

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE

2005 SPECIAL 301 REPORT

PARAGUAY

EXECUTIVE SUMMARY

Special 301 Recommendation: IIPA commends Paraguay for having adopted a new and meaningful approach to the protection of intellectual property, and expresses its admiration for the initiatives undertaken by the Duarte-Frutos Administration. While much remains to be done, we are hopeful that these initiatives will bear fruit. We recommend that USTR not place Paraguay on any list, and that it continue its monitoring under Section 306 of the U.S. Trade Act of 1974.

Overview of Key Achievements/Problems: Both the Paraguayan and the U.S. governments have invested years of effort to improve the Paraguayan system. In December 2003, Paraguay entered into another Memorandum of Understanding on Intellectual Property Rights with the U.S. Officials in the new Paraguayan administration have exhibited a great interest in tackling copyright piracy in-country and at its borders. IPR issues were also discussed by the U.S. and Paraguayan officials during regular JCTI (Joint Council on Trade and Investment) meetings. Draft laws have been submitted which would increase the penalties for violations of intellectual property rights. The Specialized Technical Unit, created by decree in 2003, along with conducting raids and seizures, has established a Statistics Center to collect data on IPR cases, and should now be operational.

There have been significant positive developments in 2004, including:

- Seizure of over 11 million blank CD-Rs and 1,600 burners;
- Detention of eight suspected pirates;
- Indictment of three people for organized crime violations;
- Indictment of 22 people for tax evasion in connection with piracy;
- Indictment of 28 people for forging import documents related to the importation of raw materials for piracy;
- Cancellation of 73 import licenses from companies found to have engaged in forgery and/or in predicate offenses related to piracy;
- Increase in the minimum declared price of CD-Rs from \$.15 to \$.18, and the adoption of a minimum declared price for DVD-Rs of \$.60;
- Limited entry of blank media to seven customs ports;
- Maintained and monitored CD-R register to establish better controls on the importation of raw materials;
- Appointment of a person to run, and fully operationalize, the special IP task force known as the UTE; and
- Sentencing of six people to prison for between 100 and 500 days, and three people for between six and seven years.

In all, the Government of Paraguay has demonstrated a real resolve to try to address a problem that has for too long hindered the country's economic development, and we recognize that effort today.

Having said that, and despite the renewed energy by the Paraguayan government to combat piracy, the piracy situation in Paraguay remains relatively dire. Enforcement efforts taken by Paraguayan authorities, while well intended, continue to be largely ineffective in deterring widespread piracy there. One of the key items contributing to the lack of deterrence is weak criminal penalties for IPR that deter judicial authorities from issuing sentences that require effective jail time. One notable exception was the recent conviction of three major pirates for IPR violations. One received a seven and half year sentence, while the other two received six year sentences. Despite this laudable action, organized crime elements remain intimately involved in the production and distribution of pirated products and/or raw materials for the manufacture of pirated products, thus making enforcement even more difficult. There are still too few criminal investigations, raids, and prosecutions against copyright pirates. We believe part of this enforcement deficiency will be ameliorated by the recent grant of \$320,000 by the U.S. State Department to Paraguay for IPR enforcement purposes. Unfortunately, the copyright law and criminal code work to frustrate the application of deterrent sentences because they treat intellectual property violations as minor offenses. The borders remain porous, despite cooperative efforts between industry and border officials to halt suspect shipments and review false documents. Amendments to the criminal code to increase penalties are urgently needed.

Priority Issues in 2005

- Enactment of legislation to amend the criminal code to increase penalties for copyright infringement (designating IPR violations as major crimes), establishment of *ex officio* actions, and the criminalization of the circumvention of technological protection measures;
- Improving border enforcement, including the interception and seizure of piratical goods and contraband PC hardware, as well as the inspection of blank optical disc media;
- Imposition of deterrent remedies against pirates, including criminal penalties;
- Controlling the points of entry for the importation of CD-Rs into Paraguay;
- Auditing of large-scale importers of blank CD-Rs who are suspected suppliers of pirate organizations for possible tax evasion. Pursue audits of customers to those importers, particularly if the importer failed its tax audit;
- Improving training for prosecutors and judges, with the objective result being that the Paraguayan system provides deterrence to copyright piracy; and
- Adoption of legislation to establish administrative procedures to fight piracy, including: creating rules for “fast-track” administrative actions; imposing administrative penalties; and coordinating with other authorities.

