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February 7, 2007

Ms. Sybia Harrison
Special Assistant to the Section 301 Committee
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508

Re: Special 301 Comments on Piracy of *Nintendo* Video Game Products

Dear Ms. Harrison:

Nintendo of America Inc. (Nintendo) submits this letter in response to the "Request for Written Submissions From the Public" which appeared in the January 9, 2007 Federal Register. In that notice, the Office of the United States Trade Representative (USTR) requested comments pursuant to Section 182 of the Trade Act of 1974 (19 U.S.C. 2242), known as "Special 301," on "countries that deny adequate and effective protection of intellectual property rights or deny fair and equitable market access to U.S. persons who rely on intellectual property protection."

Nintendo has provided information to the International Intellectual Property Alliance (IIPA) which is included in the filing of that organization. Nintendo is associated with the IIPA through its membership in the Entertainment Software Association (ESA). This letter provides more detailed information on piracy of *Nintendo* video game products, along with Nintendo's Special 301 placement recommendations.

Nintendo, its publishers and developers are being injured by the continued manufacture, assembly, distribution, import, export and sale of counterfeit *Nintendo* video game products across the globe, resulting in approximately \$762 million in lost sales in 2006. Through Nintendo's anti-piracy efforts and cooperation of various government enforcement authorities, over 1.2 million infringing *Nintendo* products and components were seized worldwide in 2006.

Worldwide piracy of *Nintendo* video game products remains a chronic problem resulting in huge losses, despite Nintendo's anti-piracy programs in almost 50 countries. Special 301 has proven to be a highly effective tool in highlighting those countries which do not provide adequate protection of copyrights and trademarks.

For 2006, Nintendo recommends that the USTR designate: (1) China and Paraguay for monitoring under Section 306 of the Trade Act and Priority Watch List; (2) Mexico be included on the Priority Watch List; (3) Brazil be designated on the Watch List; and

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(3) Hong Kong as deserving Special Mention and USTR's active monitoring. Nintendo's experience over the past year in these countries is presented below.

NINTENDO OF AMERICA INC.

Nintendo of America Inc., based in Redmond, Washington, serves as headquarters for Nintendo's operations in the Western Hemisphere and markets the highly successful line of *Nintendo* video game products. Also located on Nintendo's campus in Redmond is Nintendo Software Technology Corporation which creates game software for Nintendo's video game systems. Nintendo is the holder in the Western Hemisphere of Nintendo's intellectual property rights, including copyrights and trademarks. In addition, Nintendo coordinates the worldwide anti-piracy program on behalf of its parent company, Nintendo Co. Ltd. of Kyoto, Japan.

Nintendo video game hardware platforms (i.e. *Nintendo GameCube*, *Wii*, *Game Boy* and *Nintendo DS*) play Nintendo's proprietary game software as well as games created by its third party licensees. There are over 100 U.S. companies which independently create, license, market and sell *Nintendo* video game products. The earnings of these companies are also adversely affected by worldwide piracy of these products.

BRAZIL

The combination of extremely high tariffs and taxes placed on authentic video game products imported into the country, together with weak penalties against intellectual property crimes, has created a significant piracy problem in Brazil. Since those who smuggle counterfeit goods into Brazil do not pay duties or taxes, the price for pirated products is significantly less than the price for authentic *Nintendo* games. This has made it virtually impossible for legitimate video game companies to compete with the counterfeiters and to create a local industry in Brazil.

High Tariffs and Taxes Constitute a Market Barrier

While Brazil's large population and relative prosperity should make it a leading Latin American market for Nintendo, other factors conspire to dramatically reduce market potential. Taxes and tariffs constitute a tremendous barrier to market entry by pricing legitimate goods out of reach for most consumers. For example, Nintendo launched its latest console product called *Wii* in the Western Hemisphere in November 2006. The *Wii* had a manufacturer's suggested retail price in the U.S. of approximately \$250. In comparison, because of the high tariffs and taxes assessed on the product, in Brazil the *Wii* was priced at 2,399 Brazilian Reais or the equivalent of \$1,115 (USD).

Tariffs are generally 17.5% - 20% on video game products and a variety of taxes add even more to the cost of imported products. Relevant taxes include:

- Federal industrial products tax of 50% of the value (consisting of cost, insurance and freight or “CIF”) of the article;
- Miscellaneous tax of 1%;
- Two taxes which can be described as social security taxes which total 9.25%; and
- Value added tax of typically 17% or 18% which is imposed by Brazilian state governments.

To add to the burden, many of the above taxes are cumulative. For example, the industrial products tax is not just levied on the cost of the article, but the cost after the tariff and miscellaneous tax are already assessed. Similarly, the two social security taxes and state value added taxes are assessed on the total of the CIF figure, plus the tariff, federal tax, and miscellaneous tax.

The end result is that the eventual cost to a consumer of an authentic video game product is as much as eight times higher than the price of the counterfeit product. For example, an original *Game Boy* game is sold between the equivalent of \$120 to \$142 (USD) while the counterfeit game sells for the equivalent of \$16. Brazil’s complex tax scheme makes the price of *Nintendo* video games the highest in the hemisphere. The current tax structure prevents companies such as Nintendo from developing a market presence and providing a reasonably priced alternative to pirated products.

National Council on Piracy

According to the report published earlier this year by Brazil’s “National Council on Piracy and Intellectual Property Crime Fighting”, the actions taken by the Internal Revenue Department, the Federal Police and the Highway Police in 2006 decreased the market share of counterfeit and smuggled optical media products from roughly 70% to 40%. Counterfeiting and copyright infringement crimes were the subject of close to 7,000 inquiries made by the Federal Police during the first nine months of 2006. The Internal Revenue Department and Federal Highway Police also reported an increase in their activities against IP crimes.

