
Anna Smolchenko
299 words
1 December 2005
The Moscow Times
English
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President Vladimir Putin's representative in the parliament's upper chamber said Wednesday that widespread piracy in the country would continue to flourish if licensed products did not become cheaper.

Alexander Kotenkov, Putin's representative in the Federation Council, said that unless discs became more affordable, he and the majority of Russians would opt for pirated music and movies.

"Russians want to have access to the world's intellectual heritage," Kotenkov said at a conference devoted to the fight against piracy.

But citizens are "not at fault for being unable able to buy licensed discs."

Kotenkov, who is also a co-chairman of the public advisory board for the Russia Against Counterfeiting movement, which aims to support licensed producers, said he often purchased illegally made discs for plane trips, paying a mere 90 rubles ($3.12) for a DVD containing five or six films.

Peter Necarsulmer, president of the Coalition for Intellectual Property Rights, an international organization enforcing intellectual property rights in the Baltic States and the CIS, said progress had been made in weeding out piracy in Russia and that penalties for violating intellectual property rights had become tougher in recent years.

However, while the U.S. government continues to pressure Russia to do a better job, it fails to understand that most Russians cannot afford to pay more for genuine products, he said.

Failure to clamp down on counterfeiting has been a major sticking point in U.S. approval for Russia's accession to the WTO.

Last week, police kicked off the largest anti-counterfeiting operation to date, a move involving raids on retailers of illegal products that some industry watchers say is timed to coincide with the WTO meeting in Hong Kong set to begin later this month.

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NEWS ARTICLE BY THE HONORABLE LAMAR SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND CHAIRMAN, SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY: "U.S. AND EU TO BATTLE CHINESE COUNTERFEITING," FROM THE NOVEMBER 30, 2005 DOW JONES NEWSWIRES

U.S. and EU to battle Chinese counterfeiting

Washington is set
to share complaints
and customs data

By **WILLIAM ECHIKSON** and **JULIANE VON REPPERT-BISMARCK**
DOW JONES NEWSWIRES
November 30, 2005

BRUSSELS -- The U.S. and Europe are ready to fight Chinese counterfeiting together, said U.S. Secretary of Commerce Carlos Gutierrez.

Speaking on the first day of meetings here with European officials, Mr. Gutierrez said he was prepared to share with European authorities customs information and corporate complaints against Chinese manufacturers.



Carlos M. Gutierrez

If we work together to "protect intellectual-property rights, it will send a powerful symbolic message," Mr. Gutierrez said. "We must collaborate more closely to create a trading environment that respects intellectual property."

The U.S. was making good progress alone by jawboning China, he insisted. On a recent visit to Beijing, he said he received promises that the government would shut markets specializing in fakes, increase the number of criminal (as opposed to civil) cases against counterfeiters and intensify customs cooperation. "These are tangible results," he said.

Ahead of an afternoon meeting with European Trade Commissioner Peter Mandelson, he maintained that an international trade accord will benefit all countries involved and has more to offer than a series of bilateral deals.

"The single biggest thing we can do for developing countries is to trade with them," he said.

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Bilateral trade accords that the U.S. is currently pursuing serve as an additional platform for international trade, not as an alternative, he said.

Mr. Gutierrez called on developing countries to reciprocate European Union and U.S. offers to open up trade by offering to lower tariffs on industrial products.

Ministers and officials from the EU and U.S. will discuss how to knit the EU and U.S. economies more closely. Already, trade between the two is valued at about $500 billion a year and investment ties amount to about $2.5 trillion -- more than twice Canada's gross domestic product.

Unlike most other foreign-government representatives, he declined to blame Europe for holding up progress in talks at the World Trade Organization by sticking to its much-maligned farm-trade policy.

---- Forwarded by Chris Israel/TA/Oxnet on 11/30/2005 09:49 AM ----

Ginny Justice/HCHB/Oxnet

11/30/2005 08:40 AM

To

cc

Subject Sec. Gutierrez in AP: EU, U.S. Pledge Zero Tolerance on Fakes

EU, U.S. Pledge Zero Tolerance on Fakes
Wednesday November 30, 7:36 am ET

EU, U.S. Pledge Zero Tolerance Line on Goods Counterfeiting

BRUSSELS, Belgium (AP) -- The European Union and the United States will take a "zero tolerance" approach to counterfeiting around the world, senior officials said Wednesday.

EU Trade Commissioner Peter Mandelson and U.S. Secretary of Commerce Carlos Gutierrez said they had agreed to work together closely to share information and coordinate activities to crack down on product piracy.

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The global trade in counterfeit goods is worth up to euro360 billion (US$424 billion) a year, ranging from fake brand medicines and pirated movies to toys that don't meet safety standards, Mandelson said.

"What we need more than anything is to pool our intelligence, share our analysis, plan our activity coordinated where appropriate," said Mandelson.

Gutierrez said fighting piracy was a major priority for U.S. President George W. Bush.

The Secretary of Commerce said on Tuesday that the EU and United States had mutual interests in protecting intellectual property rights and would encourage other countries to step up enforcement.

"These are the two most innovation intense economies in the world ... a lot of our economy, a lot of our jobs are tied to things like patents, copyrights, trademarks," he said.

"We are going to ensure together that there is a global trading environment that respects those things."

He told Dow Jones Newswires that he was prepared to share with European authorities customs information and corporate complaints against Chinese manufacturers.

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EXHIBIT SUBMITTED BY JOAN BORSTEN: "CORRUPTION IN THE RUSSIAN ARBITRAZH COURTS: WILL THERE BE SIGNIFICANT PROGRESS IN THE NEAR TERM?"

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Corruption in the Russian *Arbitrazh* Courts: Will There Be Significant Progress in the Near Term?

ETHAN S. BURGER*

I. Introduction

For more than ten years, institutions such as the World Bank, European Bank for Reconstruction and Development, U.S. Agency for International Development, and others have invested significant resources in supporting the development of the Russian judiciary with the goal of furthering the establishment of the "rule of law" (as opposed to Russian President Vladimir Putin's "Dictatorship of Law")[1] in the country.[2] Sufficient time has passed to allow observers to take stock of these efforts. This article focuses on judicial corruption[3] in the Russian *Arbitrazh* [Commercial] Courts,[4] the fair operation of which influences Russia's economic development and its attractiveness to investors.[5] Despite the recognition of the problem of judicial corruption by foreign and domestic specialists, as well as commitments announced by Russian officials to address it, much remains to be done.[6]

The Russian Criminal Code, adopted in May 1996, contains articles that prohibit the abuse of service positions as well as the receiving and paying of bribes (articles 285, 291, and 293).[7] In addition, the Criminal Code contains entire chapters on (i) Crimes against State Power, the Interests of State Service, and Service in Bodies of Local Self-Government; and (ii) Crimes against Court Processes (*Pravosudiya).* So the issue is not an absence of relevant legal norms, but the non-observance and/or non-enforcement of already existing law.[8] On at least two occasions, the Russian State *Duma* (the lower chamber of the Federal Assembly, the country's bicameral legislature) considered laws addressing the problem of corruption directly. This first happened in 1997, when both the State *Duma* and the Federation Council (the upper chamber of the Federal Assembly)[9] passed an anti-corruption law, only to have then-President Boris Yeltsin

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veto it. At the present time, the State *Duma* is working on yet another draft law concerning corruption – a version of this draft law passed on its first reading in November 2002,[10] but apparently there has not been any real progress towards the adoption since then.[11] Existing Russian legal norms do not adequately address the problem of the "revolving door," the situation where individuals leave state service only to take jobs with the very same enterprises they had dealings with while they held official positions. Similarly, Russian rules governing "conflict of interest" of state officials are fairly rudimentary.

On November 26, 2003, President Putin issued an edict creating the Council for Combating Corruption.[12] Its membership includes: the Russian Prime Minister, the heads of both chambers of the National Assembly, and the Chairmen of the Constitutional, Supreme, and Supreme *Arbitrazh* Courts. Its declared objective is to assist the President in developing anti-corruption policies. In addition, a second commission was formed to examine issues, such as conflicts of interest.[13] It is premature to evaluate whether these new bodies will spearhead effective anticorruption efforts, or if they will suffer the same fate as anti-corruption bodies created during the Yeltsin years.[14] It is indeed possible, if not likely, that anti-corruption activities will be limited to persons "disfavored" by the authorities.

Georgy A. Satarov, President of the INDEM Center for Applied Political Studies (INDEM), estimates that bribes, of all types, paid annually in Russia totaled more than the equivalent of U.S. $33 billion in 2001, more than the entire Russian federal budget.[15] He conservatively estimates that court officials, presumably including judges, annually received bribes equivalent to at least U.S. $274 million.[16] Of course, since neither bribe payers nor bribe recipients report the amount of money exchanged, there is no way to assess the accuracy of these estimates.[17]

No one pays a bribe without expecting something of perceived greater value in return.

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Generally speaking, bribes fall into two categories: bribes to get an official to perform a task that he is required to perform, commonly known in the United States as "grease" payments (which are permissible under the U.S. Foreign Corrupt Practices Act), and bribes to obtain special treatment. In an interview with a correspondent from *Nowaya Gazeta* [New Newspaper], Mr. Kirill Kabanov, then the acting Chairman of the Russian National Anti-Corruption Committee indicated that the economic cost of corruption in Russia was approximately U.S. $38-40 billion in harm to the state and its citizens. Although he did not discuss the basis for this figure, Mr. Kabanov appeared to be well aware that corruption was pervasive throughout Russian society and that organized crime played a large role in corrupting law enforcement personnel. He offered certain suggestions, many of which were general in nature, concerning how corruption could be combated. Notably he called for a "judicial system with clear, distinct laws, with no gaps or loopholes."[18]

As a preliminary matter, it is worth noting that judicial corruption is not a problem found only in Russia.[19] It occurs in most of the developing world, as well as in countries transitioning from a planned to a market-based economy.[20] What makes Russia unique, apart from its former status as a superpower, is its vast mineral wealth and educated population, which would appear to make it an attractive target for investment. This means that the consequences of corruption in Russia, more so than in most other countries, will be an issue that foreign courts and international arbitral bodies may confront.

The issue of judicial corruption in Russia has been a factor in a number of cases heard in U.S. federal courts. In two 2003 cases concerning business disputes involving millions of dollars, the two U.S. federal judges hearing the matters came to opposite conclusions about whether Russian *arbitrazh* courts offer an adequate forum to resolve disputes.[21] In *Films by Jove*, the Court found that:

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> it [was] unnecessary to reach any broad conclusions as to the impartiality and essential fairness of the *arbitrazh* system as a whole. Plaintiffs have produced specific evidence in the form of documents obtained from the High *Arbitrazh* Court's file – of improprieties in the specific court proceedings . . . .[22]

In contrast, the Court in *Base Metal Trading* granted the defendants' motion to dismiss. The Court first found that the plaintiffs' selection of the U.S. federal court system was not entitled to a high degree of deference because the Court found the events at issue took place in Russia. It then dismissed the case on *forum non-conveniens* grounds.[23] In its decision, the Court stated that the plaintiffs failed to make an adequate showing of the alleged corruption of the Russian courts with respect to the specific case before it.[24] In neither case did the U.S. courts deny the existence of corruption in the Russian judiciary.[25] This issue is likely to continue to arise in future cases before U.S. and other judges and arbitrators.

The Russian public cannot rely on the promulgation of new rules governing the selection and training of judges, or improved systems for disciplining judges whose behavior does not correspond to these rules. Unfortunately, it remains unrealistic for the Russian populace to expect government officials, the press, or civil society to take the lead in combating judicial corruption.

II. A Brief Overview of the Russian Court System

The Russian courts are divided into two distinct systems: *arbitrazh* (commercial) courts and courts of general jurisdiction.[26] The courts of general jurisdiction handle primarily non-commercial matters, such as disputes between neighbors, divorces, etc. Consequently, the problem of corruption seldom plays a major role in cases before this type of court.

Arbitrazh courts resolve commercial disputes. It is important to bear in mind that the *arbitrazh* courts are part of the official Russian judicial system and must be distinguished from private arbitration, which is covered by separate legislative acts, such as the Russian Law "On

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International Arbitration," dated July 7, 1993, and the Regulations "On *Treteiskie* [private, or literally Third-Person's] *Courts*," dated June 11, 1964.

The *arbitrazh* court system is divided into Courts of the First Instance (trial courts), Courts of the Appellate Instance, Federal *Arbitrazh* Circuit Courts ("Cassation Courts"), and the Supreme *Arbitrazh* Court. The Courts of the First Instance and Courts of the Appellate Instance are part of the same court physically and organizationally. They are located in each of the eighty-nine Subjects [political subdivisions][27] of the Russian Federation.[28] The Federal *Arbitrazh* Circuit Courts are located in the designated center of each of the ten judicial *okrugy* (circuits). The Supreme *Arbitrazh* Court is located in Moscow.

The Courts of the First Instance hear cases and make the initial judgments over disputes. Appeals from decisions of the Courts of the First Instance are heard in the Appellate Instance of the *Arbitrazh* Court. The Federal *Arbitrazh* Circuit Courts are the courts of the next level of appeal. A party may obtain jurisdiction in the Federal *Arbitrazh* Circuit Court by filing a Cassation Appeal (*zhaloba*). The Cassation Courts (the equivalent of the U.S. Federal Circuit Appeals Courts) have the right to suspend execution of a decision or ruling passed in the First Instance or Appellate Instance upon a party's application. The Supreme *Arbitrazh* Court is the final level of appeal. In certain instances, the Supreme *Arbitrazh* Court may rule on matters on direct appeal from the Court of the First Instance. For example, a party in a case, or the Court of the First Instance on its own initiative, may request that the Supreme *Arbitrazh* Court hear and decide an issue involving judicial conflicts of interests. In practice, this is not a frequent occurrence.

Logically, it should be easier to bribe a single trial court judge than a panel of appellate judges or even members of the Supreme *Arbitrazh* Court. Nonetheless, the lengthy process for having an appeal heard along with other factors, such as, attorney fees, preservation of evidence,

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procurement of false documents by the other side in a dispute, lack of a trial transcript to help demonstrate that the trial court's decision was motivated by something other than the legitimate application of law to the facts, discourages many parties from pursuing appeals, particularly when the appellate court is located far away from where the case was originally heard.

III. The Soviet Legacy of Political Interference in the Court System

Many respected scholars have written about the political dominance of the Russian court system by local political leaders, such as the governors of Russia's *Oblasts* [regions] or other political subdivisions. This local dominance is in part a legacy of the Soviet era's practice of "telephone justice," where a Communist Party official would call a judge to tell him how a particular case should be decided.[29]

Although the Russian Constitution now provides for a separation of powers and declares the judiciary to be independent[30] of the legislative and executive branches of government, judges are still frequently influenced by "suggestions" by governmental authorities, wealthy individuals, and enterprises seeking particular outcomes in cases.[31] The Russian Constitution's provisions, particularly those dealing with the courts, can be best understood as "declaratory." The section on the judiciary can only be implemented through the enactment of federal laws.[32] Although the Russian Constitution does not explicitly establish rules with respect to the court system's funding, it is implicit in a constitutional system envisioning a separation of powers that the judiciary has sufficient resources to perform its function adequately. Not to do so would defeat the reality of an independent judiciary. Unfortunately, as discussed below, this functional independence has not been achieved.[33]

During Soviet times, a judge might have been inclined to resolve disputes between two state enterprises on their merits. Today, judges are likely to favor large local enterprises over small and mediate enterprises, entrepreneurs, and foreigners, since the large local enterprises

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provide employment to the local population and taxes needed by the local governments (and are often controlled by politically well-connect individuals or industrial groups). Thus it appears that the judicial system is stacked against non-local and/or politically weaker parties, unless bribery occurs. Judges can often mask telephone justice by deciding cases on the basis of form over substance. For example, ruling on the basis of technicalities to dispose of troublesome cases, rather than resolving such cases on their merits.[34]

IV. Perceptions on the Extent of Corruption in the Russian Arbitrazh Courts

In the absence of reliable statistics on the scope of judicial corruption, one is forced to rely on polling data and survey research.[35] According to Oleg Fyodorov, an advisor to the National Association of Securities Market Participants and the Investor's Rights Association, the Russian *Arbitrazh* Courts do not function as "courts" in the conventional sense. Where a case involves a dispute between "two parties of very different size [...] for instance, one very influential, very rich, and the other having only the law behind it--then almost no case is known of the court taking the side of the lesser-known side."[36] While such a remark is a bit of an overstatement, it is indicative of a significant problem that cannot be ignored.

Numerous sources indicate the perceived extent of corruption in the Russian court system. For example, the international non-governmental organization, Transparency International (TI), has for many years identified Russia as one of the most corrupt countries in which to do business. In the fall of 2003, TI ranked Russia tied for 86 out of 133 in its "2003 Corruption Perception Index" (the higher the ranking, the more corrupt a country is deemed).[37] For Russia, this represents an increase in the perceived impact of corruption over the prior two years. But there are certain problems in TI's methodology, because cross-country comparisons completed by different respondents are inherently suspect.[38] In addition, the level of corruption within a particular country will differ by region, institution, etc.[39] Given the ambitious nature of

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the effort, the results are not always clear-cut:

> According to the generalized perception of respondents . . . , the Krasnoyarsk krai, the Saratov oblast, the Republic of Udmurtia, the Primorski[y] krai, the Republic of Karelia are more than other regions contaminated by corruption. More objective indicators characterizing . . . corruption practices [rather] than the perception of corruption demonstrate a somewhat different picture. In this case, the Moscow, Nizhni[y] Novgorod and Saratov oblasts, the City of Moscow, the Chelyabinsk oblast and the City of St. Petersburg are the leaders in terms of corruption, while the regions least affected by corruption are the Republic of Karelia, the Yaroslavl, Tyumen, Arkhangelsk and Omsk oblasts. If we look at the geography of corruption, we see a "Southern belt" of regions affected by corruption, which stretches from the Rostov oblast to the Volga Region.[40]

The study did not demonstrate significant distinctions in corruption levels between the executive branch, the legislative branch, judiciary, and law enforcement agencies by region or type of respondent.[41]

TI's Corruption Perception Index offers a useful, though methodologically flawed gauge of corruption throughout the world. While other organizations and individual academics have examined corruption on a comparative basis, none have been as successful as TI in raising public awareness with respect to the extent of corruption and its consequences.

In a survey conducted by TI of individuals engaged in international business in emerging market countries, 21 percent of 835 respondents identified the judiciary as the institution in most need of improvements against corruption.[42] Economists have found there is a strong correlation between levels of perceived corruption and foreign direct investment. This relationship also affects the behavior of domestic investors as well. It appears that in practice an increase in

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corruption operates like an increase in taxes, and extreme corruption can, under certain conditions, prevent investment from occurring (at least in particular sectors).[43]

Given its nature, it is difficult, if not impossible, to determine the exact extent of corruption in an institution. Although this issue can be studied through a combination of actual court cases, press reports, interviews, and formal surveys, the results are largely impressionistic and anecdotal. One can also examine what actions particular states have taken to address perceived problems of judicial corruption. While Susan Rose-Ackerman, among others, has argued that the judiciary is the branch of government most critical to a successful and comprehensive anti-corruption program, the judiciary alone cannot end corruption in a particular country.[44]

According to a survey conducted by INDEM, 72.2 percent of the respondents agreed with the statement that "[m]any people do not want to seek redress in the courts, because the unofficial expenditures are too onerous."[45] Furthermore, 78.6 percent agreed with the statement that "[m]any people do not resort to the courts because they do not expect to find justice there."[46]

Not surprisingly, another survey of 500 Russian firms and their managerial staff in eight cities, which was conducted by VTsIOM, the All-Russian Center for the Study of Public Opinion, found that corruption played a role in many judicial proceedings in Russia. Although the respondents indicated that corruption played a lesser role in the judiciary than reported in some other studies, these results were probably influenced by the fact that the survey dealt with Russian enterprises' experience with various governmental bodies, and did not focus on matters involving foreign legal entities or disputes between private parties where the financial stakes were high. Nonetheless, the results are telling.

Since those who influence court decisions are rarely willing to discuss it, the best we can do is ask how frequently others perceive such attempts. We asked:

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> "Based on your experience and the experience of your colleagues, do you think that pressure is put on the decisions of the [*arbitrazh*] court in your region?" Of those questioned, 38 percent either did not answer the question or responded "Don't Know." This may indicate a genuine lack of knowledge or simply discomfort with the topic.
>
> Of those who did respond 66 percent believed that pressure regularly was placed on the decisions of [*arbitrazh*] court judges. Responses to this question varied little among the managers of the new, state-owned, or privatized firms.[47]

In a separate survey, VTsIOM asked one question that is particularly instructive as to the source of corruption in Russia. When asked, "Who do you think places pressure on the decisions of the arbitration court in your region?"[48] the responses were as follows: (i) Governor – 42 percent; (ii) the Regional Duma – 18 percent; (iii) the Regional Bureaucracy – 40 percent ; (iv) the Federal Bureaucracy – 33 percent; (v) the Mayor – 15 percent; (vi) the Security Forces (*siloviki*) – 32 percent; (vii) influential private citizens, such as businessmen – 54 percent; and (viii) criminal structures – 32 percent.[49] These results illustrate the perceived influence of the regional authorities and prominent business figures [including some so-called "oligarchs"] (the former often acting on behalf of the latter) on the operation of the Russian *arbitrazh* courts.

In January 2002, the Public Opinion Foundation reported on the results of its survey of 1,500 Russian respondents located in forty-four of Russia's political subdivisions. It found that 37 percent of those sampled believed corruption to be widespread in the courts and procuracy.[50]

On the issue of the existence of political will on the part of the country's leadership to combat corruption, 82 percent of the Russian population believes that either: (1) the country's leadership wants to fight corruption, but cannot do so successfully; (2) the country's leadership can, but does not want to fight corruption successfully; or (3) the country's leadership does not

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want to and cannot successfully combat corruption. Not surprisingly, an overwhelming majority of the Russian population believes that the level of corruption in Russia has either increased or remained at the same level over the last few years. It is unrealistic to expect that Russian judges are somehow immune to an affliction found throughout Russian society.

One leading scholar writing on corporate governance and corruption in Russia co-authored an article in the *Stanford Law Review*, which stated:

> [A] shareholder who sues a major company will usually lose at trial and first-level appeal, because of home-court bias, judicial corruption, or both. A shareholder with a strong case has a decent chance of getting an honest decision on further appeal, but that will take years. And judgments must be enforced (or, often, not enforced) by the same biased or corrupt lower court where the case began.[51]

Some leading businessmen and lawyers have expressed similar views with respect to judicial corruption in Russia. In a speech made at an investment conference, the then acting President of the EBRD, Charles Frank, stated, "[w]e know what foreign investors confront in Russia everyday, and we would like to see it made better."[52] Frank explained that "[w]hen we speak about the need for legal reforms, we are not speaking on a theoretical basis, but from experiences and lessons we have learned the hard way."[53] This was not simply a call for improving the manner in which business was conducted in the executive bodies, rather, the EBRD indicated that Russia needs a better-trained and better-paid judiciary to improve its court system and reduce the number of injustices in the country's judicial process.[54]

At an OECD Conference entitled "Corporate Governance in Russia," Jeffrey M. Hertzfeld, one of the leading western attorneys specializing in Russian law, noted that while Russian law provided for non-discriminatory treatment of foreign investors, "many foreign investors have found it difficult, if not impossible, to have their rights recognized, particularly

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when they find themselves in conflict with a politically powerful or well-connected Russian party."[55] Hertzfeld observed further that he read one estimate that 70 percent of all court decisions in Russia were tainted by corruption. While he acknowledged that he had no basis for knowing how the statistic had been derived, he observed that "it seems apparent that abuses are frequent and that they undermine the meaningfulness of Russian laws and regulations aimed at protecting shareholders' rights."[56] Hertzfeld concluded by calling for corrective action in this area to ensure that breaches of obligations to shareholders would be enforceable in Russian courts.

Thus, it should come as no surprise that experienced international lawyers insist on having dispute resolution clauses in their clients' commercial contracts where the value of the contract exceeds a certain amount (i.e., several million dollars, varying by the lawyer and the nature of the transaction) in order to avoid the Russian court system entirely.[57] These dispute resolution clauses usually provide for international arbitration in bodies such as the International Court of Arbitration of the International Chamber of Commerce in Paris, the London Court of International Arbitration, the Arbitration Institute of the Stockholm Chamber of Commerce, and even the Arbitration Court of the Russian Chamber of Commerce (the latter being a private arbitral body). Unfortunately, favorable arbitral awards are often difficult to enforce in Russia, either under the 1958 New York Convention on the Recognition and Enforcement of International Arbitral Awards or domestic Russian legislation.[58] Consequently, where the chance exists, a victorious party in arbitration may attempt to seize or attach a losing Russian party's assets in third countries, which have court systems that will honor the N.Y. Convention's obligations.

At the World Bank's Second Global Conference on Legal and Judicial Reform in St. Petersburg, Russia on July 8-11, 2001, World Bank President James Wolfensohn discussed in

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detail some of the problems of the Russian court system.[59] He later indicated that too much emphasis had been placed on increasing the number of judges, courts, and computers, and that judicial reform would fail without an improvement in judicial transparency.[60] Wolfensohn identified one of the "biggest obstacles to the development of legal and judicial systems [was] a situation in which the economic elites use the system in [their] own interests." According to him, corruption "too often seeps into the legal and judicial systems of some countries," including Russia.

Despite these surveys and widespread perceptions, at least one 1997 study conducted with the assistance of the Supreme *Arbitrazh* Court suggests that the problem of corruption may be exaggerated.[61] This study addressed the issue of whether the Russian courts are fair to foreigners – the presumption being that Russian companies and individuals were more likely than foreigners to obtain favorable judicial decisions through bribery than were their foreign equivalents.[62] The study, however, was based on data from less than one-half of Russia's *arbitrazh* courts, and is of limited analytical or practical value. Indeed, one of the study's investigators, Glenn P. Hendrix, acknowledged "severe limitations" in the data, including: (1) the Supreme *Arbitrazh* Court's refusal to supplement the report by obtaining copies of the underlying decisions, in part because of the financial burden of doing so; (2) the lack of information regarding the size of the parties or the amount in controversy; (3) the under-inclusiveness of the definition of "foreign entity" as including only foreign nationals; and (4) the lack of data as to whether any of the "favorable" decisions obtained by foreign entities were actually enforced.[63] Consequently, Hendrix warned readers of the study that "[g]iven the lack of opportunity to independently validate the statistics compiled by the lower court, one may, of course, question the reliability of the data;" and that "[i]t is also possible that foreign parties win cases against minor Russian firms with little political clout, but routinely lose when challenging

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entrenched interests. The data are not sufficiently detailed to test this thesis."[64] Moreover, Hendrix's use of the 1997 data is likely to have skewed his results because it was collected prior to the massive economic upheaval caused by the 1998 Russian financial crisis, which led to a large number of disputes between joint venture partners, suppliers, and customers.

V. How Corruption Operates in the Russian Court System

In common disputes, not involving large sums of money, judicial corruption does not appear to be a major problem. Over the last decade, Russian citizens have increasingly begun using the Russian court system to resolve disputes.[65] But this does not necessarily mean they have great faith in the court system. It may only mean a greater number of commercial disputes are occurring, given the changes in the Russian economy. According to some Russian attorneys, a judge might first examine a case, decide which party should prevail on the merits, and then seek payment for issuing the proper decision. Other judges will simply favor the highest "bidder" for a favorable result.

