

INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE

2003 SPECIAL 301 REPORT

UKRAINE

EXECUTIVE SUMMARY¹

Special 301 Recommendation: IIPA recommends that Ukraine remain a Priority Foreign Country (PFC) and that trade sanctions continue accordingly in 2003. IIPA also recommends that the United States government should continue the suspension of Ukraine's duty-free trade benefits under the Generalized System of Preferences ("GSP"); those benefits were suspended in August 2001 for Ukraine's IPR shortcomings. We make these recommendations because Ukraine's copyright piracy problem remains very serious almost three years after agreeing to a Joint Action Plan signed by then-President Clinton and President Kuchma that Ukraine has neither effectively nor completely implemented. By its failure to fully implement an optical media regulatory scheme and by its overall criminal enforcement failures, Ukraine is not in compliance with the June 2000 bilateral agreement or the 1992 Bilateral NTR Trade Agreement with the United States (which Ukraine agreed to implement by December 31, 1993). Also, Ukraine's overall copyright law and enforcement regime falls far short of compliance with the TRIPS obligations of the World Trade Organization; Ukraine should be prevented from accession to the WTO until it is in complete compliance.

Overview of key problems: The three problems of the highest priority in Ukraine are: (1) inadequate regulation and enforcement of optical media production and distribution facilities; (2) the complete absence of criminal prosecutions and border enforcement, especially against large-scale pirate operations (involving music, film, and/or entertainment software); and (3) a legal regime in need of critical reforms in other areas.

Actions to be taken by the government of Ukraine: The most urgent problem that the Ukrainian government must address is to complete its promised enforcement of optical media production and distribution. The steps that need to be taken by the government of Ukraine are:

- Amending the existing optical media law in several key areas, including licensing matrices, and fixing the CD source identification (SID) code importation problem;
- Fully implementing a comprehensive optical media enforcement scheme by commencing effective 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;
- Enacting and enforcing effective border measures to stop the export and import of illegal material;
- Commencing raids and following 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;

¹ For more details on Ukraine's Special 301 history, see IIPA's "History" appendix to this filing.

- Refraining from returning previously seized pirated goods to the market; and
- Making the necessary legal reforms in the administrative code and the civil procedure code to facilitate better enforcement.

COPYRIGHT PIRACY AND ENFORCEMENT IN UKRAINE

Optical Media Production and Distribution Must be Fully and Completely Regulated

Five years ago Ukraine became a major worldwide source of the production, distribution and export of illegal optical disc media (CDs containing musical works, audiovisual VCDs, and CD-ROMs containing entertainment and business software). Organized criminal syndicates were able to start up their operations in the absence of any optical media regulations and criminal enforcement. After significant worldwide pressure to act, Ukraine took some important steps to correct this problem including the adoption of new laws and regulations. However, the complete and comprehensive steps have yet to be undertaken.

The biggest reason for the failure is that the Verkhovna Rada did not follow the government of Ukraine's proposal for an optical disc regulation and instead adopted a flawed law. Even so, in 2002, optical disc production slowed in Ukraine; more precisely, it "stalled" while the pirates tried to decide whether the government was serious about regulating their practices or not. That is why adoption of the necessary amendments (detailed below) in 2003 is critical. Although optical disc production slowed in 2002, Ukraine remained a major transshipment point (by trucks, railroads and boats), and a storage facility, for illegal discs produced in Russia and Belarus because of very poor border enforcement. Pirate material from these countries continues to flood the Ukraine market.

The stall in production by the pirates is understandable. It took almost two years of debate for the Ukraine Parliament to adopt the Optical Disc Licensing Bill #8278-1 on January 17, 2002 in response to the Joint Action Plan. The law was signed by President Kuchma on February 7, 2002 and entered into force on April 7, 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 but not all of these implementing regulations were put into place in 2002.

Unfortunately, as the IIPA and its members noted all throughout this two-year saga, the January 2002 optical disc law, the decree, and the implementing regulations contained a number of key deficiencies that, taken together, failed to properly address the production and distribution (including import/export) of optical media. Ukraine must now adopt amendments to the 2002 law, and implement more effective regulations to properly and comprehensively address this problem. In the meantime, three plants remain in operation, albeit at limited capacity (and with even a government acknowledgement of some illegal production still).

IIPA is encouraged that the State Department for Intellectual Property ("SDIP") and the Ministry of Economy have been willing to work with industry representatives to draft the necessary amendments, but further progress stalled in 2002. 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.

The Joint Action Plan signed by President Clinton and President Kuchma in June 2000, with an agreed implementation date of November 2000, was intended to properly and completely address this problem by taking the steps necessary to regulate optical disc plants, and by improving border enforcement to contain the problem within the borders of Ukraine. Proper optical media regulation in Ukraine would consist of: (1) instituting plant licensing, SID code and optical media regulations and penalties for noncompliance that include the closing of offending plants; and (2) appointment of the proper agencies and officials, with the authority to undertake this enforcement effort and responsibility for putting these regulations in place.

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 seize infringing product and machinery; to introduce criminal liability for the individuals infringing these regulations at a deterrent level; 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.

