



October 14, 2005

BY E-MAIL: FR0526@ustr.eop.gov

Ms. Sybia Harrison
Special Assistant to the Section 301 Committee
GSP Subcommittee
Office of the U.S. Trade Representative
1724 F Street, N.W. Room F220
Washington, D.C. 20508

Re: Identification of Countries Under Section 182 of the
Trade Act of 1974; Request for Public Comment,
70 Fed. Reg. 54,436 (2005).

Dear Ms. Harrison:

The International Intellectual Property Alliance (IIPA) submits these written comments pertaining to: (1) the Special 301 Out-of-Cycle Review of Ukraine and (2) Ukraine's eligibility for Generalized System of Preferences (GSP) benefits.

IIPA Recommendation

IIPA recommends that the U.S. government should: (1) retain Ukraine's status as a Priority Foreign Country (PFC); and (2) continue to deny Ukraine's eligibility for GSP benefits. We make these recommendations due to the serious remaining deficiencies in Ukraine's enforcement regime for the protection of intellectual property rights (IPR).

In 2005 Ukraine did adopt significant new optical disc laws to improve its enforcement legal regime. This was a major accomplishment by the government of Ukraine and IIPA applauds the addition of this important tool in the enforcement regime. As a result of Ukraine's adoption of these critical legislative improvements, IIPA fully supported the U.S. government's decision, announced on August 31, 2005, to terminate the 100% *ad valorem* duties that were in place since January 2002 on Ukrainian exports.

However, the adoption of this key legislative reform was simply one step, albeit a crucial one, as a part of Ukraine's implementation of the Joint Action Plan of 2000, agreed upon by the governments of Ukraine and the United States. The more important and difficult steps of actually implementing effective enforcement remain unfulfilled.

To summarize Ukraine's current IPR regime: it has adopted many of the laws and regulations necessary to conduct effective IPR enforcement, but it has not yet effectively utilized

those laws and regulations to root out persistent piracy problems. In short, it has failed to meet its 2000 obligations made to the U.S. government to improve IPR protection and enforcement.¹ Only when the Joint Action Plan is fully implemented should Ukraine's identification as a PFC end, and GSP benefits be restored.

History of IIPA GSP Petition

As a result of Ukraine's serious piracy problem, the IIPA filed a petition on June 16, 1999 to request the withdrawal or suspension of Ukraine's GSP benefits. That petition was accepted by the U.S. government on February 14, 2000; in support of that petition IIPA testified at a public hearing on May 12, 2000. The U.S. government suspended Ukraine's GSP benefits on August 24, 2001. On August 8, 2005, consistent with U.S. trade law, the IIPA requested that the suspension remain in place (i.e., that the automatic 4-year sunset provisions not take effect) in a letter to Mr. William Burris, Chairman, Section 301 Committee.

Today, we request, for the reasons detailed in this filing, that the U.S. government continue to deny GSP benefits to Ukraine. Our comments illustrate the myriad ways in which Ukraine is not yet fully implementing the Joint Action Plan; we also make recommendations to additionally improve the IPR enforcement regime in Ukraine.

Joint Action Plan Has Not Been Fully Implemented

The Joint Action Plan was announced in a joint statement issued by then-President Clinton and then-President Kuchma in June of 2000. It was meant to address the poor enforcement of copyright law in Ukraine and in particular to focus on the rampant problems of the illegal production and distribution of optical disc materials (whether consisting of music CDs, DVDs, VCDs, and/or CD-ROMs containing business and entertainment software and literary materials).

The Joint Action Plan consisted of three parts, which the government of Ukraine pledged to undertake: (1) to close the illegal optical disc plants, to seize illegal material, and only to reopen the plants when there was a legal licensing scheme in place; (2) to adopt proper optical media production and distribution regulations, including identification (SID) coding and the monitoring of raw material and manufacturing equipment, as well as of exports of product; and (3) to improve significantly the copyright law and to introduce other legal reforms, including criminal and administrative penalties, necessary to implement a modern copyright regime.

The adoption by Ukraine of new laws and regulations, no matter how good these laws may be in theory, without enforcing them properly and fully means that Ukraine is not meeting its obligations to implement the Joint Action Plan. In sum, the government of Ukraine must take the necessary and promised steps to eradicate the production and export of pirate optical media product. It has been over five years since Ukraine pledged to do so.

¹ For more details about the problems facing the copyright industries in Ukraine, we attach our Special 301 filing submitted to the Office of the U.S. Trade Representative on February 11, 2005 (which was before the adoption of the optical disc law). For more information about the methodology used by our member associations to estimate trade losses due to piracy, and piracy levels in Ukraine, see <http://www.iipa.com/pdf/2005spec301methodology.pdf>.

As noted, the government of Ukraine deserves significant praise for the adoption, on July 26, 2005, of the much-needed legislative improvements to the optical media laws. But these laws must be enforced with vigor and consistency, and other critical steps contained in the Joint Action Plan must be fully implemented if the problem of piracy is to be effectively addressed.

Steps Necessary to Implement the Joint Action Plan

In our opinion the following steps are necessary to fully implement the Joint Action Plan:

First, the government of Ukraine must act – by proactively using the optical disc law and its implementing regulations - to stop the pirate production and distribution of optical media discs. To fully implement the Joint Action Plan, the government of Ukraine must close optical disc plants that have been found to be involved in illegal production (in breach of the licensing rules and/or the copyright law), seize and destroy illegal material, as well as the equipment used in the course of illegal production. In addition, it must bring criminal cases and convictions against plant operators and others involved in commercial piracy.

At present, there are two optical media disc plants in Ukraine in operation that were the subject of detailed complaints from the recording industry (IFPI). However, the relevant authorities in Ukraine, including the State Department for Intellectual Property (SDIP) and its State Inspectors have failed to take meaningful and decisive action on the basis of these complaints. Despite the fact that the complaints indicated large-scale illegal production, none of the plants or their owners/managers has faced criminal investigation, let alone prosecution. One of the complaints dates from 2004. The government of Ukraine could have taken action against these plants under the old optical disc regime but it failed to act under that law, and has not made any progress since the adoption of the new law either. Passage of the new optical media disc law is not a substitute for enforcement. The government of Ukraine must act, including the undertaking of surprise inspections of plants. This is the only means of effective plant production enforcement.