This situation is made possible by the fact that the submission of an appeal of *arbitrazh* trial court decisions is often fruitless, since higher courts are not only reluctant to overturn lower court decisions, but are hindered in their ability to conduct effective judicial review because in most civil law systems, there is no official trial court transcript to examine. Consequently, appellate courts are limited to reviewing decisions for pure errors of law, and refrain from reviewing factual determinations or the misapplication of law to fact. To make matters worse, over the years, Russian appellate courts have suffered from inadequate technical and budgetary resources, thus hindering their ability to perform there legislatively mandated functions. This situation appears to be slowly improving as the impact of judicial reforms is beginning to take effect.

Russian journalists who cover the issue of judicial corruption and the operation of the

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court system have noted that Russian appellate courts tend not to be overly inquisitive of lower court actions. As noted above, the Russian appellate courts lack the tools to properly perform their function. This would seem to explain why, according to Russian Legal Correspondent Konstantin Sklovskii, during the time period he examined, Russian appeals courts overturn a mere 0.05 percent of trial court decisions.[66]

VI. Steps Russia is taking Towards Judicial Reform and the Problem of Corruption

In the 1990s, the Russian Federation took a series of significant measures in the creation of a viable judicial system, such as the adoption of a constitution, providing for an independent judiciary (1993), the adoption of a law on the status of judges (1992, and amended 1993, 1995, and 1996), the establishment of a Constitutional Court (1994), a new law on the *arbitrazh* courts (1995), a new law on courts of general jurisdiction (1996), and a law clarifying the jurisdiction of particular types of courts within the Russian court system (1996).

Within Russia, many interest groups and individuals having a strong commitment to judicial reform have emerged. The Russian legislature has enacted various laws aimed at dealing with some aspects of judicial reform, including provisions on corruption in the Russian Federation Criminal Code. A federal program for the improvement of the courts has been organized.[67]

Despite the adoption of numerous laws on the judicial system, Russia lacks the necessary personnel to produce well-drafted legislation and normative acts implementing such legislation. This is not surprising since a large share of the Russian legislature and regulatory authorities are largely composed of non-lawyers with little legislative or rule-making experience. The Russian government, legislature, and judiciary frequently have difficulty retaining highly competent individuals, in part due to the availability of more remunerative positions in the private sector, particularly for those with valuable governmental connections.[68]

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Russian legislation often contradicts other normative legal acts,[69] and is often so vague that it permits arbitrary conduct on the part of judges and state officials. This situation gives the judiciary excessive discretion in carrying out their duties, which is often used as a device to extort bribes. Furthermore, many *arbitrazh* judges lack experience in dealing with complex commercial matters, though there has been an increase in the training of judges both before and after taking the bench.

One positive development not to be ignored is that the Presidium of the Supreme *Abitrazh* Court has been issuing *Postanovlenie* [resolutions] that explain how particular cases are resolved. The quality of these resolutions has improved over time, and not only serve to educate judges on how to interpret certain laws or normative acts, but to inform all members of the legal community (and the public at large) on important legal issues, since they are available on the Internet.[70] Furthermore, they may serve as a tool for identifying when cases have not been decided on the merits (i.e., that the ruling was mistaken or the outcome was motivated by other factors).

In his 2001 address to the Russian Federal Assembly, Russian President Putin noted the urgency of the need for judicial reforms:

> We set the goal: to build an efficiently working executive vertical, to achieve legal discipline and an effective judicial system.
>
> * * *
>
> Today, judicial reform is extremely necessary for us. The domestic judicial system [is deficient] in practice [and] does little to help the conduct of economic transformations. Not only for entrepreneurs, but also for many people, trying legally to restore their own rights, the courts have not become timely, correct and fair. I don't say "always", but in many cases, unfortunately, this is so.

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Arbitrazh practice also encounters barriers such as a contradictory and incomprehensible legislative basis. Bureaucratic norm-creation is one of the main obstacles to the development of entrepreneurship.

* * *

Now [I would like to address] the business climate in this country. Unfortunately, ownership rights are still badly protected. The quality of corporate governance remains poor. Wars between contenders for ownership do not cease even after courts render their decisions. And the decisions themselves are often based not on the laws but on the pressure of interested parties.[71]

Today, however, it appears that Putin is less focused on the problem of judicial corruption than was promised in this address, though combating corruption has been a major theme of his 2004 re-election campaign.[72]

In May 2002, the then Russian Procurator General Ustinov issued the Procuracy Annual Report for 2001 to the Federation Council (the upper Chamber of the Russian legislature). The Report discusses the activities of the Procuracy during 2001, including the Procuracy's anti-corruption campaign. While the Report outlined the overall situation in the country concerning crime, Procurator Ustinov painted a rather detailed and not optimistic picture of the Russian's struggle with corruption.[73]

The principal Russian official behind Russia's current judicial reform efforts, then Deputy Head of President Putin's administration, Dmitrii Kozak, observed:

There was corruption within the Russian judicial system, and said the fact that only 15 judges out of 20,000 had been dismissed [in 2000] suggested that "we don't have an effective system to identify corruption." In a separate presentation, he outlined measures to make Russia's judges more accountable and a special

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supervisory board to implement them in the case of malpractice or misconduct.[74]

While Mr. Kozak is trying to rectify the situation, improvement will take time and require a concerted effort by all branches of the Russian government.

The Supreme Qualification Collegium of the Courts of the Russian Federation has principal responsibility for approving individuals to sit on all courts in the judicial system (including the *arbitrazh* courts) and oversees disciplinary matters concerning judges. It publishes a *Vestnik* [Herald] that contains important information on the state of the Russian courts. In 2003, it published the following data through 2002:

Materials, Declarations and Complaints Received by the Collegium[75]

Year	Number
1996	1839
1997	2740
1998	3655
1999	4740
2000	5463
2001	5850
2002	6993

These figures show an upward trend in communications concerning the conduct of judges sent to the Collegium. They probably indicate an increased public awareness of the Collegium's function and a greater willingness of the Russian population to publicly complain about a judge's conduct.

Though the number of complaints and other communications about improper judicial conduct which were sent to the Collegium shows a steady increase, the number of judges who were forced to step down from the bench for disciplinary reasons has declined since a high in

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1998:[76]

Year	Number
1994	67
1995	50
1996	96
1997	75
1998	115
1999	92
2000	75
2001	45
2002	36

The data indicate that the official number of instances where judges were actually removed constitute a very small share of the number of complaints about judges, perhaps since they volunteered to step down from the bench rather than being removed.

The reasons that the Collegium removed judges were described as (i) violation of work discipline (13 percent), (ii) falsification of judicial documents (12 percent), (iii) other violations of the Judicial Code of Honor (8 percent), (iv) violation of substantive and procedural legislation of the Russian Federation (53 percent), and (vi) red-tape [presumably inefficiency] (14 percent).[77] It is interesting to note that the most senior judges (those with greater than ten years experience) and the most junior judges (those with less than three years experience) were the groups most frequently removed from their positions pursuant to the Russian Federation Law "On the Status of Judges in the Russian Federation," article 12.1, point 1.[78] Of course, these data identify instances where cases were actually brought to the attention of the Collegium. There is no way of knowing how representative the data are of the situation.

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Under the current circumstances, generalizing about the quality of the Russian judiciary is difficult. U.S. Ambassador to Russia Alexander Vershbow has candidly examined this problem.

> [T]here is a troubling pattern in many regions - the conflict of interests at the municipal and oblast levels of government that work to keep out competitors. This tendency is exacerbated by the weak and often corrupts judicial system that fails to uphold court decisions.
>
> This is an all too frequent element in long-standing investment disputes involving foreign investors. At the federal level, policies are often pursued to support the interest of specific firms at the expense of competitors.[79]

Thus, in the U.S. Ambassador's view, a foreign investor may be unable to receive a fair hearing of its case on the merits. That being said, even within a given judicial district, the quality of Russian judges from both a substantive and ethical standpoint is highly variable.

VII. Final Observations on Russia's Response to Judicial Corruption

In the post-Soviet era, local governments would pay judges significant bonuses to supplement their incomes and provide them with apartments and utilities free of charge.[80] This situation has officially been abolished, though the practice appears to continue. The starting salaries for Russian trial judges have been increased to approximately the equivalent of U.S. $450-500 per month.[81] This increase in salaries seemed in part motivated by the belief that judges could not support their families on their salaries alone, and to reduce both judges' and local courts' dependence on local governments and enterprises for financial and other support. Since the break-up of the Soviet Union and the availability of opportunities in the private section, relatively low salaries paid to judges have resulted in the judiciary's loss of experienced personnel.[82] On the other hand, such judges may have had greater difficulty adjusting to the

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country's new economic conditions, so their loss may have had some positive benefits.

According to then Russian Prime Minister Mikhail Kasyanov, expenditures on the judicial system were to be increased by one-third in 2004. In the fall of 2003, judges' salaries were raised by 40 percent.[83] Whether this increase in salary will reduce corruption or outside political interference remains unclear, particularly within the *Arbitrazh* court system. As of October 1, 2003, the largest salary paid to state employees was R27,000/month, approximately U.S.$900 at current exchange rates.[84] This figure does not include the additional cost of benefits. Lower level officials receive significantly less. Thus, it is far from inconceivable that payment of a small bribe can result in the misplacement of a file or the alteration of a document,[85] factors that in some instances will have an impact on the outcome of a case.

Salary increases alone will not solve the problem of judicial corruption. Russian Supreme *Arbitrazh* Court Chairman, Venyamin Yakovlev, recognizes the need to increase the accountability of judges in combating judicial corruption, although, his ability to achieve his declared goal remains unproven.[86] Speaking before the Council of Chairmen of the Russian Federation Courts, Chairman Yakovlev showed some candor in how to address the problem of corruption in the Russian Courts:

> Transparency [and] openness of the judicial system is the fundamental factor for resolving the problem of judicial corruption. Though the absolute majority of *arbitrazh* judges are completely honest servants of justice, we all recognize the seriousness of the allegations against us. Corruption is a great evil, capable [of destroying] the justice in general. And this is really a serious danger at present. It is completely obvious that we must carefully implement systematic measures aimed at prohibiting or eliminating elements of corruption. To assure the trust in judges, we all must resolve this problem.

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> What is demanded? Obviously, openness. We do not have to hide anything. Justice must be transparent. That is why we are publishing all decisions of the Supreme *Arbitrazh* Court of the Russian Federation in generally accessible legal databases. The process of publication of judicial acts is being developed -- the ten [cassation] judicial district courts are implementing similar system. In the future, when we have sufficient funding, we will extend this practice to the courts in both the first and appellate levels. Eventually, absolutely all judicial decisions will be accessible to the public. Such transparency of our work and our decisions is the most effective method for combating corruption. Another important aspect is the openness of judicial hearings to both citizens and the mass media.[87]

Another change proposed by Chairman Yakovlev is a random, computerized system of assigning cases to judges, rather than the existing system where cases are allocated based on the caseload and specialization of the judges. In his view, this step might also reduce judicial corruption.[88]

Combating corruption is not merely a question of enacting laws, developing codes of ethics, and establishing training programs for judges – at a minimum it requires a change in governmental and societal attitudes, greater transparency, and an effective training and oversight system, where penalties for transgression are severe and fairly imposed. It also demands a great deal of political will to follow through on an anti-corruption program until the magnitude of the problem is significantly reduced. In the absence of effective legislative supervision of the courts, a fully independent and aggressive press, effective whistle-blowing legislation, and a well-functioning civil society, it is unrealistic to expect a significant change with regard to combating judicial corruption in Russia.

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1. *See* Ethan S. Burger & Evgenia Sorokina, *Vladimir Putin's 'Dictatorship of Law': Its Potential Implications for the Business and Legal Communities*, 13 BNA'S E. EUR. REP., No. 12, at 19-23 (Dec. 2003).

2. *See, e.g.*, World Bank, *available at* http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/1996/05/21/000009265_3961214124817/Rendered/PDF/multi0page.pdf (last visited Mar. 12, 2004); U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT, OFFICE OF DEMOCRACY AND GOVERNANCE, BUREAU FOR GLOBAL PROGRAMS, FIELD SUPPORT AND RESEARCH, GUIDANCE FOR PROMOTING JUDICIAL INDEPENDENCE AND IMPARTIALITY, 53-71 (Washington D.C., revised ed. 2002) (citing Peter H. Solomon Jr. & Todd S. Vogelsong, *Courts in Transition in Russia: The Challenge of Judicial Reform* (Westview Press 2000)), *available at* http://www.usaid.gov/democracy/pdfs/pnacm007.pdf; http://www.parliament.the-stationery-office.co.uk/pa/cm199899/cmselect/cmfaff/815/9101202.htm (last visited Jan. 15, 2004) [hereinafter USAID, GUIDANCE FOR PROMOTING JUDICIAL IMPARTIALITY].

3. There is no universally accepted definition of corruption. In fact, unlike numerous other instruments, including those of the Council of Europe (*see* http://www.greco.coe.int/ (last visited Mar. 6, 2004)), the November 2003 U.N. Convention on Corruption does not include "corruption" as a defined term, *available at*

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http://www.jus.uio.no/lm/un.against.corruption.convention.2003 (last visited Mar. 11, 2004). Corruption is often defined narrowly as the 'use of office for personal gain.' But such a definition lacks context. Corruption takes many forms: an official advancing the interests of another (e.g., nepotism) or dealing with a matter in a fashion directed by another for political or other reasons, rather than on its merits. This latter form may be taking on increasing importance in Russia as evidenced by the YUKOS affair. For a useful framework for examining the issue of corruption, see the Website for the Carnegie Endowment for International Peace, which contains links to stories dealing with the YUKOS matter. Carnegie Endowment for International Peace, *at* http://www.ceip.org/files/Publications/khodorkovsky.asp?pr=2&from=pubdate (last visited Jan. 15, 2004). For the competing explanations of the motives behind the YUKOS affair, see the Websites of President Putin. President of Russia, *available at* http://www.kremlin.ru/ (last visited Jan. 15, 2004); Federation Government, *available at* http://www.government.ru/government/index.html?he_id=38 (last visited Jan. 15, 2004); YUKOS, *available at* http://www.yukos.com (last visited Jan. 15, 2004). *See also* SUSAN ROSE-ACKERMAN, CORRUPTION AND GOVERNMENT: CAUSES, CONSEQUENCES AND REFORM (Cambridge University Press 1999). For the purposes of this article "corruption" shall be understood as the use of authority for reasons not envisioned by law. For a particularly insightful and intellectually provocative analysis of the international policy context for the definition of corruption, see James W. Williams & Margaret E. Beare, *The Business of Bribery: Globalization, Economic Liberalization, and the 'Problem' of Corruption, in* CRITICAL REFLECTIONS ON TRANSNATIONAL ORGANIZED CRIME, MONEY LAUNDERING AND CORRUPTION 88-129 (Margaret E. Beare ed., University of Toronto Press 2003).

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4. In recent years, leading scholars and legal analysts produced a multitude of works on the development, operation, and performance of the Russian *arbitrazh* court system. Professor Kathryn Hendley of University of Wisconsin has written some of the most significant works in this area, including (i) *Remaking an Institution: The Transition in Russia from State Arbitrazh to Arbitrazh Courts*, 46 AM. J. COMP. L. 1 (1998); (ii) *Growing Pains: Balancing Justice & Efficiency in the Russian Economic Courts*, 12 TEMP. INT'L & COMP. L.J. 2 (1998); (iii) with Peter Murrell, *Dispute Resolution in Russia: A Regional Perspective in Unleashing Russia's Business Potential: Lessons from the Regions for Building Market Institutions*, World Bank Discussion Paper No. 434 (March 2002); and (iv) *Enforcing Judgments in Russian Economic Courts*, 20 POST-SOVIET AFFAIRS, No. 1 (2004) (forthcoming). For a compendium of Professor Hendley's works, visit her Website. Hendley, *available at* http://www.polisci.wisc.edu/users/hendley/research.html (last visited Jan. 15, 2004).

Unfortunately, some of the other "literature" on the operation of the Russian court system exhibits qualities of "boosterism" that often lacks complete candor. This is understandable since many donor organizations and international financial institutions have a major stake in demonstrating through "sponsored research" that improvement in the quality of "justice" available in the Russian courts is occurring. The situation is further complicated since legal analysts are often dependent on maintaining good working relations with government and judicial officials to obtain access to data and the cooperation of the local authorities in order to continue their work. Furthermore, law firms, accounting firms and investment banks also have an incentive to demonstrate that the rule of law in the country is improving and gains are being made in the struggle against corruption. In addition, Russia's political and strategic importance limits the

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willingness of some governments to be publicly frank in their assessments of the role of corruption and political influence in judicial decision making. The interdependence of aid donors (and their agents) and local elites has been insightfully analyzed in the context of western advice on privatization in Poland and Russia. JANINE R. WEDELS, COLLISION AND COLLUSION: THE STRANGE CASE OF WESTERN AID TO EASTERN EUROPE 45-174 (Palgrave Macmillan 2001).

5. Judicial corruption is not a problem peculiar to Russia. According to a 1999 study conducted by the Geneva-based Centre for the Independence of Judges and Lawyers, judicial corruption was "pervasive" in thirty of forty-eight countries examined. PETTER LANGSETH, CENTER FOR INTERNATIONAL CRIME PREVENTION, UNITED NATIONS OFFICE FOR DRUG CONTROL AND CRIME PREVENTION, STRENGTHENING JUDICIAL INTEGRITY AGAINST CORRUPTION 4 (Vienna 2001) (citing Centre for Independence of Judges and Lawyers' 9th Annual Report, Feb. 1999).

6. For an insightful Russian perspective on the issue of judicial corruption generally, see Galina E. Enyutina, *Korruptsiya v sudebnykh organanakh* [*Corruption in Russian Judicial Bodies*], *in* 1 *ORGANIZOVANNAYA PRESTUPNOST', TERRORIZM I KORRUPTSIYA* [ORGANIZED CRIME, TERRORISM & CORRUPTION] 18-30 (2002), *available at* http://www.mosorgcrimrescenter.ru/menu/viewer.htm (last visited Mar. 11, 2004). Ms. Enyutina's study outlines the structure of the Russian court system, the manner by which judges are selected, factors that contribute to the existence of corruption, and offers suggestions for improving the situation.

7. Under the Russian Federation Civil Code, the giving of a "gift" to a state or municipal official having a value of less than five times the minimum monthly wage (in recent years, below the rough equivalent of $60) is not considered a crime. *See* GK RF art. 575

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(1996). This widespread practice may be the first step towards more significant bribery.

8. The Russian Ministry of Affairs' Website presents aggregate statistics on the number of crimes registered and the number of cases prosecuted in the reporting period. The data it presents does not correspond to particular articles of the Russian Criminal Code. It also presents a breakout of crime by locality. Unfortunately, it does not set out crimes involving the judiciary in general or the *arbitrazh* courts in particular. Russian Ministry of Affairs, *at* http://www.mvdinform.ru/?docid=11 (last visited Jan. 15, 2004).

9. Chapter V of the Russian Constitution describes the composition, structure, and powers of the Federal Assembly. Articles 105 – 108 within Chapter V set forth the process by which laws are enacted. *See* KONST. RF arts. 105-108.

10. To follow this draft law's progress, see State *Duma*, *On Combating Corruption*, *at* http://www.duma.gov.ru/bot.html (last visited Mar. 11, 2004).

11. *See* Russian Federation State *Duma*, *available at* http://www.akdi.ru/gd/proekt/GD01.HTM (last visited Mar. 11, 2004). To become law, a draft law must be approved on three readings by the State *Duma*, approved by the Council of the Federation and signed (or not vetoed) by the Russian President. *See* RFE/RL Newsline (Russia), *Yeltsin Vetoes Anti-Corruption Law*, Dec. 22, 1997, *available at* http://www.rferl.org/newsline/1997/12/221297.asp (last visited Jan. 15, 2004); BBC Summary of World Broadcasts, *Federation Council approves law against corruption*, Dec. 5, 1997 (citing RIA News Agency Moscow, in English.).

12. Russian Federation Presidential Edict No. 1384, On the Council under the Auspices of the President of the Russian Federation for the Struggle with Corruption, Nov. 24, 2003, *available at* http://www.kremlin.ru/text/news/2003/11/56177.shtml. The timing of the issuance of this edict, just before the December 2003 State *Duma* elections, may not have

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been a mere coincidence.

13. Aleksandr Kornilov & Sergei Sedelnikov, *Fighting corruption on a contract basis*, Nov. 25, 2003, *available at* http://www.gazeta.ru/2003/11/25/Fightingcorr.shtml (*in* Johnson's Russia List, No. 7437, Nov. 25, 2003).

14. Russian Federation Presidential Edict, On Additional Measures to Enable the Interdepartmental Commission of RF Security Council to Combat Crime and Corruption More Effectively, June 23, 1993; Leyla Boulton, *Yeltsin's anti-graft chief to step down*, FIN. TIMES, Oct. 21, 1993, at 3 (suggesting that Mr. Andrei Makarov resigned since he lacked the ability to combat corruption among senior officials). There have also been legislative attempts to investigate corruption, including that of the Federation Council. *See* Lyudmila Yermakova, *Senators set up commission for anti-corruption problems*, TASS, Apr. 22, 1999.

15. In an interview given to Rossiiskaya gazeta, Dr. Satarov stated that according to corruption researchers, the Russian *arbitrazh* "courts are the weakest component of the legal system." *The Parties Are at the Helm*, ROSS. GAZETA, Aug. 7, 2002.

16. Interfax, *Russians spend at least $37 billion on bribes each year*, *in* Johnson's Russia List, #6261, May 21, 2002, *available at* http://www.cdi.org/russia/johnson/6261.htm (last visited March 6, 204). *See* INDEM Foundation, *Russia vs. Corruption: Who Wins? at* http://www.glasnost.ru-indemfond/indfp2e.html (last visited June 22, 2003).

17. According to a leading international specialist on the study of crime, Richard Rose, Director of the Center for the Study of Public Policy (University of Strathclyde, Glasgow Scotland), one survey of Russian citizens found 66 percent of the respondents saw the non-enforcement of laws and corruption "as the chief obstacle to Russia becoming a 'normal' society." *Russian's Challenge to Vladimir Putin*, *in* Johnson's Russia List,

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Aug. 28, 2002, *available at* http://www.cdi.org/russia/johnson/6409-6.cfm.

[18]. Igor Bederov, *Turnover in the corruption market amounts to $40 billion a year*, NOVAYA GAZETA [NEW NEWSPAPER], Nov. 20, 2003, *in* Johnson's Russia List, No. 7431, Nov. 21, 2003, item 11 (citing WPS Monitoring Service), *available at* http://www.222.wps.ru/e-index.html.

[19]. The U.S. Agency for International Development (USAID) and the World Bank has been leaders in promoting programs to combat corruption in general as well as judicial corruption. *See* USAID, GUIDANCE FOR PROMOTING JUDICIAL IMPARTIALITY, *supra* note 2; OFFICE OF DEMOCRACY AND GOVERNANCE, BUREAU FOR DEMOCRACY, CONFLICT AND HUMANITARIAN ASSISTANCE, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT, "PROMOTING TRANSPARENCY AND ACCOUNTABILITY: USAID'S ANTI-CORRUPTION EXPERIENCE (Jan. 2002), *available at* http://www.usaid.org [hereinafter USAID, PROMOTING TRANSPARENCY AND ACCOUNTABILITY]; OFFICE OF DEMOCRACY AND GOVERNANCE, BUREAU FOR DEMOCRACY, CONFLICT AND HUMANITARIAN ASSISTANCE, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT, *A Handbook for Fighting Corruption* (Feb. 1999), *available at* http://www.usaid.org [hereinafter USAID, A HANDBOOK FOR FIGHTING CORRUPTION]. The World Bank's Program on Legal and Judicial Reform maintains an excellent website that is broad both in subject matter and geographic scope. World Bank, *available at* http://www4.worldbank.org/legal/leglr/ (last visited Jan. 15, 2004). The fact that Russia is not unique in having a problem with judicial corruption can be shown by one study examining corruption in Argentine that found that over 70 percent of those surveyed believed corruption in the courts was the most important cause of corruption. Maria Dakolias & Kim Thachuk, *Attacking Corruption in the Judiciary: A Critical Process in Judicial Reform*, 18 WIS. INT'L L.J. 353, 370 (2000) (citing Gustavo

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Beliz, *Aplicar Indices de Productividad y Eficiencia en el Trabajo de los Magistrados*, EXPOSICIONES Y DEBATES, at 39 (Aug. 1996)). A valuable source of information of a comparative nature is the United Nations Interregional Crime and Justice Research Institute (UNICRI). Its International Crime Victims Surveys provides a valuable source of information showing the geographic distribution of certain crimes, including some crimes related to corruption. UNICRI, International Crime Victims Surveys, *available at* http://www.unicri.it/icvs/index.htm (last visited Mar. 12, 2004).

[20]. *See* USAID, PROMOTING TRANSPARENCY AND ACCOUNTABILITY, *supra* note 19; USAID, A HANDBOOK FOR FIGHTING CORRUPTION, *supra* note 19.

[21]. Films by Jove Inc. v. Berov, 250 F. Supp. 2d 156 (E.D.N.Y. 2003); Base Metal Trading, SA v. Russian Aluminum, 253 F. Supp. 2d 681 (S.D.N.Y. 2003).

[22]. Films by Jove Inc., 250 F. Supp. 2d at 207.

[23]. Application of this doctrine permits a U.S. court to dismiss a case in the interest of justice and the convenience of the parties. It assumes that an adequate alternative forum (i.e., a foreign court) exists to hear the case. The defendant(s) has the burden of proof to establish "(1) the existence of an adequate alternative forum, and (2) the balance of private and public factors favors dismissal [of the matter]." Stalininski v. Bakoczy, 41 F. Supp. 2d 755, 758-59 (S.D. Ohio 1998). The private factor includes whether the plaintiff's choice of forum would unnecessarily burden the defendant or the court, whereas the public factor concerns court congestion, avoidance of conflict of law issues, and problems in properly applying applicable (i.e., foreign law). *Id.* at 763. The existence of an adequate forum depends on two factors. First, all the parties must be amenable to service of process with the forum's jurisdiction. Second, the alternative forum does not deprive the parties of all remedies nor will they be unfairly treated. *Id.* at

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759.

[24]. Base Metal Trading SA v. Russian Aluminum, 253 F. Supp. 2d 681, 699 (S.D.N.Y. 2003).

[25]. The perception, if not the reality, of corruption in the Russian court system cannot be denied. *See* Enyutina, *supra* note 6. *See also* Derek Bloom et al., *Corporate Takeovers, Russian Style and Necessary Legal Reform*, Apr. 25, 2003, *available at* http://www.rid.ru/db.php?db-id=731&=en (presented at the Gorbachev Foundation of North America's Conference on Corporate Governance and Investment in Transitioning Economies, April 24-26, Boston, Massachusetts. Describing instances of corruption in the Russian court system and calling for the establishment of specialized corporate governance courts); *see also Potemkin Democracy*, WASH. POST, May 30, 2003 (stating that the [Russian] "judicial system is still corrupt" and calling for additional funding on programs to support the development of democracy in Russia).

[26]. *See* U.S. DEPARTMENT OF COMMERCE'S INTERNATIONAL TRADE ADMINISTRATION, HANDBOOK ON COMMERCIAL DISPUTE RESOLUTION IN THE RUSSIAN FEDERATION (July 2000).

[27]. The Russian Federation is divided into eighty-nine *subjects*, such as republics, *krais*, *oblasts*, and cities of a federal significance (i.e., Moscow and St. Petersburg). *See* KONST. RF art. 65.

[28]. *See* Federal Constitutional Law, *On the Judicial System of Russian Federation*, Dec. 31, 1996, art. 4, *available at* http://www.supcourt.rv/EN/jsystem.htm.