As noted, current plant production has slowed from its peak of two years ago. There are now three known licensed functioning (or able to function) optical disc plants in Ukraine, down from five plants at the height of the problem. A fourth plant recently returned under a new commercial identity to its former location in Kiev (from exile in Bulgaria). Ukrainian authorities have told industry representatives that this plant has not yet indicated its intention to resume activity. The three licensed CD plants (capable of producing music, video and software) that are SID coded are: (1) "Noiprox" (in L'viv), which obtained its code directly from Philips International B.V.; (2) "Amirtron" (in Kherson); and (3) "Rostok" (in Kiev). The last two plants agreed to use identification coding on the mastering materials and molds used to make CDs (in agreements with the Ukraine State Department for Intellectual Property, SDIP).

There are four 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. One of the plants involved has since persistently refused to provide the authorities with (or any industry visits to review) the required description of its equipment. Second, the Ukrainian authorities have not confirmed the application of codes on the relevant equipment. In contrast, the Noiprox plant (in L'viv) invited IFPI representatives to the plant to inspect the application of the code on their equipment. Third, Rostok (in Kiev) produces blank CD-Rs without using a SID code. These CD-Rs subsequently enter the pirate market because copyrighted music and other works are recorded on these discs for sale in the Ukraine market. Fourth, it will be hard to authoritatively prove illegal activity without a comprehensive set of samples from each of the Ukrainian plants' lines and molds (because the plants prohibit visits).

One of the plants operating in Kiev has at least one line that is producing (audiovisual) DVDs, although there is no clear evidence it is replicating pirate product.

Even with the reduction in plants in operation, key optical disc plant enforcement problems remain under the current law and regulations (that is, even in the absence of the needed legislative amendments detailed later in this report):

- The licensing authorities are not properly inspecting the remaining (three) plants with effective inspections, let alone surprise inspections—the only means of effective plant enforcement;
- The three plants in operation were issued SID codes without proper verification at the time. No follow-up inspections have taken place since in order to verify the maintenance of these codes;
- 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 in Ukraine;
- A database needs to be established by the Ukraine 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 now estimated by the recording industry (International Federation of the Phonographic Industry, IFPI) that the current production capacity of optical media material is around 30 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 three plants means that production of even more unauthorized material is a looming threat that can be further exacerbated at any time. That is, if not properly regulated, the existing plants alone could ramp up their illegal operations to former levels.

Due to ineffective border enforcement (and no authority to hinder import or export of equipment), at least two of the Ukraine plants suspended their operations and moved their production lines to Belarus, Russia and Bulgaria in 2001. And as noted, one line apparently returned from Bulgaria in December 2002 to Ukraine.

The government of Ukraine has failed to use its existing criminal enforcement tools against illegal producers and distributors of optical media material. One of the most egregious examples took place in January 2002, when after an eight-month investigation, the General Prosecutor's Office announced that it was terminating that investigation because of a lack of sufficient evidence of any violations of the law against the illegal plant operators. This, even after the government of Ukraine openly acknowledged to several foreign governments the nature and scope of its illegal plant activity (culminating in the Joint Action Plan with the United States).

History of Poor Optical Disc Enforcement in Ukraine

The history of copyright enforcement in Ukraine the past few years has consisted of a series of missteps, undercutting effective enforcement. Distribution, including the import, export, wholesale and retail trade of audio and audiovisual products, could have been properly regulated by Presidential Decree 491 of May 20, 1998. At the time, IIPA welcomed adoption of the decree as a positive step against piracy, but unfortunately, the decree was never implemented.

Then on March 23, 2000, the Parliament adopted the Ukraine Law on Distribution of Copies of Audiovisual Works and Phonograms (the "Hologram Sticker" law); it was signed into law on November 15, 2000. That law was not aimed at and does not achieve improvements in copyright enforcement against CD plants. Adopted over the objections of the copyright industries, that law is not an alternative to plant licensing regulations, and it remains unclear

whether the law actually, or only effectively, repealed the 1998 decree, but it clearly ended any hope of proper implementation of the 1998 provisions.

The controversial Hologram Sticker law was implemented in January 2001. As predicted, the Hologram Sticker law has proved itself to be open to abuse and delay (keeping legal material from entering the market) and fraud (issuing stickers to illegal distributors by failing to properly verify the legitimacy of requests). To make matters worse, the law completely exempted exports, the real problem with overproduction in Ukraine; and it exempted manufacturers, the real source of the problem. It established an unworkable administrative burden on legitimate businesses and kept legal product from the market, thus permitting more pirate material to flourish in the vacuum.

Adding to the confusing patchwork of laws, the Hologram Sticker law was not repealed by the Optical Disc Law. The Optical Disc Law was enacted in January 2002, and implemented (in part) by regulations in 2002. But the Optical Disc Licensing Bill has numerous flaws that prevent it from effectively stopping piracy in the production and distribution of optical media discs.

In addition, on January 8, 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. The registry is supposed 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. Under this order, all software manufacturers/distributors may 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 is expected to be available beginning on March 1, 2003. However, it remains unclear whether this new order will aid or harm the protection of copyrights in software.

Optical Disc Law of 2002 Must Be Amended

The experience of the copyright industries in many countries other than Ukraine has shown that there are at least six basic features of an effective optical media regulatory scheme.

