



Introduction

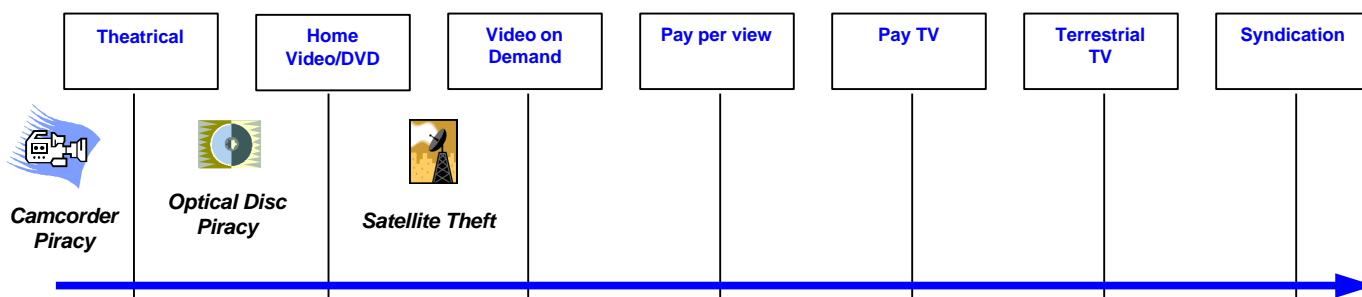
The US entertainment industry loses an estimated \$3.5 billion every year due to film piracy, which does not even include losses due to Internet piracy. This figure continues to rise with more sophisticated technology, easier means of replication and more organized and secretive distribution channels linked to organized crime. This report highlights the impact of piracy on the global market with case studies from key European markets including Germany, Russia and the United Kingdom.

Piracy is a global dilemma that needs to be dealt with through stronger legislation, tougher prosecution and stiffer penalties. Many of the world's leading pirates operate out of the select countries discussed in this report and distribute pirated materials to other parts of the world. Consequently, many other local economies and governments suffer at the hands of these global operatives.

Film Piracy- Overview

Most pirated movies are distributed in the form of hard goods, such as DVDs, CD-Rs, DVD-Rs, VCDs and VHS cassettes. The release pattern for a theatrical film follows a typical release pattern illustrated below:

Release Schedule for a Typical MPA Member Film (Piracy Timeline)



Opening Weekend

Source: Motion Picture Association

Piracy impacts each segment of the release schedule, resulting in millions of dollars of lost revenue over the life of each film. Considerable pirated product is released prior to even the theatrical release of the film. In many instances, pirate copies of blockbuster features are available for sale on street corners months before the final product has even been released.

A team of well-trained Motion Picture Association (“MPA”) experts, in partnership with

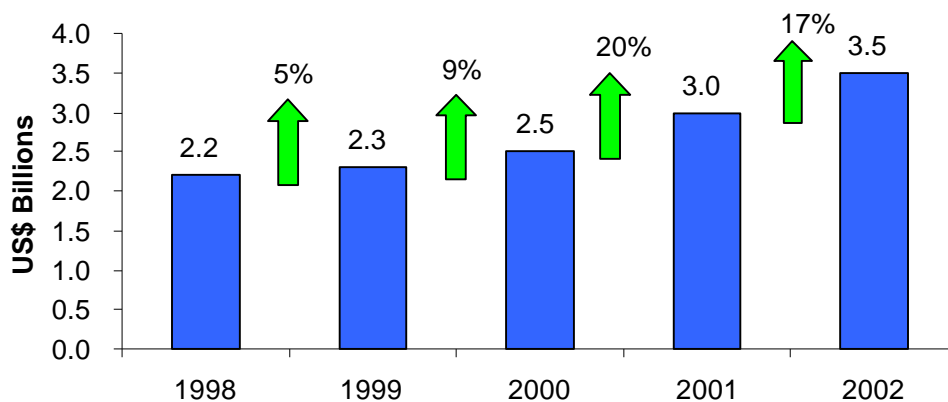


justice officials across the world, lead investigations, raids and seizures with much success. Unfortunately, the statistics paint a grim picture of the steadily growing piracy problem around the world. For instance, between 1997 and 2003, the number of investigations and raids increased 29% and 85%, respectively, while the number of seized items (including Videocassettes, DVDs, VCDs, and replication material) jumped a whopping 663%. In 2003 alone, officials seized 72.8 million items tied to piracy, compared to 9.5 million items in 1997.