[29]. *See* Louise L. Shelley, *Putin's Russia: Why a Corrupt State Can't be a Strong State in the Post-Yeltsin Era*, 9 E. EUR. CONST. REV. 12 (Winter/Spring 2000); *Prosecutors Say Russia Far From Law-Based State*, RFE/RL NEWSLINE, Jan. 15, 2001; Ronald R. Pope,

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An Illinois Yankee in Tsar Yeltsin's Court: Justice in Russia, DEMOCRATIZATIYA (Fall 1999).

30. According to a call in and online poll conducted by Ekho Moscow of its listeners, 96 percent of over 4,000 respondents indicated that they did not consider the Russian judicial system to be independent. Caroline McGregor, *Prosecutors Accused of Pressuring Court*, MOSCOW TIMES, Dec. 2, 2003, *available at* http://www.moscowtimes.ru/stories/2003/12/02/022.html.

31. *See, e.g.*, Peter H. Solomon, Jr., *Courts in Russia: Independence, Power and Accountability*, (unpublished paper presented before the 9th Annual Conference on the Individual vs. the State, May 3-5, 2001); *see also* Geoffrey York, *Canadians Red-Faced as Russians Make a Farce of Bankruptcy Law*, THE GLOBE AND MAIL, Apr. 14, 2001. The intimidation of judges by government officials, influential persons, and organized crime cannot be ignored as having a significant impact on the behavior of individual judges. The methods of intimidation may vary from physical threats against judges and their families to forcing a judge to accept a bribe so that he might be subject to blackmail in the future.

32. *See* KONST. RF ch. 7 (1993). Whether a sufficient number of voters participated in the referendum on the Russian Constitution is a subject of some dispute. Official data indicates that 54.8 percent of eligible voters participated in the referendum held on December 12, 1993 and that 58.4 percent voted in favor of the constitution. That is, only 30.7 percent of the Russian electorate voted in favor of the 1993 Russian Constitution. CENTER FOR RUSSIAN STUDIES, NEW FEDERAL CONSTITUTIONAL APPROVED, Dec. 12, 1993, *available at* http://www.nupi.no/cgi-win/Russland/krono.exe?910. At the time, there were many allegations of fraud. *See, e.g.*, Olivia Ward, *Yeltsin Faces Probe Over*

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Claim of Fraud on Constitutional Vote, TORONTO STAR, June 2, 1994, at A19 (reporting *Duma* initiated probe questioning legality of December 1993 vote adopting new Constitution). In any event, almost without exception all Russian political actors have accepted the legitimacy of the 1993 Russian Constitution.

[33]. *See* Gregory Yavlinsky, *Reforms that Corrupted Russia*, FIN. TIMES, Sept. 3, 2003, at 9 (where Yavlinsky, the leader of the political party Yabloko, stated "[t]he judicial system is corrupted by oligarchs and serves as an instrument for the authorities to settle scores by selective application of the law." Yavlinksy sees the manner of privatization in Russia as the origin of the problem).

[34]. Apparently, state enterprises are less likely to pay bribes to obtain favorable judicial decisions than privately owned enterprises. This should not be a surprise since government workers are in most cases less likely to benefit personally from a favorable *arbitrazh* decision than the management or ownership of private enterprises. According to World Bank data, corruption overall in Russia from 1999-2002 has declined. See author's private correspondence with Ms. Randi Ryterman, Lead Economist, Europe and Central Asia Region, World Bank.

[35]. Irrespective of how Russian businesspersons may gauge the extent of corruption in the Russian *arbitrazh* courts, the number of cases filed in these courts has increased significantly from 1992-2001, from 497,740 to 745,626. This increase can be attributed to a number of factors including an increase in the larger number of commercial disputes, more legally trained individuals capable of filing such cases, the growth in the number and complexity of Russian laws and other normative acts, and a decreased willingness to resolve commercial conflicts through "criminal" courts (i.e., organizations, legal or

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otherwise, that offer "protection," collection and similar services to business and individuals). *See* http://www.arbitr.ru/news/totals/10anniversary (last visited Mar. 12, 2004).

36. Sophie Lambroschini, *Russia: Judges, Plaintiffs, Defendants Face Arbitration Court Problems – Part 2*, RADIO FREE EUROPE/RADIO LIBERTY, Apr. 25, 2001, *available at* http://www.cdi.org/russia/Johnson/5223.html (quoting Fyodorov).

37. Transparency International, *Corruption Perception Index 2003, available at* http://www.transparency.org/cpi/2003/cpi2003.en.html (last visited Jan. 15, 2004).

38. In TI's 2002 bribe payer index, Russia ranked lowest among those countries ranked. That is, of those evaluated, Russian companies were considered to be the most likely to pay bribes. While this result does not mean that any specific Russian company (or individual) will pay a bribe in a given situation, it is nonetheless illustrative of attitudes towards bribery of government officials and, therefore, significant. *See* Transparency International, *Bribe Payers Index 2002* (May 14, 2002), *available at* http://www.transparency.org/cpi/2002/bpi2002.en.html; *see also* Transparency International, *Corruption Perception Index 2002: Background Information, available at* http://www.transparency.org/pressreleases_archive/2002/2002.08.28.cpi.en.html (last visited Jan. 15, 2004); PD Dr. Johann Graf Lambdsdorff, Transparency International and Göttingen University, *Background Paper to the 2001 Corruption Perception Index, How Precise are Perceived Levels of Corruption*, June 2001; PD Dr. Johann Graf Lambdsdorff, Transparency International and Göttingen University, *Background Paper to the 2001 Corruption Perception Index, Framework Document*, June 2001; OECD Observer, "Want Data?," July 7, 2000, *available at* www.oecdobserver.org/news/printpage/php/aid/296/Transparent_tables.html. *See also*

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Valeria Korchagina, *Russia Fares Better in Annual Corruption Perception Index*, MOSCOW TIMES, Aug. 29, 2002, *in* Johnson's Russia List, #6411, *available at* www.cdi.org.

[39]. In 2003, the Russian Chapter of Transparency International and INDEM conducted a survey examining the level of corruption in forty Russian political subdivisions. The survey focused on both "everyday" corruption (responses of 5666 individuals) and "business" corruption (responses of 1838 entrepreneurs). The survey sought to distinguish corruption at the federal, regional, and local levels as well as institution (executive branch, legislative branch, judiciary, and law enforcement agencies). Russian Chapter of Transparency International, *available at* http://www.transparency.org.ru/proj_index_doc.asp (last visited ~~Oct. 8, 2003~~Mar. 12, 2004).

[40]. Press Release, Center Transparency-International Russia, Center for Anti-corruption Research and Initiative, *Regional Corruption Indices 2002*, at 1, *available at* http://www.transparency.org.ru/DOC/Presentation_index-englFinal.doc (last visited ~~Oct. 8, 2003~~Mar. 12, 2004).

[41]. *See* Center Transparency-International Russia, Tables 7-2 (Indices of public trust – entrepreneurs), 8-2 (Corruption ~~perception indices~~Perception Indices – individuals), and Table 9-2 (Corruption ~~perception indices~~Perception Indices – entrepreneurs), *at* http://www.transparency.org.ru/DOC/Presentation_index-englFinal.doc (in English); http://www.transparency.org.ru/DOC/Presentation_index.doc (in Russian); and http://www.transparency.org.ru/DOC/Speczachistka-table.doc (last visited ~~Oct. 8, 2003~~Mar. 12, 2004).

[42]. Solutions to corruption (Table 6), Transparency International, *Bribe Payers Index 2002*

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(May 14, 2002), *available at* http://www.transparency.org/cpi/2002/bpi2002.en.html. Another study examining corruption in Argentina found that over 70 percent of those surveyed believed corruption in the courts was the most important cause of corruption. Dakolias & Thachuk, *supra* note 19, at 370 (citing Gustavo Beliz, *Aplicar Indices de Productividad y Eficiencia en el Trabajo de los Magistrados*, EXPOSICIONES Y DEBATES, at 39 (~~August~~Aug. 1996)).

43. Daniel Kaufmann & Aart Kray, *Governance and growth in the very long run: updated indicators, new results*, THE GLOBAL CORRUPTION REPORT 2003 (Transparency International, Profile Books 2003); *see also* Shang-Jin Wei, *How Taxing is Corruption on International Investors? available at* http://www.transparency.org/iacc/8th_iacc/papers/jinwei.html (last visited Jan. 15, 2004).

44. Dakolias & Thachuck, *supra* note 19, at 374, 378 (citing, *inter alia*, Susan Rose-Ackerman, *The Role of the World Bank in Controlling Corruption*, 29 LAW & POL'Y INT'L BUS. 93, 106 (1997)).

45. Mikhail Krasnov, *Is the "Concept of Judicial Reform" Timely?* 11 E. EUR. CONST. REV., 94 (Winter/Spring 2002).

46. *Id.*

47. Timothy Frye, *The Two Faces of Russian Courts: Evidence from a Survey of Company Managers*, 11 E. EUR. CONST. REV., 128 (Winter/Spring 2002).

48. *Id.*

49. *Id.* Respondents were able to identify more than one source of corruption or improper influence, which is why the percentages exceed 100 percent.

50. *See* The Public Opinion Foundation, *at* http://English.fom.ru (last visited Jan. 15, 2004). In the Russian legal system, a procurator fulfills functions generally similar to that of a

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U.S. prosecutor. Traditionally, procurators operated primarily as advocates for the state rather than to uphold the law and protect the rights of citizens.

51. Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?* 52 STAN. L. REV. 1731, 1755 (July 2000).

52. Reuters, *EBRD Calls for Russian Legal Reform*, THE RUSSIA J., Apr. 24, 2000, *available at* http://www.russiajournal.com.weekly/article/shtml?ad=2761.

53. *Id.*

54. *Id.*

55. Jeffrey M. Hertzfeld, *Corporate Governance in Russia: The Foreign Direct Investor's Perspective*, May 31-June 2, 1999, at 6 *available at* http://www.oecd.org/dataoecd/55/47/1921803.pdf (last visited March 6, 2004) ~~(accessed June 22, 2003)~~.

56. *Id.*

57. However, lawyers may choose not to follow this practice if the Russian counterpart has no assets abroad, which will make it necessary to enforce a foreign arbitral award through the Russian court system.

58. The use of private arbitration in Russia does not avoid problems because awards may and are still challenged in the Russian courts on various grounds. *See* Ethan S. Burger, *Russian Legislation on Enforcement of Judicial and Arbitral Decisions*, 15 RUSSIA BUSINESS WATCH 3 (Summer/Fall 1997), *reprinted in* AMERICAN BAR ASSOCIATION, A LEGAL GUIDE TO DOING BUSINESS IN RUSSIA & THE FORMER REPUBLICS OF THE U.S.S.R. (February 2000); *see also* Russian Law, On International Arbitration', July 7, 1993.

59. James D. Wolfensohn, Keynote Address to the Law and Justice Conference: Empowerment, Security and Opportunity through law and Justice (July 9, 2001),

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available at http://www.worldbank.org.

60. *See Wolfensohn Warns Former Soviet Union on Corruption*, PRESS REVIEW, July 10, 2001, *available at* http://wbln0018.worldbank.org/NEWS/DEVNEWS.NSF/1a3beeaf8ef89e2085256704004d59.

61. Glenn P. Hendrix, *The Experience of Foreign Litigants in Russia's Commercial Courts*, *in* ASSESSING THE VALUE OF LAW IN TRANSITION ECONOMIES (Peter Murrell ed., University of Michigan Press 2001), *available at* http://pewaa.umich.edu/pdf/09763-fm.pdf (last visited Jan. 26, 2004).

62. While some people suggest that foreigners enjoy a "level playing field" when their disputes are heard in Russian *Arbitrazh* courts, others would strongly disagree. For example, "Sawyer Research Products, the leading U.S. crystal quartz producer, lost an $8.2 million investment in a plant in the Vladimir *oblast* in July 2001 when Sawyer's Russian partner took over the company with the backing of the local administration and the courts, which ruled the price Sawyer paid for its lease was too low." Caroline McGregor, *Russia Still Too Green for U.S. Money*, THE MOSCOW TIMES, June 19, 2003. *See also* Bill Nichols, *When it Comes to Russia, Let the Investor Beware*, USA TODAY, Apr. 10, 2002, at B-1 (describing Sawyer Research Products' problems with the Russian authorities and courts in general, as well as the intervention of U.S. Ambassador Alexander Vershbow with Russian President Putin on Sawyer's behalf).

63. Hendrix, *supra* note 61, at 101-02.

64. *Id.* at 101.

65. Data on the number of cases filed in the Russian *Arbitrazh* can be found on the Russian Supreme *Arbitrazh* Court's Website. Supreme *Arbitrazh* Court, *available at*

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http://www.arbitr.ru/news/totals/10anniversary/index.htm (last visited Jan. 15, 2004). From 1994-2001, the number of cases filed has increased over time. This trend reflects a number of factors, including the smaller role played by state enterprises in the Russian economy and the increase in the number of Russian lawyers.

[66]. Konstantin Sklovskii, *B interesakh chastnogo litsa [In the interests of a private person]*, NEZAVISIMAYA GAZETA [INDEPENDENT NEWSPAPER], June 1, 2001. According to Sklovskii, even when a reviewing court discovers a mistake by a lower court, its response in 99 percent of the cases is simply to remand the case to the same lower court, which merely results in avoidable delays (usually favoring the party at fault). Such a system can and does contribute to corruption on the part of trial court judges.

[67]. *See* O Federal'noi Tselevoi Programme 'Razvitie sudebnoi sistemy na 2002 do 2006 [On the Federal Special Program 'The Development of a Judicial Program for 2002 to 2006], RF Govt'l Decree No. 805 (Nov. 20, 2001). Of course, it remains to be seen whether the funds necessary to implement this program have been allocated, for the manner in which it is carried out.

[68]. *See generally* John Hewko, *Foreign Direct Investment: Does the Rule of Law Matter, in* CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE, at 10-12 (Democracy and Rule of Law Project, Working Papers No. 26, April 2002), *available at* http://www.ceip.org/files/pdf/wp2b.pdf. Hewko's observation in this regard was made in specific reference to Ukraine, but the same situation is true with respect to Russia, although to a slightly lesser extent. Hewko, however, believes that businesses pursue projects where they see opportunity, and that weaknesses in a country's legal structure is a secondary consideration.

[69]. A "normative act" is an act, in the form of an official document, that is issued by an

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authorized official in the constitutionally or legislatively-required manner, which establishes mandatory legal norms or procedures. These include presidential edicts, governmental decrees, instructions or regulations, etc., issued by an authorized body of the Russian Federation, regional governments, local self-administrations, or municipal governments. *See* Decree No. 5, *Plenum*, RF Supreme Court, On Some Questions Arising in the Course of the Examination of Cases pursuant to Petitions of *Procurators* regarding the Recognition of Legal Acts as Contrary to Law (Apr. 23, 1993).

[20]. Supreme *Arbitrazh* Court, *Postanovlenie*, *available at* http://frame.arbitr.ru:8080/law (last visited ~~Oct. 15, 2003~~Jan. 16, 2004). The Supreme *Arbitrazh* Court even has a user friendly search engine for locating relevant resolutions, see http://arbitr.park.ru/default.asp?page=doc_search_form (last visited Jan 16, 2004).

[21]. President Vladimir Putin, *Annual Address to the Federal Assembly of the Russian Federation* (Apr. 3, 2001).

[22]. The extent to which the "rule of law" has taken hold in Russia remains a subject of considerable debate. Irrespective of one's view of the YUKOS affair, one cannot ignore what appears to have been the application of the law for political purposes – itself a form of corruption. The Russian Presidential Website has a section devoted to judicial reform; see http://www.kremlin.ru/eng/priorities/21897.shtml (in English) (last visited Jan. 16, 2004). See also *Poll: Vladimir Putin Receives 85% approval rating*," PRAVDA.RU, available at *http://new.sfromrussia.com/main/2004/02/02/52110.html* (last visited March 13, 2004) and *Putin puts his faith in security service*, GAZETA.RU, available at http://www.gazeta.ru/2004/01/16/Putinputshis.shtml. (last visited March 13, 2004)

[23]. Artyom Vernidoub, *Ustinov holds back on anticorruption campaign*, May 16, 2002, *reprinted in* Johnson's Russia List, # 6246 (Item 10), *available at*

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http://www.cdi.org/russia/johnson/6248.cfm.

74. *Id.*

75. *Vestnik Vyshei kvalifikatsionnoi kollegii sudii Rossiiskoi Federatisii* [Herald of the Higher Qualification Collegium of the Courts of the Russian Federation, Issue No. 2, 2003, Annex 1, at 64.

76. *Id.* at 66.

77. *Id.* at 67 (It should be noted that these official data may be misleading as how a particular action might be categorized can be highly subjective. In addition, individuals may have stepped down from the bench to avoid their removal).

78. *Id.* at 68.

79. Alexander Vershbow, May 22, 2003, *reprinted in* New Economic School, Moscow.

80. Lambroschini, *supra* note 36.

81. *See* Russian Presidential Edict No. 1117, On the Increase of Monetary Compensation of Persons Occupying Various State Positions of the Federal State Service, and Monetary Benefits of Federal Workers, Sept. 23, 2003; Russian Federal Law, On the Minimum Payment of Labor, June 19, 2000 (as amended July 26, 2002); Russian Federal Law, On Additional Guarantees of Social Protection of Judges and Workers of the Apparatus of the Courts of the Russian Federation, Jan. 10, 1996 (as amended June 28, 2002).

82. According to the U.S. Department of State's Bureau of Democracy Human Rights and Labor's Country Report for Russia, "[l]ow salaries and a lack of prestige continued to make it difficult to attract talented new judges and contributed to the vulnerability of existing judges to bribery and corruption; however, judicial salaries were increased by 60 percent during the year. Working conditions for judges remained poor and lacking in physical security, and support personnel continued to be underpaid. Judges remained

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subject to intimidation and bribery from officials and others were inadequately protected from intimidation or threats from powerful criminal defendants." State Department, *County Report for Russia*, Mar. 31, 2003, *available at*. http://www.state.gov/g/drl/rls/hrrpt/2002/18388.htm.

83. Andrei Malosolov, *Russian Prime Minister Sums Up First Results of Judicial Reform*, NOVOSTI, Jan. 21, 2003, *available at* http://www.cdi.org/russia/johnson/7027-8.cfm.

84. *See* Tatiana Smol'iakova, *Povyshenie minimal'noi zarabotnoi platy v oktiabre 2003 roga: Denezhnoe udovol'stvie [Increase of the minimum working payment in 2003 in October 2003]*, ROSS. GAZETA, Oct. 3, 2003, *available at* http://www.rg.ru/2003/10/13/denejnoeudovolstvie.html (noting that the salary for the highest ranked civil servant is R27,000/month).

85. Such acts would be punishable under various articles within Chapter 30 of the Russian Federation Criminal Code. The sanctions for such offenses, however, are relatively small so that if a payoff is large, taking the risk to engage in improper conduct might be attractive to some individuals. The standards of conduct for Russian public officials is set out principally in *On the Principles of the Civil Service in the Russian Federation*. Federal Law No. 119-FZ, July 31, 1995 (as amended). A government official's salary is reflected in a state register developed pursuant to *On the Register of the State Ranks of Federal Governmental Employees*. Russian Presidential Edict No. 33, July 11, 1995 (as amended).

86. V. F. Yakolev, *Vystuplenie Na Soveshchanii predstedatelei sovetov sudei RF v 'Prezident-otele' [Speech at the Conference of Chairmen at the Council of RF Judges at the President Hotel]*, June 16-20, 2003, *at* http://www.arbitr.ru/news/press/20030725/index.htm; *see also* Interview of Supreme

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Arbitration Court Chairman Venyamin F. Yakolev with B. K. Katanian, *Chestnomu biznesy sud ne strashen* [*The Court is Not Afraid of Honest Business*], Mar. 14, 2003, *at* http://www.arbitr.ru/news/press/20030314/index.htm (where Chairman Yakovlev acknowledged the problem of corruption in commercial cases and pledged that where appropriate, individuals would be prosecuted).

[87]. Yekaterina Zapodinskaya, *Judges Help Expropriate Property*, KOMMERSANT, June 11, 2003, at 4, *available at* http://www.cdi.org/russia/johnson/7231-7.cfm.

[88]. *Id.*

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EXHIBIT SUBMITTED BY JOAN BORSTEN: "THE CIRCUMSTANCES SURROUNDING THE ARREST AND PROSECUTION OF LEADING YUKOS EXECUTIVES."

Parliamentary **Assembly**
Assemblée parlementaire

Parliamentary Assembly
Assemblée parlementaire
COUNCIL OF EUROPE CONSEIL DE L'EUROPE

Doc ...
... November 2004

The circumstances surrounding the arrest and prosecution of leading Yukos executives

Report
Committee on Legal Affairs and Human Rights
Rapporteur: Mrs Sabine Leutheusser-Schnarrenberger, Germany, Liberal, Democratic and Reformers Group

Summary

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I. Draft resolution

1. The Parliamentary Assembly, reaffirming its commitment to the rule of law as one of the Council of Europe's core values, is concerned by the shortcomings of the judicial process in the Russian Federation revealed by the cases of several former Yukos executives.

2. The rule of law requires the impartial and objective functioning of the courts and of the prosecutors' offices, free from undue influences from other branches of Government, and the strict respect of procedural provisions guaranteeing the rights of the accused.

3. The rule of law includes the equality of all before the law, regardless of wealth or power.

4. The right to a fair trial, as protected by Article 6 of the European Convention on Human Rights (ECHR), includes the right to a fair and public hearing by an independent and impartial tribunal established by law, the presumption of innocence, and adequate time and facilities for the preparation of the defence. A fair trial requires respect of the rights of the defence, the privileged lawyer-client relationship, and the equality of arms between defence and prosecution.

5. The public character of judicial proceedings, as guaranteed by Article 6 ECHR, is an important element of a fair trial, in the interests of the accused, but also of the public at large and its confidence in the correct functioning of the judiciary.

6. The Assembly stresses the importance of the independence of the judiciary, and of the independent status of judges in particular, and regrets that legislative reforms introduced in the Russian Federation in December 2001 and March 2002 have not protected judges better from undue influence from the executive and have even made them more vulnerable. Recent studies and highly publicised cases have shown that the courts are still highly susceptible to undue influences. The Assembly is particularly worried about new proposals to increase further the influence of the President's administration over the judges' qualification commission.

7. Facts pointing to serious procedural violations committed by different law enforcement agencies against Mr Khodorkovsky, Mr Lebedev and Mr Pichugin, former leading Yukos executives, have been corroborated during fact-finding visits, whilst some allegations appear to have been exaggerated by the defence team. On balance, the findings put into question the fairness, impartiality and objectivity of the authorities, which appear to have acted excessively in disregard of fundamental rights of the defence guaranteed by the Russian Criminal Procedure Code and by the European Convention on Human Rights.

8. The most serious corroborated shortcomings include the following:

i. despite specific requests of the defence lawyers, tests were not carried out in good time that could have established whether or not Mr Pichugin had been injected with psychotropic drugs; Mr Pichugin was also held in the "Lefortovo" prison that is not subject to the usual controls of the Ministry of Justice and remains under the direct authority of the FSB, contrary to a specific commitment the Russian Federation undertook when joining the Council of Europe;

ii. shortcomings in medical attention to Mr Lebedev in prison: in the face of serious concern about Mr Lebedev's deteriorating state of health, the prison authorities have so far refused to allow an examination of Mr Lebedev by independent doctors, despite repeated requests;

iii. delays in obtaining the prosecutor's permission have prevented the lawyers from entering into contact with their clients during a particularly critical time after their arrests, making it more difficult for them to organise their defence; a legislative reform abolishing the requirement of a prior permission from the prosecutor's office for a lawyer to visit his or her client in prison has not been applied in practice, at least not in the cases of the former Yukos executives;

iv. denial of access of Mr Lebedev's defence lawyers to the courtroom during the hearing deciding on his pre-trial detention;

v. search and seizure of documents in the defence lawyers' offices, summons of lawyers for questioning on their clients' cases, and alleged eavesdropping against defence lawyers: The prosecution must not be allowed to circumvent the lawyer-client privilege by a simple play on case file numbers,

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especially when the cases are as closely related to one another as the criminal cases against Khodorkovsky, Lebedev, and Pichugin, and the tax cases against Yukos and its subsidiaries;

vi. Unjustified restrictions on the publicity of certain court proceedings: members of the public have had extremely limited access to certain hearings that were announced as public, whilst other hearings were or are being held *in camera* in the first place. In particular, all proceedings against Mr Pichugin have been held *in camera*, even though only a small portion of the case file has been classified as secret; his lawyers have been placed under strict instructions not to discuss the proceedings in public, even the reasons of the final judgment may be kept secret;

vii. denial of bail (in particular regarding Mr Khodorkovsky): Mr Khodorkovsky was placed in pre-trial detention several months after Mr Lebedev's arrest, on very similar grounds, an arrest that media reports interpreted as a "warning" to Mr Khodorkovsky. Mr Khodorkovsky's conduct showed that there was no risk of absconding, or of interfering with evidence. After the completion of the pre-trial investigation, Mr Khodorkovsky and Mr Lebedev were kept in custody, which raises additional issues in light of the judgments of the European Court of Human Rights in the cases of Kalashnikov v. Russia and Letellier v. France. Also, following a recent legislative reform, persons accused of non-violent "economic crimes", such as those allegedly committed by Mr Khodorkovsky, are generally not placed in pre-trial detention.

viii. other unfair features of the trials against Mr Khodorkovsky, Mr Lebedev and Mr Pichugin: the court systematically allows the prosecutor to read out the minutes of the pre-trial interrogation of witnesses and to put pressure on the witness in the courtroom to simply confirm those minutes. This undermines the effectiveness of the right of the defence to question witnesses of the prosecution, whose pre-trial interrogation they are generally not able to attend. The defence lawyers are also not allowed to exchange written notes with the accused in the pre-trial detention centre, and in the courtroom, they can only exchange notes after the court has first read them.

9. The Assembly notes that the circumstances surrounding the arrest and prosecution of the leading Yukos executives strongly suggest that they are a clear case of non-conformity with the rule of law and that these executives were - in violation of the principle of equality before the law - arbitrarily singled out by the authorities.

10. In particular, the allegedly abusive practices used by Yukos to minimise taxes were also used by other oil and resource companies operating in the Russian Federation, which have not been subjected to a similar tax reassessment, or its forced execution, and whose leading executives have not been criminally prosecuted. Whilst the law was changed in 2004 and the alleged "loophole" thus closed, the incriminated acts date back to 2000, and retrospective prosecution started in 2003.

11. Intimidating action by different law enforcement agencies against Yukos and its business partners and other institutions linked to Mr Khodorkovsky and his associates and the careful preparation of this action in terms of public relations, taken together, give a picture of a co-ordinated attack by the State.

12. The criminal charges laid against persons who made use of the possibilities offered by the law as it stood at the time of the incriminated acts, following a retroactive change of the tax law, raises serious issues pertaining to the principle of *nullum crimen, nulla poena sine lege* laid down in Article 7 ECHR, and also to the right to the protection of property laid down in Article 1 of the First Protocol to the ECHR.

13. In view of the above (paragraphs 8-12), the Assembly considers that the circumstances of the arrest and prosecution of leading Yukos executives suggest that the interest of the State's action in these cases goes beyond the mere pursuit of criminal justice, to include such elements as to weaken an outspoken political opponent, to intimidate other wealthy individuals, and to regain control of strategic economic assets.