To be effective, an optical disc plant law must (1) require plants to obtain a business license to commence production; (2) establish a basis for regulators to deny, suspend and revoke the license upon evidence of illegal activity; (3) require import and export licenses and transparent searches of these licenses; these licenses must cover the goods (discs) and machinery and equipment (including the raw materials) used in the production of optical discs; (4) require the plants to apply internationally recognized identifiers on the goods and machinery, to keep records of production and distribution licenses, and to cooperate with the police upon inspection; (5) require plant inspections and in particular, "surprise" plant visits, including means for the rightholder organizations to participate in such plant visits, to obtain evidence and forensic tests, and access the plant's records; and (6) require a comprehensive list of enforcement procedures, remedies, sanctions, powers granted to authorized officers, including the powers to seize equipment and discs during plant visits.

The Ukraine Optical Disc Law of January 2002 falls short of these key features. In addition, the government of Ukraine announced that 13 sets of regulations would have to be adopted to implement this patchwork of laws and decrees, adding to the confusion.

The deficiencies of the 2002 Optical Disc (OD) Law are:

- 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 the international identification practices, namely SID coding, in all production facilities, 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 timely 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 provisions for confiscation or destruction of discs, material or equipment;
- It has weak administrative and criminal penalties (a high threshold will bar use of the criminal penalties in many cases).

So, the OD Law needs significant improvement—by adoption of the provisions set forth above—before it can be enforced in a way to bring meaningful protection and enforcement in Ukraine. IIPA and, in particular, IFPI have been working with SDIP and the government of Ukraine to fix these deficiencies. These changes need to be adopted quickly in 2003 to prevent the resurgence of pirate activity at the existing plants, and the creation of a territory ripe for exploitation by other pirate operations.

One other problem related to the OD Law is the interplay of the Ukrainian Licensing Law (“On Peculiarities of the State Regulation of Subjects of Business Activity Connected with the Production, Export and Import of Discs for Laser Scanning Systems”) (the “Law”) and the related Decree 411 on the importation of legal discs. These laws and regulations when first adopted required that imported discs carry only a Ukrainian issued SID code and required customs officials to verify SID codes appearing on imported product (that meant that the seal on legal discs had to be broken, thus making discs unsaleable). This requirement, an intrusive and unnecessary regulatory burden, resulted in a total blockade of legal imports by U.S. and other foreign sound recording producers into Ukraine.

In fact, the regulations had no positive impact on the real problem of illegal CD production and distribution in Ukraine and instead encouraged black market purchases in lieu of legal product, worsening the piracy problem in Ukraine. After its initial introduction, the provisions were revised so that discs (during import or export) are now required to carry any SID code, but not one issued by Ukrainian authorities. However, the damage was done by the initial round of regulations and it continues to stifle the import of legal product. Even the new regulations prohibit the importation of legitimate discs produced outside of Ukraine if they do not use any SID code. The government of Ukraine must initiate the necessary amendments to fix the current provisions and licensing regime for CD imports, while retaining the very valuable provisions relating to the production and export of CDs.

Lack of Criminal Enforcement, Border Enforcement and Other Enforcement Deficiencies

Effective enforcement in Ukraine will require improving and enforcing the optical media law, as well as other key enforcement tools such as: (1) criminal enforcement using police and courts to target the criminal syndicates (and administrative remedies directed against smaller-scale activities); and (2) strong border enforcement measures to stop illegal optical media production and distribution and to slow the export or transshipment of that material.

Criminal enforcement in Ukraine has been, to date, very weak. There have been few cases of effective police action undertaken against large-scale commercial piracy, few deterrent prosecutions or sentences by the courts, and few administrative actions against stores, kiosks and other street piracy to report. The most critical of these steps is for Ukraine to use its criminal code to crack down on the organized crime syndicates distributing material in and out of Ukraine. While some successful raids and seizures are detailed below, few if any, resulted in successful deterrent criminal prosecutions (of a total of 278 criminal investigations). As a result of the too-high threshold for criminal prosecution, most cases resulted in administrative actions (in fact, over 3,000 cases under the Administrative Code pertaining to music and video piracy, mostly pertaining to hologram stickers).

In addition, Ukraine has failed to properly police its borders that permit this wide-scale shipment from and transshipment of these materials through Ukraine, to other countries in Eastern and Central Europe. There have been some minor seizures by customs authorities of CDs and other materials, but not nearly enough activity to stem the flow. Plus, customs authorities have not commenced or undertaken criminal investigations of pirating operations, especially against organized crime syndicates. For example, the entertainment software industry needs effective border enforcement to combat the Russian crime syndicates operating freely across the borders of Russia and Ukraine. Even with the legislative changes in December 2002 (which contains some deficiencies, notably a "commercial purpose" threshold), customs will remain ineffective absent proper training and administration (to combat corruption). The copyright industries report that Ukraine authorities have not responded to requests for information relating to border seizures of illegal product.

There are two reasons why border enforcement remains weak: (1) a lack of willpower and coordination in the government, and (2) improper authority. The Ukrainian border officials need to better coordinate their activities and need to get direction from the highest levels of the government that this is a priority. In December 2002, the Verkhovna Rada fixed the customs code to provide customs officials with *ex officio* authority to 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 this clear authority on the part of police and border officials, and proper confiscation of pirate materials (which IIPA understands can only constitutionally be undertaken by the courts), the problems will continue to worsen. In 2001, Ukraine border enforcement took a step backwards when it adopted a cumbersome registration system; IIPA understands that the amendments to the Customs Code adopted in December 2002 did not repeal these provisions (but IIPA has not been able to review the new customs code). Further, the new Customs Code narrows sanctions only to those activities meeting a “commercial purpose” threshold, which will hamper effective enforcement.

