

# EXHIBIT 1

## TO DECLARATION OF JON NICOLINI



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**Video Piracy Brief**

The United States leads the world in the creation and export of intellectual property (IP) and IP-related products.<sup>1</sup> Piracy, which is the unauthorized use or reproduction of copyrighted or patented material, jeopardizes this.

The freedom and incentive provided to authors, artists, and scientists to create new inventions and artistic works is an American tradition. U.S. patent law grants the originator of an invention or artistic work legal protection from copying and the freedom to profit from it. Article I, Section 8, Clause 8, of the U.S. Constitution declares that, "the Congress shall have power . . . to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." The First Congress of the United States further defined this with the Copyright Act of 1790.

### WHY PIRACY IS A PROBLEM

The U.S. motion picture industry loses more than \$3 billion annually in potential revenue<sup>2</sup> and unless online piracy is curbed, these losses will become even greater. It costs an average of \$82 million per film to produce and market, with only two in ten movies ever retrieving its total investment from U.S. theatrical exhibition. Each film must journey through various distribution channels – airlines, home video, satellite delivery, premium and basic cable, over the air TV stations and internationally – in order to break even or make a profit.<sup>3</sup> When piracy of a film occurs at any point in the release sequence, all subsequent markets are negatively affected.<sup>4</sup>

The Internet has the potential to be a convenient means for consumers to be able to watch any movie they want, when they want. However, with the advent of the Internet, the acquiring and spreading of illegal content is unprecedented. With just a click of a button, content can instantly be sent or received from anywhere in the world.<sup>5</sup>

Over the past few years, piracy has had a devastating impact on the music industry. The Internet has enabled individuals the ability to download music free onto their computer, in a matter of minutes. The music industry has been fighting this problem for years, and believes piracy is responsible for the low music sales they have been experiencing.

The motion picture industry however, has not experienced this problem to the same scale due to the very long time it takes dial-up users to download a movie. This has started to change as more Internet users continue to upgrade from slow dial-up Internet access to the fast-speed, broadband access afforded them through cable and DSL modems. There are roughly 70 million U.S. households with Internet access; of them, about 16 million use broadband access.<sup>6</sup> It has become all too common for newly released films to be illegally available on the Internet within 24 hours after their debut. And according to studies, millions of downloads of illegal movies occur each week.<sup>7</sup> As broadband access becomes more available and affordable to households, video piracy will likely grow.

Technology continues to improve, making illegal copies higher quality and the means to download them faster and easier. Unlike VHS tapes that degrade, the quality of the 1000<sup>th</sup> digital copy of a DVD is as good as the original.<sup>8</sup> Although many pirated movies are poor quality, movie studios are concerned that as counterfeit films become higher quality they could affect VHS and DVD revenues.

### HOW PIRACY HAPPENS

With video piracy, there are two basic phases: acquiring an illegal copy of a film, and distributing the illegal copy. There are many ways to copy illegally a movie. Some of the methods are:

**Camcording:** Pirates record a movie as it appears on a theater screen by smuggling a hand-held video camera into a theater. These copies are usually poor quality both visually and audibly.

**Telesync:** A more professional method than camcording in order to make a higher quality recording of a film. With or without the help of a theater employee, the pirate sets up a professional digital camera on a tripod in an empty auditorium and records the movie. To obtain higher quality sound they may employ methods like using wireless-transmitters on theater speakers,<sup>9</sup> running cables from the "hearing impaired" outlets or directly from the projection equipment.<sup>10</sup>

**Telecine:** A sophisticated method where the pirate has access to a film reel at a theater. Using a Telecine machine the pirate can record a very high quality copy of the movie either directly to a computer's hard drive or onto VHS tape and then digitize the copy at home.<sup>11</sup>

**Screeners:** These promotional preview films for marketing purposes are provided to video retailers or film reviewers before a movie's official street release. Pirates obtain a screener DVD and make a copy of it.

**Downloadable media:** A pirate will legally download a movie onto their computer, and then use software to break the encryption to make an illegal copy.

**Streaming media:** A pirate will copy a movie that is legally delivered to him or her in a steady stream in near real time.