Global Trends

Piracy losses are increasing at alarming rates. In 1997, piracy losses were estimated to be \$2.2 billion. These losses were primarily related to pirated material in VHS and VCD format. However, with the advent of the DVD format in North America, Europe and Asia Pacific, as well as the increased penetration of VCD players in many of the Asia Pacific countries in 1998-99, piracy has reached epidemic levels in a number of countries. In 2002, losses were estimated to be \$3.5 billion, a sixty percent jump since 1997.

**Worldwide Film Piracy Losses
1998-2002**

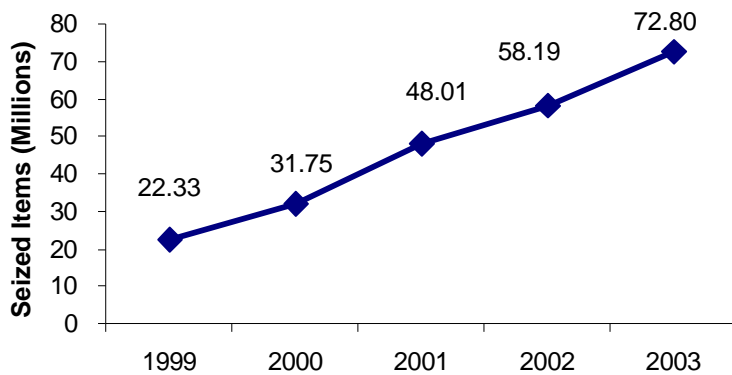


Source: Motion Picture Association



The number of seized goods related to piracy has jumped 226% since 1999, when seized items were 22.3 million. In 2003, seizures topped 72 million. This was up 25% from 2002.

Number of Seized Pirate Items* 1999-2003



*Items include optical discs, videocassettes, replication hardware, packaging, etc.
Source: Motion Picture Association



Germany

Key Statistics-2003

Piracy losses (US\$ millions)	\$100 million
Seizures (all items)	469,718
Piracy level (Video & Optical Disc)	22%

Home Entertainment

Germany has become increasingly plagued with piracy challenges. According to the German Federation Against Copyright Theft (GVU), the DVD boom in Germany has made the country an attractive market for pirates. According to *Euromonitor*, DVD households jumped 81% to 6.9 million in 2002, up from 3.8 million in 2001. The growth of the Internet has also contributed to the spread of piracy. The booming black market includes illicit film downloads and Internet auctions, as well as street sales of bootlegged films, in particular a growing number of Russian imports. There has also been a considerable increase in the presence of pirate DVDs containing German dubbed versions of recently released movies.

Optical Disc Piracy

Optical disc piracy remains essentially anchored in the CD-R format. Because of the German language requirement, pirates routinely download films from the Internet and then overlay a dubbed soundtrack once the films premiere in Germany. Consequently, there has been a significant increase in the number of German dubbed pirate discs in the market. Local production of CD-Rs and DVD-Rs is on the rise. These discs are primarily distributed over the Internet as hard goods, but there is also an increase in the amount of pirate discs being sold on street/flea markets.

The GVU estimates that 62% of all pirate transactions are done over the Internet. Street vendors sell another 25% of pirate discs and approximately 10% are sold through closed groups (so-called “playground piracy”). Pirate DVDs containing pre-theatrical titles have also started to appear, but CD-Rs and DVD-Rs are expected to continue to be the most popular format until pirate DVD manufacturers are able to meet the German language dubbing requirement. The GVU has refocused its efforts to stop the mass distribution of German dubbed movies through organized release groups and over the Internet.