There is an additional lingering matter that is hampering effective enforcement. In 1999, 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. The Copyright Agency, in essence an authors’ collecting society, and the State Department on Intellectual Property (SDIP) are not equipped or empowered on their own, to proactively monitor and close down plants that are engaged in piratical activity. That should be left to an enforcement-based agency within the government.

In fact, the lack of coordination for enforcement is a long-standing problem. In February 2002, after a visit from the WIPO Director General Dr. Idris, President Kuchma signed a decree pledging better enforcement. The decree ordered the Ministries of Education and Science, Interior, the Tax Administration, Customs Service and the Security Service to step up their efforts. But without coordination of these efforts they will likely not succeed. In fact, five years after the Ukraine government promised to establish an interministerial committee, and three years after it was “organized” (in February 2000), the committee has not proven effective. It rarely meets and the copyright industries report it has issued no concrete proposals, much less implemented any, to effectively deal with IPR crimes. Plus, a continuing problem is that information is not being shared among the enforcement agencies. This is unfortunate, because this committee and information sharing by the agencies could be an effective tool in the battle against the spread of pirated material, especially by the crime syndicates.

In sum, all enforcement agencies (that is, the police, prosecutors, judges, customs officials and the Ministries of Justice, Interior, and Taxation) should treat commercial copyright infringement as a serious crime, and should use the criminal code, as well as acquire the proper tools in the criminal procedure, customs, and administrative codes to deal appropriately with the problem. Clear government strategies and lines of authority should be developed.

In 2001, estimated losses to the recording industry, hardest hit by the optical disc production and distribution was \$170 million, reflecting the plant migration and suspension from 2000 when losses, for that industry alone, were at \$200 million.

In 2002, the combined losses for the motion picture, recording, and business software industries (based, in the latter case, on preliminary figures) were \$265.4 million.

Industry Enforcement Reports

During 2002, Ukraine law enforcement officials reported that officers had inspected more than 15,000 shops, businesses and warehouses and seized 132,000 videotapes, 178,000 audiotapes and 272,000 CDs. In total, over UAH 7 million (US\$1.3 million) worth of material was confiscated.

The International Federation of the Phonographic Industry (IFPI) and the Recording Industry Association of America (RIAA) reported that in 2002 there were several police raids run in open markets and others places where illegal CDs, CD-Rs and DVDs were sold. For example, the police carried out a “major raid” against the Petrivka CD market in late January 2002, seizing about 13,000 CDs, videotapes, and software CD-ROM discs. At the end of 2002, another large-scale police operation was conducted against the same market and other retail points in Kiev, netting some 100,000 discs of various content. In total during 2002, 278 criminal investigations were commenced under the Criminal Code (Art. 176) with about 56% of what was seized being music or video material, and 26% software material. Of the 278 investigations, 35 cases reached the court. In 16 of these cases the offenders were found guilty but the results were: suspended prison sentences in eight cases, “correctional labor” (effectively community service) in two cases, and varying fines.

The Business Software Alliance (BSA) reported 241 police raids in 2002. Of this total, 98 cases made it to the Ukrainian courts: four defendants were convicted; 16 were acquitted or dismissed; and 79 cases are still pending. There was one case that resulted in a suspended prison term and one resulted in the confiscation of the PC used to commit the crime. In sum, only two cases involving business software led to criminal convictions in the court of first instance and both of these cases have been appealed by the defendants.

The recording industry (IFPI) further reported 4,000 cases that were officially treated as administrative code violations. Most of these involved the sale of copyrighted product without hologram stickers (about 3,000 of these concerned CDs and audiovisual materials). The total amount of fines levied was more than UAH 600,000 (approximately US\$100,000).

Two examples of successful seizures in 2002: on May 17, 2002, Ukrainian Tax Police (with support from IFPI) raided a private company in Kiev and seized 50,000 CD-Rs (as well as music MP3 and software and video MP4 discs, six computers and a color printer used to make labels). The location included three underground workshops where CD-Rs were duplicated on a 24-hour basis and were below two music shops. It was estimated that each workshop could produce 2,000 discs a day, that 20 persons were involved, and that the operation had links to other pirate operations in Ukraine. That case is still under investigation. In a second example, 30,000 previously seized CDs were destroyed on February 1, 2002 at a construction plant near Kiev—the discs had been seized during a raid on a warehouse by Kiev police in June 2001 and were believed to be the old stock of one of the displaced plants.

Unfortunately these positive actions are the exception, not the rule. Two examples illustrate this point. In the first case, despite repeated raids on two major retail outlets in Kiev, where illegal discs were found on each occasion, these cases have stalled due to procedural errors and/or inaccuracies in the case materials. The result is been that the outlets continue to operate without any sanction being imposed on their owners to date. In the second instance, a successful raid on a music shop in Odessa, which features as a prominent pirate supplier in the region, netting some 11,000 pirate CDs, the case was hampered by repeated transfers between

authorities and was eventually reclassified by a local prosecutor. The end result: the imposition of a small fine, and, to make matters worse, the discs were returned to the owner.