14. The Assembly recognises the right, and even the duty, of the law enforcement bodies to bring to justice the perpetrators of criminal offences. It also recognises the legitimate right of the elected political leadership to pursue its political objectives, including in the economic sphere. However, it strongly objects to the use of law enforcement procedures for such purposes. In this context, reference is made to the judgment of 19 May 2004 of the European Court of Human Rights in the *Gusinskiy* case, in which the Court found that the detention in remand of N-TV founder Gusinskiy violated Article 5 ECHR because it had established that the applicant's prosecution had been used to intimidate him into selling off his stake in N-TV to Gazprom.

15. The Assembly therefore, in general terms,

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i. calls upon the Russian authorities to vigorously pursue and implement reform of the legal and judicial system, and of law enforcement agencies, with a view to strengthening the rule of law and the protection of human rights and to continue cooperating with the Council of Europe, in the framework of ongoing programmes;

ii. encourages the courts to assert their independence vis-à-vis the executive authorities in assessing the guilt or innocence of all accused persons, applying the law in conformity with the European Convention on Human Rights;

iii. invites the authorities in charge of pre-trial detention centres to ensure that lawyers' access to their clients in detention is no longer subjected to any conditions not prescribed by law, notably to prior authorisation or recommendation by the public prosecutor, and to provide the conditions for the effective exercise of the defence rights of the persons in their custody, including the respect of the privileged relationship between lawyers and their clients;

iv. urges the competent authorities to ensure that all pre-trial detention centres, including Lefortovo isolation centre in Moscow, be subject to supervision by the Ministry of Justice, in line with earlier commitments by the Russian Federation.

16. As regards more specifically the cases of the former leading Yukos executives, the Assembly:

i. requests the executive authorities of the Russian Federation to guarantee the full independence of the judicial proceedings against leading Yukos executives from any attempt to influence them, and to take measures to stop any such attempt;

ii. requests the public prosecutors to carry out their work in these proceedings in a professional, impartial and objective manner, respecting the letter and the spirit of the procedural protections for the accused laid down in the Russian Criminal Procedure Code and the European Convention on Human Rights, and the principles set out in Recommendation (2000)19 of the Committee of Ministers on the role of public prosecution in the criminal justice system;

iii. calls upon the courts to ensure effective public access to the hearings in the proceedings against the leading Yukos executives;

iv. urges the competent authorities to ensure in particular that only those parts of the trial against Mr Pichugin remain closed to public scrutiny which are directly linked to information for which there is a legitimate need for secrecy, taking account the importance attached to the principle of open court hearings by the European Convention on Human Rights;

v. urges the competent authorities to allow immediately an independent medical assessment of Mr Lebedev's state of health.

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II. Draft recommendation

1. The Parliamentary Assembly, referring to its Resolution ... (2004), recommends to the Committee of Ministers in general terms

i. to continue offering to the Russian Federation the Council of Europe's co-operation in preparing and implementing reforms of the legal and judicial system, and of law enforcement agencies, aimed in particular at further strengthening the effective independence and transparency of the courts and of their proceedings, in particular as regards the distribution of cases among judges of a given court (principle of the judge determined by law);

ii. to evaluate the extent to which progress has been achieved under past and current assistance and cooperation programmes carried out in these fields of judicial reform, and to inform the Assembly of the results of this evaluation and of any adaptations that may turn out to be necessary in order to achieve better results;

iii. to urge the Russian Federation to ensure that all pre-trial detention centres, including Lefortovo isolation centre in Moscow, be submitted to supervision by the Ministry of Justice, in line with earlier commitments, and be open to visits by representatives of the Parliamentary Assembly as requested.

2. Concerning more specifically the cases of the leading Yukos executives, the Parliamentary Assembly recommends to the Committee of Ministers

i. to remind the Russian authorities of the importance it attaches to the principle of open court hearings, and to ask them to ensure that exceptions to this principle in the Pichugin case are limited to the strict minimum, in accordance with Article 6 § 1 of the European Convention on Human Rights;

ii. to remind the Russian authorities of the importance it attaches to the principle that detention on remand shall be an exceptional measure, and to ensure that this principle is also applied in the case of Mr Khodorkovsky;

iii. to urge the Russian authorities to immediately allow an independent medical assessment of Mr Lebedev's state of health.

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III. Explanatory memorandum
by Mrs Leutheusser-Schnarrenberger, Rapporteur

A. Introduction

1. On the proposal of the Bureau, the Assembly referred the motion for a Resolution presented by Mr Bindig and others on "The circumstances surrounding the arrest and prosecution of leading Yukos executives" (Doc 10083 of 12 February 2004) to the Committee on Legal Affairs and Human Rights for Report. Following my appointment as Rapporteur by the Committee on Legal Affairs and Human Rights at its meeting on 15 March 2004, I carried out two fact-finding visits to Moscow (on 24-27 May and 27-30 September 2004).

2. I should like to thank the Russian delegation to the Parliamentary Assembly, in particular its chairman, Mr Kosachev, and my committee colleague, Mr Grebennikov, for their support in organising the two visits. They gave me ample opportunity to talk to members of the State Duma and representatives of the competent Russian authorities (Ministry of Justice, Office of the Prosecutor General, Federal Tax Service), the Commissioner for Human Rights in the Russian Federation, Mr V. Lukin, and to representatives of non-governmental organisations, lawyers, and retired judges. I respect the decisions of the competent courts refusing to allow me to meet with Mr Khodorkovsky, Mr Lebedev or Mr Pichugin in their places of detention, or even during a break in the court hearing that I attended on 28 September 2004, even though I do not agree with them.

B. Restatement of the Rapporteur's mandate

3. In the Introductory Memorandum dated 22 June 2004, I explained my understanding of the mandate and my determination to avoid any interference in the ongoing judicial proceedings in the Russian Federation, or before the European Court of Human Rights. As former Federal Minister of Justice of Germany, I am well aware both of the limits of public scrutiny of judicial proceedings, and of the importance of the fairness and impartiality of such proceedings, which may, however, benefit from fair public attention. The guilt or innocence of the accused persons will be for the competent Russian courts to decide, in a "fair" trial by Council of Europe standards, which the Russian Federation has voluntarily accepted when it joined our Organisation.

4. As regards the alleged procedural violations that I have looked into, I do not even pretend to pronounce a final "judgment" on it. I merely strive to come to a well-reasoned legal and political assessment of the facts that are brought to my attention from all sides, and which I endeavour to interpret and assess rigorously, from a legal and political perspective. My work shall not, and cannot in any way, prejudge the findings of the European Court of Human Rights, which with its own methods and possibilities will judge on those issues that have been, or will be brought before it in the procedurally correct way.

C. Issues examined

1. Mr Pichugin held in a prison (Lefortovo) not under the control of the Ministry of Justice

5. When acceding to the Council of Europe in 1996, Russia undertook "to revise the law on federal security services in order to bring it into line with Council of Europe principles and standards within one year from the time of accession, in particular the right of the Federal Security Service (FSB) to possess and run pre-trial detention centres should be withdrawn"[1]. Whilst all other pre-trial detention centres have been placed under the control of the Ministry of Justice, the "Lefortovo" pre-trial detention centre remains subjected to the FSB, despite exhortations by the Parliamentary Assembly and its Monitoring Committee. According to Tamara Morshchakova, a retired Vice-President of the Constitutional Court of the Russian Federation, the existence of an FSB-controlled prison is also a violation of the Russian Constitution[2].

6. When I enquired about the alleged violations of prisoners' rights during my meeting at the Ministry of Justice, I was told in very clear terms that Mr Pichugin (who I was informed is held at Lefortovo) is not on that

[1] Cf. Doc. 9396 of 26 March 2002 on the Honouring of obligations and commitments by the Russian Federation (Rapporteurs: David Atkinson (UK/EDG) and Rudolf Bindig (Germany/SOC), para. 59, and Opinion No. 193 (1996) on Russia's request for membership of the Council of Europe, para. 10. xvii.

[2] The present set-up of Lefortovo prison violates the prohibition, in Article 15 of the Constitution, of non-public restrictions of human rights, and according to Article 55 III, a federal law respecting the prohibition of disproportionate restrictions of human rights would be required. She asserted that such a law legitimising Lefortovo does not exist.

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Ministry's "list", and that I should ask my questions regarding Mr Pichugin elsewhere. I intended to raise the issues concerning Lefortovo prison with a representative of the FSB during my second visit, but I did not get an appointment.

7. During my second visit to Moscow, I was told that Mr Pichugin had been transferred to another prison shortly before my arrival. But this does not change the fact that he had been held in Lefortovo prison earlier and that this prison is still under the control of the FSB.

2. *Alleged ill-treatment of Mr Pichugin at Lefortovo Prison*

8. The allegations made in detailed written or oral submissions by Mr Pichugin's lawyers, Ms Tatiana Akimtseva, Mr Oleg Solovyov, and Georgy Kaganer, and by his wife Tatiana Pichugina are very serious: Mr Pichugin was - allegedly - interrogated on 14 July 2003 by unidentified FSB operatives in the absence of his lawyers, after having been drugged with coffee laced with drugs that made him lose consciousness for several hours. The lawyers who saw him the following day noticed that he was still drowsy. Mr Pichugin showed them clearly visible injection marks whose origin he could not explain. He asserted that he had discovered them in the morning of 15 July 2003, whilst he did not have these marks prior to the interview with the two FSB operatives. Mr Pichugin – allegedly – showed the marks again on 16 July 2003, in the presence of an investigator of the procuracy, and informed the investigator of the events on 14 July. The defence petitioned the investigator to have Mr Pichugin's report thoroughly investigated, including the performance of investigative acts to objectively confirm or refute the facts set out by him. The defence alleges that a timely medical examination had been refused as "inappropriate", and that the medical examination finally performed after a week had been a mere formality, as the injection marks or traces of drugs in the blood would have disappeared by then. Mrs Pichugina is very worried about her husband's state of health. She said that he lost 40 kg, and that the diabetes he had been diagnosed prior to his arrest is worsening due to the stress of detention.

9. The defence team fears that Mr Pichugin is being put under immense pressure to incriminate himself, as well as other leading Yukos executives. I cannot myself help being concerned about possibly illicit investigative methods and pressures that Mr Pichugin could have been subjected to in a prison that remains withdrawn from the normal supervisory procedures by the Ministry of Justice, and I regret not having been given the opportunity of meeting with him in order to obtain first-hand information from him. I find the defence's thesis plausible that if no illicit substances had been used on Mr Pichugin, the prosecution would have seen to it that a proper expertise was carried out in good time so that the defence could be held responsible for such serious false allegations.

3. Circumstances of the arrest of Mr Lebedev (whilst in hospital), and alleged shortcomings of medical attention whilst in prison

10. According to the defence team, Mr Lebedev was arrested whilst hospitalised at the Third Central Military Clinical Hospital, for a serious health condition (advanced hepatitis, uncontrolled hypertension, suspected stroke, cardio-vascular disease, leading to loss of eye-sight). According to them, Mr Lebedev was hospitalised for further tests on 2 July 2003, after doctors at the "ON-Clinic" had diagnosed on 30 June 2003 serious health problems that required more sophisticated diagnostic tools than those available at the said clinic.

11. According to the representatives of the prosecution that I spoke with, Mr Lebedev's health was practically normal at the time of his arrest, and continues to be so. They denied that Mr Lebedev was arrested whilst hospitalised, stating that Mr Lebedev had been summoned to come to the procuracy on 2 July 2003 at 10 am as a witness and that he was indeed arrested later on the same day, but at the procuracy. At the time set in the summons, Mr Lebedev's lawyer had phoned to say that his client was in hospital, without however being able to say in which one. After the Prosecution located Mr Lebedev, who had just been admitted to the Third Central Military Clinical Hospital, a medical examination had been performed resulting in an all-clear for any investigative acts required. [3]

[3] Lawyer Drel, whom I asked for written clarifications, confirmed that his client had indeed been summoned for interrogation as a witness at the Prosecutor's office at 10 am on 2 July 2003. Drel wrote that he arrived at the Prosecutor's office at the said time with the news that Lebedev had been hospitalised. At this time, he could not specify the name of the hospital, because he did not have such information at 10 am. Mr Drel said he was then handed a subpoena for Mr Lebedev to show up at the Prosecutor's office for interrogation as a witness on 3 July 2003 (of which I have now received a copy), but Lebedev, Drel insists, was arrested at the hospital later on 2 July.

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12. During my second visit to Moscow, the defence lawyers handed me copy of the official document detailing the circumstances of Mr Lebedev's arrest, which states that the place of Mr Lebedev's arrest was indeed the hospital. They also handed me copy of the convocation of Mr Lebedev, c/o lawyer Drel, for 3 July 2003 at 10 am (and not 2 July, as I was told by the representative of the prosecution).

13. Whatever the precise circumstances and place of Mr Lebedev's arrest, I consider as much more serious the disagreements between the prosecution and the defence regarding the subsequent development of Mr Lebedev's health situation. The prosecutors showed me numerous medical bulletins established by prison doctors, including one dated 25 December 2003, and by an emergency team that had intervened during a court hearing on 26 December 2003, after Lebedev had complained about an acute problem, finally by a "consilium" of doctors on 3 March 2004 lead by the Chief Physician of the City of Moscow, Mr Labeznikov. These seem to show that apart from some headaches, intestinal pains and high blood pressure, as well as some hepatitis, Lebedev was and is in reasonably good health. The prosecutors also told me that during court hearings in April 2004, Mr Lebedev had declared himself satisfied with the medical treatment he had obtained and with his state of health in general.

14. His lawyers adamantly deny this and provided me with an extract from the minutes of a court hearing on 15 April 2004 in which Mr Lebedev is cited as having made some very critical remarks, claiming that the prison doctors even refused to administer Papazol (a drug to control hypertension) to him. He now refused any treatment offered by prison doctors, whom he no longer trusted. A panel of Canadian doctors, who assessed all available data, but could not examine Mr Lebedev themselves, came to worrisome conclusions and recommended Mr Lebedev's urgent hospitalisation for further tests[4].

15. I find it difficult to understand why the prosecution has so far refused a medical examination by independent doctors, i.e. ones chosen by the defence and not linked to the administration. According to the information I obtained at the Ministry of Justice, the possibility of independent medical opinions is foreseen by Russian law, and a more forthcoming use of this possibility could easily dispel any doubts caused by protracted refusal.

4. Refusal of bail (in particular, regarding Mr Khodorkovsky)

16. *Mr Khodorkovsky was arrested several months after Mr Lebedev. According to information received* from both sides, the accusations against the two are very similar[5], based on the same documentary evidence, witnesses etc ... The arrest of Mr Lebedev was widely interpreted as a "warning" to Mr Khodorkovsky to leave the Russia – which several other former leading executives or shareholders of Yukos have indeed done. Mr Khodorkovsky chose to stay in Russia, declaring publicly that he intended to stand up in court to fight for his good name. He voluntarily returned to Russia from a business trip to the United States, which he undertook after Mr Lebedev's arrest. This is undisputed.

17. The Prosecution nevertheless maintains that he needed to be arrested and kept in pre-trial detention, because of the risk of flight, and of interference with the investigation. The prosecutors specified that he disposed of several passports, and had the means to procure himself false papers even after confiscation of all his passports, and that a number of key witnesses were economically dependent on Mr Khodorkovsky/Yukos and could therefore be influenced by him.

18. The defence pointed out other possible measures of restraint (for example house arrest with external communications cut off, confiscation of all passports, bail, personal guarantees signed by a large *number of honourable citizens) that could have taken the place of imprisonment, which was in their view* primarily a "political" signal, and designed to prevent Mr Khodorkovsky from resisting the dismantling of his

[4] I received copy of a medical panel report dated 30 March 2004 (chair: Dr. Edward Wasser/Toronto) based on the analysis of available medical reports, including those by Dr. Rumiantsev, who examined Mr Lebedev on 30 June 2003 at the "ON Clinic" and recommended his hospitalisation for further tests, those by doctors at the Military hospital where Mr Lebedev was arrested, on a number of medical certificates and readings produced during Mr Lebedev's detention, on the response from the Russian Federation to Mr Nielsen of the registry of the European Court of Human Rights, and finally on the analysis of symptoms described by members of the defence team who visited Mr Lebedev in prison. The 22-page document paints a worrisome picture of Mr Lebedev's state of health, sums up a number of undisputed facts, and exposes inconsistencies between different official statements regarding Mr Lebedev's medical condition. But the doctors on the panel were never allowed to examine Mr Lebedev themselves.

[5] The two proceedings were recently joined, at the request of the defence.

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business. They also noted that in law and practice, following a recent reform, persons accused of non-violent "economic crimes" are usually not placed in pre-trial detention. The exception made for Mr Khodorkovsky and his associate, Mr Lebedev, is in their view proof of the "political" motivation of their arrest.

19. Finally, the maintenance of Mr Khodorkovsky and Mr Lebedev in detention after the completion of the pre-trial investigations raises additional legal issues. As regards the grounds for detention on remand, the European Court of Human Rights, in the case of Kalashnikov v. Russia, states inter alia that even when interference with the investigation justified detention at the beginning of the proceedings, that ground inevitably became less relevant as the proceedings progressed and the collection of the evidence became complete (judgement of 15 July 2002, para. 117). It follows in my opinion that upon completion of the pre-trial investigation, continued detention must be justified especially carefully. I was informed by Mr Khodorkovsky's lawyers that in his case, the decision to continue detention on remand was taken by the trial court without even an application by the prosecution, without hearing the defence in any way, and without giving any reasons. I have serious doubts that this is sufficient, both according to Russian law[6] and in view of the standards set by the European Court of Human Rights in its judgment of Letellier v. France of 26 June 1991[7].

5. Alleged violations of the rights of the defence

a. Access of lawyers to their clients subjected to conditions no longer based on law

20. The defence lawyers told me at length about the difficulties they had had in obtaining the "permission" by the prosecutor's office they said they needed in order to have access to their clients in pre-trial detention. Practical problems such as the difficulty of access to the premises of the procuracy without prior appointment, difficulty to reach prosecutors by telephone to make such an appointment etc. caused delays from several days up to several weeks before they could visit their clients, who had been arrested. This led in several instances to investigative acts taking place without the lawyer being present.

21. By contrast, I was told by representatives of the Ministry of Justice, by Deputies present at my meeting at the State Duma in May, and also in the written commentary by the Russian delegation dated 14 September 2004 on the Introductory Memorandum that following a legislative reform, prepared with the help of experts from the Council of Europe, and which entered into force on 1 July 2002, lawyers need only to show their identity card as lawyers and a copy of the mandate given by their client, on a special form designed by the Ministry of Justice, in order to have access to their client, including in pre-trial detention. A permission of any sort by the procuracy was no longer required.

22. But the prosecutors with whom I spoke themselves made an important qualification: whilst a *"permission" was no longer required, it was common practice that the prosecution provided a "supportive* letter" to facilitate access to the pre-trial detention centres. These letters, which the prosecutors said are routinely issued without delay, though admittedly not foreseen by law, were merely intended to avoid "technical" problems related to access to the detention centres.

23. These findings point to the existence of a serious gap between law and practice, making the lawyers' job much more difficult. According to several lawyers I spoke to, these difficulties can vary in practice depending on how "sensitive" the case is; clients held in the "Lefortovo" isolator, under the authority of the FSB, are particularly difficult to join.

24. In my view, the right of timely access to a lawyer is a core right of the defence, and must be protected in practice, not only in law, and not only in routine cases, but even more so in "sensitive" cases.

b. Denial of access of defence lawyers to the courtroom

25. The court hearing to decide on Mr Lebedev's pre-trial detention, on 3 July 2003, the day after his arrest, undisputedly took place without Mr Lebedev's lawyers.

26. The lawyers maintain that they tried for several hours to gain access to the courtroom, knocking on the locked door.

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[6] Mr Khodorkovsky's lawyers cited to me a decision of the Constitutional Court of the Russian Federation dated 8 April 2004 which requires a minimum of procedural protections for the accused "to bring to the court's attention his own view about such an important question as the continuing of his detention".

[7] The Court found a violation of Article 5 (3) ECHR for lack of sufficient justification of the maintenance of Mrs Letellier in pre-trial detention.

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27. The prosecutors told me that the lawyers, Mr Drel and Mr Baru, were summoned on 3 July 2003. They signed the summons, for a hearing at 16h30, at 14h52 in the building of the procuracy, situated about 3 km from the courthouse. As the lawyers did not turn up, the Court waited until 18h. Then the hearing took *place in the lawyers' absence, which is possible under Article 108 of the Criminal Procedure Code, provided* the lawyers were summoned correctly. According to the representative of the prosecution, Mr Lebedev's lawyers must have given preference to the press conference, at Interfax, which they had announced that day. In reply to my question whether the courtroom had been locked, my interlocutors stated that they personally had not locked it, and had not been aware of attempts of late-comers to enter the courtroom.

28. The lawyers have maintained their version, naming several witnesses, including the president of the court who they say tried to help them obtain access to the courtroom, without success. The lawyers also deny participating in any press conference at Interfax on 3 July 2003, explaining that the Interfax reports published that day were those of journalists who were present in the courthouse and interviewed the lawyers there.

29. During my second visit to Moscow, the representative of the prosecution handed me a list of press conference announcements by Interfax, which includes a press conference on 3 July 2003 at 16h30 called by lawyer Anton Drel. During the same visit, one of the lawyers handed me a signed statement by the head of the Interfax office confirming that the above-mentioned press conference had been annulled by Mr Drel.

30. I have not had the opportunity to talk to the witnesses named by the lawyers, and I can therefore not come to a definite conclusion. If proven, the forcible exclusion of defence lawyers from a court hearing deciding on pre-trial detention would of course be a serious matter.

c. Search and seizure of documents in lawyer Drel's office and summons of defence lawyers for questioning

31. I was informed by the lawyers that an office of Mr Drel, who worked both on the Yukos tax evasion case and as defence lawyer for Mr Khodorkovsky and Mr Lebedev, was searched on 9 October 2003 and that on that occasion confidential documentation was seized, including items pertaining to the privileged lawyer-client relationship. Mr Drel insists that the search in his office was carried out in respect of criminal case no. 18-4203 to which he had been admitted as a defence attorney.

32. The prosecutors insisted that the official law office of Mr Drel, located in central Moscow, had never been searched. On 9 October 2003, only premises outside the "city ring" had been searched. The prosecutors refused to give any more specific information, relying on Article 161 of the Criminal Procedure Code (secrecy of pre-trial proceedings). I was told that the search of premises on the outskirts of Moscow concerned the Yukos case, whilst Mr Drel was a defence lawyer for Mr Khodorkovsky and Mr Lebedev as individuals.

33. During the meeting at the State Duma, several interlocutors stressed the strict separation between the "Yukos case", which did not exist as a criminal case, and the criminal cases against Mr Khodorkovsky, Mr Lebedev, Mr Pichugin *et al.* as private individuals. But the prosecutors explained to me in some detail how the criminal cases against Yukos' former leading executives had "spun off" the investigation into tax and other abuses by Yukos as a corporation. They nevertheless insisted on the importance of the split into separate cases, with separate case file numbers.

34. The defence lawyers, by contrast, stressed the common origin of the individual cases and found the separation into different case files, which consisted mainly of photocopies of the same documents that are common to most files, artificial. They insisted that the search of one of Mr Drel's premises, even if it did not concern his main (downtown) office, was in any event unlawful in that Mr Drel was also mandated by Yukos as a corporation.

35. The defence lawyers also assert that within one week of the search of his office, Mr Drel himself was summoned for questioning. On the advice of the Moscow Bar Association, Mr Drel did not comply with the summons, while the Procuracy had taken no further action against him to date.

36. Another lawyer, Mr Patskov, had been summoned to the procuracy at the end of October 2003 to take part in the interrogation of a client. When he arrived at the office, he was advised that he himself would be questioned as a witness. When Mr Patskov refused, the investigator inserted some answers of his own

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into a draft transcript of the interrogation, and put strong pressure on Mr Patskov to sign the protocol. Mr Patskov persisted in refusing, and was eventually released.[8]

37. The prosecutors explained that there is a legal difference between defence counsels representing an accused person, and other lawyers accompanying witnesses to their interrogations. I consider that a simple play on case file numbers, changing at will the role of lawyers from that of a representative of an accused person into that of a representative of a mere witness, cannot allow the prosecution to circumvent the lawyer-client privilege protected by law, especially in a situation where these cases are as closely related to one another as in cases at issue. This applies both to searches and seizures of lawyers' offices, and to the questioning of lawyers as witnesses.

d. Search of defence lawyers in the detention centre and seizure of confidential documents; *disciplinary pressures on defence lawyers*

38. Two defence lawyers complained to me about having been searched in the pre-trial detention centre, and that confidential papers had been browsed through and some of them confiscated. Whilst they do not object to security searches (metal detectors etc.), they complained that papers had been ripped out of their hands and searched, and that handwritten notes had been confiscated, which allegedly contained instructions from the accused to interfere with the investigation. Several lawyers told me that they were not allowed to exchange any written (or handwritten) notes with their clients in the pre-trial detention centres, which made communication with their clients a lot more difficult, given the complicated subject-matter. Even in the courtroom, notes could only be exchanged between lawyers and their clients after the court had read them and allowed them to be passed on.

39. The prosecution is attempting to have these two lawyers disciplined by the Moscow Bar Association. In one case – that of Ms Artyushova – the prosecution has appealed against the decision of the Moscow Bar Association, which had found that she had committed no disciplinary offence. I was told that the possibility of an appeal by the prosecution against disciplinary decisions by the Bar Association had been recently introduced and caused much concern among lawyers, who fear the courts' traditionally restrictive approach vis-à-vis their rights. In the other case – that of Mr Yuri Schmidt – I was told by Mr Alexey Simonov, a reputed human rights defender heading the Glasnost Defence Foundation that the purported handwritten "instruction for interference with the investigation" by the accused was in fact an unrelated political statement written by Mr Alexey Simonov himself that Mr Schmidt happened to be carrying with him on that day. Mr Schmidt, who is a highly regarded lawyer in Moscow, and who impressed me personally with his measured, precise, and well-argued statements, said that he had no fears for himself, but that the complaint *with the Moscow Bar Association, and a related attack on him in the press, caused him a considerable* nuisance and loss of time.

e. Alleged eavesdropping against defence lawyers

40. Several lawyers expressed their suspicion – founded on indirect evidence – that their conversations with clients held in pre-trial detention were taped and listened to by the authorities. I was told that whilst there are about ten cabins for conversations between inmates and visitors - the conversation taking place by *interphone, through glass separators - they were always directed to a particular cabin ("no. 4"), even if this* meant they had to wait for it to be liberated, whilst others were free.

41. I was told at the Ministry of Justice and at the Procuracy that conversations between lawyers and their clients at the detention centres are absolutely private in law and practice.

42. I could not clarify this issue any further, but I should like to suggest that as a "confidence building measure" - however imperfect - lawyers and inmates should in future be allowed to chose freely the cabin they wish to use.

f. Alleged unfair limitation of the time for the accused to study the case-files

43. The lawyers of all three imprisoned Yukos executives complained about the unfair and unlawful (under Russian law) limitation of the time allotted to their clients to familiarise themselves with the – voluminous – files (163 volumes, according to the prosecution, in the Lebedev case). They complained that due to cumbersome procedures at the detention centre, their clients can study files only for a few hours each day. Both Lebedev and Pichugin suffered from failing eye-sight, due to their health condition, and were

[8] I met Mr Patskov in Moscow. He confirmed these facts, and gave me his understanding of the background of this episode (cf. footnote 9 below)

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therefore even more limited in their possibilities. The prosecutors with whom I spoke in Moscow gave me detailed information on this issue as regards Mr Lebedev, which seems to show that while there were restrictions, Mr Lebedev succeeded in getting through the files before the actual beginning of the trial. In Mr Khodorkovsky's case, the number of volumes to study was considerably higher (over 250 volumes), and, according to his lawyers, even more unnecessary restrictions were placed on his ability to study these files in good time, and later the files concerning his co-accused Lebedev. Without having been able to reach definite conclusions on this issue, I found grounds for concern that here, too, unnecessary and unjustifiable restrictions have been placed on the defendants, making it that much more difficult for them to assure their defence.

g. Other unfair features of the trial, as observed during the attendance of the court hearing on 28 September 2004

44. I noticed during the session that I attended that the court, prompted by the prosecutor, systematically allowed the latter to read out the minutes of the pre-trial interrogation of witnesses. The prosecutor then exercised considerable pressure on the witness during his interrogation in the courtroom to confirm those minutes phrase by phrase. These tactics, which the lawyers affirmed are used systematically during this trial, put into question the equality of arms between the defence and the prosecution, as they undermine the effectiveness of the right of the defence to question witnesses of the prosecution, whose pre-trial interrogation they are generally not able to attend. I also noted that the defence lawyers can only exchange notes with the accused after the court has first read them.