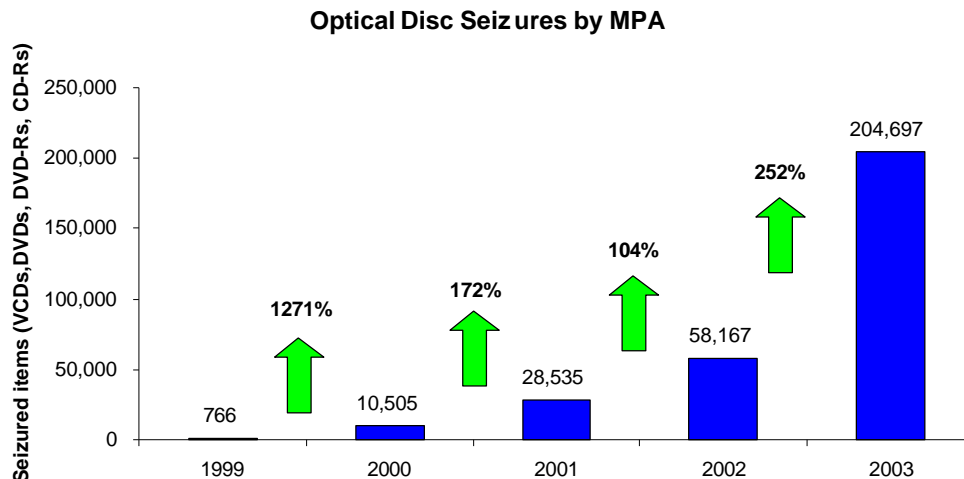
Rampant piracy in Germany appears to have impacted 2003 box office receipts. The *Hollywood Reporter* notes that box office receipts in Europe's largest territory were



down 12% to Euro 816 million (\$1.01 billion), the lowest level since 1999.

According to a recent study by the German Federal Film Board, piracy cost the German industry more than Euro 800 million (\$990 million) in 2003. "The influence of film piracy on box office returns is still greatly underestimated," says Film Board chairman Rolf Baehr, who sees a direct link between last year's surge in illegal copying and the record lows of the 2003 box office¹. The Film Board launched a major anti-piracy campaign in late 2003 to try and combat the problem.

As piracy grew in the German market, there was a considerable increase in optical discs seizures across the country during 2003. GVVU raids alone led to the seizure of 204,697 optical discs. This is a 252% increase from 2002 optical disc seizures, which numbered just over 58,000 optical discs.



According to *Variety*, authorities in Hanover broke up a large DVD piracy operation in June 2003. Police confiscated 16,000 pirated DVDs and master discs destined for the UK market, including titles like "X-Men 2", "Matrix Reloaded", "Dreamcatcher" and "Harry Potter and the Chamber of Secrets" as well as films that had yet to be released in Germany, with an estimated value of \$1.17 million.

In September 2003, the GVVU and Police raided 10 homes in the Rhine-Ruhr valley seizing over 20,000 CD-Rs and DVD-Rs containing films. The targets were members of a distribution network that sold home-burned optical discs at street markets and boot fairs.

Internet Piracy

By the end of 2003, IDC reported that approximately 44% of German households connected to the Internet, while 23% of these enjoyed high-speed, broadband access. Consequently, Internet piracy has mushroomed. The main problems on the Internet

¹ *Hollywood Reporter*, January 27, 2004.



are auctions, eMail-Networks, homepages, P2P-networks (portals) and organized release-groups (FTP, IRC etc.). File sharing has become very popular and the GVV is concerned about the rapid spread of *edonkey*, *DC++*, and other well-known P2P networks.

A study by GfK for the German Federal Film Board in September 2003 concluded that in the 8 months up to August 2003, some 13.3 million films had been downloaded by 2 million Germans. 26% of the respondents admitted downloading films before theatrical release and a further 49% admitted downloading after theatrical release but before video release. 58.5% of downloaders burned the films onto CD-Rs and 7.4% burned them onto DVD-Rs.

According to findings from a Spring 2004 survey conducted by Online Testing Exchange ("OTX"), almost one in five Germans (19%) illegally download movies from the Internet and most buy fewer DVDs and videos as a result. It also said more people were likely to join the trend as movies became easier to download through broadband and smaller file sizes.