PARAGUAY
Estimated Trade Losses Due to Copyright Piracy
(in millions of U.S. dollars)
and Levels of Piracy: 2000-2004¹

INDUSTRY	2004		2003		2002		2001		2000	
	Loss	Level								
Records & Music²	127.8	99%	154.6	99%	204.4	99%	253.6	99%	200.0	90%
Motion Pictures	2.0	95%	2.0	80%	2.0	80%	2.0	80%	2.0	80%
Business Software³	6.0	83%	5.0	83%	2.2	71%	3.5	72%	8.5	76%
Entertainment Software⁴	NA	NA	NA	NA	NA	NA	NA	NA	9.7	99%
Books	2.0	NA	2.0	NA	2.0	NA	3.0	NA	3.0	NA
TOTALS	137.8		163.6		210.6		262.1		223.2	

New Memorandum of Understanding on IPR

On December 19, 2003, the Paraguayan Ministry of Foreign Relations and the U.S. Embassy in Paraguay announced the conclusion of the first meeting of the Joint Council on Trade and Investment (JCTI) and the completion of a new Memorandum of Understanding on Intellectual Property Rights (IPR MOU). The text of the IPR MOU was made publicly available in April of 2004.⁵ The new agreement contains seven articles and an annex setting out the Government of Paraguay's Action Plan for IPR improvement. The MOU includes elements on legislative, administrative, and enforcement issues designed to strengthen the government's ability to effectively fight copyright piracy and trademark counterfeiting, and to improve its overall intellectual property system.

Specifically, the MOU requires Paraguay to implement TRIPS compliant legislation by "develop[ing] and implement[ing] effective enforcement mechanisms and practices to significantly reduce the levels of copyright piracy and trademark counterfeiting in its territory, including through the imposition of deterrent penalties." One element of this is to increase criminal sanctions for those convicted of copyright and trademark violations. Additionally, the MOU requires Paraguay to improve transparency and reporting with respect to the enforcement of intellectual property rights, and to work with the U.S. government to jointly "develop and implement a program of mandatory professional training for all Paraguayan officials who have a role in the development and maintenance of an effective intellectual property system." The

¹ The methodology used by IIPA member associations to calculate these estimated piracy levels and losses is described in IIPA's 2005 Special 301 submission at www.iipa.com/pdf/2005spec301methodology.pdf.

² RIAA reports that its estimated piracy losses include both domestic piracy in Paraguay and estimated losses caused by transshipment. The decrease in 2003 and 2004 estimates are due to lower average prices of recorded music and currency devaluation.

³ BSA's final 2003 figures represent the U.S. software publisher's share of software piracy losses in Paraguay, as compiled in October 2004 (based on a BSA/IDC July 2004 worldwide study, found at <http://www.bsa.org/globalstudy/>). In prior years, the "global" figures did not include certain computer applications such as operating systems, or consumer applications such as PC gaming, personal finance, and reference software. These software applications are now included in the estimated 2003 losses resulting in a significantly higher loss estimate (\$9 million) than was reported in prior years. The preliminary 2003 losses which had appeared in previously released IIPA charts were based on the older methodology, which is why they differ from the 2003 numbers in this report.

⁴ ESA's reported dollar figures reflect the value of pirate product present in the marketplace as distinguished from definitive industry "losses." The methodology used by the ESA is further described in Appendix B of this report.

⁵ The full text of Paraguay's 2003 IPR MOU is available on the U.S. Department of Commerce's website at <http://www.tcc.mac.doc.gov/cgi-bin/doi.cgi?204:64:1:185>.

MOU also requires regular review of Paraguay's progress throughout the term of the agreement, which is set to terminate on December 31, 2005.

COPYRIGHT PIRACY

Optical Media Piracy: Transshipment and CD-Rs

In 2004, Paraguay continued to serve as a favorite destination for much of the pirated optical media product being produced in Southeast Asia (e.g., Malaysia, Macau, Hong Kong, Singapore, and Taiwan). As a result of this sourcing problem, Paraguay continued its significant regional role as a transshipper of pirate product to its neighbors.

Blank CD-Rs and CD-R burning: Pirates in Paraguay have continued to shift their products from pre-recorded optical disc product to importing blank recordable CDs (CD-Rs) into Paraguay. In 2004, approximately 240 million units were imported versus 119 million units in 2003, compared with approximately 100 million units in 2002 and 104 million in 2001.