**PVR/DVR and Video-on-Demand:** A pirate can intercept, divert and save media content that has been retrieved from a storage system, as it is being output to a TV screen

**Cable, satellite and Telco TV:** A pirate can intercept and save digital media content that has been delivered to a set-top box and decoded, as it is being output to a TV screen

**Workprint:** A pirate will obtain an incomplete copy of a film and copy it.

**Theatrical print:** A pirate steals a film from a theater, film depot, courier service or other industry-related facility.<sup>12</sup>

Once a pirate obtains an illegal copy of a movie, depending on the quality of the copy, the pirate can distribute it either online or sell it as a hard good. To distribute a film over the Internet, the pirate uses file compression software, and can then use Internet Relay Chat (IRC), which is a system used for chatting and file-swapping. Other Internet distribution methods are using peer-to-peer file-swapping software like Kazaa, Grokster or Morpheus, or using popular Usenets, which allow users to post messages, and share audio and video files. If a film is going to be sold, then copies are made onto VHS tapes, DVDs, or VCDs. These counterfeit films are then sent to illegal distribution channels in the U.S., or shipped overseas for sale even before the movie's international theatrical debut.

### WHY PIRACY HAPPENS

There are three groups of pirates: ordinary Internet users, amateurs, and professionals. Many ordinary Internet users believe that if it is on the Internet, it is free to all who can download it.<sup>13</sup> Those who believe this, will download and watch an illegal movie if it is easy to do. Amateur pirates are usually computer or Internet hobbyists with varying skills and motivation for pirating. Some make illegal copies for the "bragging rights" of being the first to provide a newly released film. Others believe they are providing a service to their Internet community at large. Some feel they are fighting the power of the movie industry or the government. Then there are those who do it as a hobby.

On the other hand, professional pirates are motivated by money. They sell illegal videos on the street, at open markets, on auction websites, etc. International criminal groups are getting rich from the high gain/low risk business of stealing America's copyrighted works.<sup>14</sup> The FBI reports that, "There is strong evidence that organized groups have moved into IP crime and that they are using the profits generated from these crimes to facilitate other illegal activities."<sup>15</sup> The link between organized crime groups and counterfeit goods is well established. Interpol is sounding the alarm that Intellectual Property Crime is becoming the preferred method of funding for a number of terrorist groups.<sup>16</sup> Participants at the 1<sup>st</sup> International Conference on IPR hosted by Interpol in Lyon, France in 2001 "all agreed the evidence was indisputable: a lucrative trafficking in counterfeit and pirate products – music, movies, seed patents, software, tee-shirts, Nikes, knock-off CDs and 'fake drugs' accounts for much of the money the international terrorist network depends on to feed its operations."<sup>17</sup>

### RECENT MOVIE PIRACIES

**Lucasfilm:** A week after the new "Star Wars Episode I" blockbuster opened in the United States in May of 1999, pirated copies were already hitting store shelves in Hong Kong. Reports of widely available video CDs of the film selling from \$3.20 to \$3.80 were reported.<sup>18</sup> With this experience fresh in executives' minds, May of 2002, George Lucas' highly anticipated Episode II of the Star Wars saga debuted. This time two pirated versions of the film was available a week before the film opened at the theaters. Reports indicated that the versions appeared to have been recorded with digital camcorders at a private screening.

**Warner Brothers:** Rumors circulated that a copy of "Matrix Reloaded" was available online the day before the film was released at theaters in May of 2003. Within two weeks of its debut, a high-quality copy of the film was available on the Internet for downloading. In addition, low-quality DVD copies were available for purchase.<sup>19</sup> All this, despite Warner Brothers decision to avoid piracy by opening the movie worldwide in 62 countries.<sup>20</sup>

**Universal Studios:** "The Hulk," which opened June 20, 2003, was predicted to be one of the blockbuster movie hits of the summer. However, two weeks before its theater release, a New Jersey man obtained a "workprint" of the film. The individual is not a professional pirate, rather a self-described computer hobbyist. He used software tools to defeat security protections in the film designed to prevent unauthorized duplication, and then posted the copied film onto the Internet. The release of the pirated movie is believed to have contributed to the lower than expected ticket sales at the box office.

### HOW PIRACY IS COMBATED

Piracy is fought on many fronts: legislatively, with law enforcement, and through technology. The Motion Picture Association of America (MPAA) is tasked with fighting movie piracy and thus takes copyright infringement very seriously. The MPAA has been vocal in voicing their concerns to Congress, and new laws have been passed in regards to intellectual property protection. Some of the most recent laws are the 1997 "No Electronic Theft Act (NET Act)," which was viewed as "closing a loophole" in copyright law. It expanded the law to make it illegal to reproduce or distribute copyrighted works, even if the accused acted without commercial purpose or for private financial gain. The "Digital Millennium Copyright Act of 1998," for updating U.S. copyright laws for the digital age, and for preparation in ratifying the World Intellectual Property Organization Copyright Treaty. In the "Digital Theft Deterrence and Copyright Damages Improvement Act of 1999," Congress approved a significant hike in the minimum statutory damages for various types of copyright infringement.