Unfortunately, most of the positive enforcement activities by the Brazilian Government were quite limited to a very specific market segment. The actions initiated by the government were focused on optical media products such as illegal music and movie discs. Few actions, out of the 7,000 cases initiated, involved *Nintendo* video game products. In July 2006 the Specialized IP Unit of the State Police in Rio de Janeiro seized 600 counterfeit *Nintendo* cartridges while pursuing retailers at the Cameldromo de Uruguina for distributing illegal optical media products. While Nintendo is encouraged by the number of raid actions conducted, the Brazilian authorities have yet to prosecute these crimes and impose penalties against the infringers.

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According to the Brazil Council, the main goals for 2007 are: (1) to take actions for educational purposes, in order to discourage consumer consumption of counterfeit products; (2) provide assistance to the industries who are applying for tax cuts and assist them on coping with the impact the applicable tax rates have on product pricing; and (3) support legislative bills that will provide for severe penalties against smuggling or dealing in counterfeit products.

Although the 2007 goals appear promising, they are limited in scope to specific industries. Nintendo's hardware and cartridge based products would not benefit from the Council's objectives. Unless the Council broadens its enforcement actions and goals, Nintendo will continue to face significant market barriers in Brazil.

Anti-Piracy Actions

In 2006, Nintendo participated in 24 industry led anti-piracy actions, seizing over 10,000 products infringing Nintendo's IP rights. Acting on complaints filed by the industry organization, the police targeted street vendors and known markets for a wide variety of illegal goods. The police did not conduct a single action in 2006 on their own initiative targeting counterfeit *Nintendo* products. In addition, Brazil Customs did not stop any shipments of counterfeit *Nintendo* products in 2006. Considering Brazil borders Paraguay, a major transshipment country, Brazilian Customs must consistently patrol its borders to stop the flow of counterfeit products from entering the country.

While actions were initiated to combat the level of pirated products in the market, Nintendo has not seen much improvement. The piracy level for counterfeit *Nintendo* products in Brazil is at approximately 75%. Conducting raids merely to confiscate illegal products is not enough to curtail rampant piracy. Infringers must be held accountable for their illegal activities through strong prosecutions resulting in tough sentences and fines. Even the occasional conviction does not bring a meaningful sentence. Under the current system, there is little to deter IP crimes in Brazil.

The state and city government authorities in Sao Paulo have made attempts to curtail piracy by shutting down establishments in local area malls that fail to comply with tax regulations and fail to possess valid business licenses. Although this is a positive step, shop owners reopen their stores with little impact on their business operations or sales of counterfeit products.

Proposed Legislation

Bills have recently been introduced, but not yet approved by Congress, to impose harsher penalties on dealers of smuggled and counterfeit products. In particular, Bill No. 3.964/2004 proposes to amend Articles 184 and 186 of the Criminal Code in an effort to increase prison terms for piracy crimes and remove less significant sanctions such as community service. Bill No. 3.965/2004 proposes to increase jail terms and penalty fines for software infringement cases. Intellectual property crimes would no longer be

considered minor offenses by the court, but viewed as significant felonies. Another proposal is to eliminate the requirement of expert reports for all products seized, making the forensic review process quicker and more efficient. Nintendo respectfully requests that the U.S. press the Brazilian Government to adopt these laws in an effort to strengthen enforcement regimes and create stronger deterrence against IP crimes.

Recommendations

Nintendo is encouraged by some steps taken by the Brazilian Government in 2006, but piracy levels remain very high. Following are suggested steps which could improve IPR protection in Brazil:

- Improve coordination between federal, state and municipal authorities in pursuing IP crimes.
- Increase the number and sophistication of border controls and customs inspections, especially at the Brazil-Paraguay border. Customs seizures would have a stronger impact if cases were referred to the appropriate authorities for criminal prosecution.
- Develop greater judicial awareness of the effect of IP crimes on national and economic interests through training and education, with the goal of producing more deterrent sentences for IP crimes.
- Adopt new legislation to raise the importance of intellectual property crimes in the Brazilian legal code and create an effective deterrent to smuggling and counterfeiting of video games and other IP products.
- Alter the current tax and duty structure to encourage the growth of the video game industry. If a legitimate video game market is to develop, the Brazilian Government must adopt an appropriate tax and duty scheme to allow for the import of authentic video game products. High tax rates on products, including video games, encourage piracy and counterfeiting rather than stimulating the national economy.

PEOPLES' REPUBLIC OF CHINA

Throughout 2006, China remained the international production center of infringing *Nintendo* video game products. China is clearly the leading production site, has the largest domestic consumption of these illicit products, and is the leading worldwide exporter of counterfeit *Nintendo* video game products. As a result, Nintendo recommends that China remain on the Priority Watch List and subject to Section 306 monitoring.

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Further, Nintendo has seen no progress in fulfilling China's commitment to increase use of criminal prosecutions as a deterrent to the rampant piracy affecting Nintendo and hundreds of other IP rights holders.

Anti-Piracy Actions

Over 800,000 infringing *Nintendo* items were seized in China during the year. Customs authorities in 13 countries around the globe seized over 75,000 counterfeit *Nintendo* video game products originating in China. While many products are shipped directly from Chinese ports, Hong Kong is perhaps the single largest transshipment point for counterfeits manufactured in China.

Nintendo focused its anti-piracy activities in Guangdong Province. Guangdong Province is the home to countless factories and wholesalers producing and distributing mass quantities of counterfeit *Nintendo* software. Based upon complaints filed by Nintendo, a total of 24 factories, warehouses and retail operations in the Province were raided by Chinese administrative authorities in 2006, including the local Administrative Information Committees (AIC) and Technical Supervision Bureaus (TSB). Despite the fact that over three quarters of a million infringing items were seized in China in 2006, not a single criminal action pursuing a counterfeiter involved in fake *Nintendo* products was initiated during the year.