Second, retail piracy in markets and in the streets (especially at big outdoor markets, such as the Petrovka market in Kiev, as well as at street stalls and kiosks) has unfortunately not seen any significant decrease. The government of Ukraine did a good job of reducing such piracy, temporarily, for the May 21, 2005 Eurovision event in Kiev – so we know that this type of activity can be undertaken if it is made a priority of the government. The government of Ukraine has demonstrated that it can effectively prevent retail piracy when the political will and resources are allocated to this problem. However, the open availability of pirated materials has once again reached previous levels as Ukrainian law enforcement has failed to clamp down on street and market piracy on an on-going basis.

Third, the Ukrainian Ministry of Science and Education should issue written and irrevocable instructions to the licensing body to automatically suspend an operating license and seal the relevant production facilities if and when it is presented with forensic evidence of breach by a given optical disc plant of the licensing rules (including copyright infringement). We recommend that this suspension should endure for at least the duration of an in-depth

investigation into infringing behavior, and the possible subsequent criminal or administrative investigation, even if this evidence is presented by a private sector representative organization.

Fourth, we recommend that the government of Ukraine should appoint the Ministry of the Interior as the body responsible to carry out forensic expertise in cases of copyright crime.²

Fifth, the government of Ukraine should provide the specialized intellectual property rights unit within the customs service with the mandate, and operational competence, as well as sufficient resources to act (*ex officio*) against intellectual property rights crimes. This step is necessary for effective enforcement at the border. In sum, the government of Ukraine must move away from creating yet another bureaucratic entity and instead devote more resources and show more willingness to effectively enforce intellectual property rights crimes at the border.

Sixth, the government of Ukraine should take affirmative steps to stop on-line piracy. Websites offering pirate material continue to thrive in Ukraine, with the support of local Internet service providers.

This list of deficiencies and recommendations is not exhaustive. A review of the attached IIPA Special 301 filing (February 2005) will provide a more in-depth analysis of the problems facing U.S. copyright owners in Ukraine.

In sum, as a result of the government of Ukraine's failure to live up to its agreement to implement the Joint Action Plan and its refusal to thus far provide copyright owners with adequate legal enforcement, IIPA requests that the U.S. government should continue to deny GSP benefits to Ukraine, and continue to identify Ukraine as a Priority Foreign Country (PFC).

The IIPA believes that the retention of both of these sanctioning measures are necessary to encourage the government of Ukraine to fully implement the obligations it promised it would undertake over five years ago. We firmly believe that, when fully implemented, the adoption of an effective copyright enforcement regime in Ukraine will benefit not only U.S. copyright owners, but also the government and people of Ukraine, by encouraging foreign investment and growth within the Ukrainian copyright industry.

Sincerely,



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

Attachment

² One positive step worth noting was the government's establishment of a specialized unit for intellectual property rights crime within the Economic Crime Division under the Ministry of the Interior. This unit has the exclusive competency to deal with intellectual property rights crime. In addition, the General Prosecutor reconstituted economic crime status to criminal violations of authors' and neighboring rights.

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE 2005 SPECIAL 301 REPORT [FILED FEB. 11, 2005] UKRAINE

EXECUTIVE SUMMARY³

Special 301 Recommendation: IIPA recommends that Ukraine remain a Special 301 Priority Foreign Country, and, as a consequence, that the current trade sanctions and suspension of Ukraine's duty-free trade benefits under the Generalized System of Preferences ("GSP") continue in force, until Ukraine fulfills its obligations under the Joint Action Plan signed by then-President Clinton and then-President Kuchma in 2000. In the past two years, implementation of the Joint Action Plan has been ignored by the Ukraine government, rather than treated as a priority. Instead the Ukraine government has sought to end the U.S. sanctions and GSP suspension through diplomatic means while it has failed to adopt the promised legislative reforms that are needed to end optical disc piracy in Ukraine and permit the development of a healthy legitimate industry. Ukraine must amend the Optical Disc Law of 2002 to correct and fully implement the optical media regulatory scheme set out in the Joint Action Plan in order to terminate the PFC designation and the trade sanctions (and to restore GSP benefits). The required actions include adoption of the necessary criminal enforcement tools as well. The situation in Ukraine the past two years has been static—with numerous failed attempts to remedy the shortcomings of the 2002 law. Ukraine is neither in compliance with the 2000 Bilateral Agreement, nor the 1992 Bilateral NTR Trade Agreement with the United States (which Ukraine agreed to implement by December 31, 1993). In addition, Ukraine's overall legal system for the protection of copyright and the related enforcement regime falls short of compliance with the TRIPS obligations of the World Trade Organization. Until its legal regime is remedied and Ukraine is fully compliant with TRIPS, Ukraine should be prevented from accession to the WTO.

Ukraine has recently undergone a dramatic regime change. The copyright industries are encouraged by the perceived willingness of the new President of Ukraine to develop a more open trading policy with its main Western trading partners, to implement measures to rid the country of corruption, and to eliminate other obstacles that have discouraged foreign investment and economic development. The coming year will show whether the new regime is capable of dealing with the challenge posed by well-organized and well-connected pirated criminal syndicates that control the illegal production and distribution of copyrighted materials.

Overview of Key Problems: The three highest IP priorities that the Ukraine government must address are: (1) the inadequate regulation and ineffective enforcement of optical media production and distribution facilities, that, for example, permit optical disc plants to continue operating despite strong evidence of on-going large-scale piracy; (2) the complete absence of criminal prosecutions and deterrent sentencing coupled with ineffective border

³ For more details on Ukraine's Special 301 history, see IIPA's "History" appendix to this filing at <http://www.iipa.com/pdf/2005SPEC301HISTORICALSUMMARY.pdf>. Please also see previous years' reports at <http://www.iipa.com/countryreports.html>.

enforcement, especially against large-scale pirate operations (involving music, film, and/or entertainment software); and (3) a legal regime in need of critical reforms.

