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May 18, 1999

Honorable Howard Coble
Chairman, Courts and Intellectual Property Subcommittee
House Judiciary Committee
B-351-A Rayburn House Office Building
Washington, D.C. 20515-6219

Re: No Electronic Theft Act Hearing of May 12, 1999

Dear Chairman Coble:

Thank you for inviting the United States Sentencing Commission to testify before the Courts and Intellectual Property Subcommittee concerning the implementation of the No Electronic Theft Act (the “NET Act”). During the course of the hearing, several issues were raised by other witnesses that we believe reflect a misunderstanding of the current intellectual property offense sentencing guideline and the NET Act Report issued by Commission staff in February, 1999. As a result, I am writing to provide some clarification and respectfully request that this letter be included as part of the hearing record.

Several witnesses, including the Department of Justice, claimed that the current intellectual property offense guideline provides insufficient incentive for United States Attorneys to prosecute precisely the type of offenses that the NET Act was designed to address: illegal copying via the Internet of exact duplicates of legitimate software, recordings and videos. The paradigm case provided at the hearing is one in which an infringer illegally makes available on the Internet at no cost to others software that sells in the legitimate market at a retail price of \$300. The Department and industry representatives testified that in this scenario, the monetary adjustment provided by the guideline would be \$0 because the price at which the infringing item is sold is zero. **We believe this result is incorrect and reflects a fundamental misunderstanding of the sentencing guideline for intellectual property offenses as it currently exists.**

The intellectual property offense guideline currently provides for increasing penalties based on a monetary calculation using the retail *value* of the infringing item, *not the retail price* of that item. In many infringement cases (particularly trademark cases), these amounts may be

approximately the same and, therefore, the distinction between the two is immaterial. However, the distinction is very important in cases like the Internet theft case outlined by the Department and industry representatives. Although the retail price at which the infringer may sell the duplicate software may be zero, the retail *value* of the pirated software is far greater. Indeed, as several witnesses stated, the retail *value* of infringing software that is an exact duplicate of the legitimate version is virtually the same as the retail value of the infringed version. In other words, in the case above, the monetary adjustment under the guideline **as it currently exists** should be calculated using the \$300 figure, not zero, as the value of the infringing software. Thus, the assertion by some witnesses that the current intellectual property offense guideline provides insufficient incentive to prosecute this type of case because the monetary adjustment is zero is without merit.

In fact, several circuit courts have recognized the appropriateness of using the retail value for genuine merchandise to determine the monetary adjustment under the current intellectual property offense guideline when the unauthorized copies are of sufficient quality to permit their distribution through normal retail outlets. See United States v. Cho, 136 F.3d 982 (5th Cir. 1998); United States v. Hicks, 46 F.3d 1128 (4th Cir. 1995); United States v. Kim, 963 F.2d 65 (5th Cir. 1992); United States v. Larracuente, 952 F.2d 672 (2nd Cir. 1992). We have attempted to explain this issue of guideline application to representatives of the Department on a number of occasions, as well as in our NET Act Report. See NET Act Report at pp. 12-13, 27. **In sum, notwithstanding the NET Act and how the Commission ultimately responds, when properly applied, the sentencing guideline already permits the Department to effectively use the retail value of the infringed software in the type of case specifically targeted by the NET Act.**

Moreover, contrary to the implication of some witnesses' testimony, there is widespread agreement among Commission staff that using the retail value of the infringed software is the appropriate result in cases as described above. In addition to being able to use the retail value of the infringed software under the current guideline, **under every option analyzed by Commission staff in the NET Act Report, the retail value of the infringed software would be used to calculate the monetary harm adjustment.** See NET Act Report at pp. 21 (Method 1), 25-26 (Method 2), 27 (Method 3). Thus, it is patently incorrect that Commission staff have issued a report "rejecting the direct congressional mandate," as one witness stated.

Toward the end of the hearing, it was suggested that additional legislation may be required to force the Commission to implement the directives contained in the NET Act. We hope that the Subcommittee will not find this step necessary. As does the Subcommittee, Commission staff anxiously await the appointment of new commissioners, and we have every reason to believe that the President will appoint and the Senate will confirm commissioners who are ready and eager to fulfill their statutory duties responsibly. Commission staff cannot, of course, dictate to incoming commissioners what their priorities should be, but we certainly expect, and have prepared for, their prompt attention to the implementation of the NET Act. That also was the expectation of former Chairman Conaboy and his fellow commissioners for, prior to their leaving, they instructed staff to continue its analysis of the NET Act in order to make sure that incoming commissioners are prepared to respond to the NET Act in short order.

In preparing the report, Commission staff tried to anticipate questions that may be raised by incoming commissioners. It has been our experience that, before promulgating any amendments to the guidelines, commissioners request, among other things, a proportionality analysis. Indeed, under the Sentencing Reform Act, commissioners are required to consider proportionality of punishment in setting the guidelines. In the intellectual property offense area, this translates into treating intellectual property infringers similarly to other economic crime offenders. The guidelines for economic crimes generally provide for increasing punishment depending on the amount of harm caused to the victim, and, as a result, the Report is largely devoted to trying to estimate the harm caused by intellectual property offenses. In the theft of real property such as a car, that calculation is easy. However, Commission staff, through extensive discussions with economists, civil lawyers who specialize in intellectual property law, and representatives of the Department of Justice and industry, have found that estimating the harm to the victims of an intellectual property offense is far more complicated. Accordingly, we would welcome further dialogue on that issue with Subcommittee staff, the Department of Justice, and industry representatives.

The staff of the Sentencing Commission stand ready to assist incoming Commissioners in implementing the congressional directives contained in the NET Act and look forward to working more closely with Subcommittee staff. Thank you for the opportunity to supplement our testimony and further clarify how the current guidelines operate and how the Commission to date has responded to the NET Act.

Sincerely,

Timothy B. McGrath
Interim Staff Director
United States Sentencing Commission

cc: Subcommittee Members
Hearing Participants