Troubling New Restrictions on Bringing Administrative Cases

Fewer raid actions were conducted by *Nintendo* in 2006 because of new evidentiary requirements adopted by some administrative agencies. Administrative officials in Shenzhen and Guangzhou – the latter perhaps the largest piracy center in the Province -- have now required the complainant to submit samples of counterfeit goods along with sales receipts. Many assembly factories, warehouses or workshops that distribute counterfeit *Nintendo* video game products operate illegally without a business license. The illegal businesses certainly do not provide an invoice or sales receipt at the time they sell a counterfeit item. The new restrictions appear to be specifically designed to signal infringers as to precisely how to avoid being raided. As a result, the administrative officials refused to raid numerous targets that Nintendo thoroughly investigated and confirmed their counterfeit activities. As these new requirements become better known among the criminal community involved in manufacturing and distributing counterfeit *Nintendo* products, it is predictable that none will be willing to provide sales receipts in the future.

At a time when Chinese authorities assert they are trying to increase the number of criminal cases, by this action local authorities have made it far more difficult to bring charges.

Criminal Cases

Nintendo continues to be frustrated by the Chinese enforcement authorities' failure to pursue infringers through the criminal justice system. During the year, 24 raid actions

involving counterfeit *Nintendo* products were conducted, but not a single action was initiated or prosecuted by Chinese criminal enforcement authorities. Many of these actions involved willful commercial-scale infringement. For example, acting upon Nintendo's request, Guangzhou AIC officials in the Liwan Branch raided a warehouse storing 16,600 counterfeit *Game Boy Advance* products on July 21, 2006. Subsequently, the illicit goods were destroyed; however, the counterfeiter received no monetary penalty. Moreover, the case was never transferred to the Public Security Bureau (PSB) for criminal prosecution.

While there were no criminal prosecutions in China during the year, criminal actions were initiated in 16 countries worldwide involving far smaller amounts of counterfeit *Nintendo* products. For instance, a Polish court sentenced a street vendor to three months in prison and a fine after the police seized only 45 counterfeit *Game Boy Advance* products. As another example, a German court mandated an eBay seller to 24 months in prison after customs confiscated 14 counterfeit *Game Boy Advance* products.

Imprisonment and stiff fines serve as strong deterrents to counterfeiters. China must pursue infringers through criminal prosecutions in order to achieve a reduction in counterfeiting. China is totally out of step with the rest of the world in dealing with these IP crimes.

Chinese Customs

Counterfeit *Nintendo* products continue to flow freely out of China and into the global market place. Chinese Customs have failed to vigorously target and inspect items exported from Guangdong Province. During the year, customs authorities in 13 other countries seized pirate *Nintendo* products originating from China; however, not a single shipment was halted by Chinese Customs.

Continuing Enforcement Obstacles and Recommendations

Problems in effective enforcement of IP rights in China are well known and common to rights owners. They did not change significantly in 2006 and remain as follows:

- In order to avoid detection by investigators, counterfeiters will refuse to provide an invoice or sales receipt at the time of sale. The increased evidentiary requirement to have sales receipts, making administrative actions much more difficult, is a huge new obstacle to enforcement and should be abolished.
- In 2006, seven administrative penalty decisions were reported. No jail time was assessed in any of these cases. In three cases the counterfeiters were fined. The largest fine of the three was \$753 (USD), which was based on a seizure that was conducted in 2004 of 2,600 counterfeit *Game Boy Advance* products. In the remaining four cases, the administrative authorities only ordered the infringers to forfeit the seized products, totaling 13,800 items. Repeat offenders often pay

insignificant administrative fines and ignore judicial orders to cease their infringing activities. Significant administrative fines consistently imposed on counterfeiters would help to financially impact the production of the illegal products.

- The methodology used for placing a value on seized articles is seriously flawed. China's local Price Evaluation Bureau (PEB) authorities use the price of the counterfeit item, or the price provided by the infringer, to calculate the value of the infringing goods. As a result, the value placed on the infringing products is quite low and the criminal threshold is seldom ever met.
- In order to avoid punishment, many counterfeiters are sophisticated enough to keep stock levels below the criminal threshold and not keep sales records. They keep components on hand and then quickly assemble and ship finished products immediately after the infringing products are assembled. To overcome this loophole, the method of valuation must include the value of all finished and partially assembled products and infringing components. These components often present the best evidence of the scale of the illegal operation.
- Even when the criminal thresholds are met, some cases are not accepted by the Public Security Bureau (PSB) because the PSB is not satisfied with the evidence provided by the administrative authorities. In the past five years, Nintendo has seized over seven million fake products and components from hundreds of factories, warehouse and retail outlets in China. During that time, the local administrative authorities have only successfully transferred three cases to the PSB for criminal prosecution. Only one resulted in a conviction. In addition to the PSB, Chinese administrative agencies must be granted the authority to transfer cases to the People Procurator for further prosecution.
- Major criminal organizations operate well-developed and protected distribution networks in China, with close connections to Hong Kong and Taiwan. China, Hong Kong and Taiwan do not work together to investigate and pursue these organizations. Indicted criminals can flee to one of the other countries and successfully escape justice. These operations are so tightly organized that only the Chinese Government can stop the illegal activities.
- Despite the flow of tens of millions of counterfeits from China which were distributed globally, Chinese Customs did not seize one single shipment of counterfeit *Nintendo* video games in 2005 or 2006. Chinese Customs has weak inspection procedures and they need additional resources devoted to pursuing intellectual property crimes. Customs must develop the means to deal effectively with false documentation of shipments which makes tracking down criminals virtually impossible. Inspectors must continually be trained on how to identify infringing goods. Further, Customs needs to be better integrated into China's

administrative and criminal justice systems so significant penalties can be imposed. Penalties must be high enough to serve as a deterrent and procedures must be implemented to allow for cases to be easily transferred to the criminal authorities for prosecution.