The Department of Justice has a specific section of the criminal division – the Computer Crime and Intellectual Property Section – devoted to combating cybercrime. In addition, the FBI has created Computer Crime Squads in 16 metropolitan areas around the country specifically to investigate cybercrime.<sup>21</sup> The primary objective of the FBI's IP program is to reduce the economic loss associated with the counterfeiting and theft of U.S. intellectual property by criminal conspiracies and other major offenders. To accomplish its objective in the area of IP crime, the FBI is focused on increasing both the quantity and quality of IP investigations and prosecutions.<sup>22</sup>

The MPAA uses Ranger, a sophisticated search engine, to track down illegal movies that are on the Internet. When a pirated movie is found, they send "Cease and desist" letters to the website in violation.<sup>23</sup> In addition, the MPAA has an internal Internet piracy task force that works closely with law enforcement agencies throughout the world to find and catch video pirates. In an attempt to stop illegal copying of movies in theaters, the MPAA has begun using, in certain situations, airport style security to find concealed video cameras.<sup>24</sup> They have also used theater personnel with night vision goggles to detect video cameras during a movie showing.<sup>25</sup>

Digital Rights Management (DRM) is a general term used to describe various techniques that content providers use to protect their copyrighted material and define the rights on how their copyright material is to be made available to users. In the technology industry, most DRM attention is focused on producing better means of ensuring only authorized users have access to content and in preventing illegal copying of content. The method in which to achieve this is by making better encryption software and technology. This effort, while needed, continues to be defeated. As highly intelligent as the individuals in this field are, and as sophisticated the encryption software and technology continues to evolve, there are equally intelligent hackers and pirates from around the world who are highly motivated to break the encryptions.

The MPAA is experiencing major problems. In the numerous cases of pirates using digital camcorders to record movies in theaters, encryption methods are powerless to prevent this. Moreover, with the Internet available worldwide, fighting piracy by U.S. legislation alone cannot solve this issue. Furthermore, not all countries abide by or enforce their own copyright laws. In addition, when a website that contains illegal movies is shut down, they simply relocate.

#### SUMMARY

As Jack Valenti, president of the MPAA has clearly stated, the real way to combat piracy is by catching and bringing the pirates to justice. When this occurs, it will send the message to pirates that they can no longer be anonymous and continue to believe pirating movies is high-reward with low risk of being caught.<sup>26</sup>

Combating content piracy is an uphill battle that is unlikely to subside any time soon. Individuals no longer have to physically steal a product, they can simply download information or transmit it electronically to a single accomplice or to tens of thousands of people in an instant -- and they can do so with total anonymity. It is hardly surprising that there are so many organized "hacker" groups engaged in large scale distribution of pirated products over the Internet or that there are also thousands of websites that exist solely to distribute pirated products when the money to be made from this type of activity can be significant, and the risk of being caught so minimal.<sup>27</sup>

Please visit us at [www.usvo.com](http://www.usvo.com), to read USA Video Interactive's press release on our upcoming anti-piracy software. For more information, contact Edwin Molina, CEO ([info@usvo.com](mailto:info@usvo.com)).

<sup>1</sup> [http://www.fbi.gov/hq/cid/fc/fifu/about/about\\_ipc.htm](http://www.fbi.gov/hq/cid/fc/fifu/about/about_ipc.htm)

<sup>2</sup> <http://www.mpa.org/anti-piracy/>

<sup>3</sup> "If You Cannot Protect What You Own, You Don't Own Anything! A brief report concerning the dark underside of Internet piracy as well as the possibility of a cleansing redemption to benefit the American consumer", Presented to the Senate Committee on Commerce, Science and Transportation, on behalf of the member companies of THE MOTION PICTURE ASSOCIATION OF AMERICA, by Jack Valenti, President and Chief Executive Officer, February 28, 2002

<sup>4</sup> <http://www.mpa.org/anti-piracy/>

<sup>5</sup> "COPYRIGHT & CREATIVITY - The Jewel in America's Trade Crown": A call to the Congress to protect and preserve the fastest growing Economic Asset of the United States, Presented by Jack Valenti, President & Chief Executive Officer of the Motion Picture Association of America to The International Trademark Association, Santa Monica, California, January 22, 2001

<sup>6</sup> "The Impact of the Internet on the Law and Economics of the United States Motion Picture Industry," by Stanford L. Levin, Department of Economics & Finance at Southern Illinois University, John B. Meisel, Department of Economics & Finance at Southern Illinois University and Timothy S. Sullivan, Department of Economics & Finance at Southern Illinois University, January 30, 2003