The MPA and IFPI reported that within the past year they started to engage in (combined) investigations and raids. But they face several obstacles. First, there is little government support for these activities; second, police lack the necessary enforcement tools (no confiscation authority); and third, because of the involvement of organized crime syndicates, corruption hampers success. Also, the certification procedure enacted by the government to protect legal copies (the hologram system described above) is cumbersome and ineffective and in effect helps the pirates by tying up legal product.

IFPI and RIAA report that Ukraine is still the second largest music market after Russia in the C.I.S. The recording industry reports that piracy of international repertoire is estimated to be approximately 80%. The total value of pirate sales, including exported CDs, is estimated at \$150 million.

Ukraine continued to be a transshipment territory for pirate CDs in 2002. According to the State Customs Committee, border control measures in 2002 resulted in the seizure of some 50,000 CDs. No details about these seizures, including the disposition of the seized items, have been disclosed to the copyright industries. This contrasts sharply with the more effective (if still deficient) customs actions in neighboring countries such as Poland, where significantly higher numbers of pirate CDs were seized upon entry into Poland from Ukraine.

To add to the severity of the problem, certain Ukrainian CD plants and/or their related distribution companies continue to offer their entire illegal catalog of recordings for sale via the Internet. These companies have no licenses from any music publishers or sound recording producers to replicate this material.

According to the Business Software Alliance (BSA), the preliminary figures of estimated trade losses in 2002 due to software piracy in Ukraine were \$75.4 million. In 2001, the BSA estimated that in the Commonwealth of Independent States (C.I.S.) other than Russia the total loss figures were \$58.4 million (up from \$29.7 million in 2000). The preliminary figures for 2002 on the level of piracy in Ukraine were estimated to be 86%.

In 2001, the business software industry began working with the Ukrainian police and prosecutors to undertake the first raids ever against computer shops installing illegal copies of business software onto the hard disks of computers sold to consumers (known as "HDL reseller piracy"). By the end of 2002, the software industry recorded a total of 241 police raids involving illegal business software; 34 HDL reseller raids; 171 raids of computer clubs or Internet cafes; and, 36 raids against small CD-ROM resellers. In 2001, the business software industry received favorable judgments in three cases in the court of first instance. In 2002 two of those case decisions were revised in favor of the defendants.

On July 23, 2001, the Moskovskiy District Court sentenced the director of an HDL reseller firm to a suspended term of five years (with a three-year probationary period). The defendant was also ordered to pay a \$320 fine and was banned from holding a directorship position in other companies in the future. The sentence was appealed, and has now been remitted for further investigation; the case is still pending.

In the second HDL reseller case decided by the Goloseevskiy District Court on November 29, 2001, two individuals were fined \$640 and sentenced to pay \$11,000 in damages

to the rightholder. Both defendants appealed the decision to the Kiev Court of Appeals. On May 23, 2002 the court ruled that the case was initially investigated incorrectly, and subsequently the lower court's decision was overruled. The case now will be considered by the Supreme Court of Ukraine and obviously, the final decision is eagerly anticipated by the software industry. In a third case involving an HDL reseller in Odessa, the court proceedings were treated under the administrative code and as a result, the only punishment meted out was the confiscation of the defendant's computers.

Although the business software industry has had some enforcement successes with the Ukrainian police and prosecutors, it is discouraging that in most cases strong leads on infringing activity provided to the police by right holders resulted in no action. To date, all raids conducted by the police were initiated without consulting the right holders. Further, civil litigation is not a practical option because of the absence of *ex parte* provisions in practice, which makes it impossible for right holders to collect evidence without police assistance.

The entertainment software industry (Interactive Digital Software Association, IDSA) is also vulnerable to the same optical media production and distribution problems as the other industries. The IDSA reports that material has been confiscated throughout Eastern and Central Europe that was made illegally in Ukraine, and that material currently or previously produced in Ukraine is still being widely distributed in the region. As in the music industry, the Ukraine material produced in the past few years created a regional problem, first because the production was unregulated, and now by the distribution and export of this previously produced material throughout Ukraine, Romania, Poland, the Czech Republic, Hungary, Russia, Belarus and the rest of the countries of the C.I.S. The movement of pirate entertainment software into Ukraine and neighboring countries (of material produced in Russia) is believed to be run by a major Russian pirate syndicate; this syndicate has even apparently begun to affix its own "brand" or logo onto the pirate video game products it is distributing. Internet café piracy is also a problem for the entertainment software industry.

The Motion Picture Association (MPA) reports that the video piracy rate is 85%; optical disk piracy is at 90%; and broadcast piracy remains at 95%.

It is estimated that for all types of audiovisual piracy the levels are over 90%. Ukraine is not the main producer of pirate optical discs in Eastern Europe that it was just two years ago—Russia now claims that title. But pirate replication continues in Ukraine and one of the plants, as noted, has a DVD line though it is unclear if it produces illegal material. Ukraine is a major transshipment point for audiovisual material from Russia (especially DVDs) that is then shipped and sold in the neighboring countries of Slovakia, Hungary, the Czech Republic, Poland, Bulgaria and Romania. In the local market, pirate films continue to appear in Ukrainian kiosks within weeks of their U.S. theatrical release. Street kiosks sell pirate optical discs off the spindle and package them on the spot. Video retail stores stock pirate product including pre-release material that is available within days of the U.S. theatrical release. This type of piracy is found not just in Kiev but also throughout the country and as a result, legitimate distributors are struggling to survive.