- China must better educate its judicial and enforcement personnel as well as the general public that piracy is a serious crime. The government should periodically launch campaigns to urge consumers to buy legitimate products and report piracy to local enforcement authorities.

HONG KONG

Hong Kong is the home to one of the busiest container ports in the world. In 2004 alone, Hong Kong authorities report that they handled 22 million 20-foot containers, 35,900 ocean vessels and 189,520 river vessels. All vessels entering or leaving the waters of Hong Kong are subject to customs inspections. It is no wonder that Hong Kong serves as a major transshipment point for pirated *Nintendo* video games originating in China, destined for the U.S., European and Latin American countries.

In 2006, over 34,000 counterfeit *Nintendo* products exported from Hong Kong were confiscated by authorities in France, Germany, Italy, Netherlands, Taiwan, the United Kingdom and the U.S. The majority, if not all of these products were manufactured in China and illegally exported without detection by Chinese or Hong Kong border authorities. In the U.S. alone, customs seized nine shipments, totaling 27,500 in counterfeit *Nintendo* products transshipped via Hong Kong. To date, Nintendo is not aware of a single seizure conducted in 2006 by Hong Kong border authorities of fake *Nintendo* products despite the flow of goods being imported into and exported from Hong Kong. While Nintendo recognizes the volume of containers that pass through Hong Kong's borders, it is important that the Hong Kong Government evaluate its current financial and human resources and place a higher priority on inspecting shipments. Hong Kong's failure to sufficiently police its borders is seriously impacting Nintendo's ability to distribute authentic video game products globally.

For over ten years, Nintendo has worked with Hong Kong authorities in an attempt to curtail the distribution of counterfeit *Nintendo* products. As a matter of practice, Nintendo provides Hong Kong Customs with copies of the seizure notices issued by U.S. Customs when a shipment of counterfeit products, transshipped via Hong Kong, has been stopped. While Nintendo has been assured that investigations and legal actions will be initiated against the exporters of the counterfeit goods, not a single such action has been brought. Over the past four years, Nintendo has provided Hong Kong Customs with over 30 notifications.

On a positive note, in 2006, Hong Kong Customs has had considerably greater success in raiding retail outlets than seizing shipments. Acting on information provided by Nintendo, there were 17 retail raids during which 46,000 counterfeit video game products were seized. The number of counterfeit *Nintendo* products seized at the retail level is almost eight times higher than the number seized in 2005. Nintendo appreciates the enforcement efforts of Hong Kong Customs in reducing the availability of counterfeit *Nintendo* products at the retail level.

Recommendations

Following are suggested steps which could improve IP protection in Hong Kong:

- Allocate substantially greater financial resources towards monitoring the import and export of counterfeit *Nintendo* video game products. Goods entering Hong Kong from China require special attention.
- Take measures to prevent importers and exporters from falsifying contact information on shipping documentation. Exported products shipped with false documentation are a common problem that prohibits customs authorities from investigating the source of suspect shipments.
- Establish more cooperation with Chinese enforcement authorities to curtail the flow of counterfeit *Nintendo* products made in China for international export.
- Improve training and performance of customs inspectors, prosecutors, and judges in IPR cases.
- Continue enforcement efforts against retail outlets and street markets with raids and seizures, followed by arrests, prosecutions and deterrent sentences.
- Secure convictions against business and business owners/ managers/ directors that are exporting or selling counterfeit *Nintendo* video game products.
- Investigate upstream suppliers, distribution channels and syndicates engaged in piracy operations.

MEXICO

Mexico is Nintendo's largest market in Latin America. Mexico's high piracy rates have a negative impact on Nintendo's ability to market and distribute its product in the country. Significant obstacles in conducting enforcement actions permeate throughout the Mexican system, including the role of organized crime and the constant threat of violence. Media coverage in the past year has shown an alarming level of violence and civil unrest that challenge the authority of the Mexican Government and spread fear and

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intimidation to Mexico's law enforcement, making it difficult to take an aggressive stance against IP enforcement and criminal activity. Hopefully the strong steps taken by President Calderon will significantly reduce the level of violence in Mexican society.

Pirated products will continue to saturate the Mexican market until efforts are taken at the borders to prevent the entry of illegal goods. Criminals are taking advantage of ineffective border enforcement to build major assembly operations for pirated *Nintendo* video game products in Mexico. Nintendo therefore recommends that Mexico be elevated to Priority Watch List for 2007.

Anti-Piracy Actions

In July 2005, customs authorities in Mexico, acting on a tip from Canadian authorities, seized a total of 115,000 *Game Boy Advance* components, including PC boards, plastic cartridges, packaging, and instruction manuals. Tools necessary for assembly of the products were also seized in the larger of the two shipments. Both originated in Shenzhen, China, a manufacturing center for counterfeit *Nintendo* products. Unfortunately, 18 months later, the importers have never been located. The case is dormant and the fate of the seized counterfeit *Nintendo* products is not known.

In 2006, acting on complaints filed by Nintendo, two major multi-target anti-piracy operations were conducted by Mexican enforcement officials, whereby approximately 106,400 counterfeit *Nintendo* products were seized. Both actions were criminal police seizures targeting street vendors and known markets for a wide variety of illegal goods.

In September, the Attorney General's Office and Federal Agency of Investigations coordinated with the police to raid two major markets in Guadalajara. A total of 32 vendors were targeted in the Mercado La Fayuca and Mercado San Juan de Dios markets, resulting in the seizure of 105,948 infringing *Nintendo GameCube* and *Game Boy Advance* products. Although the issuance of search warrants had been continuously postponed due to the instability of the political environment, the raids finally took place with the support of approximately 100 police officers. Some market vendors had fairly sophisticated operations for burning counterfeit *Nintendo GameCube* discs on site, while others were focused on assembling counterfeit *Game Boy Advance* cartridges. The seized products are being held by the Attorney General's Office for their expert examination. Although market stalls were temporarily shut down, no arrests were made during the operation.