Actions that Need to be Taken by the Government of Ukraine

In order to reinstate GSP benefits and to end the trade sanctions, the Ukrainian government must, after years of delay, take the following six steps:

- Amend the existing optical media law in several key areas, including licensing the production of matrices, clearly imposing an obligation to engrave all manufacturing equipment with a source identification code (“SID Code”), including equipment used for the production of blank (recordable) optical media and abolishing the SID Code requirement for imported optical discs;
- Fully implement a comprehensive optical media; enforcement scheme by regularly carrying out effective (surprise) CD plant inspections by properly empowered inspectors, verifying SID codes that have been issued and including SID codes/inspections on all equipment used to make optical media, and imposing criminal sanctions against violators;
- Enact and enforce effective border measures to stop the export and import of illegal material;
- Commence raids and follow up with criminal prosecutions against pirates engaged in commercial distribution (for example, against organized crime syndicates involved in entertainment software distribution), as well as using administrative procedures against store and other smaller-scale pirates, and refraining from returning previously seized pirated goods to the market;
- Undertake a review of the hologram system and its administration/enforcement to stop the widespread practice of issuing holograms to bad-acting companies using fraudulent license agreements; and
- Introduce the necessary legal reforms in the criminal code and administrative code (to impose criminal liability for licensing violations), and in the civil procedure code to facilitate better enforcement.

COPYRIGHT ENFORCEMENT

Amendments necessary to 2002 Optical Media Law to properly regulate the production and distribution of optical discs

In 2000, Ukraine took several important steps to try to remedy its position as one of the world’s largest producers and distributors of illegal optical disc media (CDs containing musical works, audiovisual VCDs, and CD-ROMs containing entertainment and business software). The then-existing optical disc problem was not adequately addressed by the 2000 legislation, nor by the flawed Optical Media Law introduced in 2002. More recently, the problem has been further complicated: CD-R production by plants and pirates has become a coordinated effort where the plants sell discs (often with pre-printed artwork) to pirates who subsequently illegally burn the music onto discs for public sale. This is a growing problem in Ukraine.

In addition to CD-R production, piracy by organized criminal syndicates continues to flourish because of Ukraine’s weak criminal enforcement regime. The legal reforms adopted in 2000 and 2002 have fallen short of the comprehensive steps necessary for effective

enforcement, and do not meet the commitments the Ukraine government made to the U.S. government. It was unfortunate that the Verkhovna Rada rejected the government of Ukraine's proposal for proper optical disc regulation and instead adopted a flawed law in 2002 which ultimately resulted in the imposition of U.S. trade sanctions and suspension of GSP benefits. It is further disappointing that the Rada has, since 2002, failed to rectify the problem.

The Ukraine government needs to take the six steps outlined above in order to end the sanctions and restore GSP in compliance with the 2000 Action Plan. For three years, the IIPA and its members have spelled out the details of what this compliance looks like in numerous filings. IIPA and the U.S. government have watched in frustration as myriad attempts to remedy the flawed enforcement provisions have either been stalled or defeated (with the support of the pirates) in the legislature.⁴

As late as last month, on January 13, 2005, yet another bill (Bill # 5520) to remedy the flawed system was rejected by the Rada. In several previous attempts at passage, the pirates have added provisions to the so-called "remedy" legislation that would make the existing legal regime even weaker. As one example, in May 2004, a proposal was circulated that would have fined the rightholders who requested a plant search if such a search revealed no infringing materials. This is preposterous. Ukraine agreed to adopt a comprehensive plant inspection and plant licensing regime to stop piracy, not a system that penalizes the very rightholders who are losing millions as the result of piracy. On the other hand, an appropriately crafted legislative fix (Bill #3676) did not even make it past the first reading in the Rada when it was considered, and rejected, on February 17, 2004. Another version (Bill #5182) that would also have met Ukraine's obligations was also rejected in 2004.

It is also true, however, that over the past three years optical disc production has slowed in Ukraine. In 2003, a fourth plant (formerly Lazer-Inform, now Replitec) came on line. In February 2005, the copyright industries were made aware of a fifth plant in Ukraine, Odyssey Disc, capable of producing CDs and DVDs. There is the ongoing possibility that others will follow now that the pirates understand that the government is not serious about regulating and effectively controlling their practices. That is why adoption of the necessary amendments is critical.

At present, the deficient laws have meant that: (1) there is no reliable mechanism for adequate surprise inspections of the plants (thus, pirates are often tipped off and are able to dispose of contraband in advance of an inspection); (2) mastering codes have been issued to plants that have no mastering facilities, thus allowing facilities to produce masters and engraving codes without any oversight by the copyright owners; and (3) key enforcement tools (the use of production samples) that could aid in the detective work for uncovering illegal activity have been held back by the agency responsible for optical media licensing, the State Department for Intellectual Property (SDIP). Rightholders' organizations should get access to production samples of optical discs via SDIP so that they can properly conduct anti-piracy investigations. To date, SDIP has failed to cooperate, which has further frustrated anti-piracy activity.

Although overall optical disc production has declined somewhat, Ukraine, with the continuing involvement of organized crime groups, remains a major transshipment point (by

⁴ For a full history of the imposition of trade sanctions and the withdrawal of GSP benefits imposed against Ukraine by the U.S. government, see <http://www.iipa.com/rbc/2003/2003SPEC301UKRAINE.pdf> at page 12, i.e., IIPA's Ukraine filing.

trucks, railroads and boats), and a storage facility, for illegal discs produced in Russia and elsewhere because of very poor border enforcement. Pirate CDs and DVDs dominate the market in Ukraine and are sold in markets, kiosks and street stalls; one example is the Petrovka market in Kiev, which has close to 300 stalls openly selling pirate material.

In 2004, four plants remained in operation in Ukraine, albeit at less capacity than at their peak five years ago. Even the government acknowledges that illegal production continues. The slowdown in overall production by the pirates is understandable. It took almost two years of debate for the Ukraine Parliament to adopt the flawed Optical Disc Licensing Bill #8278-1, which entered into force on April 22, 2002. In addition to the law, an Implementing Decree was signed on January 30, 2002 and it set in motion a series of (13) regulatory laws that were necessary to put the law into force. Many of these implementing regulations were put into place; however, many key regulations have not. Further, the government of Ukraine has not effectively inspected, licensed and/or sanctioned the few plants that are in operation. For example, the ineffective inspection of the Rostok (Kiev) plant in mid-2004 revealed only that the plant operators anticipated a search, and the search did not produce the type of professional samples and evidence necessary to properly conduct an investigation into the alleged illegal activities of that plant. The government of Ukraine needs to do a better job both on the ground and legislatively.

