December 1, 1997

MEMORANDUM

TO: John Steer

FROM: Tom Brown

SUBJECT: "No Electronic Theft Act"

The House and Senate recently (November 4, 1997) passed the "No Electronic Theft Act" (NET). NET's primary purpose is to close the "LaMacchia Loophole" by providing a statutory basis to prosecute and punish those who, without authorization and without realizing financial gain or commercial advantage, encourage others to electronically access copyrighted materials. The LaMacchia court (D. Mass.) had concluded that existing statutes did not permit prosecution of people who, without realizing financial gain or commercial advantage, accessed copyrighted material by electronic means without authorization.

In pertinent part, NET states:

> (1) . . . the United States Sentencing Commission shall ensure that the applicable guideline range for a crime committed against intellectual property (including offenses set forth at section 506(a) of title 17, United States Code, and sections 2319, 2319A, and 2320 of title 18 United States Code) is sufficiently stringent to deter such a crime and to adequately reflect the considerations set forth in paragraph (2) of this subsection.
>
> (2) In implementing paragraph (1), the Sentencing Commission shall ensure that the guidelines provide for consideration of the retail value and quantity of the items with respect to which the crime against intellectual property was committed.

Each of the criminal statutes referenced by NET is currently referred to §2B5.3. Criminal Infringement of Copyright or Trademark. §2B5.3 provides for incrementally greater punishment when "the retail value of the infringing items exceeded $2,000." When the $2,000 threshold is reached, the base offense level is to be increased to the extent appropriate under the loss table in the fraud guideline, §2F1.1. "Infringing items" means the items that violate the copyright or trademark. "Infringing items" does not mean the legitimate items infringed upon. See §2B5.3, App. N.1.

The Congressional direction to the Commission that penalties for intellectual property crime be "sufficiently stringent to deter such a crime" does not seem to warrant any change in the body of §2B5.3. Adjusted offense levels under §2B5.3 and its cross-reference to the "loss table" of §2F1.1 can easily result in penalties up to the statutory maximums for all statutes designated in NET. Thus, it appears that the Guidelines currently provide a penalty scheme for intellectual property crimes which is consistent with Congress' view of their gravity.

The Commission is also directed to "ensure that the guidelines provide for consideration of the retail value and quantity of the items with respect to which the crime against intellectual property was committed." This direction appears to require some adjustment to either §2B5.3 itself or to its commentary. The Congressional direction precludes calculation of offense levels for violations of NET by determining the value of infringing items. Rather, the retail value of the items infringed upon must be "considered" by the Guidelines.

When copyrighted materials are infringed upon by electronic means, there is no "infringing item" as would be the case in a case involving counterfeit goods. The value of "infringing items" is, as Congress seems to have appreciated, meaningless where intellectual property is infringed upon electronically. Thus, the central question for the Commission is how to "consider" the retail value of intellectual property infringed upon. To do this, it is necessary to determine: (a) the retail value of the copyrighted material in question; and (b) the number of persons who view it without authorization as a result of the defendant's conduct. One could then multiply a x b to determine the figure to be used in the table at §2F1.1.

The problem with this approach is that it overestimates "loss." Even if one assumes that every person who views the infringed upon intellectual property was about to purchase it at its suggested retail value, a very suspect assumption, the loss to the holder of the copyright would more properly be viewed as its anticipated net profit from such sales. Consequently, a more accurate way to reflect the retail value of the items infringed upon is to indicate in an application note that loss in an electronic theft of copyrighted material is to be measured as the copyright holder's aggregate lost profit as a result of the defendant's conduct. To do otherwise is to use the table at §2F1.1 to measure something other than loss when loss is precisely what it purports to measure.

Finally, I did contact Scott Charney, Chief of DOJ's Computer Crime and Intellectual Property Section, as you had suggested. I solicited only DOJ's input on how electronic theft of copyrighted material should be treated in light of NET. He did provide that, along with a DOJ proposal for a more detailed amendment to §2B5.3 for non-electronic theft situations, at 3:42 p.m. today. The proposals sweep broader than my conversations with Scott led me to expect. I include them as an attachment to this memorandum without immediate comment and certainly without endorsement.