In September 2003, the *Hollywood Reporter* reported that German police and anti-piracy authorities shut down "one of the world's largest illegal download servers, responsible for distributing thousands of illegal copies of prerelease feature films to Web sites around the globe". Police and the GVV raided the offices of IT service company GATEL in Frankfurt, where the 11 terabyte server, known as Unreality or UNR was located. The Unreality server acted as a wholesale distributor of illegally pirated films, where users paid UNR a fee to acquire the latest films. The UNR server had been running for as long as 2 ½ years, causing damage to rights holders estimated at several millions of dollars annually.

In March this year, the GVV launched a massive series of raids against Internet pirates across Germany in cooperation with local prosecutors and the police. Over 750 separate locations were raided in the areas of Munich, Frankfurt am Main, Bremen, Cologne and the Ruhr. The raids were targeted against "release groups" believed to have been responsible for the first release of German-language versions of over 500 films since 2001. The raids resulted in the seizure of 19 servers (with a total capacity of 38 terabytes containing pirate films and entertainment software), over 40,000 CD-Rs and DVD-Rs, and over 200 PCs. Over 15 individuals were detained for questioning and the operation also netted a gang in the Ruhr region supplying current films and the latest software on DVD-Rs and CD-Rs. The gang obtained its source material from "release groups" and operated a disc-burning lab with 24 high-speed burners. In August, the GVV followed up these raids with further seizures of large release group servers in Frankfurt.

Television

Signal theft piracy is thought to be approximately one percent in Germany. According to *Informa Media*, piracy is kept in check because of its state of the art encryption



technology. This software prevents the majority of unauthorized viewing of pay-television services and is constantly being enhanced to counter the growing threat of piracy.

Piracy Losses

Between 1998 and 2003, economic losses to the US motion picture industry due to audiovisual piracy in Germany were estimated at over one-half of a billion dollars (\$542 billion). These losses do not include the impact of Internet piracy or the losses incurred by the local German economy resulting from piracy.



Russia

Key Statistics-2003

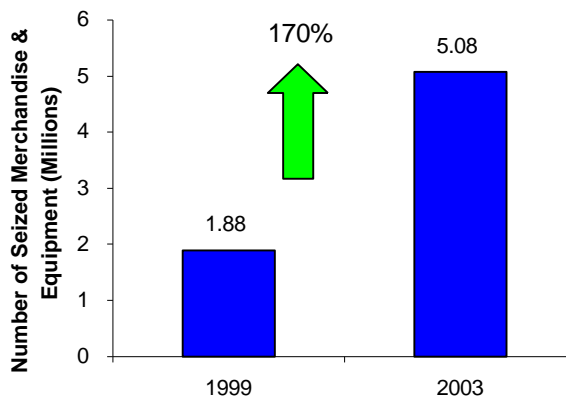
Piracy losses (US\$ millions)	\$275 million
Seizures (all items)	5.1 million
Piracy level (Video & Optical Disc)	75%

Home Entertainment

Piracy in Russia continues to rise at an alarming rate, especially optical disc piracy. There has been an explosion of large-scale factory production of pirate DVDs in Russia over the past few years. There are now some 34 DVD lines (both legal and pirate) in the country with a maximum capacity of about 200 million discs a year. Pirate plants (with an estimated production capacity of over 50 million discs a year) dominate the local market and they are now supplying demand in neighboring markets in Eastern and Central Europe, and beyond. These pirated discs are clearly being made for export to markets across Europe, carrying multiple language tracks and subtitles. Russian exports of pirated DVDs have been found in markets all over Europe, as well as in Israel and Turkey.

Russia's domestic market is saturated with pirate DVDs. The level of piracy is estimated at over 90%. Sales of legitimate DVDs have fallen back to 1999 levels despite a significant increase in the number of households with DVD players, and despite efforts by foreign producers to move legitimate product into the Russian market quickly. Piracy is undermining the creation of a healthy legitimate home entertainment market in Russia.