The second action took place in October at Mexico City's Pericoapa Bazaar, targeting 18 stalls in the marketplace. Criminal authorities seized 452 counterfeit *Nintendo* products. Fourteen prosecutors attended the action and at least 150 police officers were present. In addition to the seizure of counterfeit *Nintendo* products, authorities uncovered equipment such as disc burners, monitors and consoles used to manufacture and assemble counterfeit products for the entire video game industry. The status of this case remains under review by the Attorney General's Office.

Assembly Underway in Mexico

Based on the raids conducted in Mexico and the shipments stopped by U.S. Customs in 2005 and 2006, it is clear that Mexican counterfeiters have strong connections to Asian factories producing fake components. Mexico has major assembly operations underway producing counterfeit *Nintendo* products.

In December 2005, U.S. Customs authorities stopped two large shipments of *Game Boy Advance* components, transshipped through Hong Kong, that were destined for Mexico. One shipment contained over 44,000 counterfeit components including *Game Boy Advance* manuals and packaging. Investigations failed to find any data about the existence or commercial activity of the Mexican import company.

In 2006, U.S. Customs stopped six separate shipments consisting of close to 32,000 counterfeit *Nintendo* components intended for Mexico. Four of the seizures conducted, totaling over 29,000 counterfeit components, originated in China, transshipped through Hong Kong and were stopped by customs in Alaska. The remaining two shipments heading for Mexico originated in China and were seized by Miami Customs. *Nintendo* was able to track one of the shipments to its Chinese source and the factory was raided. However, the Mexican importers were never identified due to false shipping records. In all cases, investigations confirmed that the importer information was false or untraceable.

Mexican Customs

Even though U.S. Customs blocked significant quantities of counterfeit *Nintendo* components from entering Mexico in 2006, it is only a fraction of the amount of counterfeit products that flow freely into the country. Infringers effortlessly import counterfeit *Nintendo* components and products into Mexico and establish assembly operations in well-known markets. Counterfeit *Nintendo* products are widely available at informal markets and through local street vendors.

Mexican Customs appear to have no policies or controls in place to curb the smuggling of counterfeit components or products into the country. Customs authorities must aggressively screen, target and inspect consignments in an attempt to limit the high volume of counterfeit goods entering Mexico. In particular, mandatory screening protocols must be established to target all suspect consignments that fall within the scope of products known to have high piracy rates in Mexico.

Nintendo's experience with Mexican importers shows a common pattern where companies are simply invented and fake information is provided in order to import counterfeit goods. Pirates use customs brokers to avoid detection by authorities when importing counterfeit products. At present, customs brokers have no responsibility for the role they serve as "middle men" for counterfeit transactions and thus avoid being directly linked to infringers. Customs brokers must be held accountable for ultimately

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concealing criminal identities and for managing counterfeit shipments that cross Mexican borders.

U.S. Customs issued a recent report of top trading countries for IPR seizures in fiscal year 2006. Mexico has been added to the list of top 10 trading countries for infringing products. Mexico is now associated with countries which are notorious for piracy such as China and Malaysia.

Enforcement Obstacles

Due to the widespread availability of counterfeit *Nintendo* video game products in popular shopping areas of Mexico City and Guadalajara, additional criminal actions were planned during the busy holiday season. Unfortunately, obstacles hindered Nintendo's ability to conduct additional raids in 2006. One was the lack of police agents available to carry out raids. The Mexican Government sent a large number of police officers to Michoacan State to restore order in areas plagued by drugs and violence, reducing police strength in the capital. Another factor was the threat of violence. In December, police attempted to raid the popular Plaza Meave marketplace. Officers were faced with dangerous conditions as violence erupted during the attempted raid. As a result, criminal authorities made the decision not to conduct additional actions for the remainder of the year.

Problems in effective enforcement of IP rights in Mexico have not improved in 2006 and remain as follows:

Mexican Industrial Property Institute (IMPI). Though administrative enforcement through IMPI can produce results, there are major challenges in the system. IMPI actions are merely "inspections" whereby infringing products can be seized. IMPI inspections conducted at informal markets are extremely risky due to the potential for violence. Inspection actions must be carefully planned and involve hundreds of security personnel to deter violence. This can bring long delays in conducting the actions and leads to leaks which alert criminals to the raids. Accordingly, IMPI's results are insignificant.

When IMPI seizes counterfeit products, it can take years to issue a final decision. Meanwhile the infringers continue their illegal distribution at alternate locations. IMPI's actions have had little impact on the market and certainly do not served as deterrence against piracy.

In addition, injunctive relief issued against infringers is rarely enforced by IMPI and the orders are consistently challenged before Federal Courts. There are constant disputes about IMPI's procedures on the applicability of the Federal Law on Administrative Procedures between the Judicial Federal Courts and the Fiscal and Administrative Tribune.

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There have been recent press reports in Mexico about the formation of IMPI's new "intelligence agency". Apparently, the Department of Treasury has authorized 17 new posts to handle IP enforcement activities. Other than the media reports, there is little known about this agency. To date, Nintendo has been unable to obtain information from IMPI regarding its new agency and its activities.