Broadcast television piracy is also widespread. There are three national television stations, two of which Ukrainian State Television runs and which broadcast original Ukrainian programming and retransmitted Russian signals. There also are many regional channels, which almost exclusively broadcast pirated films. Some of these stations use legitimate U.S. videos to make pirate broadcasts, often broadcasting the U.S. copyright anti-piracy warning at the beginning of those videos.

The Ukrainian Copyright Agency and the National Council for Television and Radio, which have licensing authority over Ukrainian television, have still not been effective. The Ukrainian government should require compliance by broadcasters with copyright laws to obtain and maintain their licenses.

MPA estimates that trade losses in 2002 due to audiovisual piracy in Ukraine remained at \$40 million.

The book industry continues to experience piracy as well, with most of the problem being books illegally printed in Ukraine (and Belarus) for sale in Russia. This includes both overruns of licensed works and the production of unlicensed works, which flow freely into Russia and the other countries in the C.I.S. as the result of lax border enforcement.

History of Trade Sanctions and the Withdrawal of GSP Benefits Imposed Against Ukraine by the U.S. Government

On June 1, 2000, then-President Clinton and President Kuchma agreed on a Joint Action Plan in Kiev to be implemented by November 1, 2000. The Action Plan consisted of three parts: (1) to close the plants, seize illegal material, and only to reopen the plants when there is 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 significantly improve the copyright law and to introduce other legal reforms, including criminal and administrative penalties, necessary to implement a modern copyright regime.

On March 12, 2001, Ambassador Zoellick designated Ukraine as a Priority Foreign Country (PFC) for its failure to implement the Joint Action Plan. The designation commenced a formal investigation of the IPR protection and enforcement failures in Ukraine, consistent with Special 301 legal requirements. On December 20, 2001 that formal investigation ended and the U.S. government announced the imposition of trade sanctions amounting to \$75 million, effective on January 23, 2002, as the result of the continued and complete failure on the part of the government of Ukraine to meet its obligations under the Joint Action Plan, namely to properly regulate optical media production and to engage in effective enforcement of copyright law in Ukraine.

The imposition of sanctions in January 2002 was in addition to the complete withdrawal of trade benefits to Ukraine under the Generalized System of Preferences program (effective in August 2001). The suspension of the GSP benefits was also considered in light of the Joint Action Plan shortcomings.

The GSP benefits are part of a U.S. trade program that offers preferential trade benefits to eligible countries; that is, duty-free status for certain imports. In order to qualify for such unilaterally granted trade preferences, the U.S. Trade Representative must be satisfied that the country meets certain discretionary criteria, including that it provides “adequate and effective protection of intellectual property rights . . .” This includes that a country is providing adequate and effective protection and enforcement of copyright and neighboring rights. Ukraine did not fulfill the statutory obligations of GSP and in fact caused millions of dollars of losses to the U.S. due to piracy at the same time it was enjoying trade benefits worth close to \$40 million a year without duty.

IIPA filed a petition with the U.S. government on June 16, 1999 to request the suspension or withdrawal of Ukraine's GSP benefits. That petition was accepted on February 14, 2000 and public hearings were held on May 12, 2000. The PFC investigation moved on a parallel track with the GSP case and public hearings were held on April 27, 2001 with IIPA testifying and filing voluminous written material in support of its petition. In the filings, the IIPA identified the losses to its members resulting from Ukraine's acts, policies and practices. The IIPA estimated that these losses (from just three of its members with available statistical information) were \$216.8 million in 2000—that is, but for the Ukrainian piratical practices, \$216.8 million would have been repatriated back into the U.S. economy.

On August 10, 2001 the U.S. government, satisfied by the evidence presented about the ineffective Ukraine legal and enforcement regime, announced it was suspending all of the GSP benefits to Ukraine, effective August 24, 2001.

In January 2002 the Verkhovna Rada adopted Optical Disc Licensing Bill 8278-1. President Kuchma signed it into law on February 7, 2002. Because of serious deficiencies in that law that are incompatible with the Joint Action Plan requirements, the U.S. government announced it would maintain the trade sanctions and the suspension of GSP benefits until that law was corrected (as it was deemed unlikely that the flaws could be corrected by implementing regulations). Attempts to adopt amendments in the Verkhovna Rada in 2002 stalled.

LEGAL REFORMS

In 2000 and 2001 Ukraine made several key legal reforms (other than the optical media law reforms already detailed). These include:

- Geneva Phonograms Convention accession effective February 18, 2000 providing for the first time, a point of attachment for U.S. and other foreign sound recordings;
- Copyright Law of 2001 (effective September 5, 2001) an entire revision of the Copyright Law of 1993;
- Criminal Code Reform (effective September 1, 2001) adding important criminal penalties;
- WIPO Copyright Treaty (WCT) and WIPO Performances and Phonograms Treaty (WPPT) accession (depositing papers November 29, 2001) and including implementation at least in part in the Copyright Law of 2001. The WCT and WPPT entered into force in 2002.

