



**TESTIMONY OF THE UNITED STATES SENTENCING COMMISSION
BEFORE THE COURTS AND INTELLECTUAL PROPERTY
SUBCOMMITTEE OF THE HOUSE JUDICIARY COMMITTEE (May 12, 1999)**

Chairman Coble, members of the Subcommittee, I am Timothy McGrath, Interim Staff Director of the United States Sentencing Commission (the “Commission”). John Steer, our General Counsel, also is with me and available to answer questions. I appreciate the opportunity to update the Subcommittee on the progress the Commission has made toward implementing the two legislative directives contained in the No Electronic Theft Act (the “NET Act”).¹

As you know, the Commission has been without any voting members since October 1998, and as a result has been prevented from promulgating amendments that respond to the NET Act. However, both the former Commissioners and staff have worked diligently to implement the NET Act. Today I would like to review the process the Commission has undertaken, summarize some of the complicating factors we have confronted, and briefly highlight some of the Commission’s findings.

The NET Act contains two directives to the Commission — first, that it ensure that the guideline range for intellectual property offenses is sufficiently stringent to deter such offenses, and second, that the guidelines provide for consideration of the retail value and quantity of the items that were infringed. Congress passed the NET Act in December 1997, and the very next month the Commission began to act on it. In January 1998, the Commission published a proposal from the Department of Justice as well as a general issue for comment on how to address the directives. In March, 1998, the Commission received public comment and heard

¹ Pub. L. No. 105-147.

testimony from various industry representatives, including the Recording Industry Association of America and the International AntiCounterfeiting Coalition. The Commission supplemented the formal public comments the next month by conducting informal meetings with Department of Justice and industry representatives. Our staff also examined the characteristics of all 106 copyright and trademark infringement cases sentenced in fiscal year 1996.

However, by the end of April, the former Commissioners agreed that it would not be prudent to force a rushed unanimous consensus on the complicated issues raised by the NET Act — particularly at a time when there were only four commissioners — and instead they voted to publish for further comment three amendment options. The Commission also directed staff to conduct a more detailed study to assist incoming commissioners in responding to the Act.

Commission staff subsequently completed an extensive report on the NET Act that was released in February, 1999. This report reflects a series of meetings with economists and industry representatives, including the Business Software Alliance and the Motion Picture Association, both of which are testifying today, as well as the Software Publishers Association, the Interactive Digital Software Association, and others.

Developing an appropriate response to the Act has been a complicated task for several reasons. First, the legislative history indicates that Congress's primary purpose in enacting the NET Act was to reverse the practical consequences of the LaMacchia case² and criminalize the computer theft of copyrighted works, whether or not the defendant derives a financial gain or commercial advantage.³ However, the directives to the Commission sweep far broader. They cover not only electronic copyrighted works, but all copyrighted works, and also trademark infringements. Indeed, the first directive requires the Commission to do nothing less than conduct a comprehensive reassessment of the intellectual property offense guideline.

² United States v. LaMacchia, 871 F. Supp. 535 (D. Mass. 1994).

³ See 17 U.S.C. § 506(a)(2).

Another complicating factor is the difficulty in calculating the harm caused by intellectual property offenses. Like the guidelines for other economic crimes, the guideline for intellectual property offenses provides for increasing punishments based on an adjustment that estimates the harm to the victim. However, the relevant guideline covers a variety of infringement crimes, and the type and magnitude of harm in infringement cases varies widely depending on the type of item infringed, the method of infringement, and the quality of the infringing item. For example, the sale of obviously counterfeit purses at deep discounts at a flea market and the illegal uploading to an Internet site of high quality, pirated software that results in the infringed software being made widely available at no cost cause very different types and magnitudes of harm. The Commission faces the challenge of developing a guideline that takes these differences into consideration in attempting to provide proportionality in sentencing.

Finally, I would like to share some of our findings in the Report as supplemented by an updated data analysis. First, there were 137 cases sentenced under the intellectual property offense guideline in fiscal year 1998, compared to 107 in fiscal year 1996, a 28% increase. Nonetheless, the relatively low number of prosecutions might raise the question of whether increasing the number of cases prosecuted would deter intellectual property offenses as well as changing the penalty structure. Second, the vast majority of cases sentenced under the guideline involve the manufacture and distribution of counterfeit goods such as clothing, accessories, handbags, watches, and pens. Copyright violations of videos and recordings comprise approximately 25% of cases sentenced under the guideline.

Our study revealed only five cases of online infringement. The Internet poses a unique challenge for setting an appropriate penalty structure because of four factors: 1) the relative ease and low cost of software duplication, 2) the high quality of the pirated articles, 3) the difficulty in locating the offender, and 4) the difficulty in ascertaining how many times an illegal copy has been made.

Perhaps our most important finding is that no simple formula exists for accurately

calculating the harm caused by the range of different types of intellectual property offenses. Distinct types of harm can be categorized, but whether and to what degree each harm is present in any given case will depend on the type of item infringed, the method of infringement, and the quality of the infringing item. Take, for example, lost sales. The majority of cases sentenced under the relevant guideline involve the sale of trademarked goods at a fraction of the price of their legitimate counterparts, often in settings that suggest the purchasers knew they were not buying legitimate articles. The consumer's complicity and the large disparity between the price of the legitimate and counterfeit good suggest that the consumer would not — or could not — have purchased the legitimate good if the infringing item had not been available. Thus, a one-to-one correlation between sales of infringing items and the displacement of sales of legitimate items generally does not exist in most cases sentenced under the guideline.

Finally, just to underscore how comprehensive our reassessment of the intellectual property offense guideline has been, the Commission has looked beyond the specifics of the directives for other ways to better measure the seriousness of the offense and the culpability of the defendant. Commission staff have identified eight proposals that may warrant consideration by the incoming Commission. Although I cannot go into all of them here, they include sentencing enhancements for defendants who illegally manufacture, import or upload copyrighted or trademarked articles, or for defendants who breach special security measures such as encryption. Other suggestions include adding a sentencing enhancement for offenses involving the violation of pre-release copyrighted or trademarked articles or the conscious or reckless risk of serious bodily injury. A revised guideline that contains these types of enhancements might offer a more proportionate and effective way of accomplishing crime control objectives in this area.

In conclusion, we are confident that incoming Commissioners will be well prepared to develop, evaluate, and promulgate appropriate responses to the NET Act in short order. Mr. Steer and I will be glad to try to answer any questions you may have. Thank you.