Attorney General's Office. There are several limitations on the ability of the Attorney General to protect intellectual property rights. Prosecutors in general have little knowledge of intellectual property laws. "Experts" within the Attorney General's Office have limited ability to analyze counterfeit products. The procedural requirements one must follow when filing a criminal complaint with the Attorney General's Office are extremely formal and cumbersome. As there is no priority placed on pursuing IP crimes, it currently takes approximately one to two months to obtain a search warrant. Currently, the IP owner provides the prosecutor with the evidence necessary to persuade the Penal Judge to grant a warrant. Unfortunately, the prosecutor can sit on the evidence for long periods of time delaying the issuance of the search warrants. Certainly this practice is a clear example of the lack of attention placed on conducting anti-piracy actions. Once evidence is received, the prosecutors must act quickly to request the Penal Judge to issue the search warrants.

Attempts are being made to change the criminal law and allow prosecutors to act *ex officio*. Many cases uncover counterfeit products but prosecutors are not authorized to seize the counterfeit goods if they do not have a complaint filed by the IP rights owner. In principle this is a very beneficial change, but Nintendo is concerned that should criminal actions change from "*ex parte*" actions to "*ex officio*" actions, incidents of extortion and corruption will increase. Due to the prosecutors' lack of knowledge of both intellectual property laws and identification of counterfeit products, there are concerns that legitimate products will be seized, criminal cases will be severely impaired and it could increase the level of corruption. Transition to an *ex officio* regime must consider these potential difficulties.

Federal Preventive Police (FPP). Weaknesses also exist within the FPP. As an example, Police have little knowledge of intellectual property laws. All actions taken by the FPP must first involve IMPI, the Attorney General's Office or any other authority such as the Department of Treasury. Although they can be effective, this procedural hurdle results in significant delays in FPP actions. There are power disputes between the FPP and the Attorney General's Office, as well as with IMPI, which detract from any meaningful enforcement activities.

Mexican Court Systems. There are significant problems found within the Mexican Court systems which impair effective enforcement of IP rights. Nintendo's 18 year effort to gain exclusive rights to the *Game Boy* mark in Mexico stands as a prominent example.

Courts give a low priority to IP cases, so final resolutions are very slow in being

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reached. During the long pendency of these cases, counterfeiters go unpunished and continue to sell infringing goods. The Administrative, Penal and Civil Courts are all generally unfamiliar with intellectual property laws, resulting in poor and inconsistent decisions related to IP matters. Decisions of the Federal Tribunal of Fiscal and Administrative Justice are extremely slow in being reached (often more than 12 months). This practice certainly discourages IP owners from enforcing rights in Mexico.

The Mexican Supreme Court of Justice has decided that damages can only be collected when administrative procedures are finally decided by the Mexican Federal Courts. This reasoning is inconsistent with Mexican IP laws and ultimately prevents IP owners from properly enforcing their rights in Mexico.

Trademark Dispute

Nintendo's trademark dispute in Mexico, now in its 18th year, over full rights to the famous *Game Boy* trademark was not resolved during 2006. Details have been presented in recent Special 301 submissions beginning with Nintendo's 2002 filing. It is also the subject of a trade complaint filed with the Department of Commerce in November, 2001, which remains pending.

Grupo Von Haucke (GVH), a company owned by Juan Manuel del Castillo Von Haucke, was granted rights to the famous *Game Boy* name in 1989. Von Haucke has no right to the mark under international law and Mexico is the only country in the Western Hemisphere in which an individual or organization other than Nintendo has any rights to the *Game Boy* trademark. However, repeated attempts to recover its famous mark under Mexican law have been fruitless.

During 2006, Nintendo continued to pursue this matter on several fronts. Most prominent was Nintendo's effort to combat GVH's cancellation of Nintendo's trademark registration for "*Nintendo Game Boy*" on the grounds of non-use. This claim dates back to 1997 when GVH first filed a cancellation action against the registration before IMPI. In 2001, IMPI cancelled Nintendo's registration, asserting that despite the evidence Nintendo submitted proving use of the trademark, such as affidavits, invoices and magazines, the use was done by its authorized distributors and not Nintendo directly. IMPI further stated that there was no recorded license agreement between Nintendo and its distributors. Nintendo strongly disagrees with this reasoning.

Since the 2001 decision, the case has been appealed to numerous courts and then remanded with differing opinions issued. In early 2006, the Superior Court of the Federal Tribunal of Fiscal and Administrative Justice (TFJFA) issued a judgment ordering IMPI to reverse its decision and deny the cancellation of Nintendo's registration of this famous mark. Seven of ten TFJFA Magistrates found that with other evidence, it was proved that Nintendo participated in the commercialization of the products bearing the *Nintendo Game Boy* trademark from the first moment of manufacturing to the distribution of products in the Mexican market.

Ms. Sybia Harrison
Office of the United States Trade Representative
February 7, 2007

Unfortunately, GVH once again filed another Amparo with the Second Circuit Court. The Magistrates of that Court by ruling dated March 27, 2006 overturned the TFJFA judgment. They ruled contrary to what the Superior Court of the TFJFA found, that none of the evidence filed and analyzed by the TFJFA established that Nintendo had the intention to commercialize products within the Mexican Territory. On May 3, 2006, the Superior Court issued a fourth judgment in fulfillment of the Circuit Court's third Amparo ruling and confirmed the IMPI's resolution to cancel the *Nintendo Game Boy* trademark 411276 (owned by Nintendo) based on non-use. Nintendo filed an Amparo against the Superior Court's fourth judgment with the Second Circuit Court. As of December 2006, the Second Circuit Court has remanded the case back to IMPI to review. It is Nintendo's hope that IMPI will reevaluate and evolve its rules concerning the trademark use.

The original issue which Nintendo raised in Mexico concerned a registration of the *Game Boy* brand by GVH in 1989. Though previous cancellation proceedings had been unsuccessful, with IMPI's encouragement Nintendo filed its own new application for a *Game Boy* registration. In December 2003, also with IMPI's encouragement, Nintendo filed a third cancellation action against GVH, asserting non-use of the *Game Boy* mark. However, IMPI ruled against Nintendo in November 2004 and an appeal resulted. In December 2005, TFJFA denied Nintendo's appeal, again ruling in GVH's favor. Nintendo filed an Amparo appeal seeking further review. As a result of several rulings, the case has been remanded to IMPI for consideration of evidence offered by Nintendo. Further decisions are expected to be made in mid - 2007.