These statistics represent a significant increase from the 34 million units imported in 2000. Paraguay does not have the legitimate markets to absorb these immense amounts of product. In addition to their clandestine industrial CD production capacity, the pirates of Ciudad del Este shifted their replication methods. Now, hundreds of labs using CD burners have replaced the previous underground illegal CD plants. Nonetheless, it is obvious that those burning facilities are supplied by pirate kingpins who coordinate their work and provide the small labs with blank CD-Rs. These "sprayed" plants serve Paraguayan, Argentine, Uruguayan and (mostly) Brazilian illegal CD-R duplicators.

Organized Crime Elements Still Control Piracy in Paraguay

Organized criminal groups remain involved in the production and distribution of pirated and counterfeit product, and/or in the importation and distribution of raw materials. Organized crime elements from Taiwan, the Far East and the Middle East control much of the distribution in Ciudad del Este and in other cities. Paraguay continues to be a transshipment point for areas throughout Latin America, for the large amounts of surplus optical media product manufactured in Southeast Asia. Organized groups from Korea, Lebanon, Libya, Brazil, Bolivia and Argentina are involved. Of course, Paraguayan groups also take part in these illegal activities. The influence of organized crime is pervasive.

Domestic Piracy Remains Widespread in Paraguay

The entertainment software industry reports that Paraguay continues to be a hub for the assembly, sale, import and export of pirated entertainment software in all formats. Both CD-based piracy of videogames (which includes console CDs for PlayStation®) and cartridge-based piracy remain major problems. Counterfeit videogame components (such as semi-conductor chips and packaging) and cartridges are imported from the People's Republic of China, Taiwan, Hong Kong, for assembly in Paraguay, and then exported to other countries in the region. In 2004, the police conducted twelve raids at warehouses and retail stores, and seized a total of 240,000 pirated videogame cartridges. The customs authorities, in early 2004, seized three 40-

foot containers, originating from China, which contained 92,500 infringing products, among them multi-game cartridges and Super Nintendo controllers. The containers were bound for Ciudad del Este.⁶

The business software industry reports that Ciudad del Este continues to be a major source of piracy for business software, primarily for distribution to other Latin American markets such as Brazil and Argentina. Severe problems with end-user piracy in businesses inflict the most economic harm on the potential growth of a legitimate software base in Paraguay. Furthermore, the software industry is concerned about the increasing illegal importation of computer hardware parts and components, which are then assembled into computers and frequently loaded by system builders and assemblers with illegal software. Much of this contraband hardware arrives in Paraguay, and then enters Brazil, Argentina and Uruguay. Stronger border measures and much better border enforcement are necessary to combat this practice.

The motion picture and recording industries report that their primary concern is Paraguay's position as a transshipment and organization hub for optical disc piracy. Ciudad del Este is the central distribution point for an increasing amount of blank optical discs (CD-R and DVD-R) and locally reproduced CD-R and DVD-R. This product is primarily exported to Brazil, Chile and Argentina. Annual losses to the U.S. motion picture industry due to audiovisual piracy in Paraguay are estimated at \$2 million in 2004 (this figure is for in-country market losses only; the damage inflicted on neighboring countries is not calculated). The recording industry reports losses of \$127.8 million based almost exclusively on the sale of pirate product with a nexus to Paraguay but intended for consumption outside the country.

AAP reports increasing amounts of photocopied materials being used in place of legitimate books in institutions of higher learning. Suspicions regarding presence in the market of pirated versions of trade books and English language teaching materials continue as well. Estimated trade losses due to book piracy remained at \$2.0 million for 2004.

COPYRIGHT ENFORCEMENT IN PARAGUAY

Despite longstanding enforcement challenges in Paraguay, new initiatives are underway to strengthen the fight against copyright piracy. In 2004, the U.S. State Department announced an allocation of \$320,000 to Paraguay to be used for "training and technical assistance" in support of Paraguayan IPR enforcement units.⁷ This represents a significant contribution to enforcement in Paraguay and is part of the Department of State's broader, \$2.5 million initiative to fight piracy through international training programs. The MOIC has named a person to take charge of the UTE and should be taking more aggressive actions soon.

Paraguayan border measures should be strengthened: Not surprisingly, many piracy problems in Paraguay are centered in the border cities. While the Paraguayan Government has improved its efforts, much remains to be done, and the government needs to further its customs

⁶ In addition to pirated cartridge-based video games, the sale of "PolyStation" controllers is also of concern to Nintendo of America (NOA). These PolyStation controllers come with pre-loaded or built-in Nintendo video game software—none of which are licensed by Nintendo. In December 2004, highly publicized raids were conducted against several warehouses which resulted in the seizure of almost 20,000 PolyStation units.