6. Unjustified restrictions on the publicity of court hearings

45. Most of the pre-trial hearings in the three proceedings were held in camera. I was told at the Ministry of Justice that the decision on the public or in camera character of court hearings is the competence of the courts. As I have not been able to ask the Presidents of the two courts concerned, who twice refused to meet with me, I have had to content myself with explanations given by the prosecutors. They referred in general terms to the interests of the victims, of witnesses, and the extent of public and media interest, which could justify in camera hearings. I was told that for those hearings which were held in public, ordinary courtrooms were used and all members of the public wishing to attend had been able to do so.

46. The "Commentary" dated 14 September 2004 prepared by the Russian delegation on my Introductory Memorandum stresses that "the court hearings on former Yukos executives' cases are public in character" and that "[d]ifficulties may arise only because of the small capacity of courtrooms". The hearings in the cases of Khodorkovsky and Lebedev take place in one of the largest courtrooms of Meshchanksy Court, which has a floor space of 64 sq.m., and which can seat 41 persons (including the court, prosecution, defence lawyers, defendants, and guards).

47. My own impression of the courtroom in which I followed the proceedings against Mr Khodorkovsky and Mr Lebedev for a few hours was that it was by far too small to accommodate serious interest by the media and by the public at large. The procedure required to enter the courtroom was rather cumbersome, if not to say intimidating, seemingly designed to keep a lid on public curiosity. I was also rather dismayed by the way the accused were displayed in an iron cage, but I was told that this is standard practice in Russian criminal courts.

48. The defence lawyers protested against the holding of the pre-trial hearings in camera, and pointed out that even for those few hearings, which were purportedly public (19 March and 23 April 2004/Khodorkovsky), representatives of the public had *de facto* had hardly any access. In one instance, the few seats available (10-15) were allegedly mostly taken up, from the beginning, by men wearing uniforms. I was informed of a statement of protest by journalists who were refused admission to the courtroom, addressed to Mrs Moskalenko, of the Centre for Assistance in International Protection.

49. I was informed by lawyers that the trial against Mr Pichugin, which has just begun, would be held completely *in camera*. Even the judgment itself would be kept secret, with the exception of the operative part (i.e. the sanction imposed). The public at large may therefore never be informed of the reasons or evidence on the basis of which Mr Pichugin may be condemned. I was also informed that in the course of the pre-trial investigation, only a small proportion of the documentary evidence to be introduced into the trial (2%) had been declared as "secret" by the prosecution. In conjunction with the fact that Mr Pichugin has spent most of his pre-trial detention in the Lefortovo prison run by the FSB, where he may well have been subjected to illicit methods of investigation (see para. 8 above), and that his case has been much less in public view from the beginning, I cannot help worrying that Mr Pichugin, under cover of secrecy, will be subjected to pressures

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aimed at using his case to project more serious accusations also against other leading former Yukos executives.[9]

50. I consider the public character of judicial proceedings, as guaranteed in Article 6 ECHR, a very important element of a fair trial. The right to a public hearing is for the benefit of the accused and of the public in general, as it maintains public confidence in the courts and contributes to the fairness of a trial by making it transparent. Exceptions from the public character of hearings, which are possible for a number of reasons both in Russian law and under the ECHR, must be properly justified and limited "to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice" (Article 6 para. 1 phrase 2). Unjustified restrictions of the public character of court proceedings are serious matters amounting to a violation of the right to a fair trial (Article 6 ECHR).

51. In view of the public allegations, my advice to the Russian authorities would be to ensure in future a maximum of transparency of the proceedings against Mr Khodorkovsky and his associates. This may be the best way to counteract the impression nurtured by the secrecy imposed so far that the authorities may have something to hide.

7. The political and economic circumstances of the arrest and prosecution of the leading Yukos executives

52. I have collected large amounts of information and analytical input regarding the alleged "political" and economical background of the arrest and prosecution of the leading Yukos executives. I consider this background an important factor that needs to be clarified in order to better understand the "circumstances" of the arrest and prosecution of Mr Khodorkovsky, Mr Lebedev and Mr Pichugin, in the terms of the motion at

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[9] In this context, I am particularly worried about the following:

During my second visit to Moscow, I interviewed Mr V. Patskov, one of the lawyers I had been told beforehand had been summoned by the prosecution to witness against their clients, and who had been put under undue pressure when they refused to testify (cf. para. 36 above). Mr Patskov, who gave me the impression of being a serious professional, confirmed the aforementioned incident and went on to give me his understanding of the reasons for which he had been summoned. In his view, the main purpose was to disqualify him, for the future, from acting as a lawyer for his client, Mr Y. Reshetnikov. He had been trying for several weeks to join Mr Reshetnikov at Lefortovo prison, to where he had been transferred in the autumn of 2003 from the ordinary penal colony where Mr Reshetnikov was serving a long prison sentence for a 1999 attempt to murder Mr Rybin, an outspoken Yukos foe that I was introduced to during the meeting at the State Duma in May. Lawyer Patskov told me that when he was finally allowed into Lefortovo prison, shortly after the reported incident at the prosecutor's office, his client had asked his advice on an "offer" he had received at Lefortovo. According to Mr Patskov, his client was made to understand that his case may be favourably reviewed if he would be prepared to collaborate with the prosecution in such a way as to accuse a certain senior former Yukos executive of having been behind the attempted crime against Mr Rybin. Mr Patskov, who is convinced that Mr Reshetnikov is innocent, advised him to refuse such a "deal", in the interest of justice, but also of his client, who may well be at risk of being tricked out of his reward, or endangered. Mr Patskov gave me a harrowing account of the court proceedings against Mr Reshetnikov, who was convicted on the sole basis of his identification by Mr Rybin as the perpetrator in a seriously flawed police line-up; Mr Rybin had almost one year earlier identified another man as the perpetrator of the crime who looked completely different; in addition, evidence that might have proved Mr Reshetnikov's innocence had disappeared from the case file. Mr Reshetnikov had been convicted in the first instance of having attempted to murder Mr Rybin on behalf of unnamed Yukos executives. Mr Patskov believes that Mr Rybin orchestrated the conviction of an innocent person in order to improve his position in a business dispute with Yukos before an Austrian court. Upon appeal, the reference to Yukos was struck out of the judgment, for complete lack of evidence, but Mr Reshetnikov's conviction for attempted murder (though then without a motive) was upheld.

I cannot of course draw any conclusions from the statement made by one person, without having been able to check this story with Mr Reshetnikov himself, or even to check with the prison authorities whether Mr Reshetnikov was indeed transferred to Lefortovo in the autumn of 2003, and if so, why. I have also not been able to check Mr Reshetnikov's case file to ascertain whether Mr Patskov's affirmations as to its content are correct. But I have received copy of a written appeal to the UN Committee on Human Rights by lawyer Karinna Moskalenko, which describes in a lot of detail the proceedings against Mr Reshetnikov, confirming the version I was given by Mr Patskov during my oral interview with him. In my view, Mr Patskov's statements deserve to be carefully investigated by the competent authorities, which must also ensure Mr Reshetnikov's personal safety. Lawyer Karinna Moskalenko has confirmed that Mr Reshetnikov himself told her, too, about the illicit offer, during a visit to him in Lefortovo prison.

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the origin of my mandate and that of our Committee. I consider that the political and economic context of the arrest and prosecution of the former Yukos executives may legitimately be taken into account as part of the wider "circumstances", as it may shed some light on possible motives for the action taken against these persons.

There are two main groups of explanations for the action of the prosecution:

53. The first, defended by representatives of the State and (in a more nuanced way) by some Western interlocutors is that the State, lead by a new more patriotically-minded elite is – finally - mustering the strength to assert the rule of law, including the respect for laws against tax evasion and fraud, also vis-à-vis the most powerful players in the economic field. According to the proponents of this approach, the cases against the leading Yukos executives are only the beginning of a campaign to reassert the authority of the State, and to create a level playing field on which small and large firms can develop under the protective umbrella of a strong legal system. For the proponents of this approach, it is high time that the days of the "Wild East" are brought to an end and that normal legal standards are enforced against all. Proponents of this approach also asked me to understand that certain procedural violations may have been committed by sheer incompetence of government agencies that had lost many of their best collaborators to higher-paying employers in the private sector, and that some of the "strong-armed" methods may be the expression of a feeling of perceived helplessness of resource-starved State agencies vis-à-vis their "rich" adversaries who they knew by experience have long been in a position to "buy" their way out of any troubles with the justice system.

54. The second explanation I heard mainly from representatives of NGO's active in the human rights field is that the "Yukos" - related cases are part of a long-term strategy to "centralise" power in the hands of the "siloviki" (the representatives of the power structures, in particular the FSB), by way of a series of show trials. According to the proponents of this approach, the first stage of this strategy was the lawsuit on the takeover of N-TV by State-controlled Gazprom. The ruthless eviction of the founders, including Mr Gusinskiy, of this independent TV chain and its "ratification" by the judiciary was a warning addressed to all other media companies that made the introduction of actual censorship quite unnecessary[10]. The second stage of this strategy, in this view, is the attack on the richest, best-known and best-protected of the "oligarchs", who had dared using part of his considerable means to generate "counter-power", by advancing transparency in business and by funding civil society groups and opposition parties: Mikhail Khodorkovsky. According to this theory, the demonstration will be made that the "siloviki" can crush anyone they want, as a warning to all those who are less rich and less powerful than Mr Khodorkovsky. The final stage, predicted for the near future, would be an attack on the independence of civil society organisations, by way of limitations placed on foreign funding, "tax terror", and judicial harassment.

55. A variant of the second "version" was presented to me by independent Duma members, political analysts and journalists during my second visit. They, in brief, consider the attack on Yukos as a case of large-scale "asset grab". In their view, Khodorkovsky and his associates were jailed – and denied bail - in order to prevent them from defending Yukos against being deprived of its principal assets. In their view, the trumped-up tax reassessment, which was made legally executory in record time, and the subsequent freeze of Yukos' accounts, was designed to force a sell-off of assets at below-market prices, benefiting companies linked to the Kremlin. As the evaluation of the market value of Yugansneftegaz (Yukos' main oil producing subsidiary) by Dresdner Kleinworth (a close business partner of Kremlin-controlled Gazprom) did not produce the expected low figure, as Dresdner had a reputation in the financial markets to protect, the interested circles would further open the tap of "political risks" in order to drive down the value of Yugansneftegaz, towards the range of what Gazprom or the State-owned oil company Rosneft could afford. These analysts found that the new power elite, who considered themselves as having unfairly lost out in the first round of "robbery of the State" by the Yeltsin era oligarchs, made one strategic error in that they did not content themselves with seizing control over remaining State assets, but decided to "rob the robbers". The mistake, in these analysts' view, lies in the fact that the new power elite thereby created a precedent, and made themselves vulnerable to being in turn deprived of their assets by the next "power elite". This "mistake" now obliged them to build a dictatorship, i.e. to put into place structures that would ensure that they would remain in power indefinitely. This explained in their opinion the recent hardening of Government policies – *from the abolition of the direct election of provincial Governors (that of local mayors being predicted as the* next step), via the elimination of the possibility of independent candidatures in the next State Duma elections, to the threats against civil society, the repression against dissident scientists (Sutyagin case) and lawyers, and (typically tax-based) threats against remaining independent media. The proponents of this analysis also told me that local and regional power elites are feeling encouraged to follow the Kremlin's

[10] cf. paragraph 14 of the draft resolution (judgment of the European Court of Human Rights in the Gusinskiy v. Russian Federation case).

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example at their own levels, and that business, especially small and medium-sized enterprises, had already reported increased "administrative pressure" in many places.

56. I cannot and I will not speculate as to which of the analyses presented above in a deliberately pointed manner (in which they had also been presented to me) is correct.

57. I have come to my own conclusion, namely that the presence of an interest of the State that exceeds its normal interest in criminal justice being done and includes such elements as: to weaken an outspoken political opponent, to intimidate other wealthy individuals, and to regain control over "strategic" economic assets - can hardly be denied.

58. This assessment is based on the conjunction of (a) the accumulation of procedural violations and the absence of adequate safeguards against government interference in court proceedings, (b) information pointing at Yukos executives being deprived of their main assets, and (c) other items relevant to the "political" or "economic" circumstances of the proceedings against the leading Yukos executives.

a. The accumulation of procedural violations and the absence of adequate safeguards against government interference in court proceedings

59. The sheer number and seriousness of procedural violations that I described above[11] in my view exceeds a mere accumulation of mistakes that could be explained by a lack of experience or professionalism. During my mandate, I have been confronted with a number of examples of the serious problems from which the Russian judiciary suffers in general, including its notorious openness to corruption, lack of respect for the rights of the defence, and, in particular, the overwhelming influence of the procuracy, which in turn is a tool in the hands of the executive.[12]

60. In my interviews with retired Constitutional Court Vice-President Morshchakova, I learnt that recent legislative reforms have done nothing to improve the independence of the courts, or have even gone in the opposite direction. The December 2001 Law modifying the Legal Status of Judges brought back a disciplinary arsenal that had been abolished in 1992, and facilitated the criminal prosecution of judges. For judges to be prosecuted, it was now sufficient that three judges of the Supreme Court agree, whereas the agreement of the "Qualification Commission", a professional self-regulatory body, had been required beforehand. The March 2002 Law on the Organs of Judicial Bodies laid down rules about the "Qualification Commission" that decides about the downgrading or dismissal of judges. Mrs Morshchakova also criticised the procedure of the constitution of popular juries, which was open to manipulation. She also disagreed with the composition and procedural functioning of the Qualification Commission, which gave too much power to the courts' presidents, and the sweeping formulation for the grounds for dismissal of a judge for "behaviour incompatible with the honour of a judge and the status of the courts", a formulation left unchanged from previous law. Meanwhile, I have been informed through the media that a draft law has been introduced in the Russian parliament that would further change the composition of the "Qualification Commission", giving the President of the Russian Federation the right to propose half of its members, and to directly appoint another one, thereby putting the Kremlin even more in control of hiring and firing judges. I believe that such a law would be a step in the wrong direction, further away from effective independence of the judiciary.

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[11] Without being able, or even intending to establish them as proven facts, as explained above under item B.

[12] cf. the "Russian Animation" case referred to in footnote [3] below; a detailed study published on 21 October 2004 by the London-based think tank "Russian Axis" on the crisis of the Russian judiciary, which also refers to the Yukos-related cases, comes to the conclusion that the Kremlin's control over the judiciary is even increasing.

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61. The case of Moscow City Court judge Kudeshkina[13], for example, highlights the pressures judges are subjected to, and the abuses which are made possible by the complete absence of objective rules determining which judge, or chamber, will hear a given case. The distribution of cases among judges is left entirely to the discretion of the court president. This state of affairs - to make sure sensitive cases come before "responsible" judges - was confirmed by several official interlocutors. Mrs Tamara Morshchakova, a law professor and former Vice-President of the Russian Federal Constitutional Court, has confirmed the weakness of the judges' position in the Russian courts and that instructions from prosecutors to judges are by no means exceptional. She has long pleaded in favour of reforms to strengthen judicial independence and *to introduce, inter alia, objective criteria for the distribution of cases within a given court. She pointed out that* Article 47 of the Russian Constitution foresees the citizens' right to have their cases heard by a judge "determined by law". But this principle was not implemented in the Law on the Organisation of Courts, which she considers to be outdated. I am aware that objective criteria for the distribution of cases within courts are also lacking in some other Council of Europe member states, but I believe that this should not stop the Assembly from pushing for reforms in this sense, in the interest of the independence and transparency of the courts. The argument that I have heard from certain official interlocutors that the independence of the courts needs to be kept in check in order to fight corruption is in my view completely inadmissible, as a matter of principle, and from a practical point of view: whoever wishes to "buy" a judgment will simply bribe the prosecutor instead of the judge, if it is known that the former can give instructions to the latter.

b. *Information pointing at Yukos executives being deprived of their main assets*

62. I am aware that the information pointing at Yukos (and thereby its former leading executives and main shareholders) being deprived of their main asset, its oil-producing subsidiary Yugansneftegaz, must be treated with utmost caution: apart from some factual elements obtained from Yukos' current CEO, Steven Theede, and CFO, Bruce Misamore, and Yukos' international lobbyists on the one side, as well as the head of the Federal Tax Service, Mr Serdyukov, on the other, I am basing myself entirely on reports in the press, which are in turn a reflection of sometimes incomplete or contradictory public declarations by different actors, or of leaks that may be intended to test national and international public opinion, and market reaction.

63. This being said, it seems at present that the scenario unfolding before our eyes is the following: Yukos was first confronted with huge tax reassessments that were made executory in a very short time, through astonishingly rapid procedures in the competent arbitrage courts. The authorities then promptly froze Yukos' accounts, creating pressure to sell of its assets.

64. As explained by Yukos CEO Steven Theede, and CFO Bruce Misamore, whom I met in Moscow in September, 50% of Yukos' gross revenue (not: profits) has to be immediately put towards the reassessed tax debt. The remaining 50% were insufficient to cover current taxes and duties, transport costs, utility bills and salaries. Management were therefore put before harrowing choices, including cutting off (transport-intensive) oil deliveries to China, or delaying payment of bills that could lead to serious legal consequences. In the face of new tax re-assessments (the original claim of 99 bn Roubles or USD 3.3 bn concerns only the year 2000), the forced sale of assets became practically inevitable. Mr Misamore provided me with figures as to the comparative tax burden on Yukos and its Russian competitors, before and after the reassessment, which show that while Yukos' tax burden, per barrel of oil produced, was only slightly higher than their competitors before the reassessment, it rose to about the triple with the reassessed amounts included[14].

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[13] Mrs Kudeshkina, formerly a senior judge at the Moscow city court, gave me a detailed account of the way she was ousted from the judiciary after she refused to carry out the "instructions" of the prosecutor on how to decide a case before her. The case concerned an appeal by the prosecution against the acquittal of an investigator of the Ministry of the Interior, Pavel Saitsev, who had been accused of exceeding his powers in ordering a search of the headquarters of a furniture chain belonging to a well-connected person without first asking the permission of the prosecutor's office. The prosecutor in this case had, according to Mrs *Kudeshkina, understood that she was not prepared to simply follow instructions, and put pressure on Mrs* Kudeshkina and her assessors in an unspeakable manner. Mrs Kudeshkina's assessors finally resigned from the case for health reasons, and she herself was taken off the case in the midst of the procedure by the President of Moscow City Court, Mrs Egorova, who had also instructed the court's secretariat to falsify the records of the proceedings in order to eliminate the references to the prosecutor's behaviour. As a result, Mr Saitsev was convicted. Mrs Kudeshkina made the scandal public, in an interview with Radio Echo Moscow, and decided to run as an independent candidate for the State Duma. She withdrew her candidature when allegations were raised in the media that her public criticism of the judiciary was merely a ploy to gain votes, in order to disprove these allegations. Mrs Kudeshkina was later fired from her job as a judge, on the initiative of Mrs Egorova, and she lost her last appeal against this decision in October 2004.

[14] According to an article in Neue Zürcher Zeitung (NZZ) of 4 November 2004 (p. 13), Steven Theede has *just announced that Yukos had just been confronted with another reassessment of USD 6.7 bn for 2002,*

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65. This raises two separate issues: that of the justification of the tax reassessment, which pushes Yukos with its back against the wall; and the appropriateness of the price for which Yukos' assets are being forcibly sold off, and to whom. While an examination of the substance of the tax claim exceeds my possibilities and my mandate, I had to address the reproach that Yukos and its former leading executives have been discriminated against, as any discriminatory treatment would point in the direction of a "political" motivation behind these proceedings. The conditions of the sale of Yukos' assets could also shed some light on the true motives for Mr Khodorkovsky's arrest and prosecution.

66. As to the reproach of discriminatory treatment, I had an interesting exchange of views during my first visit at the State Duma with a representative of the tax ministry. He described to me the "abusive" techniques used by Yukos to minimise taxes by letting part of the profits of the mother company accrue to dependent companies domiciled in inner-Russian tax havens. He confirmed that in 2000 (the year for which the first tax reassessment – RRoub 99 bn/USD 3.3 bn - is levelled against Yukos), these techniques were widely used and considered "legal", albeit anti-social in the case of large companies not contributing to any real economic development of the tax haven regions. The law making such "abuses" possible has therefore been changed, so as to make such techniques impossible in practice. In reply to my explicit question, he confirmed that the new law entered into force only in 2004. This clearly raises an issue of the retroactive application of changes in tax laws, which is quite problematic, under property protection aspects, even when it is merely a matter of retroactively charging higher taxes for the past. In the cases of Mr Khodorkovsky and Mr Lebedev, even criminal charges seem to be attached to these retroactive changes of law or of its interpretation, which in my view would be incompatible with the principle of *nullum crimen, nulla poena sine lege* (Article 7 ECHR).

67. The meeting in September with the head of the Federal Tax Service, Mr Serdyukov focused on the discrimination issue. Referring to the figures received from Yukos, I asked for official figures as to the comparative tax burden on Russian oil companies, and inquired about the possibility for, and general practice of the Russian tax authorities to grant temporary reprieve for taxpayers threatened by financial difficulties following tax reassessments. I finally asked whether other Russian oil companies, and if so, which ones, had been subjected to similar reassessments and their executives criminally prosecuted, given that we had been told that other oil and resource companies had used the same tax minimisation schemes[15]. As these questions could not be answered on the spot, I sent them in writing after my return from Moscow, through the chairman of the Russian delegation at the Parliamentary Assembly, as agreed with Mr Serdyukov. Unfortunately, I have not yet received an answer.

68. As to the conditions of the forced sale, it is at present too soon to tell. For several months, but in particular since the middle of October, numerous press reports raise the spectre of a forced sell-off of Yugansneftegaz, Yukos' main oil producing subsidiary, at a price that would be far below the market value as previously assessed. Andrei Illarionov, a senior Kremlin economic policy adviser, reportedly[16] said at an investment conference in Moscow on 28 October that "the probability of a Yuganskneftegaz sale is high, [but] the question is the price... Yuganskneftegaz' revenues this year will be at least USD 17 bn one cannot sell the company at less than its annual revenues." By the time this report will be discussed in our committee, rumours and reports may have evolved into actual facts. At the present stage, I can only make two points: firstly, any sell-off below fair market value, forced upon Yukos by the State authorities, would raise serious issues of the protection of property under Article 1 of the First Protocol to the ECHR[17]; and

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which would bring the total tax burden to over 100% of Yukos' turnover for that year. In a commentary on the same issue, an NZZ commentator (p. 24), referring to recent "plump ordered judgments" (plumpe Auftragsurteile), calls the Russian Federation "Absurdistan".

[15] According to press reports, "a long awaited report by the Audit Chamber has concluded that flaws in legislation and the absence of a free market for oil in Russia permitted the large Russian Oil companies Yukos, Lukoil, and Sibneft to avoid paying most taxes. When the Audit Chamber announced its review of those companies, some observers expected a report citing criminal wrongdoing. Instead, the Chamber's report focused on loopholes that enabled the companies to reduce their tax payments, such as subsidiaries that served as "internal offshore companies"" (RFE/RL newsline vol. 8, no. 180, part I, 21.9.2004, p. 4).
Similarly, Igor Shuvalov, a senior presidential aide on economic affairs, said at an investment conference in Moscow on 28 October that "[M]any oil companies have used tax optimization schemes – many will have to look back at their tax history and pay more taxes." (according to *UBS Daily News, October 29, 2004*)

[16] according to UBS Daily News, October 29, 2004

[17] In this context, another example of an alleged "expropriation" by courts acting under instruction was brought to my attention by the President of a Hollywood cartoon studio which had been deprived of an investment it had made buying the copyright of and then modernising and marketing Soviet-era cartoon

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secondly, any sell-off below market value could hardly be justified by "fiscal" (i.e. State revenue maximising) considerations: it would deprive Yukos of the assets needed to pay, over time, the outstanding tax claims, and in addition, the "collateral damage" resulting from the handling of the Yukos affair in terms of loss of investor confidence, capital flight, delayed productive investments etc. has already caused the Russian State to lose more revenue than it could have possibly hoped to gain.

c. Other items relevant to the political or economic circumstances of the proceedings against the leading Yukos executives

i. Khodorkovsky's financial support for opposition groups

69. As a matter of simple fact, Mr Khodorkovsky and his associates had, prior to the legal action taken against them, begun to support financially a number of political parties and civil society organisations (in particular the "Open Russia Foundation"). In May 2003, Mr Khodorkovsky had announced that he would give approximately USD 15 million to the Yabloko party and a smaller amount to the Union of Right Forces, whereas I was told that he had repeatedly refused "requests" addressed to him to finance President Putin's "United Russia" party. These activities may violate an alleged "pact" between President Putin and the Yeltsin-era oligarchs according to which they would be allowed to keep their business empires provided they would not get involved in politics.

70. I was informed that in the meantime, financing for liberal-oriented political parties and a number of civil society organisations has practically dried up, not only from Yukos-related sources, but also from other donors on whom the proceedings against Mr Khodorkovsky and his associates seem to have had a chilling effect. While I do not wish to insinuate that this was the intention of the authorities, the fact remains.

ii. Yukos as business competitor of State-controlled Rosneft and Gazprom

71. I was informed that Yukos has or had several business disputes with State-owned or –controlled energy companies, in particular bitter disputes with Rosneft and Gazprom.

72. As regards Rosneft, I was informed inter alia about a public struggle for control over the Vankorskoye oil and gas field (Yeniseyneftegaz).

73. As regards Gazprom, which has a share of about 20% in the world natural gas market and owns almost 60% of Russia's know gas reserves, whose largest shareholder (38%) is the Russian State, and whose senior management is closely linked to the Kremlin, Yukos may have been perceived as a threat to Gazprom's quasi-monopoly. Mr Khodorkovsky had stated publicly that Yukos, which owns gas as well as oil reserves, and already produces gas for certain markets, could produce gas more economically than Gazprom. I was informed that Yukos had been exploring the possibility of building a pipeline to the Arctic Ocean where its gas could be liquefied and exported to Europe, which would place Yukos in competition with Gazprom in the sale of gas to Europe and enable Yukos to bypass Gazprom's pipelines.