The 2002 law is flawed and its deficiencies cannot be undone by regulation alone. IIPA was encouraged in 2001 and 2002 by the fact that the SDIP and the Ministry of Economy were willing to work with industry representatives to draft the necessary amendments, but such progress has stalled for almost two years. The government of Ukraine must now work to see that these amendments are adopted and then that the entire optical media scheme is implemented effectively.

A properly implemented plan to regulate the production, distribution and export of optical media would include provisions to close plants that are caught illegally producing copyrighted material; to immediately seize infringing product and machinery used for its production (including spare parts and certain pieces of equipment) as well as equipment lacking the appropriate SID code; to introduce criminal liability and deterrent punishments for the individuals infringing these regulations; and to monitor the importation of raw materials (optical-grade polycarbonate) used in the production of CDs, DVDs and CD-ROMs (and other optical disc media). All of the plants would be required to adopt source identification (SID) codes on all molds and mastering equipment to deter plants from infringing production of optical discs.

There are numerous significant shortcomings pertaining to these plants under the current licensing scheme. First, Ukrainian authorities—despite the provisions that require the issuance of SID codes only after a CD plant has provided the necessary information on its equipment—issued codes to two of the plants without having a comprehensive submission concerning the equipment held. Second, the Ukrainian authorities have not confirmed the application of codes on the relevant equipment. In contrast, in 2003, the Noiprox plant (in L'viv) invited IFPI representatives to the plant to inspect the application of the code on their equipment.

An example of the failed system has been the regulation of the Rostok (Kiev) plant. After producing CD-Rs without SID codes for more than a year, the plant operators decided to produce blank CD-Rs with a SID code. But there are no legal obligations to monitor molds (a major shortcoming of the licensing law). As a result, the copyright industries suspected Rostok of using a coded mold for a single production run, and any number of other molds for undeclared production of CD-Rs—all as a result of other regulatory shortcomings including the

lack of checks on polycarbonate imports/use and production records. Such CD-Rs would then subsequently enter the pirate market with copyrighted music and other works recorded on these discs for sale in the Ukraine market. In addition, without a comprehensive set of samples from the Ukrainian plants' lines and molds there can be no effective evidence of wrongdoing. In July 2004 a search was undertaken of the Rostok plant by the Ukraine government. However, it was so poorly executed that it yielded no results. First, the inspection was not a surprise inspection, contrary to the government's claims; second, it was only carried out by inspectors from the SDIP, with no law enforcement agency present during the inspection; third, it did not yield any evidence of plant operations that could be used in a professional investigation; finally, as a result of the failed inspection, the plant was able to continue its operations.

SDIP, despite having access to a wealth of detailed and well-documented evidence of large-scale pirate production at this plant, simply concluded that no illegal activity had taken place. This demonstrates once more that (under the former regime in Ukraine) the relevant state bodies were not given a clear political message from the highest levels, that strong and truly effective measures needed to be undertaken to definitively root out pirate production. It is hoped that the new government will make IPR enforcement a priority, and take plant inspections and licensing much more seriously.

In 2003, the motion picture industry reported that Rostok had added a DVD line to its operations, although there was no clear evidence it was then or is now replicating pirate product. The July 2004 inspection of the plant proved inconclusive because SDIP concluded that the DVD line was "disabled." But as further evidence of the failed licensing system, SDIP was not aware, until told by private industry, of the DVD equipment in the plant, even though, under the optical disc licensing law, it should have been notified of the existence and operation of such a line. There is evidence now that another DVD line is in operation at the same plant—but by an operating company that "leases" space from the Rostok plant—further obfuscating the lines of ownership and responsibility for optical disc operations. In short, SDIP failed in its investigation of this matter, both before and after the July 2004 inspection. This example illustrates both the flawed licensing scheme and the failure of on-the-ground optical disc regulations in practice.

The key remaining optical disc plant enforcement problems

- The licensing authorities are not conducting effective plant inspections, let alone surprise inspections—the only means of effective plant production enforcement;
- The plants in operation were issued SID codes without proper verification at the time of issuance. No comprehensive and in-depth follow-up inspections have taken place since in order to verify the maintenance of these codes on all equipment and molds (and mirror blocks);
- The equipment used at the plants in operation has not been monitored to make certain that source identification (SID) codes are in fact properly engraved on all molds, matrices and all relevant equipment used in the production of optical discs;
- A database needs to be established by the enforcement authorities (likely SDIP) to establish a complete and detailed inventory of the equipment used in the production of optical discs at the licensed plants.

It is estimated by the recording industry (the International Federation of the Phonographic Industry, IFPI) that the current total production capacity of optical media material is around 50 million units per year. The demand for legitimate CDs in Ukraine is still less than 10 million units. Most seriously, the current inability to properly regulate the existing five plants

means that production of even more unauthorized material is highly likely at any time, as evidenced by the addition of new lines at existing plants (e.g., Rostok) without proper licenses. Because the plants are not properly regulated, existing plants can ramp up their illegal operations to former levels and new plants can come on line.

In the past two years, because of the failure of legal authorities to control and, where necessary, prevent the import or export of equipment suspected of having been used in illegal production, two of the Ukraine plants that suspended their operations were able to move their production lines to Belarus, Russia, and Bulgaria, and then move back into Ukraine. The plants that moved out of the country simply recommenced pirate production, utilizing their traditional distribution routes and channels in Ukraine. One of the lines that moved to Bulgaria returned to Ukraine in 2003; IFPI alerted the authorities of its return at the time without enforcement action (to date). The movement of these plant lines out of and then back into Ukraine was facilitated by the very weak border enforcement system in place, along with the SDIP's failure to properly regulate optical disc equipment—and it illustrates the overall failure of the optical disc plant licensing law and its enforcement. In addition, Ukrainian nationals suspected of being part of organized crime syndicates have been arrested recently in Portugal and Thailand.