Seized Piracy Items*

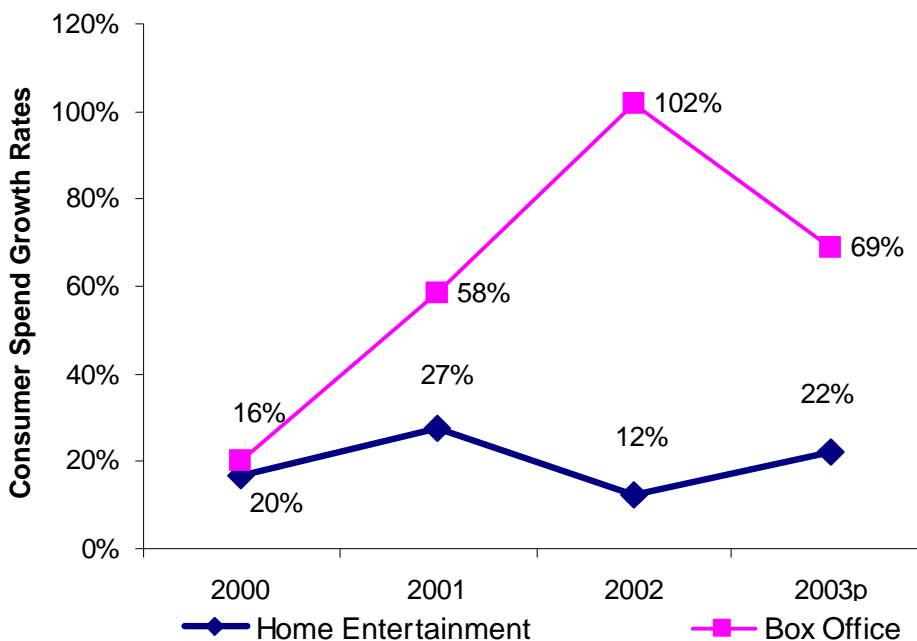


*Items include optical discs, videocassettes, replication hardware, packaging, etc.
Source: Motion Picture Association



According to *Wilkofsky Gruen*, piracy remains a major problem in the home entertainment market in Russia and the industry is operating well below its potential. Price cuts of 30%, however, have helped stimulate sales and contributed to double-digit annual increases in recent years. Nevertheless, evidence that piracy is a major drag on home video sell-through is revealed by comparing box office growth with home video growth. Between 2000 and 2003, box office spending rose by a cumulative 438%, compared with only 75% cumulative growth for home video sell-through over the same period. In virtually every other country, home video grew much faster than box office during the last three years. In this context, home video in Russia has been relatively sluggish, due in large part to the high incidence of piracy.

Home Entertainment v. Box Office Consumer Spend 1999-2003p



Source: *PricewaterhouseCoopers, Wilkofsky Gruen*

The piracy problem is an epidemic in Russia, and some films are available before their theatrical release in the US. According to the *Moscow Times*, Russian video pirates are obtaining high-grade pirate copies by duplicating the film right in the projector booths of movie theaters and adding subtitles in many European languages.

Sales of pirate product outpace those of the legitimate market and are clearly taking a toll on the entertainment industry. Pirate DVDs are sold everywhere including, street markets, kiosks, retail stores and over the Internet. Lax enforcement, in particular, the lack of deterrence in the Russian criminal enforcement system to address persistent commercial piracy, is one problem that needs to be addressed. Moreover, there is a



need for critical legal reforms that will deter commercial piracy.

In July 2004, Russia passed long-awaited amendments to its Copyright Law, and enforcement efforts have been increased over the past year. In 2002, over 226,000 pirate DVDs were seized in raids on warehouses and outlets across Russia. That number jumped in 2003 to over 1.4 million and to over 3 million in the first 8 months of 2004.

However, despite vigorous enforcement activities by the Russian Anti-Piracy Organization (RAPO) and, more recently, ex-officio actions against pirate DVD plants (4 have been raided since the beginning of 2004 and over 3 million pirate DVDs seized), barely a dent has been made in the problem, despite significant political pressure on the Russian Government. Pirate production and export continue to grow. The organized criminal groups that control most of the manufacture and distribution of pirate product continue to grow in wealth, strength and influence. Piracy is openly acknowledged to be one of the most profitable criminal businesses in Russia. Much more needs to be done on an urgent basis to have even a nominal impact on this problem. In effect, only the shutting down of the great majority of the pirate DVD plants operating in Russia will address the problem. More urgently than ever before, attention is needed at the highest level of the Russian Government, given the lack of focus and clarity on the enforcement of copyright that has resulted from recent government reorganization.