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characters. The studio presented me with copies of translated documents belonging to a "secret supervisory file" attached to the case file of the legal dispute decided in the last instance by the Russian High Arbitrage Court (the court that is also in charge of the Yukos tax cases). These documents, and an expert statement provided by Mr Pashin, a highly respected reformer of the judiciary under President Yeltsin, former judge and legal scholar, have convinced the US Federal District Court of New York that the Russian court had, in substance, simply followed instructions. The New York court, in a 90-page decision dated 8 May 2003, refused to follow the interpretation of applicable Russian law given by the Russian courts in the following terms:

"*Although the alleged flaws in the Russian judicial system are troublesome, the present record does not support a sweeping condemnation of Russia's judiciary. However, in this case, it is unnecessary to reach any broad conclusions as to the impartiality and essential fairness of the arbitrazh system as a whole. Plaintiffs have produced specific evidence – in the form of documents obtained from the High Arbitrazh Court's file – of improprieties in the specific arbitrazh court proceedings leading up to the December 18, 2001 decision.* (Lexis p 49) *(...)*
It is, furthermore, apparent that the High Arbitrazh Court's December 18, 2001 decision was strongly influenced, if not coerced, by the efforts of various Russian government officials seeking to promote "state interests." Under these circumstances the High Court's decision is entitled to no deference." (Lexis p 57)

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74. Before Mr Khodorkovsky was arrested, Yukos had been close to completing a merger with Sibneft. I was informed that YukosSibneft would have become the world's fourth largest oil company. At the same time, it was widely reported that Yukos was engaged in merger talks with several Western oil companies, including US-based ExxonMobil. These events may well have been perceived by the Russian Government as a threat to national control over strategic resources.

75. In my view, such strategic issues may well have played a part in the motivation of the arrest and prosecution of leading Yukos officials. In this context, I should like to recall Gazprom's role in the process that lead to the change of hands of the (then) independent and critical "NTV" television network[18].

iii. A campaign of intimidation against Mr Khodorkovsky and his associates

76. I was informed of a number of intimidating action by different State powers (judiciary, federal and regional tax authorities, even environmental probes) launched against Yukos and its former leading executives and against other persons associated with them: repeated military-style searches by masked men in camouflage uniforms armed with assault rifles of Yukos offices, with threats and insults being launched against ordinary employees; similar raids on the headquarters of Yukos' IT contractor Sibintek, of the Podmoskovny Lyceum boarding school in Koralovo and a Menatep business club in Zhukovka – I was given a lot of detail about these and other, similar events, and also about the "black public-relations" campaign against Mr Khodorkovsky preceding his arrest. This "campaign" began with an anti-Khodorkovsky edition of "Compromat" magazine in May 2003, devoted entirely to allegations against Mr Khodorkovsky and Yukos, and continued with the publication on the compromat.ru website of the transcript of an alleged high-level plot to bring down Khodorkovsky, a report published in May 2003 under the aegis of a Russian think-tank (Council for National Strategy) alleging an imminent "oligarchic coup". During my second visit to Moscow, I was informed that an NTV documentary televised on the weekend before my arrival had made allegations linking Yukos and Mr Khodorkovsky to Chechen terrorism, such as the attack on the school in Beslan.

77. Last but not least, the dramatic material circumstances of both Mr Khodorkovsky's arrest by special forces soldiers on a remote airfield in Siberia and Mr Lebedev's arrest in hospital give the impression of having been designed to intimidate.

D. Conclusion and outlook

78. The findings that I felt obliged to describe above in some detail, given their seriousness, have lead me to propose the above draft resolution and draft recommendation. The proposed texts, in line with the Committee's mandate, do not address the guilt or innocence of the accused persons, which will be for the courts to decide on[19].

79. The draft resolution and recommendation focus on the legal and procedural issues raised by the arrest and prosecution of the leading Yukos executives, but they also do not ignore the context of these proceedings: the desolate situation of the Russian judiciary in general pointing to the need for specific reforms designed to improve its independence and transparency, as well as the political and economic considerations that in my opinion are needed to correctly explain the arrest and prosecution of Mr Khodorkovsky, Mr Lebedev and Mr Pichugin, former leading Yukos executives. The latter issue, in my view, needs to be further followed by the Parliamentary Assembly, and it would be logical to also involve in this work the Assembly's Economic Affairs Committee, and, possibly, the OECD, with whom that Committee has good working relations.

[18] The European Court of Human Rights, in its judgement of 19 May 2004 in the case of Gusinksiy v. Russia, had come to the conclusion that Mr Gusinskiy's detention, on fraud charges, had been motivated by the intention of the authorities to coerce him to sign away his stake in NTV to Gazprom.

[19] It was the official Russian side which confronted me, during my meeting at the State Duma in May, with extensive and emotionally charged presentations by two "crown witnesses" (Mr Kantor and Mr Rybine), who accused Mr Khodorkovsky, Mr Lebedev, and Mr Pichugin of various criminal wrongdoings. As I do not consider the guilt or innocence of the accused persons as a subject covered by my mandate, I continue to refrain, as in the Introductory Memorandum, from discussing the content of their statements (as regards Mr Rybin, cf. footnote 9).

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Dissenting opinion of the delegation of the Federal Assembly of the Russian Federation on the draft report by Sabine Leutheusser-Schnarrenberger on "The circumstances surrounding the arrest and prosecution of leading YUKOS executives"

The Russian delegation considers that Mrs Leutheusser-Schnarrenberger has carried out substantial work in preparing the report on "The circumstances surrounding the arrest and prosecution of leading YUKOS executives", of which some individual points will doubtless help improve the work of Russia's law enforcement and judicial authorities.

Nevertheless we believe that Mrs Leutheusser-Schnarrenberger has produced an unbalanced report based essentially on the views of the defence team and taking no account whatsoever of the official documents passed to her by the Russian authorities.

The rapporteur twice visited Moscow, where she was given the opportunity to meet competent representatives of the Russian Federation's law enforcement and judicial authorities, but her document reflects only statements of non-governmental organisations involved in rights protection.

Acknowledging in passing that the lawyers of the former leading executives of YUKOS have also made a few errors, the rapporteur has nonetheless constructed her report solely on accusations (incidentally not supported by the documents) levelled at the law enforcement agencies. Such an approach, were it to be accepted by the Assembly, could not contribute to the usual Parliamentary Assembly practice of objectively and fully elucidating the circumstances of a matter with a view to preparing exhaustive recommendations to remedy the shortcomings.

The unnecessarily emotive language used in the memorandum clearly shows whose side the rapporteur is on.

Furthermore, Mrs Leutheusser-Schnarrenberger has stepped beyond the brief given to her by the Committee. In considering the facts of the criminal case in question, the rapporteur does not have sufficient information and grounds to conclude that the entire law enforcement and judicial system has malfunctioned or to gauge the economic context underlying the events analysed.

In this connection, we deem the draft report, presented at the meeting of the Committee on Legal Affairs and Human Rights held in Paris on 18 November 2004, inadmissible for examination at a plenary session and in need of substantial reworking.

In addition we believe it necessary to discuss the question, for consideration by the Assembly, of the need to refrain from designating those who propose topics for examination by the Assembly as rapporteurs.

[signature] GREBENNIKOV, Russia, 18.11.04
[signature] FEDOROV, Russia, 18.11.04
[signature] SHARANDIN, Russia, 18.11.04

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Reporting committee: Committee on Legal Affairs and Human Rights

Reference to committee: Doc 10083, Reference No 2931 of 2 March 2004

Draft resolution and draft recommendation adopted by the Committee on 18 November 2004 with respectively 13 votes in favour and one abstention, and15 votes in favour, 3 votes against and no abstentions

Members of the Committee: Mr **Lintner** (*Chairperson*), Mr **Marty**, Mr **Jaskiernia**, Mr Jurgens (*Vice-Chairpersons*), Mrs Ahlqvist, Mr Akçam, Mr **Alevras**, Mr Alibeyli (alternate: Mr R. **Huseynov**), Mr **Arabadjiev**, Mr Arias, Mrs Arifi, Mr **Ateş**, Mrs Azevedo, Mr **Bartumeu Cassany**, Mrs Batet, Mrs Becerril, Mrs **Bemelmans-Videc**, Mr Berisha, Mr Bindig, Mr Bokeria, Mr Bruce (alternate: Mr **Lloyd**), Mrs Christmas-Møller, Mr **Cilevics**, Mr Colfan, Mr Dell'Utri, Mr Engeset, Mrs Err, Mr **Exner**, Mr **Fedorov**, Mr Fico, Mr Frunda, Mr Gedel, Mr **Goris**, Mr **Grebennikov**, Mr **Gündüz**, Mrs Hajiyeva, Mrs Hakl, Mr **Holovaty**, Mr Ivanov, Mr Jakič, Mr Jurica, Mr Kaikkonen, Mr Kaufmann, Mr Kelber, Mr Kelemen, Mr Kovalev (alternate: Mr **Sharandin**), Mr Kroll, Mr **Kroupa**, Mr Kucheida, Mrs **Leutheusser-Schnarrenberger**, Mr **Manzella**, Mr Martins, Mr Masi, Mr Masson, Mr **McNamara**, Mr **Monfils**, Mr Nachbar, Mr Nikolić, Mr Olteanu, Mrs Ormonde (alternate: Mr **Mooney**), Mrs **Pasternak**, Mr Pavlov, Mr Pehrson, Mr Pellicini, Mrs Pétursdóttir, Mr Piscitello (alternate: Mr **Budin**), Mr Poroshenko, Mrs Postoica, Mr Pourgourides, Mr Pullicino Orlando, Mr Raguz, Mr Rochebloine, Mr Rustamyan, Mr Spindelegger, Mr Stankevic, Mr Symonenko, Mr Varvitsiotis (alternate: Mr **Dendias**), Mr **Wilkinson**, Mrs Wohlwend, Mr Zhirinovsky, Mr Žižic

N.B. *The names of those members who were present at the meeting are printed in bold.*

Secretariat of the Committee: Mr Schokkenbroek, Mr Schirmer, Mrs Clamer, Mr Milner

Berichterstattung auf der Homepage des Europarates

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STATEMENT AND EXHIBITS FROM THE HONORABLE DAN GLICKMAN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, MOTION PICTURE ASSOCIATION OF AMERICA, INC. (MPAA)

PREPARED STATEMENT OF STATEMENT PREPARED FOR THE RECORD FROM

DAN GLICKMAN

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

MOTION PICTURE ASSOCIATION OF AMERICA, INC.[1]

CHAIRMAN SMITH AND MEMBERS OF THE SUBCOMMITTEE: When, six months ago, you last examined the problems we are facing protecting our intellectual property rights (IPR) in China and Russia, we painted a bleak picture: We estimated then that piracy in both markets exceeds ninety-five percent, costing our members in excess of half a billion dollars every year. Additionally, we told the Subcommittee that not only was piracy corrupting the two internal markets, pirates in Russia and in China have been the source of stolen material exported to markets all over the world.

I wish today we could report that this scenario had brightened, that piracy rates had fallen, losses dropped, and that the two countries were no longer sources of pirated product far from their borders. I cannot. With little amendment, we could submit for your consideration virtually the same testimony as we did then in describing the scope of the problem. With respect to the steps we are taking in both markets, I can report progress, and will report steps we are taking on our own, with the US government, and, yes, with the host governments.

Before doing so, I want to thank you and the Subcommittee for your enduring support of our work and, in particular, the fact that you are keeping these problems high on your agenda. As I will elaborate, that you are doing so is, in our view, one of the critical elements to a successful strategy of combating the theft of our product, and essential to motivating both governments to take action.

Adequate laws and resources, effective enforcement, and private sector initiatives and cooperation with the US government as well as the Chinese and Russian governments are all important tools in this fight. However, unless these governments exercise the political will to address the rampant theft of US IPR, those tools are meaningless. This hearing keeps IPR high on both the US-China and US-Russian agendas, demonstrating, yet again in a yet another forum, to the Chinese and Russian authorities the priority you and your colleagues attach to seeing satisfactory results.

On behalf of the member studios and the hundreds of thousands of Americans who earn their livelihoods in this industry, thank you for your interest and the opportunity to provide these comments to the Subcommittee.

RUSSIA

Russia ranks, along with China, as one of the two largest producers and exporters of pirated DVDs and other copyrighted materials in the world. As serious as the problems are in China, and they are indeed quite serious, the challenges we face in Russia - lawlessness, physical danger, and corruption - are even more daunting. I cannot underscore enough the scope and depth of the problem we face in Russia - and it is getting worse, not better.

Last year alone MPAA member companies lost $275 million to piracy in Russia. All copyright industries lost $1.7 billion due to piracy last year, and over $6 billion in the last five years in Russia. These figures are staggering.

The Government of Russia has allowed the problem to grow significantly worse in recent years. The number of plants manufacturing optical discs increased twenty-seven percent, from thirty-six to forty-six in the past year alone. Sixteen of these plants are located on property owned by the Russian government. Moreover, the number of DVD lines has increased fifty percent in the past year.

[1] The Motion Picture Association of America (MPAA) represents the major producers and distributors of motion picture and television programs in the United States; its members are Metro-Goldwyn-Mayer Studios; NBC Universal City Studios, Paramount Pictures Corporation, Sony Pictures Entertainment, The Walt Disney Company, Twentieth Century Fox Film Corporation, and Warner Brothers Entertainment.

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A matter of immediate and utmost importance is that Russia, right now, is actively pressing to accede to the World Trade Organization (WTO). MPAA cannot support Russia's accession to the WTO, an organization founded on rules, until these problems are addressed satisfactorily.

The Agreement on Trade-Related Aspects Intellectual Property Rights (TRIPS) agreement, establishes minimum levels of protection that WTO members must give to fellow WTO members' intellectual property. It is an integral component of the international trade regime. Taking effective criminal action against piracy is a key TRIPS requirement.

For the record, I am attaching to my statement a fuller description of the problems we face. Every year, we compile a submission of the trade barriers we face for the Office of the United States Trade Representative's (USTR) annual National Trade Estimate Report on Foreign Trade Barriers; the comments we filed with USTR last month on the Russian market detail those problems. Here is a sketch of what we are confronting on a daily basis in Russia.

- Russia's domestic market is literally saturated with pirate DVDs. The level of piracy is estimated to be over ninety percent.
- Seventy percent or more of the seized pirated material ends up back in the marketplace.
- Russian DVD plants are, it is estimated, manufacturing between 50 and 80 million DVDs a year for export.
- Pirate discs manufactured in Russia have been found in twenty-seven countries, negatively affecting our legitimate business in countries such as Bulgaria, Finland, Germany, Hungary, Israel, Poland, Turkey, and the United Kingdom.
- All of the optical disk plants that were raided in 2004 remained in operation after those raids.
- The plant owners remain unscathed by the criminal justice system.

We have presented this evidence to Russia over and over again. The Government of Russia has acknowledged that these plants exist and while the number of raids has recently increased, recall that seventy percent of the seized product finds its way back into the marketplace and that *not one plant has been closed.*

Much of the piracy in Russia is orchestrated by organized crime syndicates and gangs. No small-scale, independent operator could afford the false-bottomed compartments in trains and cars that these syndicates use to export pirate copies of our films to other organized criminal syndicates across Europe. Two years ago, shortly after a major raid against a pirate facility, in what clearly was designed as an intimidation effort, a thug shot at the car in which one of our anti-piracy investigators in Russia was driving from work. Fortunately, our employee was unharmed. While the assailant ended up in a psychiatric hospital, those who contracted the assailant remain unscathed and grow ever wealthier.

This rampant organized crime flows from and thrives because of endemic corruption. The entrenched corruption of Russia's judicial system has caused our complaints to be routinely dismissed. An indication of prosecutorial corruption is the number of requests prosecutors make of rights holders organizations to return seized material to prosecutors because they "need to show the evidence to the judges". In fact, the goods confiscated during raids on factories and warehouses are frequently returned to commercial channels connected to the prosecutors. Russian authorities openly acknowledge that only eight non-suspended prison sentences have been imposed on intellectual property infringers in 2005.

Circling back to the TRIPS agreement, criminalizing all acts of copyright piracy on a commercial scale and taking effective criminal action against such acts are key WTO TRIPS requirements. There is no argument that can be made that Russia complies with the WTO TRIPS obligations. We do not believe that our problems can be effectively addressed upon Russia's accession to the WTO. We tried this with China and we learned an expensive and difficult lesson. The U.S. government and U.S. industry cannot afford to make the same mistake twice.

Russia has repeatedly promised both the US government and the US copyright industry that it would take the steps necessary to meet these WTO obligations. However, Russia has to date failed - and this failure can only be attributed to lack of political will - to step up and address these concerns. We are reminded of Russia's lack of commitment to combating piracy every time Government of Russia officials assert that piracy is the acceptable result of legitimate product pricing. Most recently, on November 30, President Putin's representative to the Duma's upper chamber said that widespread piracy would continue to flourish if legitimate product did not become cheaper.

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Russia's accession cannot be paved with empty promises. Russia must only be permitted to accede upon demonstration that it has the political will to inspect all known plants, and to close and repeal the licenses of those engaged in production and distribution, as well as to criminally prosecute the plant owners and operators. We will not see progress in the enforcement against intellectual property crimes in Russia unless President Putin directs all relevant agencies to make the fight against piracy a priority. Until the President himself demands accountability from his senior officials, corruption will continue to shelter the pirates.

Mr. Chairman, members of the Subcommittee, we need your help in ensuring that Russia addresses its piracy problems before it is permitted to join the WTO. We greatly appreciate the fact that you and your colleagues voted overwhelmingly in favor of H. Con. Res. 230. That sends a clear signal to the Russian authorities that they must address these matters before it joins the rules-based WTO, and ensures that both Russia and the Administration know that a grant of Permanent Normal Trade Relations to Russia, a prerequisite to WTO relations, will be endangered without meaningful progress on protecting intellectual property rights.

CHINA

The source of the problems we face in China is twofold: First, China imposes strict limits on the number of foreign films that can be exhibited in its theaters on a revenue-sharing basis, and applies burdensome regulations and confiscatory taxes on foreign home video and television content. This creates a marketplace vacuum that pirates are only too happy to fill. Second, China has not asserted the political will necessary to reduce the level of piracy. Yes, it has conducted some raids and even put a few pirates in jail, but it has not materially reduced the level of piracy and the ready availability of pirated products in the shops and in the streets.

As I will elaborate, fighting piracy, especially in a restricted market such as China, means more than simply enforcing laws and going after the counterfeiters - the traditional anti-piracy tools. Getting better access to the Chinese market is a critically important tool in the fight against piracy. The controls the Chinese government imposes upon legitimate film producers and distributors have no effect whatsoever on the pirates. Until we have the same unrestricted access to that market, we will not be able to compete effectively and stop the theft of our content.

Regrettably, to coin a phrase, if you did not see a counterfeit DVD, you were not in China. Unfortunately, I fear our collective perception of China has become so ingrained with the notion that China is overflowing with pirate DVDs we frequently fail to appreciate the magnitude of the problem.

The problem is ubiquitous - on virtually every street corner, packed on to the shelves of audio-visual shops in every neighborhood. We estimate that the piracy rate exceeds ninety percent - more than nine of every ten DVDs in the Chinese market is a fake, stolen product. Counterfeit, stolen motion pictures cost our members nearly $300 million annually, in China alone.

Too many, especially some around the world who should be allies in the fight against piracy in China, view this as an American problem. While we certainly bear the disproportionate share of the burden of this problem, movie piracy in China affects film makers all around the world. Our research indicates that almost half the pirated product is actually Chinese product. We also find stolen copies of Japanese, Korean, French, and Indian movies in China.

A few weeks ago, a young Chinese film producer visited my office. When asked to define his number one problem, he did not mention financing, distribution, or any of the other obstacles film producers must overcome: He said piracy is his biggest problem - the theft of his movies, in his home country.

It is clearly more than an American problem, it is a problem afflicting film makers no matter where they live and make movies, in more than one way. Not only are the pirates sapping legitimate movie makers in the China market, they are encroaching on legitimate markets all around the world. Our analysis of pirated DVDs seized from around the world traced their production back to over fifty plants in China.

As we dig deeper into this problem, particularly the global spread of China-sourced pirated product, we are coming to a disturbing conclusion: There is a growing link between piracy of motion pictures and organized crime. Our Asia-Pacific Regional Office just completed a new study on these connections. With your permission, Mr. Chairman, I have included a copy of that study with my statement and would like to have it included in the record. Let me cite a few of its findings:

> Criminal theft of IPR dwarfs criminal revenues from narcotics trade: US government and international law enforcement records peg the illegal nar-

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> cotics trade at $322 billion last year; criminal revenues from all IPR theft were significantly higher, $512 billion.
>
> Part of the allure for organized crime to move into DVD piracy is the incredible profit margins, exponentially higher than for drugs: The mark-up on pirated DVDs made in Asia and sold in Europe, for example, averages an astounding 1,150%, three times the mark-up of heroin sourced in Asia and sold on the same street corners, and the criminal risk is far lower.
>
> The report cites two recent cases linked back to China, with tentacles around the world, including into the US. In September 2005, a federal grand jury in New York indicted thirty-nine individuals tied to the Yi Ging Syndicate, based in New York but which funneled much of its one million dollars plus a year earnings back to China. Next January, an American, Randolph Guthrie, will stand trial in the US for his role in leading a criminal syndicate, based in Shanghai, that made and distributed hundreds of thousands of pirate DVDs around the world; when he was arrested last summer, Chinese authorities seized more than 210,000 counterfeit DVDs.

I think it goes without saying that many of these revenues finance other illegal activities in which these criminal organizations are involved, making the reach of piracy even more pernicious: This is not just an American problem, and it is not just a motion picture industry problem, it is now underwriting activities that threaten all of us, in all walks of life.

Of course, it affects some of us more directly than others. As I said at the outset, our members employ nearly one million American men and women, at all job levels. We employ thousands of laborers, electricians, technicians, truck drivers, as well as professionals in finance, legal positions, and specialized support services.

There seems to be a view - a myth - that buying a stolen DVD only means a movie star earns a few dollars less on that movie. Let me be clear: That notion is just that, a myth. Every dollar the pirates earn is one less dollar going to an American worker, a worker employed in an industry that is one of the few in this country bringing more money back to the US in export earnings than it sends overseas.

Chinese piracy of US motion pictures also hits some of us very personally. I was in China the last time in May. I strolled the neighborhood near my hotel, and looked into one of the audio-visual stores I came across. I admit I was not surprised to see shelves of pirated DVDs, disappointed, but not surprised. I was, however, taken aback when one title caught my eye: "*The Hitchhikers Guide to the Galaxy.*" At the time, the movie was not available on DVD in the US, so I knew it was a fake, taking the money out of a US film maker's pocket. That film maker: my son. He is a producer and that was his most recent film. I relayed the story to him, and he replied: "And what Dad, Mr. Chairman of the MPAA, are you going to do about this?"

MPAA invests millions every year in fighting piracy in China and around the world. We go after the pirates, we work with governments to enact and then enforce adequate laws, we work to educate the public about the consequences of piracy, and the legal alternatives to piracy, and we are constantly seeking new ways to prevent the problem through technology, education, and changing business practices.

As I have indicated previously, piracy in China is indeed a China problem, but it is also a problem with global reach. A pirated disc made in China can, in a day or two, be in the street markets of Los Angeles. Someone can illegally camcord a movie in Moscow, send the file by way of the internet to someone in Guangzhou who then dubs and subtitles the Russian dialogue, and then illegal presses thousands of DVDs.

We approach the problem fully cognizant of its global reach, with a seamless strategy of going after the producers, distributors, and sellers of DVDs and the machinery they use to make the fakes. We have aggressively pursued a strategy to stop the illegal camcording of movies, which is still the largest source of pirated product. We are very appreciative of the action Congress took to make illegal camcording a federal crime and that the President signed the bill earlier this year.

We seek to track the production of optical discs, to make sure the plants that make them are legal, registered, and their product produced with internationally recognized identifying codes. Increasingly, we are beefing up our Internet strategy to go after the thieves who think they can anonymously download and send stolen movies over the Internet.

We are also on the ground in China. Our representatives survey the market for information about the incidence of piracy and pass on this information to the Chinese authorities. In many cases, this information helps Chinese authorities formulate cases for raids on sellers and distributors, and often, those authorities invite our representatives to accompany them on such raids.

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We operate and participate in training sessions for Chinese authorities and jurists on IPR laws and enforcement, in the US and in China. We also work closely with US officials in elevating the importance of IPR enforcement; for example, our representatives participated in the IPR Roundtable our Embassy conducted in Beijing at the first of this month.

One of the most significant initiatives we have been able to launch with the Chinese government was the joint anti-piracy memorandum of understanding (MOU) we executed with three entities of the Chinese government: Ministry of Culture (MOC), State Administration of Radio, Film and Television (SARFT), and National Copyright Administration (NCA).

This MOU was signed last July 13, in connection with the most recent discussions held under the auspices of the Joint Committee on Commerce and Trade (JCCT). Under its terms, every three months MPAA will submit to the MOC and SARFT a list of motion pictures scheduled to be screened in China by its member companies. All home video products that are available in the marketplace prior to the legitimate home video release date in China will be deemed illegal audio and visual products and forfeited, and when a criminal copyright infringement offense has been committed, the case will be prosecuted.

On October 25, we met with the Chinese side to review the results of the MOU. For our part, we surveyed a small selection of shops in four key cities: Beijing, Shanghai, Guangzhou, and Shenzhen. The surveys were by no means intended to provide a comprehensive assessment of anti-piracy enforcement progress across China; merely an indication as to whether the needle had moved at all.

> Specifically, during October, the surveys of target outlets in Shanghai showed that of the films covered under the agreement, no pirate versions were available at all.
>
> In Guangzhou, the availability in October of pirated versions of the identified titles was down quite sharply from September, when almost all titles were available.
>
> In Shenzhen, availability in October of pirated titles fell fifty percent from September.
>
> In Beijing, in August, with the exception of one shop that carried only fifty percent of the protected titles, pirate versions of the six films ran from seventy to ninety percent. In September, the original shops continued to offer pirated versions of the protected titles. In October, the original ten shops had cleaned up remarkably; however, an additional ten shops surveyed showed piracy rates averaging around eighty percent.

The MOU only covers a handful of movies, and though it applies to the entire country, we have only been able to survey a limited number of cities and only a selection of retailers in each. We are disappointed with the results.

In spite of their formal commitment to protect specific US movies, the Chinese authorities failed to demonstrate meaningful progress even within the limited review we conducted. Our next review of the MOU will occur in January and we would be pleased to keep the Subcommittee apprised of our progress.

In addition to the work we are doing with the Chinese government and industry, and with other US copyright industries, most notably the sound recording industry, our key partner is the US government. I commend this Administration for the priority it has given this problem, and its willingness to work with us. Credit goes right to the top: President Bush made IPR a top agenda item during his summit with President Hu. Having our views and concerns addressed at this level is invaluable in elevating the priority of IPR on the bilateral agenda and we greatly appreciate the President's support as well as the support from USTR, the State Department, and the Commerce Department. Our work with the US government goes on virtually every day, and we are currently working very closely with the USTR on next steps to secure adequate protection of our product in China.

Mr. Chairman, having surveyed the scope of these problems and the steps the US motion picture industry is taking, I want to bring my statement to conclusion by reiterating some points for you and your colleagues to consider for ways you can help protect American IPR in China. Many of these mirror the recommendations I outlined with respect to the Russian problems.

First, help make sure our government has the resources it needs. I know fully well the difficulties with which the Congress has been dealing on controlling the deficit, I also know that it ought to be in our national interest to promote and protect winning industries, and this industry is a winner. As I have said, we employ nearly one million Americans, in good, well paying jobs, and we have a positive balance of trade in every market where our countries do business, except one: China.

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Why do we run a movie trade deficit with China? Piracy is certainly a key reason, though another is the onerous, burdensome restrictions we have on doing business in China, and even in getting into that market.

Consider some facts about our access to the China market: The good news is that the money our movies made in China in 2004 doubled the amount they made in 2003. The sobering side is that that amount was only $10 million. As we saw in November with *"Walk The Line," "Harry Potter and the Goblet of Fire,"* and *"Chicken Little"*, and will see every weekend for the rest of the year, one American movie can make more on an opening weekend in the US alone.