A fifth plant in Ukraine was recently disclosed (February 2005) when the plant, Odyssey Disc, made an application to Philips Electronics BV for a source identification (SID) code (Philips is responsible for allocation of SID codes). The plant is capable of producing both CDs and DVDs, and has a total annual capacity of at least 7.5 million discs. The SDIP seems to be completely unaware of the existence of this new plant and has not been able to provide any information on its operations. This is yet another example of SDIP's inability to reliably monitor, let alone regulate, optical disc production in Ukraine.

In short, the government of Ukraine has failed to use its existing criminal enforcement tools against illegal producers and distributors of optical media material. Much more work is needed. The government needs to re-appoint the Economic Crime Division within the Ministry of the Interior as the prime unit responsible for fighting IPR crimes. It must speed up and simplify the prosecution of IPR crimes, especially against organized syndicates. And it must instruct the courts to hand down deterrent penalties for IPR crimes.

Another misstep that has undercut effective enforcement was the adoption of the controversial Hologram Sticker law in 2000. The inconsistent and haphazard implementation of the Ukrainian hologram system (administered by the government) is seriously harming the interests of legitimate record companies while it permits suspect companies to receive thousands of holograms for foreign repertoire for which they have no licenses despite objections from the legitimate licensees. These holograms are ultimately found in the market on pirate products. The copyright industries are trying to compete against the pirates, even pricing their products lower (\$5 to \$7 per CD, for example; DVDs are \$20 compared to the pirate price of \$4) and printing materials in Cyrillic for local distribution. However, legitimate rightholders cannot compete against the pirates without effective enforcement by the Ukraine government to stop piracy, and to stop the misuse of the hologram system.

Entertainment software companies are also experiencing problems with the hologram stickering program. One member company of the Entertainment Software Association (ESA) only recently entered the market; yet, it found that over 70 labels/stickers had already been issued for its entertainment software products—all to pirates selling illegal versions of their games. In addition, the pirates appear to have convinced the government that labels or stickers should be issued on a "genre" basis, rather than just on a single title basis. This "genre" rather

than per title labeling means that a slew of entertainment software gets the labels all at once, rather than having to meet the more rigorous application (and proof) requirements for a label for each particular title. With the widespread use of false documents to obtain "genre" stickers, pirates are not only obtaining these stickers, but are getting a toehold in the unauthorized distribution network within Ukraine and in neighboring countries.

In January 2003 the Ukrainian Ministry of Education and Science passed an "order" requiring the State Department of Intellectual Property (SDIP) to organize a voluntary registry for software manufacturers and distributors in Ukraine. This registry, in place as of March 2003, was intended to contain the names of software manufacturers/distributors, data about their registration, location, and contact details as well as information about management, type of business activity and a short description of all software products manufactured/distributed. According to the government, as of early 2004, 109 companies that produce and distribute software had used the registry. Under the order, all software manufacturers/distributors can obtain a certificate to verify their registration. For a fee, SDIP will provide users with information from this registry about a particular software manufacturer/distributor.

The registry was intended to improve a level of copyright protection for computer programs and databases, as well as to provide information to the public regarding software manufacturers, distributors and licensing information. However, the Business Software Alliance (BSA) reports that the registry, to date, has not fulfilled its intended function to distinguish legal software manufacturers/distributors from illegal ones.

The full details of the six basic features of an effective optical media regulatory scheme, many of which are missing from the 2002 law, can be found in the 2003 Ukraine report available on the IIPA website at <http://www.iipa.com/rbc/2003/2003SPEC301UKRAINE.pdf> at page 5.

A summary of the deficiencies of the 2002 Optical Disc (OD) Law

- It does not properly regulate all of the equipment used in the production of (illegal) discs. In particular it essentially does not cover the molds (and their components), or matrices used in the manufacturing process;
- It keeps some of the important records and licensing information out of reach of investigators seeking information on possible illegal activity;
- It leaves loopholes in the requirement that Ukrainian plants comply with international identification practices, namely SID coding, in all production facilities and on all equipment including all molds (and mirror blocks), leaving room for manipulation of the use of the international unique identifiers;
- It does not require plant operators to keep sample copies of the discs (all of this evidentiary and coding information is essential to identify the source of the illegal material);
- It does not effectively regulate the issuance, denial, suspension, or revocation of a license for plants producing or distributing discs—the law allows convicted plant operators to be reissued a license, and delays the suspension of licenses even in cases of clear violations;
- It does not permit effective or proper inspections of the plants—for example, surprise inspections are permitted only after compliance with cumbersome and time-consuming procedures that eviscerate their effectiveness;
- It also does not allow for either the effective securing of evidence or the seizure of equipment and discs during plant visits;

- It contains loopholes for import and export of some of the tools (matrices and manufacturing equipment) essential to produce discs;
- It sets the liability for violators at a level that is too limited—with low minimum penalties;
- There are no effective provisions for the confiscation or destruction of discs, material or equipment (beyond Article 9.4 of the Optical Disc Law);
- It has weak administrative and criminal penalties (a high threshold bars the use of the criminal penalties in many cases).

Lack of effective criminal and border enforcement, and other enforcement deficiencies

In addition to the optical media law, two additional key enforcement tools are needed: (1) enforcement efforts targeted at the criminal syndicates (and administrative remedies directed against smaller scale activities); and (2) strong border enforcement measures to stop the export and transshipment of illegal optical media.

In 2004, there were encouraging signs of increased and geographically wider police activity, both in Kiev and elsewhere, against the retail sale and distribution of pirate products. However, significant improvement will only occur when the number of effective police action undertaken against large-scale commercial piracy grows. There remain serious concerns over the very few deterrent prosecutions or sentences by the courts, which are often burdened by long delays. Also, there are still too few administrative actions against stores, kiosks and other street piracy. Virtually all of the reports of activity in 2004 were directed against sellers and small-scale distributors, with the criminal gangs involved in organized large-scale piracy remaining unscathed. Thus, the most critical criminal enforcement step is for Ukraine to use its criminal code to crack down on these organized crime syndicates who distribute material in and out of Ukraine. Over the past few years there have been some successful raids and seizures (detailed in previous IIPA filings), but few, if any, resulted in successful deterrent criminal prosecutions. In fact, as a result of the too-high threshold for criminal prosecution (i.e., material damage amounting to at least UAH 26,200/US\$4,931), most cases result in administrative actions. IPR-related offenses are hampered by procedural problems such as the use of expert evidence, and instead need to have clear sets of rules guiding procedure. In addition, there are overall problems with police competence pertaining to IPR criminal investigations.