<sup>7</sup> "Hollywood hunts for pirates," By Michael McCarthy, USA TODAY, July 30, 2003

<sup>8</sup> "A CLEAR PRESENT AND FUTURE DANGER: The potential undoing of America's greatest export trade prize, An Accounting of Movie Thievery in the Analog and Digital Format, in the U.S. and Around the World," Offered to the House Appropriations Committee, Subcommittee on Commerce, Justice, State, the Judiciary, and Related Agencies, by Jack Valenti, Chairman & Chief Executive Officer, THE MOTION PICTURE ASSOCIATION, in Ashburn, Virginia, April 23, 2002

<sup>9</sup> <http://www.divx-digest.com/articles/telesync.html>

<sup>10</sup> "Secure content protection: An overview of the proposed security mechanisms in digital cinema," By Michael Strömberg, KTH Advanced Media Technology Lab Royal Institute of Technology, Stockholm, Sweden

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<sup>13</sup> "COPYRIGHT & CREATIVITY - The Jewel in America's Trade Crown": A call to the Congress to protect and preserve the fastest growing Economic Asset of the United States, Presented by Jack Valenti, President & Chief Executive Officer of the Motion Picture Association of America to The International Trademark Association, Santa Monica, California, January 22, 2001

<sup>14</sup> Testimony of Jack Valenti, President and CEO, Motion Picture Association of America, Before The Subcommittee On Courts, The Internet, And Intellectual Property, Committee on the Judiciary U.S. House of Representatives "International Copyright Piracy: Links to Organized Crime and Terrorism", March 13, 2003

<sup>15</sup> [http://www.fbi.gov/hq/cid/fc/fifu/about/about\\_ipc.htm](http://www.fbi.gov/hq/cid/fc/fifu/about/about_ipc.htm)

<sup>16</sup> "The links between intellectual property crime and terrorist financing," text of public testimony of Ronald K. Noble, Secretary General of Interpol Before the United States House Committee on International Relations, One hundred eighth congress, July 16th 2003

<sup>17</sup> Testimony of Jack Valenti, President and CEO, Motion Picture Association of America, Before The Subcommittee On Courts, The Internet, And Intellectual Property, Committee on the Judiciary U.S. House of Representatives "International Copyright Piracy: Links to Organized Crime and Terrorism", March 13, 2003

<sup>18</sup> "Pirated copies of 'Star Wars' hit Hong Kong store shelves," Hong Kong (AP), May 27, 1999

<sup>19</sup> "Matrix sequel pirated online," BBC News, May 27, 2003

<sup>20</sup> <http://keanuweb.com/credits/movie.matrix2.html>

<sup>21</sup> Remarks of Attorney General John Ashcroft, First Annual Computer Privacy, Policy and Security Institute, May 22, 2001

<sup>22</sup> [http://www.fbi.gov/hq/cid/fc/fifu/about/about\\_ipc.htm](http://www.fbi.gov/hq/cid/fc/fifu/about/about_ipc.htm)

<sup>23</sup> "A CLEAR PRESENT AND FUTURE DANGER: The potential undoing of America's greatest export trade prize, An Accounting of Movie Thievery in the Analog and Digital Format, in the U.S. and Around the World," Offered to the House Appropriations Committee, Subcommittee on Commerce, Justice, State, the Judiciary, and Related Agencies, by Jack Valenti, Chairman & Chief Executive Officer, THE MOTION PICTURE ASSOCIATION, in Ashburn, Virginia, April 23, 2002

<sup>24</sup> "Mission (Im)possible? Combating Film Piracy in the Digital World," By Nasya Bahfen, June 24 2003

<sup>25</sup> "The movie industry fights off the pirates," By Andy Seiler and Mike Snider, USA TODAY, May 6, 2003

<sup>26</sup> "How Hulk Crushed the Online Pirate," By P.J. Huffstutter, Times Staff Writer, June 26, 2003

<sup>27</sup> [http://www.fbi.gov/hq/cid/fc/fifu/about/about\\_ipc.htm](http://www.fbi.gov/hq/cid/fc/fifu/about/about_ipc.htm)

### ***About USA Video Interactive Corp.***

USVO is a developer and supplier of Internet media delivery services, systems, and innovative end-to-end solutions. The Company developed its StreamHQ™ architecture to provide a wide range of business customers with value-added media delivery services. USVO holds the pioneering patent for store-and-forward video, filed in 1990 and issued by the United States Patent and Trademark Office on July 14, 1992; it has been cited by at least 165 other patents. USVO holds similar patents in Germany, Canada, England, France, Spain, and Italy. For more information, visit [www.usvo.com](http://www.usvo.com).

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