The raiding of factories involved in illegal replication of optical discs is a top priority for the MPA in Russia. In 2003, RAPO conducted three DVD plant raids, including the first against a government licensed factory in April that was believed to have been responsible for the manufacture of up to 30% of the pirate DVDs on the Russian market. On February 26 last, the Economic Crime Police raided a clandestine pirate factory in Pushkino near Moscow and seized three new DVD 9 lines, about 800 stampers and over 25,000 pirate DVDs. Like many optical disc factories in Russia, the raided factory was situated on the territory of a government defense facility. On April 9, the Economic Crime Police in Samara (about 840 km southeast of Moscow) found a pirate DVD plant during a routine tax inspection at a cement factory. When the Police came across the two DVD lines, they immediately contacted RAPO and seized the equipment. RAPO has since found over 7,000 pirate DVDs and 30 stampers at the plant. The Director of the plant has been questioned and a criminal prosecution is now under preparation with the assistance of RAPO. On April 30, a plant in Koroliov was raided and 2 DVD lines and a CD line were seized. Finally, on June 20, RAPO participated in a raid on a plant in Zelenograd where 2 further DVD lines were seized along with over 30,000 pirate DVDs.

The criminal groups running piracy operations are well-funded and highly organized. Such groups cannot be effectively opposed by rightsholders alone or by local organizations acting on their behalf, regardless of the dedication, bravery or expertise of their personnel. The committed help of the Russian Government is required to face



down such criminal syndicates. The only way to combat the syndicates is by effective criminal enforcement.

Unfortunately, Russia's criminal enforcement system is the weakest link in its intellectual property protection regime. Swift criminal prosecutions do not follow raids. Prosecutors drop cases for no justifiable reason, or cite a lack of public interest. When cases are prosecuted, the penalties imposed are not at deterrent levels. Prison sentences are usually suspended. There have been welcome exceptions, of course, but police and prosecutors are generally discouraged by their experiences from investigating and prosecuting more offenders.

On August 9, 2004, RAPO secured its first ever unsuspended prison sentence for a pirate in Rostov-on-Don. The local video shop owner, who was raided a year ago and found in possession of DVD burners and hundreds of pirate DVDs, DVD-Rs and VHS cassettes, was sentenced to 3 years and 2 months in prison.

Another problem that needs urgent Russian Government attention is the unacceptable return to the marketplace of confiscated pirate product. It is estimated that up to three quarters of the pirate product seized in raids finds its way back onto the market.

Television

Television piracy is an on-going problem in Russia. Although the government has made significant progress in regulating the television industry, television piracy outside of Moscow remains a problem. Moreover, outside of Moscow, cable piracy abuses are still rampant.

Piracy Losses

By the end of 2003, economic losses since 1999 to the US motion picture industry due to audiovisual piracy in Russia, are estimated to have reached \$1.3 billion. These losses do not even include the impact of piracy on the local Russian economy.

Russia serves as a manufacturing and distribution center for much of the pirated material around the world. Pirate Russian DVDs have now turned up in many countries across Central and Eastern Europe, and beyond. In 2002, the local anti-piracy organization in Poland (FOTA) seized over 17,000 Russian made pirate DVDs compared to only 481 in 2001. Pirate DVDs accounted for about 40% of Poland's pirate market last year compared to only 1% in 2001. Other markets that have been negatively impacted by imports of pirate Russian DVDs are Estonia, Finland, Ukraine, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Israel and Turkey. Small numbers of Russian discs carried in travellers' luggage have also turned up in other territories. Suspected Russian discs have also appeared in Belgium, Germany and Serbia. The \$1.3 billion in losses since 1999 do not include the losses suffered in those foreign markets, whose legitimate home entertainment markets are clearly suffering from having to compete with the "black" market.



2004 European Country Piracy Fact Sheets





United Kingdom

Key Statistics-2003

Piracy losses (US\$ millions)	\$120 million
Seizures (all items)	2.4 million
Piracy level (Video & Optical Disc)	20%

Home Entertainment

Fueled by rapid DVD growth, piracy in the United Kingdom (UK) has become a primary concern. According to *Euromonitor*, DVD households jumped 77% last year to 11.2 million, up from 6.3 million in 2002.