Provisions do exist in the Ukrainian criminal code (e.g., Article 28) to prosecute organized groups or criminal organizations, including those engaged in IPR offenses, but to date they have not been used for this purpose. The entertainment software industry notes that Russian organized criminal syndicates control distribution of pirated video game products in the country through their local affiliates and are not being prosecuted under the criminal laws. In fact, pirated entertainment software products bear the “marks” of the criminal syndicate producing and distributing particular pirated product. The business software industry (BSA) reports that the criminal code is (albeit rarely) being applied to smaller groups of collaborating pirates, such as two individuals selling illegal software in a store. But overall, the criminal laws are not being more broadly applied to large-scale organizations as is necessary to stem the levels of piracy.

The copyright industries did report one large-scale seizure operation, in May 2004, involving raids by the police, customs, tax authorities and the Security Service across Ukraine. The raids netted over 580,000 discs of music and audiovisual material (including 60,000 DVDs). The operation included a raid on an underground warehouse (a former bomb shelter) in

Lugansk which netted 100,000 discs and thousands of forged hologram stickers; it also uncovered gang activity involved in the production of over 400,000 hologram stickers (using forged licensing documents).

Ukraine has also failed to properly police its borders, which has resulted in wide-scale shipment from and transshipment of these materials through Ukraine, to other countries in Eastern and Central Europe. The soon-to-be created common trade regime among Russia, Ukraine, and Belarus will only exacerbate the border enforcement problems, putting additional pressure on neighboring countries such as Slovakia, Hungary and Romania. There have been some minor seizures by customs authorities of CDs and other materials over the past few years, but cooperation has been spotty and the activity has not been nearly enough to stem the flow. In fact the government of Ukraine, in its semi-annual enforcement report (July 2004) was only able to identify a single criminal case of two individuals (Russian nationals) arrested at the border, in this instance, in the Kharkiv region in April 2004, with 793 CDs seized.

Comparisons of seizures by Polish and Czech customs officials against those by Ukraine officials bear out the paucity of seizures by Ukraine border enforcers. Customs authorities have not commenced or undertaken criminal investigations of pirating operations against organized crime syndicates. In November 2004, the Ukrainian Customs Agency signed a Memorandum of Understanding of cooperation with IFPI and the Motion Picture Association (MPA) in Kiev. Since then, IFPI and MPA report that Ukrainian customs officials have demonstrated better cooperation for enforcement of IPR crimes at the border. However, the copyright industries generally report an absence of political willpower necessary to improve border enforcement to the extent needed to have a real impact on cross-border trade in pirated goods.

The Ukraine government must devote more resources and show more willingness to enforce IPR crimes at the border. Customs officials were granted *ex officio* authority to properly conduct enforcement investigations (in amendments to the Customs Code effective January 1, 2004). With this *ex officio* authority customs officials can seize illegal material at the border without a court order. The police and other enforcement officials also reportedly have equivalent *ex officio* authority, but in practice they still depend on rightholder complaints to commence investigations—this needs to be corrected. Without proper implementation of this clear authority on the part of police and border officials, and without proper confiscation of pirate materials (which IIPA understands can only constitutionally be undertaken by the courts), the problems will continue to worsen. Waiting for the rightholders to file complaints in each instance given the widespread scope of the illegal activity is a recipe for failure. Also, a statutory deficiency still exists because the Customs Code narrowed sanctions to only those activities meeting a “commercial purpose” threshold, which hampers effective enforcement (especially against the widespread cross-border suitcase trade in pirated goods).

There is an additional matter hampering effective enforcement. Almost five years ago, the Ukraine Copyright Agency (SCAU) was closed and then reorganized into a much weaker structure. The government of Ukraine never clarified the authority and role of the Ukraine Copyright Agency vis-à-vis other government agencies, including its role, if any, in verifying the legality of the issuance of certificates for import, export, and the wholesale and retail trade of copyright material. This needs to be corrected. The lack of coordination for enforcement is a long-standing problem. The government needs to re-appoint the Economic Crime Division within the Ministry of the Interior as the prime unit responsible for fighting IPR crimes and otherwise provide clear government strategies and lines of authority.

In addition to enforcement against hard copy piracy, Ukraine enforcement officials must also begin actions against on-line piracy. It is estimated that there are over 400 ISPs in Ukraine and that over 150 of these support sites offering pirate DVDs (for on average US\$10).

In 2004, the recording industry continued to suffer from large-scale pirate optical disc production and distribution, with estimated piracy levels at around 65% for international repertoire, and losses estimated at \$115 million (including losses from exports of pirate product made in Ukraine), slightly down from 2003 figures.

Pirate films are sold in kiosks, and retail stores sell pirate DVDs including pre-release (in Ukraine) materials, available within days of the U.S. theatrical release. In 2004, estimated losses for the motion picture industry were \$45 million, with piracy levels remaining at 90%.

Pirated entertainment software products continue to be exported from and through Ukraine (from Russia). ESA member companies report that optical discs containing pirated entertainment software are now being produced in Ukraine for sale both locally and for export. Several thousand pirated video game products, sourced from the Ukraine, have been seized in foreign countries (including Israel and Lithuania); sales of this material have also been confirmed in the United States. Many are shipped with fake documentation claiming that the shipper has the appropriate licenses for the products shipped. Forensics identification information indicates that these pirate entertainment software discs are being made in well-known factories in Ukraine.

BSA reports (and appreciates the) good cooperation with the State Department of Intellectual Property (SDIP) in improving IPR awareness (helping legitimate sales), and reducing software piracy rates. SDIP has coordinated special IPR events including press briefings, practical training programs for law enforcement and other government officials, and projects regarding needed legislative amendments.