Based upon Nintendo's years of experience, it is clear that the trademark cancellation procedures in Mexico are terribly weak. They simply provide no relief whatsoever. Mexican law has no opposition procedure and IMPI generally ignores opposition writs, leaving cancellation the only alternative for an aggrieved rights holder. The cancellation process may take years to be resolved, as in the Grupo Von Haucke case. Decisions by IMPI currently take approximately 18 months. Mexican law provides that an administrative act should not take longer than four months. According to Mexican Law, when a mark has not been used actively it may be cancelled. However, IMPI has consistently taken the position that "token use" suffices to thwart a cancellation action for non-use. This position is not in compliance with Mexican Law, particularly article 62 of the Regulations of Industrial Property.

Recommendations

Following are suggested steps which could improve IP protection in Mexico:

- Trademark cancellation procedures are weak and must be strengthened to comply with Mexican law, particularly article 62 of the Regulations of Industrial Property.
- Procedures involving filing of criminal complaints and the issuance of search

warrants must be improved. It is critical that anti-piracy actions be conducted in a swift manner. Currently, the long delays in obtaining a search warrant makes it virtually impossible to conduct a successful action.

- IMPI must accelerate issuance of penalty decisions. Currently, it takes many months or sometimes years to obtain a final resolution. The continued delays actually promote piracy, rather than stopping it.
- Mexican Courts and prosecutors must place more priority on IP cases. The Courts must order prosecutions and deterrent sanctions against counterfeiters.
- Additional resources must be devoted to customs in an effort to improve effectiveness in halting the importation of counterfeit goods and components. Procedures must be developed to effectively deal with importers falsifying shipping documents.
- Customs must implement inspection procedures to effectively screen for and seize products known to be highly counterfeited, such as video game products and components.
- Customs regulations must be revised to allow the agency to quickly facilitate the seizure of products without first obtaining approval from IMPI, which is not immediately granted.
- Procedural hurdles for actions taken by the FPP should be removed. The conflict between the various enforcement agencies, such as the FPP, IMPI and the Attorney General's Office, must be immediately resolved so that actions and criminal prosecutions can be conducted.
- Prosecutors must be adequately trained on criminal procedures and detecting counterfeit products before any legislation is enacted granting them the authority to act *ex officio*.
- The Mexican Government should launch an effort to better train its judicial and enforcement agencies on IP laws.
- The government should also begin an aggressive educational campaign to demonstrate to the general public the impact piracy has on its local economy and the benefits of supporting legitimate businesses that pay taxes.

PARAGUAY

Paraguay has long been recognized as a major hub and transshipment point for pirate *Nintendo* video game products entering Latin America from Asia. Residents of neighboring countries travel to Ciudad del Este in particular just to purchase counterfeit goods. Further, due to the history of lax enforcement, pirates have set up assembly operations within Paraguay's borders. Seizures in 2006 and in previous years involved thousands of counterfeit components such as packaging, labels and cartridge housings intended for assembly of finished goods. Police have identified some assembly operations in progress during raids of warehouses.

Due to the lackluster work performed by the Paraguayan authorities in 2006, Nintendo has seen an increase in piracy in the retail market. The piracy level of counterfeit *Nintendo* video game products in Paraguay is now estimated at 95%. In addition to hard goods piracy, there is a new trend involving Internet piracy. The tendency for users to upload and download illegal copied *Nintendo* software from the Internet has become more problematic.

Anti-Piracy Actions

Paraguay's role in international *Nintendo* video game piracy did not change in 2006, but unfortunately its enforcement efforts did. Enforcement activities involving counterfeit *Nintendo* products plummeted in 2006 compared to the prior year. In 2005, there were 26 actions resulting in the seizure of approximately 395,000 counterfeit *Nintendo* products. In contrast, there were only five actions in 2006 during which less than 50,000 infringing *Nintendo* items were seized. The police conducted all five raids which targeted warehouses and retail establishments.

Over one half of all seized items were obtained in a single notable raid at the CDE Gallery Page market. Police discovered a secret latch that opened three separate stockrooms at the market. Close to 30,000 counterfeit *Nintendo* products were seized from underneath a bunker in one of the stockrooms. The police also confiscated documentation and invoices identifying the owner and origin of products from China. The case remains in the investigation phase by the Attorney General's Office. Unfortunately, it has been in this phase for the past seven months with no activity reported.

Despite the flood of counterfeit components entering Paraguay and the assembled goods exiting the country, there were no shipments of infringing *Nintendo* products stopped by Paraguayan Customs in 2006. Fortunately, in early 2006, U.S. Customs, located in Miami, seized a shipment of close to 2,000 components used to assemble counterfeit *Nintendo* products, originating from China destined for Paraguay. Since Paraguay remains probably the top transshipment country for counterfeit goods smuggled into other Latin American countries, the lack of effort by Paraguayan Customs is disturbing and impacts the availability of pirate *Nintendo* products throughout the

region.

Memorandum of Understanding

The U.S. and Paraguay renewed the existing Memorandum of Understanding (MOU) in March 2006 and it remains in effect until the end of 2007. Nintendo welcomes this development. The MOU commits the Paraguayan Government to a serious effort to enforce intellectual property rights and Nintendo believes it has been effective in past years in spurring the Paraguay Government to focus more attention and resources on combating intellectual property crimes.