Optical Disc Piracy

The UK has become a principle market for international organized criminal networks trading in “pressed” optical discs, in part because of the “instant” English-language compatibility with most new movies that are in demand. A comparison of optical disc seizures from January - June (an admittedly rough comparison), demonstrates that 2004 seizures have increased by 207% over 2003 and by 1,768% over 2002. Last year, the number of pirate DVDs seized in the UK hit almost 1.6 million. This year, the Federation Against Copyright Theft (FACT), expects over 3 million pirate DVDs to be seized. Program intelligence confirms the expanded influence of Asian crime networks in this area, and the Federation Against Copyright Theft (FACT) estimates that these criminal syndicates will make a £480 million profit from DVD piracy in 2004. In addition, groups with multiple criminal interests have adopted the manufacture and distribution of DVD-Rs as a mainstream activity, establishing extensive “burning” facilities to sustain their enterprises. Pirated optical discs are readily available in many of the 7,000 weekend markets across the country, through street vendors, in the workplace, and under-the-counter in shops, bars and other public establishments. Additionally, the Internet is being used to facilitate transactions with tech-savvy customers.

According to FACT, pirate DVDs have all but completely taken over the UK pirate market. The DVDs are imported into the country via mail and courier packages, cargo shipments, and in passengers’ luggage. The main sources of these pirate DVDs are Pakistan, Malaysia and China. Evidence is also emerging to suggest that discs are being sent to ports elsewhere in Europe and then shipped to the UK to bypass UK Customs controls.

The pirates are becoming increasingly ingenious in their smuggling efforts. In January this year, Customs officers at Stansted Airport intercepted two 7-foot cylindrical pipes marked as “dirty water processors” that were imported from China and contained around 4,000 pirate DVDs. Pirate discs have also been found hidden in toys, water



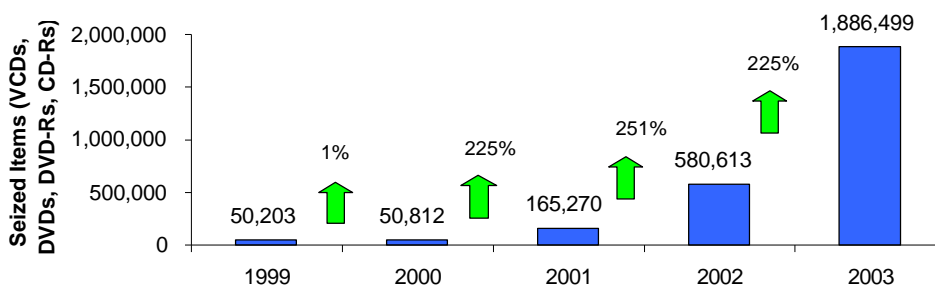
dispensers, stuffed animals, computer equipment, and have been disguised as blank CD-Rs.

In July 2004, a coalition of movie studios, retailers and crime-fighting groups ("Industry Trust for IP Awareness") announced plans to push a \$2.73 million UK campaign against video piracy that will focus attention on links to organized crime and terrorist groups among those selling bogus DVDs and videos valued at \$728-\$910 million this year. According to a *Daily Variety* report, seizures of pirate DVDs are rising 400% yearly in the UK, and Trust executives said the illicit trade would rise to \$1.82 billion in 3 years.

Authorities said organized criminal groups and others are attracted to the piracy racket because of the high return on investment -- 10 for every 1 invested -- and lower penalties than for drug dealing. One kilo of pirated DVDs is worth more than a kilo of cannabis resin, a report from Interpol said.

The *Daily Variety* recently reported that the Organized Crime Task Force in Northern Ireland had reported that paramilitary gangs "carry out 80% of organized (Internet piracy) crime in Northern Ireland. Both Loyalist and Republican gangs are equally involved." It said that of all pirate and counterfeit products seized in Northern Ireland, pirate DVDs form the largest product type.

Optical Disc Seizures by MPA 1999-2003



The pirate market in the UK has become so lucrative that there now exists a wholesale/retail structure. This means that vendors at street markets and boot fairs buy their discs in bulk domestically rather than importing them from Asia themselves. Criminal networks, comprised mostly of Asian immigrants, are the main importers. It is almost impossible to infiltrate these networks and they use violence to maintain control over their members.