In recent years, in fact, two Chinese movies *"Kung Fu Hustle"* and *"House of Flying Daggers"* both, individually, made more in the US than all US movies made in China for the years they were released, and, ironically, both were distributed in the US by one of our member companies.

The primary barrier is the quota the Chinese impose on the number of foreign films they permit into their market under normal business terms, what we call revenue-sharing, whereby the US producer shares the box office with the Chinese distributor. The Chinese allow only twenty such films into China a year, from all countries, not just the US. That means film makers from France, Japan, the UK, Korea, and the US together can only hope to get a part of that twenty-film quota.

Once into the market, the government controls the distribution of the movies. A state agency, through two divisions, distributes all the films in China, and dictates the terms of the revenue sharing with US film makers.

There are many other restrictions, detailed in the attachment to my statement, but the net effect is critical. When fighting piracy and protecting IPR, most are familiar with what I call the traditional methods - effective laws, enforcement, raids, and the like. In China, getting better access is just as critical and intertwined closely with our strategy towards that market.

My second recommendation is that we want the same access to the Chinese market as the pirates have. The barriers I outlined and that are enumerated in the attachment do not, at all, restrict the number of movies in China. Virtually any movie Chinese consumers might want is available, not necessarily through legitimate channels controlled by the restrictions applied to us, but from pirates who have no such restrictions and who operate largely without deterrent sanctions applied to offenders. Not only are our movies being stolen, but we also face an enormously unbalanced playing field at distinct competitive disadvantage.

We are convinced access to the Chinese market on fair terms, the same terms as the pirates, is central to fighting piracy in China and protecting our rights there. We want to be able to compete, not bound by quotas, government restrictions on distribution rights, black-out periods when only Chinese movies are screened, nor onerous taxes, and we want transparent clearance procedures.

Third, let me come back to where I started: political will. Just as the US government needs adequate resources and strong laws, so do the Chinese. However, for the most part, that is not the main problem. With a few notable exceptions, the Chinese IPR statutory regime is adequate and with changes, can easily be brought into compliance with WTO standards.

The problem is political will, and keeping the pressure on is a key way to bolster that will. For example, we know the Chinese can stop pirates. When the Chinese open a film the government wants to promote and protect, pirated copies of it are non-existent; the word goes out that piracy will not be tolerated. Even when we surveyed results of the MOU, we saw some modest improvements in some places - evidence that the Chinese can crack down on the pirates if they want.

The Chinese frequently recite this rationale for the IPR problems: The US, they say, has over 200 years experience with IPR; China has only twenty. China needs time to grow and develop. True. I acknowledge the problems with developing an adequate and effective IPR system, and culture. On the other hand, I have seen what China can accomplish when it makes something a priority. My first trip to China was about twenty years ago. The changes I saw between then and my last visit last May are breath taking. The lesson here is that when the Chinese have the will and desire to change and reform, they can.

I saw another personal example of how the authorities can act when properly motivated. Last May, the day after I discovered the pirated copy of my son's movie, *"The Hitchhikers Guide to the Galaxy,"* I met with the mayor of Beijing and told him. The next day, the shop where I got the movie was raided and closed: political will in action. Unfortunately, it was short-lived; our China representative informed me the other day that the shop is back in business.

A couple of weeks ago, *The Wall Street Journal* carried a telling story, about the paucity of counterfeit Olympics-logo goods in China. The production, distribution, and sale of those goods is tightly regulated and policed, and fakes are not tolerated.

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It is virtually impossible to find counterfeit Olympics goods in China. Why? As one of the Chinese officials said, it is because fakes dilute the value of the logo, the intellectual property upon which the Chinese have invested to finance the games.

The lesson: When the Chinese want to stop piracy, they can be enormously effective. They do not need twenty more years experience with IPR, they have the resources, they have the basic statutes, and they can make the changes needed to improve them. They need the political will to protect our goods as effectively as they are protecting the Olympic logo.

Please keep the pressure on; this hearing is one way to do so. Make sure you mention this when meeting with Chinese authorities. Above all else, unless the Chinese know this is a priority for all of us, we fear they will fail to exercise the political will to protect our IPR.

Mr. Chairman, members of the Subcommittee, I appreciate again your attention to the acute problems we are facing in Russia and China and the chance to share with you the perspective of the US motion picture industry.

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CHINA

Trade Data	
Population	1.3 billion
GDP	1.6 billion
GDP Growth Rate	9.2%*
US Exports to China	34.7 billion
US Imports from China	196.7 billion
US Trade Balance with China	-162 billion

Sources: US Department of Commerce, EIU, US Bureau of the Census
* Estimate

American entertainment firms continue to struggle to establish a foothold in the Chinese market, despite extensive and multi-faceted efforts and investments MPA and its member companies have made over the last decade, the signing of the 1995 bilateral intellectual property rights agreement and China's accession to the World Trade Organization (WTO) in 2001. Market access restrictions and rampant piracy continue to thwart the US filmed entertainment industry's attempts at meaningful growth in China, even as China's economy grows at nearly ten percent annually and the US industry increasingly relies on overseas sales for a growing share of its annual revenue.

A web of market access restrictions mean far less legal filmed entertainment enters China than the market demands. Those restrictions include: (i) a government monopoly on film importation and distribution by which one state-run monopoly controls a single importer and two film distributors; (ii) an unreasonably low quota of only twenty international films a year into the market on revenue sharing terms; (iii) the government *determines box office revenue share; (iv) limits on the retail sale of legal home* entertainment; and (v) government-imposed restrictions on foreign investment, foreign channel carriage, and programming content in the television sector.

Due to these restrictions and the resulting pirate market growth, revenues from US theatrical releases in China decreased 24% since 1996. At the same time, the home video and television markets are also negatively affected by rigid government control, which includes regulations on home video licensing agreements, foreign investment restrictions, restrictions on retransmission of foreign satellite signals, television quotas, and other regulations.

These restrictions on foreign audiovisual products effectively leave the China market to the pirates, who fill the void resulting from government delays and limited legitimate foreign access to the market. Pirates comply with none of the government's regulations

MPA has identified the barriers in boldface, preceded with I as barriers that pose an immediate threat to MPA member company operations.

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and restrictions, while capturing at least 95% of the U.S. audiovisual industry market's sales in China.

The piracy rate in China climbed to 95% in 2004, a level not seen since 1995, and the fact that there has been no progress in the last few years indicates that the government has not taken adequate measures to address the problem. China lacks deterrent penalties and enforcement can be better coordinated, transparent, and adequate. The common-place abundance of pirate optical discs drives down the price of such discs to levels below other markets in the region. Disturbingly, pirate discs replicated in China continue to appear in increasing numbers in markets worldwide; the export of pirate product is reemerging as a serious problem.

China must commit to set a fixed timetable for the removal of the limits, restrictions, and structural distortions on imported audiovisual products, and allow a free and competitive market in which Chinese consumers, not the Chinese government, are able to determine which films and other audiovisual products are most appealing to them to address the rampant piracy problem.

1. IMPORT POLICIES

I Import Quotas – Limits on the number of films allowed to be imported into China remain unchanged in 2005. Under the terms of China's WTO commitment, China agreed to allow 20 revenue sharing films into the country each year. However, the Chinese have stated that 20 is a "maximum," not a "minimum," an interpretation which is not in accordance with WTO policy and should be corrected. Censorship and the monopoly import structure are the tools by which these quotas are imposed and enforced. In addition, under Rules for the Administration of the Import and Broadcast of Foreign Television Programs (1994), the government's acquisition arm, China TV Program Agency, must approve all importation of foreign programming. The Chinese government imposed trade barriers that limit the importation of legitimate filmed products create opportunities galore for pirates to fill the great demand that exists in China for US audiovisual content by providing stolen media.

I Import Duties – Import duties on theatrical and home video products may be assessed on the potential royalty generation of an imported film, a

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method of assessment which is excessive and inconsistent with international practice of assessing these duties on the value of the underlying imported physical media. As part of its accession to the WTO, China committed, in addition to reducing import duties, to changing the valuation method used to assess these duties. Rather than calculating a percentage of the value of films and videos based on expected revenues generated by the film in China ("royalties"), China agreed to assess duties on the value of the imported physical media, the same method generally used internationally. MPA appreciates the US Government's discussions with the Chinese on shifting the method of applying the duties as agreed on in WTO negotiations and following general international practice. It is *vital that import duties are based solely on the value of the imported* physical media and not on potential royalties, as excessive import duties place a severe drag on investments in legal business, and impede distribution of legal filmed entertainment product.

Taxation – The theatrical and home video industries are subject to very complicated duties and taxes in China. These duties and taxes have a significant impact on revenues and continue to hinder market access. With its accession to the WTO, however, China committed to reducing import duties by approximately 1/3 and will now apply a specific rate of duty to both theatrical (reduced from 9% to 5% for Special Film Fund) and for home video (to 14.5%).

5. *LACK OF INTELLECTUAL PROPERTY PROTECTION*

I Piracy – Piracy has reached a rate of almost 100% of the retail market, with pirate DVDs of the latest US theatrical release titles readily available within days of release internationally. The export and transshipment of pirate optical discs from and through China continues to grow, especially pirate DVDs of US film titles, while Internet piracy and television piracy are also serious impediments to legitimate entertainment business growth.

The US Government should continue its efforts to ensure that China significantly reduces the piracy rate. Despite several government agencies' efforts to fight piracy, including raids, arrests, investigations and penalties, lack of deterrent penalties for piracy and a lack of a coordinated, transparent and adequate enforcement program, as well as the restricted

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market access to legitimate films, are key causes for the failure of piracy rates to decline in China. With unreasonable trade barriers to legitimate product protecting the pirates' market, retail piracy has reached a piracy rate of almost 100% of the market.

Export Piracy – The export and transshipment of pirate optical discs from and through China continues to grow, especially pirate DVDs of US film titles. The transshipments flow out of China to destinations worldwide through express mail and courier companies. Examples of recent known seizures include UK Customs' seizure of 197,733 pirate DVDs originated from China in 2004, Kuming Customs' seizure of 3,500 pirate optical discs from outgoing mails on January 13, 2005, and in two separate August 2005 actions, Hong Kong Customs' seizure of 20,000 pirate DVDs from China headed to Calgary and Los Angeles (1,200 DVDs were infringing MPA member companies' titles and 1,000 DVDs were infringing Japanese titles) and seizure of 54,136 pirate optical discs from China (4,000 DVDs were infringing MPA member companies' titles and 2,000 DVDs were infringing Japanese titles). These known seizures are only the tip of the iceberg on exports of pirate optical discs from China.

Pirate Optical Disc Manufacturing – During the Chinese government's nationwide summer anti-piracy campaign between June 20 to August 31, 2005, authorities seized 51,390,000 illegal and pirate optical discs from the pirate warehouses and markets. On September 16, 2005, National Anti-Piracy & Pornography Working Committee (NAPPWC) organized a nation-wide piracy destruction campaign and openly destroyed 15 million pirate optical discs. Also, since 1996 the National Anti-Piracy Reward Scheme established by NAPPWC has resulted in seizure of 213 illegal optical disc production lines. However, despite the government's efforts, it has become increasingly difficult to locate remaining optical disc plants because they have gone underground and are dispersed throughout China. The large number of illegal optical discs still being seized in China clearly indicates a significant number of plants still in existence.

MPA has identified the barriers in boldface, preceded with I as barriers that pose an immediate threat to MPA member company operations.

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Internet Piracy – Pirate hard good sales online in all formats and illegal downloading and streaming of MPA member company films are also increasing in China. A large number of websites provide fee-based or free download and streaming services without permission. Chinese Internet Service Providers (ISPs) are also hosting these infringing websites organized by overseas syndicates targeting users outside China, which again involves China in the "export" of pirate content. During 2004 MPA had to issue 3,905 "cease and desist" letters to ISPs in China, requesting they take down infringing websites, compared with 444 "cease and desist" letters sent during 2003, a nearly 800% increase. The less than 35% compliance rate in taking down the infringing websites is unacceptably low.

Television Piracy – China's 360 government-controlled television stations at different provincial levels, which reach hundreds of millions of households, commonly make unauthorized broadcasts that increasingly include popular MPA member company titles. These stations rely on false "letters of authorization" or "licenses" from companies in Hong Kong, Thailand or Taiwan, which purport to convey broadcast rights. Some stations also try to hide behind the "fair use" exception, broadcasting heavily edited versions of MPA member company films under the guise of being an "introduction to the film." Additionally, there are approximately 1,500 registered cable TV operators in China and 45 digital TV operators, serving more than 100 million households, all of which routinely include pirate product in their programming.

As a result of cinema surveys conducted by MPA over the past three years, and the continued support from the Ministry of Culture to punish offenders, there has been a significant reduction in illegal screenings of MPA member company titles in major cities.

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I Laws and Enforcement – Although government officials collaborate in efforts to fight piracy, legislation does not contain deterrent penalties and continues to set high criminal thresholds which preclude effective prosecution and sentencing (more than 99% of raids currently result in administrative fines, most of which are quite low and do not act as a deterrent). The US Government should continue its efforts to ensure that China significantly reduces the piracy rate, promote adequate technological protection measures in emerging digital formats, and reviews the criminal sanctions available under copyright and other relevant legislation (in particular, to redress criminal copyright proceedings, which remain problematic).

Recent Chinese Government Efforts – On July 13, 2005, MPA, Ministry of Culture (MOC) and State Administration of Radio Film & Television (SARFT) signed the Memorandum of Understanding (MOU) for a joint effort to press down piracy in China. MPA welcomed the initiative by the Chinese government and is proactively working with the MOC and SARFT to secure measurable results for this initiative. Quarterly strategic meetings between the two authorities and MPA beginning in August 2005 will be held to assess progress and formulate the latest strategies against copyright pirates.

During the summer of 2005, the Ministry of Propaganda, National Anti-Piracy & Pornography Working Committee (NAPPWC), Ministry of Public Security, Ministry of Culture, General Press & Publication Administration (GAPP), National Copyright Administration of China (NCAC), General Administration of Customs, General Administration of Industry & Commerce and Beijing Municipal Government collaborated in a nationwide summer anti-piracy campaign that resulted in the seizure of 51.4 million illegal and pirate optical discs.

Also in 2005, there was a nationwide reorganization of the culture task force in major cities including Beijing, Guangzhou, Shenzhen, Chengdu and Wuhan, that resulted in greater manpower and resource allocation for enforcement in those cities.

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The National Copyright Administration of China's (NCAC) successful title *verification program continues to provide for the verification of rights to US* motion picture titles submitted for distribution and duplication in China. In the first nine months of 2005, a total of 1,564 title verification requests were submitted by NCAC to MPA, and 198 titles have been challenged by MPA and Independent Film and Television Alliance (IFTA, formerly AFMA) as unauthorized.

However, despite these efforts, piracy continues to be rampant.

Lack of Effective Enforcement Program – Despite such government agencies' efforts to fight piracy, lack of a coordinated, transparent and adequate enforcement program remains one of the key causes for the failure of piracy rates to decline in China. Focus, co-ordination and effectiveness of the various Chinese enforcement agencies should be achieved through strong direction from the top Chinese leadership. Transparency is another vital necessity. For example, although MPA's 1997 Memorandum of Understanding (MOU) with China Customs resulted in an increase in Customs enforcement efforts against audiovisual piracy with MPA support and assistance in training, title verification and technical support, very little transparency is provided on the export situation. MPA is unaware of any significant seizures being made by Customs on pirate discs attempting to be exported.

Copyright Law Deficiencies – Since 2002 a total of ten civil cases have been brought by MPA under the recent Copyright Law amendments of 2001, all of which have been successful. Four cases against factories were settled while six cases against three retail outlets in Shanghai resulted in the awarding of damages against the defendants. Despite the successful cases, however, complex documentation to prove foreign copyright ownership is required in civil cases. The Copyright act should be amended to allow a prima facie copyright interest to be established in court cases by a copy of the foreign copyright certificate or a statement from the relevant title verification office.

The US Government should continue its efforts to ensure that China reviews the criminal sanctions available under copyright and other relevant legislation (in particular, to redress criminal copyright proceedings, which

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remain problematic. The National Copyright Administration of China (NCAC) must agree that any copyright infringement matter be subject to criminal jurisdiction. Currently, the high financial threshold required for copyright offenses to constitute a criminal offense under Chinese law effectively prevents Chinese authorities from prosecuting piracy cases under the copyright law.

For a copyright offense to be considered to constitute a crime it must meet certain broad criteria set out under Articles 217 and 218 of the Criminal Code (Article 217 relates to reproduction offenses, while Article 218 relates to retail offenses). The offenses under each provision are further defined as either "grave" or "serious" and can be committed by either a corporation or an individual. Although in December 2004 the Supreme Court issued an interpretation in which the thresholds were lower than the interpretation in 1998, the thresholds are still difficult to achieve and need further reduction. The interpretation lowered the criminal threshold for "illegal business volume" from RMB200,000 (US$24,700) to RMB50,000 (US$6,200) and the illegal operating income threshold from RMB50,000 (US$6,200) to RMB30,000 (US$3,700). The numerical threshold for reproducing and distributing illegal copies was lowered to 1,000. Infringers are subject to fixed-term imprisonment of not more than 3 years. Copyright infringers who commit huge or especially serious acts – i.e., illegal gains exceed RMB150,000 (US$18,600), or whose business volume exceeds RMB250,000 (US$30,900), or who reproduce and distribute more than 5,000 copies – will be subject to 3-7 years in prison. In addition to the need for further reducing the thresholds, the distinctions between crimes of entities and individuals must be eliminated for the law to have real deterrent effect. There is no guarantee that criminal cases will be brought as the profit from the sale of private goods is still the basis for determining whether the minimum threshold has been met. Ultimately, the resolve of the government to use criminal sanctions will be the main factor determining their success in reducing piracy.

China's failure to apply the criminal law to piracy is "in practice" in violation of TRIPS Articles 41 and 61 (provide enforcement which "on the ground" deters further infringements, provide effective *ex parte* civil search orders, and provide specific deterrent "criminal" remedies).

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Copyright Protection for Digital Environment – China has more than 10 different government bodies claiming some sort of control or influence over the Internet, with inconsistent policies, which creates uncertainty for potential investors and limits investment and growth in the sector. The rights ownership confusion allows the medium to be exploited by pirates. *Internet policies are necessary components of legitimate audiovisual* industry, as digital piracy severely curtails the growth of the new and existing marketplaces for entertainment product.

Copyright protection in the digital environment is deficient: the provisions which prohibit circumvention of technological protection measures on copyrighted content, alteration or deletion of electronic rights management systems, and temporary copies are not adequate. Although NCAC and Ministry of Information and Industry's (MII) April 2005 document, "Methods on Internet," contained some administrative responsibilities for take-down notice for ISPs, the proposed Internet Regulation to be submitted to the State Council by the end of 2005 should also include effective liability for Internet Service Providers (ISPs) for piracy related offenses and strengthen further satisfactory measures for notice-and-takedown of websites offering pirated materials. The US Government should also continue its efforts to ensure that China promote adequate technological protection measures in emerging digital formats.

Specific Goals to Address Piracy in China – In order to sufficiently address its serious and growing piracy situation, China must at a minimum take the following steps:

- Strengthen focus, co-ordination and effectiveness of the various enforcement agencies through strong direction from the top Chinese leadership;
- Establish one authority with clear administrative and approval and control powers over the whole of the Internet;
- Establish consistent, centralized and transparent regulation of the Internet, in order to attract investors and develop such prominent sector;
- Build consumer awareness of the dangers and penalties of engaging in piracy;

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- Implement and ratify the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treat ("WIPO Treaties"), and remedy copyright law deficiencies;
- Establish credible legal deterrents to piracy, through (1) lowering the high threshold of commercial piracy necessary to trigger a criminal prosecution, and (2) establishing stronger penalties, beyond the current fines that are not of deterrent value;
- Provide adequate protection in the digital environment by (1) criminalizing end-user piracy; (2) adding reference to all the *exclusive rights now provided in the law, particularly the new WIPO* treaties' rights and unauthorized importation; (3) adding criminalization of violations of the anti-circumvention provisions and rights management information; (4) criminalizing Internet offenses that are without "profit motive" but that have impact on rightholders "on a commercial scale"; and (5) eliminating distinctions between crimes of entities and individuals;
- Adopt Internet regulations that include adequate liability for Internet service providers (ISPs) for piracy related offenses, and satisfactory measures for notice-and-takedown of websites offering pirated materials;
- Set a fixed timetable for bringing piracy rates steadily down from current levels exceeding 95%. An immediate goal should be to bring *piracy below 50% by the end of 2006;*
- Take immediate action to stop the rising volume of pirate exports from China; and
- Take more criminal actions against pirates and ensure that more deterrent jail sentences are served.

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6. SERVICES BARRIERS

I Regulations on Home Video Licensing Agreements – New regulations issued by the Ministry of Culture (MOC) on May 20, 2004 require that copyright owners enter into home video license agreements of no less than three year's duration with their licensees in China, and that the agreement cover the licensing of all rights for all home video formats for each title. These restrictions are an intrusion into the freedom of contract for copyright owners in China. MPA strongly objects the implementation of this regulations and will work with Chinese authorities, both within MOC and elsewhere, to ensure that the regulations are rescinded.

I Retransmission of Foreign Satellite Signals – Foreign satellite channels are not allowed carriage on local cable networks unless with government approval or landing permits, which currently is limited to Guangdong province in southern China and a handful of foreign channels. Foreign satellite channels may only be shown in three to five star hotels, government buildings and foreign institutions. MPA opposes such restrictions that impede the growth and development of the television industry. Moreover, under guidelines issued in August 2001 by SARFT, foreign satellite channels beaming into China are required to uplink from a government-owned encrypted satellite platform using the Sinosat-1 satellite. The annual fee for each channel is set at US$100,000. This requirement places an unnecessary financial burden on foreign satellite channel providers, as it requires them to pay two uplinking expenses, one for its original uplink outside of China, and one in China using the Sinosat-1 satellite. In addition, there is no assurance that the encryption technology employed meets international standards.

Television Quotas – Administrative Order No. 2 of State Administration of Radio Film and Television (SARFT), effective since June 15, 2000, restricts foreign programming to no more than 25% of total airtime and no more than 40 minutes of prime time between 6:00 pm and 10:00 pm on terrestrial stations. SARFT's Interim Regulation on Digital Cable TV Pay Channels, effective since November 14, 2003, also restricts foreign programming to a maximum of 30% of total airtime on pay television channels. A further SARFT Notice issued in April 2004, "Design on Strengthening and Improving the Healthy Development of Ideas and Ethics of the Underage through Radio, Film & Television," reiterates that foreign

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animation is restricted to no more than 40% of total airtime and that the ratio between animation production and importation is 1:1 for all the production entities. Entities are also prevented from importing foreign animation without domestic animation production. Overall, the trend is to decrease imported programs shown during prime time. MPA opposes such restrictions that discourage competition and effectively prevent expansion of the television market.

Screen Quota – In addition to the import quota on foreign revenue sharing films, the government sets strict guidelines in the public screening of foreign films. Under "Regulations for the Administration of Films" (2001) Decree No. 342, Article 44, issued by the State Council, the total annual screening time for foreign films must not exceed one-third of the total screening time of all films (domestic and foreign). Domestic films may not be less than two-third of total annual film screening time. MPA opposes discriminatory measures that ignore market demand for US and other foreign films and stifle the development of the theatrical market in China.

7. INVESTMENT BARRIERS

I Foreign Investment Restrictions – Under the terms of China's WTO Agreement up to 49% foreign ownership was permitted in cinemas and in video distribution companies. In the theatrical sector, SARFT's Administrative Order, effective January 1, 2004, restricts foreign capital investment in cinemas to a maximum of 75% in Beijing, Shanghai, Guangzhou, Chengdu, Xian, Wuhan and Nanjing and up to 49% in all other cities. However, the ability to approve investments up to 75% is discretionary in the selected cities and current practice is to limit the investment to 49%. In 2004, up to 49% foreign ownership was permitted in production joint ventures. In the television sector, under the 1995 Foreign Investment Guidelines, companies that are wholly or jointly owned by foreign entities are strictly prohibited from investing in the broadcast industry. MPA member companies are therefore not allowed to invest in broadcast stations or pay television systems. Also, the Chinese government classifies Internet under telecommunications and media, two sectors that are subject to stringent foreign investment restrictions. All

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such foreign investment restrictions are discriminatory, limit competition and inhibit the potential growth of the film industry.

9. ELECTRONIC COMMERCE

Complex Array of Internet Regulations – To monitor the Internet, more than 10 different Chinese government bodies have staked out their turf and have drafted competing regulations that are often vague and inconsistent, making navigation and interpretation difficult. Until the State Council completes its task of creating a clear, effective and consistent Internet policy, the Internet will remain governed by confusing Internet regulations promulgated by a dizzying array of ministries and agencies, including the State Secrecy Bureau, the Ministry of Information and Industry (MII), the Ministry of Commerce (MOFCOM), the Ministry of Culture (MOC), the SARFT, the Internet Administration Propaganda Bureau, the State Administration for Industry and Commerce (SAIC), the General Press and Publishing Administration (GAPP), and the National Copyright Administration (NCAC), among others. Moreover, in 2005 two new bodies entered the fray: the Network Copyright Alliance (NCA) of the Internet Society of China, intended to stimulate the development of the Internet through research and self-governance, and the China International Electronic Commerce Center (CIECC), intended to create a standard and effective transnational e-commerce network.

A stable, transparent and comprehensive set of regulations is necessary to guide the development of the Internet and e-commerce in China. These regulations should include potential Internet Service Provider (ISP) liability, satisfactory notice-and-take down provisions, and anti-circumvention measures.

Internet Censorship – China has attempted to regulate and censor content on the Internet through regulatory and technological controls. Among the regulations promulgated are: the State Secrecy Bureau's announcement of the control and censorship of all websites in China (2000); the State Council's creation of the Internet Propaganda Administration Bureau to "guide and coordinate" website news content (2000); the State Press Publication Administration and the Ministry of Information and Industry's Provisional Regulation on Management and Control of Internet Publications to intensify government supervision of audiovisual and other content available online (2003); and the Ministry of Culture's "Interim Regulations on the Administration of Internet Culture" to require that providers of Internet-based content (with any broadly defined "cultural" attributes) receive

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MOC approval prior to distribution in China (2003). A newly-introduced measure by the government gave Chinese-run websites until the end of May 2005 to register their sites or face being shut down as part of a new government campaign to police the Internet. This registration drive was an effort by the Ministry of Information Industry to deal with fraud and other "unhealthy" activities on the Internet.

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

Internet Registration Requirements – The Chinese government has issued regulations requiring every company doing business related to the Internet to register with the Administration for Industry and Commerce. Such restrictions represent a damaging precedent and may create an undue burden on foreign companies attempting to leverage the unique global nature of the Internet to do business in different regions around the world.

WIPO Treaties Ratification – China has yet to ratify the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty (together the WIPO Treaties). On October 27, 2001, the National Peoples Congress adopted copyright law amendments, which include provisions that attempt to implement the WIPO Treaties. Some of the key issues involved in changing the copyright law are anti-circumvention measures, temporary copy protection, and rights management. In October 2005, a submission was made by the International Intellectual Property Alliance to the National Copyright Administration of China (NCAC), reinforcing the need for Internet regulations to be compatible with the Berne Conventions, the World Trade Organization (WTO) Agreement on Trade Related Aspects of Intellectual Property (TRIPS), and the WIPO Treaties.