⁷ See U.S. Department of State, Press Release, Intellectual Property Training Programs Funded (Aug. 10, 2004), available at <http://www.state.gov/r/pa/prs/ps/2004/35078.htm>. See also U.S. Department of State, Fact Sheet, Intellectual Property Training Programs (Oct. 6, 2004), available at <http://www.state.gov/g/inl/rls/fs/36830.htm>.

procedures to combat cross-border piracy and corruption of its agents. The border with Brazil is completely open today and *sacoleiros*, individuals who come to buy counterfeit products to later sell in Brazil, are flooding Ciudad del Este.

Customs operations and industry coordination with the Ministry of Industry and Commerce (MIC) have greatly improved during 2004. In September 2003, the recording industry reached an agreement with customs and the MIC which provides that no blank CD-R shipment will be released until these groups verify that the submitted invoices and documents are valid and accurate. As a result of this new system, over 11 million blank CD-Rs with false or questionable invoices have been seized from January 2004 to December of 2004. In addition, 53 criminal complaints were filed and 73 import licenses were revoked for false statements and documentation.

The legitimate recording industry in Paraguay (represented by APDIF Paraguay) continues to be very active in conducting investigations and filing cases mainly against pirates operating in Ciudad del Este and Encarnación. However, since the business model for pirates has changed from large-scale operations to loosely knit, small-scale groups, the tasks of identifying and immobilizing these organizations has become more difficult. The more sophisticated criminals involved in music piracy groups have adopted the “cell” structure of operations. The recording industry has continued to provide information for prosecutors to conduct raids. In 2004, the recording industry conducted 141 raids, which resulted in the seizure of over 725,000 units of infringing products (mostly music CDs) and the closure of 26 manufacturing facilities, most of them small to mid-sized CD-R replication facilities, and 41 storage facilities of different sizes. Two major organized crime cases with international nexuses are currently under investigation. Shipments of contraband blank CD-Rs amounting to 11.2 million units, allegedly destined for the pirate market, were seized by Paraguayan authorities based on information provided by APDIF Paraguay.

As for business software enforcement, during 2004, BSA conducted five civil end-user actions, as opposed to four in 2003. In addition, in 2004, BSA assisted the Prosecutor’s Office in 26 criminal raids against software resellers in Ciudad del Este and Asunción compared to six criminal raids in 2003. Agents of the Revenue Service participated in these raids. Despite evidence of tax evasion, the Paraguayan authorities have refused to criminally charge the defendants with any tax related offenses. In some of these cases, minor administrative fines were imposed.

The need for effective prosecution and deterrent sentencing: There are six specialized IPR prosecutors (each unit usually consisting of one prosecutor and two assistants) in Paraguay, three in Asunción and three in Ciudad del Este. The prosecutors now have, at least temporarily, the ability to pursue copyright infringement cases as “public” actions, thanks to Law No. 1.444, which entered into effect on July 9, 1999. At present, only one of these prosecutors is assigned full time to IPR cases.

Even in this area, there has been some progress. In early 2004, three major IPR pirates were sentenced to lengthy jail terms involving the fraudulent import of over U.S. \$10 million in contraband, counterfeit goods, and blank optical media. The leader of the group engaged in these illegal acts received seven and a half years imprisonment, while his two accomplices each received a six year prison sentence. In addition, in late 2004 another international ring was dismantled after the seizure of 3.2 million blank CD-Rs and DVDs were discovered as “computer parts” during inspection by MIC and APDIF personnel. Follow-up investigation determined that the ring would “clone” containers prior to their arrival at the designated customs

inspection point. Two Chinese nationals were indicted, one is under arrest, and the other is a fugitive. Three Paraguayans were also arrested and the investigation is ongoing.

The recording industry reports that in 2004, Paraguayan courts issued 36 criminal judgments against pirates of sound recordings. Sentences included imprisonment of up to two and a half years, but 16 were suspended, 20 became fines and the rest were granted probation. The recording industry initiated 30 judicial actions in 2003.

BSA reports that in 2004, no convictions against resellers of illegal software were issued. In addition, during 2003, the Criminal Court of Appeals of Paraguay (*Tribunal del Crimen Cuarta Sala*) issued a decision substantially reducing the amount of the fines that two defendants were ordered to pay in a prior conviction.

Civil end-user actions and civil *ex parte* searches: In 2004, BSA conducted five civil copyright infringement actions (compared to four inspections conducted in 2003). Two of the cases conducted in 2004 are currently pending. One of the main problems that BSA faces with civil enforcement is the sometimes unreasonable delay of some courts in granting *ex parte* search orders. In many cases, it can take a minimum of 45 days to obtain a civil warrant search. It takes an average of three years to reach a decision from a district court and an additional year if the case is appealed.