In addition to the discs brought into the country, there is also an active business in home-burned CD-Rs, and DVD-Rs. These discs, manufactured in small labs and often



mastered from imported pirate product or from Internet downloads, are a fast-growing problem.

Internet Piracy

The UK broadband market is growing at a rapid pace. The current population broadband penetration rate is 5.3%, making the UK the country with the third highest number of broadband users in the EMEA region (after Germany and France). By the end of 2003, *IDC* reported that approximately 57% of UK households were connected to the Internet, while 16% of these enjoyed high-speed, broadband access.

Consequently, Internet piracy has mushroomed. By end 2003, there were over 3 million broadband enabled UK households, a number set to pass 12 million by 2008 – by which time, according to *Screen Digest*, the UK will be Europe's largest broadband country. Cable operators are now offering higher broadband speeds (1Mbits/s and 2Mbits/s respectively) that enable the downloading of movies in around two hours, with British Telecom already piloting its own 1Mbits/s connections.

According to a 2004 survey commissioned by the British Video Association (BVA), Film Distributors Association (FDA) and British Phonographic Institute (BPI), four per cent of weekly UK Internet users have illegally downloaded a feature film. Figures show a corresponding two per cent drop in DVD purchases with a calculated loss in sales of £46m in 2003. In the BVA/FDA/BPI survey, 18 per cent of film downloaders said that they were buying fewer VHS cassettes, whilst 10 per cent said it was adversely affecting DVD buying. Similar percentages seem to operate for the rental market: 13 per cent of those surveyed said they were renting fewer VHS tapes, with again 10 per cent renting fewer DVDs. The study concluded that last year, some 1.8 million Britons had downloaded films (each of them averaging 20 films a year). P2P filesharing networks are providing an ever-easier source of free illegal movies – and are likely the biggest unquantified threat to film industry revenues in the UK, with 28 per cent of those not currently downloading films in the country saying they are likely to do so in the future.

According to findings from a Spring 2004 survey conducted by Online Testing Exchange (“OTX”), one in five British people illegally download movies from the Internet and most buy fewer DVDs and videos as a result. It also said more people were likely to join the trend as movies became easier to download through broadband and smaller file sizes.

MPA statistics point to a continuing escalation in P2P filesharing, particularly on BitTorrent, and FACT searches in domestic environments are increasingly revealing computers with massive hard drive storage capacity with films stored on them, instead of master disc collections which would previously have been found. The films are offered either as Internet downloads or are burnt onto discs and sent by post. A developing aspect of this problem is the emergence of insular filesharing groups who will not accept newcomers without established members as sponsors, making test



purchases very difficult. In January 2004, FACT, working in conjunction with the British Phonographic Institute (BPI) and Police and Trading Standards, smashed an Internet piracy ring that consisted of 300 subscribers, in around a dozen major UK towns and cities. FACT also worked this year with the National Hi-Tech Crime Unit (NHTCU) to help crack a multi-million pound global Internet piracy organization following a joint operation with the Federal Bureau of Investigation and the U.S. Department of Justice. As a result of the international investigation three men believed to be part of a piracy organization known as 'Fairlight' were arrested in the UK. The UK arrests took place on April 21, 2004, when NHTCU officers together with officers from local forces executed search warrants at three addresses in Belfast, Manchester and Sheffield. Three men, a 30 year-old from Belfast, a 34 year-old from Manchester, and a 22 year-old from Sheffield were arrested. Recovered from these addresses were cracked software from all types of media, as well as seven computers, more than 100 CD copiers, offensive weapons and counterfeit driving licenses and credit cards.

Television

The level of signal theft piracy is thought to be approximately ten percent in the UK. Following an interview with a pay-television expert, *Inside Digital TV*, reported that pay-television subscriptions have increased over the last couple of years. It was revealed that this increase was due, in part, to a coordinated crackdown on piracy by manufacturers and operators alike.

Piracy Losses

Between 1998 and 2003, economic losses to the US motion picture industry due to audiovisual piracy in the UK were estimated at \$393 million. These losses do not include the impact of Internet piracy or the damage to the local British economy resulting from piracy.