Even with these improvements Ukraine is not in compliance with WTO TRIPS obligations and 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; (3) the addition of key administrative remedies; and (4) new procedures for civil *ex parte* searches necessary for effective end-user (software) piracy actions.

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.

Before that “fix,” foreign sound recordings released prior to February 18, 2000 (the date of adherence to the Geneva Phonograms Convention), and works published prior to May 27, 1973 (the date of adherence to the Universal Copyright Convention) were unprotected in Ukraine. The most important next step in order to create legitimate markets for music and motion picture materials is for the Ukrainian police to rid the marketplace of back-catalog material that has flooded the market along with optical media products because of the past and present legal and enforcement deficiencies by using these provisions.

The Copyright Law of 2001 grants pre-existing foreign works and sound recordings protection if they are less than 50 years old. This provides a shorter term of protection than is reciprocated by the United States for Ukrainian works and sound recordings but is a vast improvement on the pre-2001 situation. Also, although the intention of the drafters was clear, the actual provisions are difficult to understand, especially for material that was never protected in Ukraine such as sound recordings (pre-February 2000) and non-renewed U.S. works (covered under the pre-1978 U.S. copyright laws). Since the passage of the law, numerous Ukrainian copyright experts and government officials have assured U.S. government officials (and the IIPA) that there is a full 50-year “retroactive” term of protection for works and sound recordings and that that position will be supported by Ukrainian enforcement officials and courts.

There are several provisions in particular in the Copyright Law of 2001 (especially Article 43.3) that are troubling because they permit the over-regulation and consolidation of power into government collecting rights societies. The Ukrainian Council of Ministers has, under this provision, recently adopted fixed tariffs for the broadcasting of sound recordings. This 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 current tariff decision by the Council of Ministers should be withdrawn. Collective management should be a private, not a government, enterprise; plus, legal entities and foreign rightholders should be permitted to be members on their own in Ukrainian collecting rights societies.

Criminal Code and Criminal Procedure Code Reforms

Criminal code amendments were enacted in April 2001 and went into force on September 1, 2001.

These amendments fixed a major problem (in a new Article 176) by applying the criminal penalties, for the first time, to neighboring rights violations. The adoption of this provision applicable to infringements involving producers of sound recordings or performers was a step in the right direction, closing a gaping loophole in the old law. Unfortunately, the new provisions deleted an interim law with tougher five-year penalties and reverted to sanctions that provide for up to two years’ imprisonment and fines ranging from 100 to 400 times the (tax-free) minimum income (roughly US\$320 to \$1300) for copyright and neighboring rights violations. These fines can multiply up to 200 to 800 times the tax-free minimum income for repeat offenders, and up to 500 to 1000 times the tax-free minimum income in certain instances (for officials abusing their “official positions”).

However, a major shortcoming remains. The Criminal Code amendments in 2001 retained the provision that the penalties can only be imposed for “substantial material damage”—this is a standard that creates an unwarranted threshold for copyright piracy. This

provision creates two problems: (1) it sets a threshold that is too high; and (2) the threshold will be impossible to prove with the certainty necessary for criminal proceedings.

The criminal code should have been (and now needs to be) amended to include a low and clear threshold to instigate a criminal action. IIPA recommends a threshold no higher than 50 times the minimum daily wage. Not only would this help to identify criminal infringing acts for prosecutors but it would 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.

Even more troubling now over a year after enactment of the (new) criminal code amendments, is that deterrent criminal sanctions (under the old or new code) have yet to be imposed in a copyright or neighboring rights case. As indicated, the few cases proceeding (such as the software case in November 2001) have resulted in light sentences and have been reversed before sentences were served. The criminal code provisions must be used against the criminal syndicates involved in wide-scale piracy as a first step towards effective enforcement.

The criminal procedure in law and practice must also be fixed so that police act *ex officio* to initiate criminal intellectual property cases. Ukrainian criminal procedures in practice (although not required by the code) currently require right holders to file complaints to initiate actions. This acts as a bottleneck to successful enforcement. This should be changed to improve police actions 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.

Administrative Remedies

As part of the Joint Action Plan, Ukraine agreed to adopt and implement appropriate administrative remedies to deter piracy as well to enact a 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

On December 24, 2002 Law of Ukraine No. 348-IV (“On Amending the Customs Code of Ukraine”) was enacted; it goes into force on January 1, 2004. IIPA has not reviewed a copy of the new law. IIPA understands that the customs code revision will now provide clear *ex officio* authority to customs officials to seize suspected illegal material at the border for effective border enforcement and to commence criminal investigations. If true, this would close a legal loophole in the current border enforcement scheme. Unfortunately, IIPA understands that the new Customs Code narrowed the sanctions (permissible under the old code) to those meeting a “commercial purpose” threshold. This will limit the effectiveness of the new code. As a result of current border enforcement legal (and operational) failures, material is flowing freely into and out of Ukraine. The customs code must be used to properly seize material and to commence investigations for effective enforcement (which is a WTO TRIPS requirement). In addition, the

registration requirements and fees (which we understand were not repealed by the new law) must be abolished; these act as a bar to border enforcement action.