COPYRIGHT LAW IN PARAGUAY

Copyright Law of 1998

The new copyright law entered into effect on October 21, 1998 (Law No. 1.328/98). The 1998 law represented a much-needed improvement over the old 1951 copyright law. After some delay, implementing regulations for this law were signed by the President on September 13, 1999 (Decree No. 5.159). IIPA has summarized deficiencies in the 1998 Copyright Law in prior Special 301 filings.⁸ Paraguay already has deposited its instruments of ratification to both the WIPO treaties—the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty. In order to achieve the kind of comprehensive implementation desired by the copyright industries, further refinements to Paraguayan laws will be necessary.

Need to amend the Copyright Act: To mitigate the obstacles above, and in order to bring Paraguay into compliance with its MOU requirements, the copyright industries have been working on a bill which calls for the following reforms:

- Increase criminal penalties for intellectual property rights violations to between two years and eight years (ten years in some enumerated cases). Fines would be added to prison terms;

⁸ Problems in the 1998 copyright law include: a term of two to three years' imprisonment (with levels of fines remaining unchanged), which were shorter than prior drafts; failure to make copyright infringement a "public action," in which police and prosecutors can take action on their own initiative (this problem was temporarily corrected by legislation in mid-1999); the hierarchy of authors over neighboring rights remains in the law, contrary to international norms (including the WIPO treaties); the TRIPS element on the machine-readability of databases is missing from the law; a Berne/TRIPS-incompatible provision permitting third parties to edit or translate works 20 years after the author's death remains; terms of protection for various works vary throughout the law—industry had argued for longer terms for certain products; the administrative authority for the National Copyright Office to carry out surprise inspections and seizures was removed.

- Specifically make these criminal provisions “public” offenses;
- Include knowingly supplying raw materials to pirate organizations as a punishable criminal offense;
- Provide penalties for violations of technical protection measures and rights management information;
- Ratify *ex officio* action for prosecution of intellectual property rights violations.

We encourage the Paraguayan government to support these amendments to create the necessary legal framework to fight piracy effectively.

Criminal Code and Administrative Remedies

Paraguay reformed its criminal code in October 1998. This reform, however, has caused more problems, for several reasons (all of which IIPA has identified in previous 301 submissions). First, Article 184 of the Criminal Code identifies cases involving acts infringing the author’s right. But it does not contain any provisions regarding the infringement of neighboring rights, the rights which protect producers of sound recordings. The criminal code therefore does not protect against acts of piracy involving sound recordings. This new law in fact abrogated the penalties provided under an 1985 law (Law No. 1.174), which established relatively strong criminal prohibitions for piracy of sound recordings, and also clearly provided that the state could proceed *ex officio* against infringers. The recording industry continues to bring cases based on the copyright law, but all the general provisions regarding penalties follow the criminal code. As a result, few people go to jail, greatly undermining the deterrent effect of otherwise well intentioned law enforcement efforts. The recording industry has been forced to bring cases for different violations (such as contraband, tax evasion, etc.) rather than violation of copyright.

Second, the criminal code provides a penalty of up to three years or a fine. Unfortunately, this allows judges to impose either a fine or a prison sentence. This kind of choice will likely limit the deterrent effect of the law because convicted defendants could buy out, or convert, their jail time into fines. The current penalty of six months to three years for IPR violations prevents any effective deterrent sentences. IIPA and its members suggest increasing these penalties in order to elevate them to major crimes.

Third, in June 1999, the President signed into law an amendment to the criminal code which made copyright crimes “public” actions, and therefore prosecutors can pursue these cases on their own initiative. This law (Law No. 1.444 of June 10, 1999) was signed on June 25, and entered into effect on July 9, 1999. This bill deleted language in the Criminal Procedures Act of 1998, which required that private parties had to initiate and bring prosecutions. Unfortunately, according to an interpretation issued by the Paraguayan office in charge of judicial training, this law was scheduled to sunset in July 2003. Despite this interpretation, prosecutors continue to bring public actions in copyright infringement cases. To IIPA’s knowledge, to date no judicial decision has contested this interpretation of the law.

In 2004, MPA proposed establishing administrative procedures designed to help effectively fight piracy. Among other things, this included creating rules for fast-track administrative actions, imposing administrative penalties, and coordinating with other authorities on anti-piracy matters. The proposal was presented to the Director of the Intellectual Property Office of the Ministry of Industry, who is preparing a similar bill to present in Congress.