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10. OTHER BARRIERS

! Government Film Importation and Distribution Monopoly – Although new film policies are reportedly being prepared, the extent to which they will open the film industry remains unclear. At both the central and regional levels, inter-connected agencies under the State Administration for Radio, Film and Television (SARFT) dictate the terms under which films can be produced and distributed. SARFT permits only one film importer and two film distributors (which are both components of the same monopoly managed by SARFT) to operate in China. Inter-connected agencies under SARFT include: the Film Bureau, which oversees the China Film Distribution and Exhibition Corporation; China Film Export and Import Corporation; China Film Co-Production Corporation; Huaxia Film Distribution Corp., China Television Service and the China Television Authority. For theatrical releases, this monopoly importer and distributor dictates the films that will be imported (currently limited to 20 revenue-sharing films a year), when they will be released in the market, and the box office revenue sharing terms (currently fixed at 87% to China Film / 13% to US rightsholder). 13% from the box office share is possibly the lowest sharing ratio in the world and is likely lower than if negotiated independently based on market forces. There is an urgent need to remedy the fixed box office revenue share master contract with the Chinese government counterparts to ensure that it reflects the market forces operating in China and encourages, and not discourages, competitive market development.

At the exhibition level, most cinemas are controlled by the China Film Corporation and its regional subsidiaries, notwithstanding the establishment of new competing exhibitors in most provinces. China Film dictates, as instructed by Beijing authorities, the contractual terms, play dates and other aspects of film exhibition. Although conditions in the exhibition market have generally not changed, in late 2003, Time Warner initiated a joint venture with several local companies to build 30 multiplex cinemas in China and obtain the management right for the new projects.

Regulations against direct distribution by non-Chinese companies of foreign theatrical films, home video, public performance video, and/or television product remain in force. MPA member companies and their

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authorized distributors seek an open and competitive market in which to freely distribute film, video and television products.

I Restrictions on Retailers – Foreign retailers are precluded by regulation from obtaining a license to sell home video products in China without first entering into a qualifying joint venture with a Chinese firm. Although in limited cases Chinese authorities have agreed not to enforce the regulations pending the commencement of such a joint venture, it is vital to MPA member companies and foreign retailers that regulations are transparent and allow access to the retail market. The number of legitimate distribution points remains far less than the number of pirate distribution points. It is essential the Chinese Government further releases the restriction of the selling of legitimate audiovisual products in convenience stores to enable consumers easier access to legitimate home video products. Video sales and rentals should be permitted in hyper-markets, super markets and other chain stores.

I Blackout Periods During Peak Seasons – Chinese government has decreed "black-out periods" in which no new revenue-sharing blockbuster foreign films may be released continues to prevent competition with some Chinese films being released on the same period. In 2005, there was a six-week period from July 15 to August 25, 2005 during which the Chinese title "Seven Swords" was released while no new foreign films were released, although three US releases already in theaters in July (*Batman Begins, Mr. & Mrs. Smith*, and *Madagascar)* continued in theatres beyond August 15, 2005. SARFT and China Film portray it as a commercial decision by China Film to clear the applicable periods for the release of the Chinese famous films, not a blackout against foreign films. There is another blackout period scheduled for December.

The banning of release of new foreign blockbuster titles during peak seasons creates not just a burden for theatrical revenues but also contributes to increased piracy, as pirates meet immediate consumer demand for foreign blockbuster titles through offering illegal downloads through the Internet, pirate optical discs, and pirate video-on-demand channels. MPA appreciates the US government's continued discussions with Chinese government to avoid imposition of periods when new foreign revenue-share blockbuster titles cannot be released.

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Censorship - The Ministry of Culture, the State Administration for Radio, Film and Television, the Press and Publications Administration, and Chinese Central Television all perform censorship functions. Although there have been improvements in the censorship process over the past couple of years, all film, video or television content submitted for censorship continues to be required to be acceptable for "all audiences" in China or it is not allowed into China. At the same time, despite this policy and import restrictions, pirates freely and easily move illegal stolen content into the theatrical, video and television markets with no censorship of content and no delays, satisfying consumer demand. China should establish a ratings system, with age classifications for recommended audiences, as it would be most beneficial for the local market, and most effective against the threat of piracy.

! Video Rights - When Chinese entities contract for the rights to distribute titles in various home video formats, the differentiation between video rights and rights for home use or public use are often ignored. MPA continues to find its member companies' products being used for public performance exhibitions in mini-cinemas and by some Pay-TV operators providing to hotels. The Chinese government should ensure that home video contracts are fully respected, and that home video product is not used for public performances.

! Local Printing/Duplication Requirement - China Film continues to require that film prints be made in local laboratories. The requirement pertains to theatrical distribution in most cases, and it applies to home video distribution in all cases. Local printing and duplication requirements reduce rights holders' ability to control the quality of a film copy and may result in increased costs. As in previous years, the Chinese government has made no attempt to alleviate this requirement.

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Motion Picture Association – 2006 Trade Barriers Report

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RUSSIA

Economic Indicators	
Population	144 million
GDP	563.7 billion
GDP Growth Rate	7.0%*
US Exports to Russia	3 billion
US Imports from Russia	11.9 billion
US Trade Balance with Russia	-8.9 billion

Sources: US Department of Commerce, EIU, US Bureau of the Census
* Estimate

Russia is the largest economy in the world that is not yet a member of the World Trade Organization (WTO), and joining the WTO remains one of Russia's primary geopolitical goals after President Putin's re-election in 2004 and the substantial government reorganization that occurred at the same time. Russian legislation, however, still needs to be fully harmonized with international convention and copyright standards, and the WTO's Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) will need to be implemented. In addition, Russia will need to make progress to providing real protection of intellectual property rights in Russia, and particularly address the lack of effective enforcement. Although joining WTO by the end of 2005 had been the goal of the Russian government, the target date has been pushed back to spring 2006.

1. IMPORT POLICIES

I Customs Duties – Customs authorities in Russia continue to assess duties on the royalty value of imported audiovisual materials (such as television master tapes, DVDs, etc.), rather than solely on the physical value of the material substrate. This is contrary to international and European legal standards. While a new Customs Code was adopted effective January 1, 2004, the Law on Customs Tariffs, which underlies the royalty-included valuation, remains intact. MPA discourages customs duties which are assessed on potential royalties: these serve as a form of double taxation, since royalties are also subject to withholding, income, value-added and remittance taxes. Such duties are a barrier to further growth of the Russian audiovisual market.

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5. LACK OF INTELLECTUAL PROPERTY PROTECTION

I Piracy – Russia has become one of the world's largest producers and distributors of illegal optical media material, decimating the local video market as well as infiltrating video markets across Europe. As the criminal groups running piracy operations are well-funded and highly organized, the committed help of the government and of local law enforcement is required to fight effectively against piracy. The government must also turn its attention to the fact that Russia home to growing internet piracy, including one of the largest commercial internet pirates in the world, called allofmp3.com.

Optical Disc Piracy – In Russia, the domestic market is saturated with pirate DVDs. The level of piracy is estimated to be over 90%. Sales of legitimate DVDs have totally failed to keep pace with increases in DVD household penetration, despite efforts to lower the prices of legitimate product and to quickly move legitimate, locally replicated product into the market. As a result, piracy is continuing to undermine the creation of a healthy legitimate home entertainment market in Russia.

Increasing production of pirate DVDs in Russia is the number one problem not only for the Russian market, but for video markets across Europe. Russia has become one of the world's largest producers and distributors of illegal optical media material. There are now some 51 known DVD lines in the country (up from 34 just one year ago). The estimated maximum production capacity of these known lines and of the suspected handful of clandestine lines is about 300 million discs a year. Using a more realistic estimate (based on replication order documentation found in Russian Anti-Piracy Organization (RAPO) raids and inspections and other factors), the *actual annual production of these lines is between 150 and 180 million* discs. Assuming local annual consumption of about 100 million DVDs (about 90% of which are pirate), it is believed that Russian DVD plants are now manufacturing between 50 and 80 million DVDs a year for export to markets outside Russia. As a result, pirate optical discs of all kinds manufactured in Russia existing plants have been found in some 27 countries worldwide. Markets that have been negatively impacted by imports of pirate Russian DVDs include Bulgaria, Czech Republic, Estonia,

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Finland, Germany, Hungary, Israel, Poland, Romania, Slovakia, Turkey, Ukraine, and United Kingdom.

Further evidence that the piracy problem is an epidemic in Russia is found in the fact that some films have been available before their theatrical release in the US. Russian pirates are obtaining high-grade pirate copies by duplicating films in the projection booths of theaters, by making telecine copies of stolen or borrowed theatrical prints on their way to local theaters, and by camcording from local theater screens. Investigations into the *telecine piracy problem have revealed 12 telecine machines in Moscow* alone. Pirate DVDs are sold everywhere including street markets, kiosks, retail stores and over the Internet.

The manufacture and distribution of pirate DVDs (and the sourcing of their film content through camcording in Russian cinemas or through the making of telecine copies of theatrical prints) is controlled by sophisticated organized criminal groups that are involved in all sorts of other criminal activity. *Their pirate activities provide them with a low-risk and highly* profitable source of funding. Piracy is openly acknowledged as one of the most profitable criminal operations in Russia. The criminal groups running piracy operations are clearly well-funded and highly organized. Such groups cannot be effectively opposed by rights holders alone or by local organizations acting on their behalf, regardless of the dedication, bravery or expertise of their personnel. The committed help of the Government and of local law enforcement is required to face down such criminal syndicates.

Internet Piracy – Although both broadband penetration and the level of Internet piracy remain low, Russia is nevertheless home to one of the largest commercial Internet pirates in the world, called "allofmp3.com." This site sells music and movies to consumers worldwide. Russian prosecutors recently declined the music industry's request for a criminal investigation of this site, claiming that it did not violate Russia's Copyright Law.

Annual losses to the US motion picture industry due to audiovisual piracy in Russia were estimated to be US$275 million in 2004.

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I Laws and Enforcement – Widespread corruption within the entire law enforcement community (police, prosecutors and judges), coupled with the involvement of organized criminal syndicates and the continuing absence of deterrent sentencing from the courts must urgently be addressed. Only the shutting down of the pirate DVD plants operating in Russia will finally address the growing piracy problem. Moreover, there is a need for critical legal reforms that will adequately deter commercial piracy, even as Russia has yet to effectively enforce the laws it has in place to have any appreciable effect on the levels of piracy.

Enforcement Efforts – Enforcement efforts in Russia have increased over the past year or so. In 2003, over 1.4 million pirate DVDs were seized in raids on plants, warehouses and outlets across Russia. That number increased in 2004 to over 4.75 million, and to over 5 million in the first 9 months of 2005. There has been increased activity by law enforcement authorities in not just raids but prosecutions, especially in recent weeks and, notably, against plants located on defense facilities.

In 2005, RAPO participated in eight raids on suspect DVD plants, including raids on three plants in Zelenograd, Moscow and Kazan in early October. The plant in Kazan, Tatarstan, was located on a defense or "restricted access" facility and the local authorities in Tatarstan tried unsuccessfully to hinder the raiding party from the Economic Crime Police in Moscow and RAPO, which eventually managed to gain access to the plant through a ventilation shaft. As of March 2005, Ministry of Interior officers and State Trade Inspectors have the right to 24 hour access to "restricted access facilities" for the purpose of conducting raids on optical disc plants located on such facilities.

Despite the initiation of criminal cases following plant raids, the plants generally remain in operation and their licenses have not been suspended by the Ministry of Culture's Federal Licensing Service (Rosokhrankultura). This new Federal Licensing Service was given responsibility for supervision of the licensing of audiovisual and optical disc replication plants (under the 2002 Reproduction Licensing Regulations) in 2004, a responsibility that used to rest with a department within the Ministry of Press and Mass Media. When the responsibility was moved, there was an inevitable delay in this Service getting to grips with its new functions and

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responsibilities, especially given that the head of the new service had no previous experience in the industry and none of the experienced staff from the former Ministry of Press and Mass Media were retained. The Federal Service eventually contracted out the inspection of replication facilities to the Ministry's Federal Press Agency (Rospechat) and regular inspections of optical disc plants finally re-commenced in May 2005, with the active participation of RAPO. All known plants have since been inspected.

Although RAPO was able to secure the first-ever convictions of people involved in pirate DVD replication (previous convictions were obtained for distributors, kiosk owners and retailers) in 2005, the best sentence obtained to date was a suspended four year prison term for the operator of a plant in Pushkino, near Moscow, that was raided in February 2004. Russian authorities openly acknowledge that only 8 non-suspended prison sentences were imposed on intellectual property infringers of all kinds in 2005.

Prosecutors have been instituting more criminal cases following raids in 2005 (in about 50% of raids, up from 33% last year), and there has been a noticeable improvement in the number of such cases actually brought to court. RAPO's new in-house attorney has participated in about 135 criminal trials in 2005, all of which produced successful results. Despite these improvements, the sentences imposed by the courts remain woefully non-deterrent, and RAPO has only been able to secure the actual imprisonment of three pirate offenders this year (and none for pirate DVD replication). As mentioned above, a total of only eight pirate offenders have been jailed in 2005. The government also needs to address the unacceptable return to the marketplace of confiscated pirate product. It is estimated that over two-thirds of pirate product seized in raids still finds its way back onto the market.

Despite increased enforcement activity, the seizure of over 5 million pirate DVDs so far in 2005, and increased political pressure on the Russian government, Russia's DVD manufacturing capacity continues to grow at an *alarming rate and the piracy level shows no sign of abating.* Pirate production and export continue to grow. Widespread corruption within the entire law enforcement community (police, prosecutors and judges), coupled with the involvement of organized criminal syndicates and the

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continuing absence of deterrent sentencing from the courts, create an extremely difficult and dangerous environment within which RAPO must operate. These problems must urgently be addressed to have an impact on the growing piracy problem in Russia. Only the shutting down of the pirate DVD plants operating in Russia will finally address the problem. Moreover, there is a need for critical legal reforms that will adequately deter commercial piracy, even as Russia has yet to effectively enforce the laws it has in place to have any appreciable effect on the levels of piracy. More urgently than ever before, attention is needed at the highest level of the Russian Government, given the lack of focus and clarity on the enforcement of copyright that resulted from the government reorganization in 2004.

Copyright Legislation – Russia's progress on intellectual property protection since it passed its modern Copyright Law in 1993 has been principally limited to legislative reform. In July 2004, Russia passed long-awaited amendments to the Copyright Law, bringing it towards conformity with the standards of the World Trade Organization's Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement. However, the Law includes a number of problematic provisions including: the right of making available to the public will only enter into force on September 1, 2006; the scope of a number of exceptions, including for private copying, seems overly broad; the provisions on the protection against circumvention of technological measures and the related legal consequences seem to be too closely linked to copyright infringements, and thus do not seem to provide sufficiently "adequate legal protection and effective legal remedies"; and the provisions on enforcement should have been further updated. Moreover, a number of important issues were not addressed at all, including: extended collective management of rights without copyright owners' mandate and inadequate provisions on retroactivity (related to the extension of the term of copyright protection to 70 years – no restoration for works which have fallen into the public domain).

Furthermore, the vague wording of Article 45 of the Copyright Law, which is allowing collective management organizations to claim representation of MPA member company product, has resulted in a totally pirate market in St. Petersburg and has made copyright protection confusing for law

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enforcement. The so-called Association of Collective Management of the Authors' Rights, which claims to represent MPA member companies, has entered into a cooperation agreement with the head of the city and regional police, and enjoys the support and protection of local officials. This association actively enforces its own "trade rules" that require the application of a pirate hologram on all products sold with its license. Federal government involvement is urgently required to regularize this unacceptable situation.

Optical Disc Legislation – There is an urgent need for amendments to the 2002 Reproduction Licensing Regulations. The regulations need to be considerably strengthened and expanded (e.g., to cover the import and distribution of optical disc lines and of high-grade polycarbonate, and to cover operators of telecine machines and mastering laboratories), and the Federal Licensing Service must begin to suspend (or, preferably and if at all possible, withdraw) the licenses of plants caught in violation of the regulations. It is believed that the Federal Service will be proposing amendments to the regulations at the next meeting of the Government's Intellectual Property Commission scheduled for November 2005. There is reportedly a conflict at the government level between ministers, such as the Minister of Economic Development and Trade, who advocate the total abolition of licensing regimes for trade liberalization purposes, and others, such as the Minister of Culture and Mass Communication, who want to preserve and strengthen such regimes for law enforcement purposes, particularly in the case of optical disc plant licensing.

Anti-Camcording Legislation – Pirates are illicitly camcording from local Russian theater screens to use as a source for pre-release pirate product,. Effective measures against camcording in Russian theaters are necessary so that infringers can't claim to be making private copies for their personal use. Anti-camcording legislation, to facilitate enforcement and prosecution should require jail sentences, preferably up to a year or longer for the first offense, and a higher penalty for any subsequent offense.

Government Will – There is a general consensus in Russia that aspects of the anti-piracy battle lost considerable momentum in 2004 with the major government reorganization that occurred, and with the replacement of Prime Minister Kasyanov with Mikhail Fradkov, who is both less powerful

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In his position and is on record as questioning the usefulness of the Government's Intellectual Property Commission or Task Force which he now heads. The Commission itself has since not been as active or effective a forum as was the stated intent, although in September 2005 it began a 3-year intellectual property public relations campaign, involving TV trailers, radio advertisements, newspaper articles, etc. The trailers have recently aired on a number of TV and radio stations. Although it appears that intellectual property protection and enforcement has recently moved up in the list of priorities of the Russian Government, it is still nowhere near as high on that list as it should be.

The government reorganization weakened the focus on copyright protection by reshuffling the institutions tasked with oversight of copyright issues. Copyright regulation and oversight was handed to the Ministry of Education's new Federal Service for Intellectual Property, whose primary interest to be in the area of trademark and patents, for reasons of potential economic returns. Also, there is an inherent conflict of interest between the copyright industries and an education bureaucracy. Furthermore, the Federal Service has no coordinating role over law enforcement authorities.

Fundamentally, there is a need for such a central coordinating body with wide powers, derived directly from the President. This new body or agency would combine the Economic Crime Police, the Police of Street Order, Police Investigators (who investigate major cases from beginning to trial) and Department K (New Technologies Police). At the moment, there is a serious lack of coordination between the various law enforcement authorities involved in the fight against piracy and counterfeiting, and even between individual units within existing law enforcement authorities.

Russia still suffers from the grip of organized crime and corruption, and RAPO's efforts are often hampered by corrupt enforcement officials, police, prosecutors and judges. Corrupt police officers protect most pirate kiosks, shops and markets. Corrupt police and prosecutors protect major pirate outlets, distributors and replication plants. Corrupt judges impose light suspended sentences and fines that are seen as no more than an additional small cost of doing business. The Russian Government needs to take urgent and effective measures to combat corruption, including the rigorous prosecution of enforcement officials who take bribes.

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While RAPO has generally good working relationships with prosecutors, many continue to regard copyright offenses as minor crimes and refuse to initiate criminal cases. The maximum penalty under Article 146 of the Criminal Code is five years imprisonment. Under Russian law, offenses carrying maximum sentences of less than six years imprisonment are not regarded as serious crimes. Such refusals have a negative effect on RAPO's efforts to encourage police and other prosecutors to act. The recent publication and distribution of the intellectual property manual for prosecutors and police that was prepared by RAPO, other rightsholder organizations, and the General Prosecutor's Office is seen as a major step forward in educating local prosecutors on IP offenses and on how to prosecute them effectively. There is also a need for the creation of a specialized IP Prosecutors Unit within the General Prosecutor's Office to be responsible for oversight of IP prosecutions across Russia.

Unfortunately, Russia's criminal enforcement system is the weakest link in its intellectual property protection regime. Swift criminal prosecutions do not follow raids. Prosecutors continue to drop cases for no justifiable reason, or cite a lack of public interest. When cases are prosecuted, the penalties imposed are not at deterrent levels. Prison sentences are usually suspended. There have been welcome exceptions, of course, but police and prosecutors are generally discouraged by their experiences from investigating and prosecuting more offenders.

Concrete Steps Needed to Address Piracy – To put into effect its stated commitments to tackle its piracy crisis, the Russian Government should take the following steps:

- Announce, from the office of President Putin, that fighting copyright piracy is a priority for the country and for law enforcement authorities;
- Inspect, on a regular, unannounced and continuous basis, each of the 42 known optical disc plants, immediately closing and seizing the machinery of any found to be producing pirate product;

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- Issue a Supreme Court decree setting forth sentencing guidelines for judges - advising the courts to impose meaningful penal sanctions - as already provided for in Russian law;
- Establish a central coordinating body for law enforcement authorities with wide powers, derived directly from the President, that would combine the Economic Crime Police, the Police of Street Order, Police Investigators (who investigate major cases from beginning to trial) and Department K (the New Technologies Police);
- Amend Article 146 of the Criminal Code by providing for a maximum penalty of six years imprisonment or more;
- Immediately take down websites offering infringing copyright materials, such as allofmp3.com, and criminally prosecute those responsible;
- Pledge to investigate all complaints from copyright owners with respect to the commercial replication, distribution or export of pirate optical discs;
- Investigate and prosecute organized criminal syndicates that control piracy operations in Russia (including operations that export pirate material to markets outside Russia);
- Introduce, either via executive order or legislation, modifications of the optical disc licensing regime to provide effective control over the operations of optical disc plants, including withdrawing licenses and sanctioning illegal plants; stricter controls on the importation of polycarbonate and machinery; mandatory seizure and destruction of machinery used to produce pirate materials; and the introduction of criminal penalties for the owners of such plants;
- Extend the scope of the current replication licensing regime to the operators of telecine machines and mastering laboratories;
- Introduce and enforce effective measures against camcording in Russian theaters, so that infringers can't claim to be making private copies for their personal use;

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- **Take measures to change the confusing situation in St. Petersburg where the legitimate market has been effectively lost due to the activities of a collective management organization known as the Association of Collective Management of the Authors' Rights (see above); and**

- **Act through Customs to prevent the continued export of pirate discs to other countries.**

GSP Review – **The US Government continues to review whether Russia is eligible to receive reduced customs duties on the import of its products into the United States under the Generalized System of Preferences (GSP) because of its weak protection of intellectual property. In early 2004, MPA joined other US copyright associations in asking the US Government to review Russia's eligibility to receive these trade benefits. The US Government needs to revisit this issue to determine whether Russia has made sufficient progress to retain its GSP benefits. It would not be acceptable for the United States to continue to provide preferential trade benefits to a major trading partner like Russia, if Russia fails to halt the widespread theft of American intellectual property.**

7. INVESTMENT BARRIERS

Foreign Ownership Restrictions – Pursuant to Amendments to the Law on Mass Media, which entered into force on August 6, 2001, foreign legal entities, or Russian entities with over 50% foreign ownership, are prohibited from sponsoring television or video programs, or establishing television channels capable of being received in more than 50% of the Russian Federation's subject territories or broadcasting over a territory comprising more than 50% of the Russian population. This restriction also applies to foreign nationals and Russian citizens having dual nationalities. The law also forbids the transference of stock in favor of a sponsor of a television or video program, or of a television organization, if such transfer results in 50% or more foreign ownership. MPA opposes such restrictions because they are discriminatory and unreasonably favor local investors who already may have a foothold in the market. Foreign investment is

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often necessary and beneficial for the development of infrastructure for the motion picture industry.

9. ELECTRONIC COMMERCE

WIPO Treaties Ratification – Russia has not yet ratified the WIPO Copyright and Performances & Phonograms Treaties (together the WIPO Treaties). These treaties provide the essential legal infrastructure for e-commerce through obligations that assist rightsholders in safeguarding the transmission of copyrighted works over advanced networks like the Internet and through higher standards of protection for digital products generally. While amendments to Russia's Copyright Law, which came into force in August 2004, finally implemented certain key provisions of the WIPO Treaties, important deficiencies remain:

- The 'making available' right will enter into force only on September 1, 2006. At a time of rapid Internet development, such application must take effect immediately.
- The provisions introducing protection of technological measures and rights management information lack necessary effectiveness. Further amendments to the Administrative and Criminal Codes are required.

MPA appreciates US government assistance in encouraging the Russian government to enact adequate Copyright Act amendments in compliance with the WIPO Treaties, which would include sufficient remedies against piracy of audiovisual product over the Internet, including provision for notice and take down of infringing materials, temporary copy protection, making available rights, protection for technological protection measures, protection against electronic rights management information removal/alteration, etc.

10. OTHER BARRIERS

Moscow City Stamp Tax – Until January 2001, Moscow City Government required that all video and audiocassettes, optical discs and computerized information carriers have a "protective identification mark" (i.e., a stamp tax). The stamps bore no relation to the copyright ownership, yet purported to legalize video product in the market. Protests against this tax resulted in another

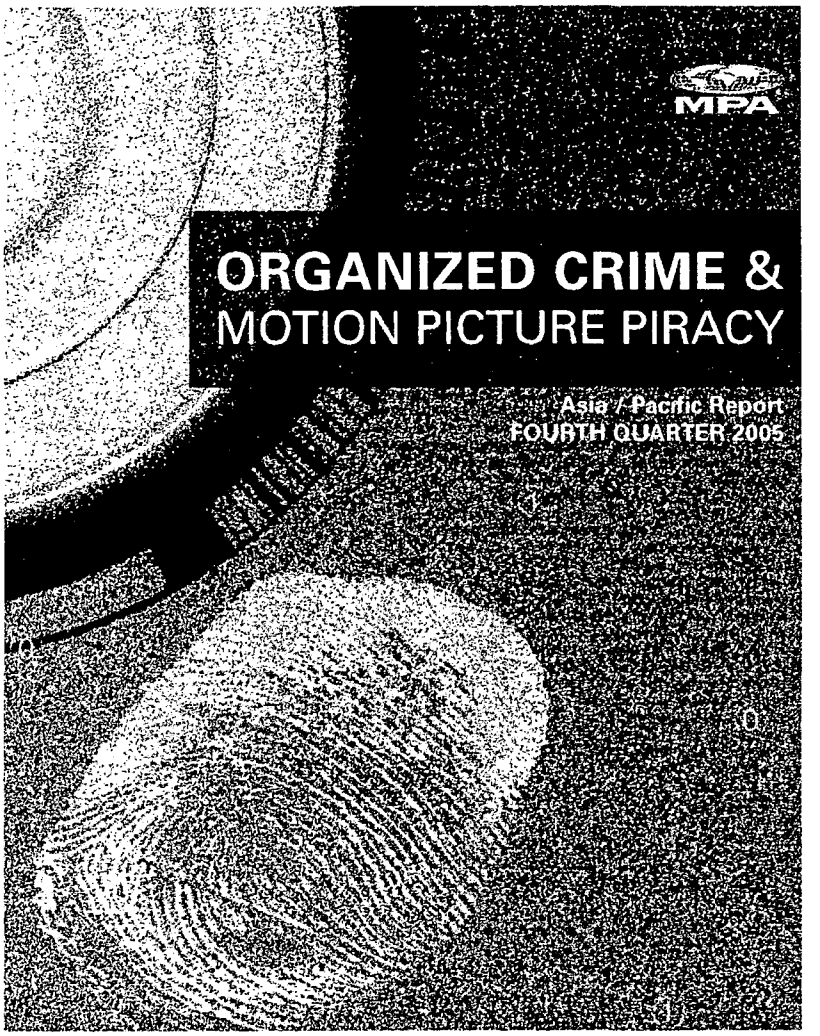
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ordinance, which abolished the stamps but created a registration stamp/mark in its place. While the former Ministry of Press examines the idea of a Federal stamp, the Moscow City government reintroduced the city identification stamp, effective January 1, 2004. While no longer a binding obligation, this can constitute an additional burden for legitimate companies, without providing sufficient off-setting benefits, for piracy or otherwise.

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Motion Picture Association – 2006 Trade Barriers Report

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