Civil Code Should Not Weaken Copyright Law

Amendments to the Civil Code (Chapter IV) pertaining to copyright continued to circulate for another year for consideration by the parliament. For many years, IIPA has urged that this draft law not be passed because it is a dangerous development jeopardizing effective application of the Copyright Act, and would be in breach of the bilateral trade agreement. It is also a development not unique to Ukraine, as it has been considered in several countries of the C.I.S., including the Russian Federation, as part of the comprehensive reform of the civil codes of these nations.

In Ukraine, as in other countries in the C.I.S., the efforts to revise the civil code will result in the addition into that code of new copyright provisions inconsistent with Berne, WTO TRIPS, and the bilateral trade agreement. Efforts to so revise the civil code in Ukraine should be opposed. IIPA understands that the latest draft of Chapter IV of the Civil Code was reduced to 14 articles. This is an improvement over earlier drafts that contained over 140 articles (and then 50 in a subsequent draft), many of which would have undercut the copyright law. However, even the shorted version with 14 articles is confusing and could overlap the copyright provisions. Plus, because the 14 articles make reference to over 90 other laws, this could make the provisions confusing (and obsolete) if and when any of the other laws referred to are amended. IIPA continues to urge that the Civil Code Chapter IV not be adopted, certainly not in a manner that would in any way weaken the copyright law or its effective enforcement.

Government Software Asset Management

On May 15, 2002, the Ukrainian government adopted a tentative proposal calling for government software asset management—meaning that the government has agreed to use legal software programs within all of its agencies. The IIPA urges the government to continue down the path towards implementation of effective software asset management practices, and to work closely with the private sector in doing so.

WIPO Digital Treaties

Ukraine was not a signatory to either of the two new WIPO Internet treaties when these were completed in 1996. On September 20, 2001, the Ukraine Parliament ratified legislation to accede to both of the treaties – the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonogram Treaty (WPPT). On November 29, 2001 Ukraine deposited its instruments of accession with the WIPO and both treaties entered into force (in Ukraine and the other member states) in 2002. The Copyright Law of 2001 included amendments to implement these treaties. Unfortunately the amendments fall 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).

If Ukraine properly implements and enforces these treaties they will act as important tools against Internet and other forms of digital piracy, and should help with the development of electronic commerce in Ukraine.

Brief History of Legal Reforms

On May 6, 1992, Ukraine signed a bilateral trade agreement with the U.S. that entered into force on June 23, 1992. That agreement included wide-ranging commitments for Ukraine to enact and enforce modern laws protecting intellectual property rights and to provide effective enforcement. In exchange, the U.S. granted Ukraine Most Favored Nation (MFN), now Normal Trade Relations (NTR), treatment; the Ukrainian deadline for meeting the IPR obligations was December 31, 1993. In December 23 1993, Ukraine enacted a new law on copyright and neighboring rights (in force on February 23, 1994). That law was closely modeled on the Russian Federation's 1993 copyright law and separate legislation and regulations on broadcasting were later adopted. The 1993 copyright law was significantly revised and replaced by the Copyright Law of July 2001 (effective September 5, 2001).

On October 25, 1995, Ukraine adhered to the Berne Convention (Paris Act); Ukraine also adhered to the Universal Copyright Convention on December 25, 1991 but acknowledged its successor status to the Soviet Union's membership in the U.C.C., effective May 27, 1973. On February 18, 2000, Ukraine adhered to the Geneva Phonograms Convention. All of these acts were obligations, even if some were undertaken belatedly, to comply with the bilateral agreement.

The 1992 agreement stipulated a bilateral obligation of both countries to provide a full retroactive term of protection to each other's works on the date when both countries became members of the Berne Convention in accordance with Article 18 of Berne (this is also a WTO/TRIPS obligation). All during this time, the United States unilaterally provided full retroactive protection for all Ukrainian works and sound recordings (and extended the term of 75 years to 95 years in 1998).

In October 25, 1995, when Ukraine adhered to the Berne Convention its instrument of accession included a declaration stating that it would *not* apply Berne's Article 18 obligations to protect pre-existing foreign works in Ukraine. Ukraine's decision not to grant protection to pre-existing U.S. copyrighted works (prior to May 1973) was incompatible with its bilateral trade agreement with the U.S., as well as with Ukraine's Berne Article 18 and national treatment obligations.

On February 18, 2000, Ukraine adhered to the Geneva Phonograms Convention, also an obligation of the bilateral trade agreement. However, the copyright law of 1993 did not provide protection for pre-existing sound recordings (leaving pre-1995 recordings unprotected until September 2001). That created an intolerable situation, especially for the music industry, allowing older unprotected material to flood the market. During the seven years that Ukraine, slowly and only in piecemeal fashion, implemented the bilateral IPR obligations with its legal reforms it allowed itself to become a "safe haven" for an increasing number of pirate manufacturers of copyright material. That is why enforcement of new and pre-existing material is essential. The combination of illegal optical media material produced in Ukraine by organized criminal syndicates and the lack of any criminal or administrative enforcement has prevented the development of any legal markets. So it is imperative that Ukraine authorities enforce the new laws that have been enacted, and that the government of Ukraine further amend the deficiencies in the enforcement scheme including adopting effective optical media regulations as well as better criminal, customs and administrative remedies.