Unfortunately, enforcement levels in 2006 suggest Paraguay's efforts to disrupt piracy operations slackened considerably last year. The failure of Paraguayan Customs to identify a single shipment of pirate *Nintendo* products is particularly disturbing. Nintendo urges USTR to press the Paraguayan Government to return at least to the enforcement levels seen in 2005 and to continue to monitor the MOU under Section 306 of the Trade Act of 1974. U.S. assistance has played an important role in building the capabilities of Paraguay to fight piracy and counterfeiting in the past. Nintendo urges the U.S. to continue providing financial assistance and training to aid the Paraguayan Government only if the government accepts and makes every effort to fulfill its responsibilities under the agreement.

Ties to Organized Crime and Terrorism

The piracy operations in Paraguay appear to have strong connections to organized crime and fund international terrorism. In 2005, a police and customs action involving counterfeit *Nintendo* products targeted the operations of the Barakat family. Nintendo first learned of a Barakat family member, Assad Ahmad Barakat, involved in *Nintendo* piracy in 2001 when Customs at the Chaco-i border station on the Argentine border seized approximately 4,000 counterfeit *Nintendo* products destined for his warehouse. Press accounts in 2002 suggested that he was a regional operative for Hezbollah. Strong deterrent effects that will damage the effective management of piracy business operations must be a major focus for U.S. and Paraguayan Governments.

Corruption

Nintendo has pursued anti-piracy actions in Paraguay since 1997. In 2004, it decided to launch a more aggressive campaign coinciding with the election of a new government publicly announcing its dedication to end smuggling and corruption which have long been endemic in the country's economy. Unfortunately, despite the claims made by the new government, Nintendo continues to witness corruption at various levels within the judicial system. Counterfeit products have mysteriously disappeared from storage facilities or authorities have simply released counterfeit goods to the importer without explanation. One of the most flagrantly corrupt practices in the judicial system lies with purportedly expert witnesses, who routinely sell their testimony to the highest bidder and submit false testimony. Corruption also brings violence and a lack of security to those fighting piracy and struggling to protect intellectual property rights.

Corruption, especially in Ciudad del Este, pervades all aspects of the judicial system, e.g. Customs, prosecutors, the courts, etc. Strong measures must be taken to have any positive impact. In a timid step, the new Paraguayan Government reportedly targeted IP-related corruption by removing corrupt authorities from the Paraguay-Brazil border. However, recent reports indicate that the removed officials kept their ranks and continue to work at the border between Paraguay and Argentina. Merely transferring corrupt officials to different locations will not end the serious corruption that continues to plague Paraguay.

Tax Reform

The Paraguayan tax reform (Law No. 2421/04 Administrative Re-ruling and Tax Reform) legislation that was to be implemented on January 1, 2006 was postponed several times. Finally, the legislation was implemented on January 1, 2007. Consequently, it is too soon to see any benefit from this new tax reform law. Nintendo has been advised that if this law is properly enforced, it will allow the authorities to pursue individuals who fail to place the appropriate value on their shipments and who take steps to avoid paying taxes. Hopefully targeting individuals who are illegally profiting from the undervaluation of pirated goods and bypass paying taxes in connection to their counterfeit operations will be an efficient tool in the fight against piracy in Paraguay.

Recommendations

Following are suggested steps for improvement of IP protection in Paraguay:

- Enforcement problems in Paraguay begin at the borders. Paraguayan Customs has always been under-funded and improvements to better control piracy and counterfeiting have traditionally not been priorities of the central government. While the current government has recognized deficiencies and is striving to improve border enforcement, much remains to be done to root out corruption and recover from years of neglect. Nintendo urges the U.S. Government to make strengthening customs a priority in the consideration of aid to Asuncion.
- A major deficiency in enforcement in Paraguay is the ease with which criminals sentenced to prison sentences for IP crimes can buy their way out of serving time. Current law permits those convicted of IP crimes to substitute a fine for a prison term for such offenses. A law to eliminate this practice as well as to increase sentences for conviction of these crimes must be enacted. Copyright violations should be subject to longer prison sentences and fines should be added to prison terms, not be a substitute for them. Most infringers in Paraguay are very prosperous because of the lucrative nature of their crimes. For them, paying a fine is only a minor cost of doing business. Deterrent sentences must be imposed if Paraguay is to make a dent in piracy levels.
- Copyright offenses should remain a public offense. While this very positive

change in the law was made in 1999, a subsequent interpretation suggested that the provision could expire. Treating copyright infringement as a public offense is important for the criminal authorities' ability to initiate actions on their own initiative. Nintendo believes proactive actions by prosecutors are vital to combat piracy and counterfeiting.

- Nintendo encourages the U.S. Government to assist Paraguay in its battle to end the corruption that is embedded throughout its judicial system. Paraguay must find a way to disqualify expert witnesses who sell their testimony to the highest bidder. Such individuals must be stopped from testifying and corrupting the legal process. Furthermore, corrupt expert witnesses have never been punished or disqualified for rendering fake testimonies. The Supreme Court of Justice must actively intervene against this type of corruption.
- Paraguay needs strong independent district attorneys who specialize in intellectual property law and who are unquestionably above political influence and economic corruption. One area where progress has been noted is in the caliber of individuals recently appointed as district attorneys by the Attorney General.

CONCLUSION

The Special 301 process has become one of the most effective tools the U.S. has to encourage countries to make the necessary commitment to improve their intellectual property protection to the level of international standards. Nintendo of America Inc. respectfully submits its recommendations on Brazil, China, Hong Kong, Mexico and Paraguay. Nintendo welcomes the opportunity to work with USTR in any way possible to reduce piracy in these countries, and would be pleased to provide any further information or documentation that would be helpful.

Very truly yours,

NINTENDO OF AMERICA INC.

A handwritten signature in black ink, appearing to read "Richard C. Flamm". The signature is written in a cursive, flowing style.

Richard C. Flamm
Senior Vice President & General Counsel