During the first half of 2004, Ukraine law enforcement officials reported that officers had inspected shops, businesses and warehouses and provided anecdotal evidence of effective enforcement. For example, the Ministry of Internal Affairs reported that it had commenced 103 copyright criminal investigations and 313 cases of administrative violations in the first half of 2004. In total, it reported seizing 167,000 audiovisual works and phonograms (no breakout was provided of videos, DVDs and CDs per se). Other regional police representatives reported on additional investigations, such as a raid in Crimea that netted 8000 pirate DVDs and the commencement of a criminal investigation; another in Donets'k netted 41,000 CDs and the initiation of a criminal investigation. In sum, the government reported that in 2003 a total of 33 individuals were convicted of IPR crimes (including trademarks and copyrights) compared with 11 in 2002. However, the report did not detail the nature or severity (suspended sentences or served) of the criminal cases. Separately, the Tax Police reported in July 2004 at a press conference that in the previous year, they had destroyed 140,000 to 150,000 pirate CDs. Over 150,000 pirate discs were publicly destroyed in Kiev in July 2004 (these were the discs seized by the Tax Police over the preceding 18 months), and another 30,000 discs were destroyed in October 2004. No year-end totals were available as of the time of this filing for the total number of inspections, raids and seizures by police and customs officials.

The copyright industries reported the following enforcement statistics in Ukraine. In 2004, the industries reported that the total number of opened IPR criminal cases was 455; in 2003, there were 374 such cases. Of these 311 (of 455) were Article 176 copyright and neighboring rights cases in 2004; in 2003, the figures were 297 (of 374). Approximately 60%

were music and audiovisual cases and 31% were software cases. The total amount of material seized in 2004 was 600,000 copies, compared with only 300,000 in 2003. The total amount of material destroyed was 70,000 units in 2004; in 2003, it was 80,000. The Tax Police reportedly seized (in all formats) 340,000 copies and destroyed 150,000 discs; in 2003, the figures were 200,000 seized, 5,000 destroyed. Customs authorities seized 100,000 copies in 2004; in 2003, they seized 34,411 copies. Last, administrative actions by state inspectors (there are 16 in all of Ukraine) resulted in the seizure and destruction of 270,000 analog (VHS) and digital copies; in 2003 the figure was 50,000 copies seized and 25,000 destroyed. There were 390 administrative cases in 2004; in 2003 there were 110 cases. The state inspectors opened 58 cases in 2004 compared with 40 in 2003. Last, during 2004, SDIP issued close to 22 million hologram stickers for optical discs for music and video (43 million total), compared with 8 million in 2003.

LEGAL REFORMS

A history of the key legal reforms made by Ukraine in the past few years is available on the IIPA website at <http://www.iipa.com/rbc/2003/2003SPEC301UKRAINE.pdf> at page 13, including Copyright Law and Criminal Code reforms, as well as accession to the Geneva Phonograms Convention and the WCT/WPPT.

The law of May 2003 introduced broad changes to numerous laws relating to the protection of intellectual property; it amended Article 176 of the Criminal Code pertaining to violations of the rights of authors and neighboring rights, adding new sanctions for IPR violations. The 2003 amendments maintained existing practices regarding the confiscation of infringing (including imported) material; and no amendments were made to the administrative offenses code.

Even with these improvements, Ukraine is not in compliance with WTO TRIPS obligations; the draft package of legislative proposals under discussion in Ukraine in 2002 would not have corrected this shortcoming. The key missing pieces needed for effective enforcement (and TRIPS compliance) are: (1) amendments to the criminal procedure code; (2) amendments to the customs code (the customs code revision, effective January 1, 2004, did not repeal the restrictive “commercial purpose” threshold nor the onerous registration and fee requirements for IP-related materials; and (3) the addition of key administrative remedies. The law of May 2003 included in the Civil Procedure and Commercial Procedure Codes *ex parte* search provisions necessary for effective end-user (software) piracy actions. In June 2004, the Highest Commercial Court of Ukraine adopted recommendations to implement these procedures. However, practical difficulties remain, most critically, the inability of the authorized enforcement agency (the state executive service) to actually undertake *ex parte* searches.

Copyright Law

The Copyright Law of 2001 fixed a major deficiency of the old law, namely, the protection for pre-existing works and sound recordings. Several problematic provisions in the 2001 law were never corrected, such as Article 43.3; this provision permits the over-regulation and consolidation of power into government collecting rights societies. The Ukrainian Cabinet of Ministers has, under this provision, adopted fixed tariffs for the broadcasting of sound recordings, which totally undermines the right of phonogram producers to freely negotiate their fees with users. Article 43.3 of the Copyright Act should be deleted and the tariff decision by the Council of Ministers should be withdrawn. Collective management should be a private, not a government, enterprise; legal entities and foreign rightholders should be permitted to be

members on their own in Ukrainian collecting rights societies. In addition, as noted below, Ukraine must further revise the Copyright Law to fully comply with the digital treaties in order to properly protect the production and dissemination of materials on digital networks.

Other Legal Reform Issues

Criminal code and criminal procedure code reforms: The criminal code was completely reformed in September 2001, and further revised in May 2003. As revised, Article 176 provides sanctions including fines ranging from 200 to 1000 minimum tax-free incomes, approximately US\$640 to US\$3,200, (up from 100 to 400 times), or correctional labor for a term of up to two years, or imprisonment for a term of up to two years with confiscation of infringing material. The threshold for criminal liability is met when material damage caused by an infringement equals or exceeds 200 minimum tax-free incomes (i.e., “substantial material damage”). The sanctions foresee an increase for repeated offenders and cases where the material damage equals or exceeds 1,000 minimum tax-free incomes (i.e., “very substantial material damage”), such as for officials abusing their “official positions.” In those cases fines can reach up to 1,000 to 2,000 times the minimum tax-free incomes (previously it was 500 to 1,000 times), which is the equivalent of US\$3,200 to \$6,400; the term of imprisonment ranges from two up to five years. A new system for the calculation of minimum tax-free incomes entered into force in January 2004, applicable to the Article 176 provisions—the 2005 minimum monthly wage is UAH 262 (US\$49.31) for purposes of the threshold calculation (for purposes of actual fines, the minimum tax-free income of UAH 17 [US\$3.20] still applies). The criminal code provisions sanction both copyright and neighboring rights violations.

In general, the criminal penalties can only be imposed for “substantial material damage” which creates a threshold that is too high to commence a criminal copyright piracy case. Before January 2004 the threshold was UAH 3,400 (US\$639). But the thresholds are rising as follows: in January 2004 the threshold rose to UAH 12,300 (US\$2,314); starting November 2004, the threshold was UAH 14,220 UAH (US\$2,676) and on January 2005, it rose again to not less than UAH 26,200 UAH (US\$4,931). Next year, it will rise to UAH 45,120 UAH (approximately, US\$8,492). If the value of seized illegal product is below the threshold there will be no criminal responsibility, only administrative fines (usually very minor).

Obviously, there has been a substantial increase in the threshold for activities to qualify as a crime which is a problem for two reasons: (1) the level is too high (and getting higher); and (2) it is impossible to prove with the certainty necessary for criminal proceedings. Activities that fall below the threshold can be sanctioned by the much weaker administrative offenses code; while far short of deterrent sanctions, if properly implemented and prosecuted, those penalties can provide some relief for certain low-level offenses.

The criminal code needs to be amended to provide a lower and clearer threshold to instigate a criminal action. IIPA recommends a threshold no higher than the equivalent of 50 times the minimum daily wage or some other low and clear threshold. Not only would this help to identify criminal infringing acts for prosecutors, but it would also provide critical guidance for the police when they are conducting initial raids and need to assess, in a particular situation, whether a case should be brought under the criminal code or the administrative code. Another missing element in the criminal code (or copyright law) is a provision that makes the possession for commercial purpose of illegal copies of works or sound recordings a criminal offense; the government of Ukraine should introduce and push for the passage of such a provision. Even more troubling than the statutory shortcomings is that now, three years after enactment of the criminal code amendments, deterrent criminal sanctions are very rare. In 2004, the one industry

that did have success was the BSA which received eight criminal judgments in software piracy cases, all resulting in fines of between US\$500 and US\$1,600; these included five cases against end-users, one hard-disc loading case, and two CD-R cases.

The criminal procedure must also be fixed in law and practice so that police can act *ex officio* to initiate criminal intellectual property cases. Ukrainian criminal procedures in practice (although not required by the code) currently require rightholders to file complaints to initiate actions. This acts as a bottleneck to successful enforcement. The procedure code should be changed so that police initiate intellectual property criminal cases and investigations for submission to the court; it must also be clear that the police (as they sometimes do in software cases) have the authority to hold confiscated products and equipment for use at trial.

WIPO Digital Treaties: In 2001, Ukraine acceded to the two digital treaties—the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonogram Treaty (WPPT). The Copyright Law of 2001 included amendments intended to implement these treaties. Unfortunately, the amendments fell short of complete and effective implementation, especially with regard to technological protection measures (requiring proof of “intentional” circumvention, which could prove a major impediment to protection). Ukraine needs to fully implement the treaties with amendments to its copyright law.

Administrative remedies: As part of the Joint Action Plan in 2000, Ukraine agreed to adopt and implement appropriate administrative remedies to deter piracy as well to enact criminal penalties. Ukraine authorities need to more effectively use administrative remedies to remove the business licenses of infringing retail stores, kiosks, and other smaller scale pirates. Administrative remedies must be properly implemented alongside available and properly implemented criminal penalties at levels sufficient to deter piracy for effective copyright protection and to comply with WTO TRIPS obligations.

Customs Code reforms: The Customs Code of Ukraine (Law No. 92-IV, “On Amending the Customs Code of Ukraine”) entered into force on January 1, 2004. It provides clear *ex officio* authority to customs officials to seize suspected illegal material at the border, thus closing a major legal loophole in the enforcement regime of Ukraine. Unfortunately, the new Customs Code narrowed the sanctions (permissible under the old code) to those meeting a “commercial purpose” threshold; this limits the effectiveness of the new code. In addition, the registration requirements and fees (which we understand were not repealed by the new law) must be abolished; these provisions act as a bar to effective border enforcement action by causing a confusing maze of unnecessary regulation. Now that *ex officio* authority is in place, Ukraine customs authorities must use it because customs enforcement has been uniformly weak.

Civil Code should not weaken copyright law: A new civil code came into force on January 1, 2004. Chapter IV of the Civil Code (Intellectual Property Rights) contains 90 articles in total, 15 in the section on copyright, and 8 pertaining to neighboring rights. Most of the copyright and neighboring rights provisions duplicate provisions in the Copyright Law of 2001, setting up the possibility of confusion, especially for judges who need to provide effective IPR enforcement. IIPA had urged that civil code reform exclude anything but passing reference to copyright and neighboring rights because of fears that duplicate provisions would jeopardize effective application of the copyright law (and breach the bilateral trade agreement). Experts in Ukraine report that the 2004 civil code provisions, since they duplicate the copyright law ones and do not contradict them, will not weaken implementation or enforcement of the copyright law. IIPA will continue to monitor the progress of copyright law implementation and enforcement and

any redundancy in the laws. IIPA urges the enforcement agencies and the judiciary in Ukraine to rely on the copyright law, not the Civil Code Chapter IV, for effective enforcement.

Government software asset management: In September 2003, the Cabinet of Ministers of the Ukrainian government passed a regulation establishing procedures for the use of software in government agencies. It provides (among other things) for government institutions to use properly licensed and legally held software, and prohibits public servants from installing, using, or copying software without prior consultation with a responsible system administrator. In March 2004, the government issued a new regulation to implement legalization. It assigned all procurement authority for software products to a single entity, SDIP, in order to try to eliminate the use of pirated software products in the public sector. In addition to the software legalization program, the government created separate budgets for legalization funds in the state budget for various government agencies; this plan was approved by the Ukrainian Parliament. Separately, the BSA reported similar developments in the commercial sector. For example, the Association of Ukrainian Banks created a special program for software legalization to reduce the level of unlicensed software use within the financial sector.