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HEADLINE: Congress Toughens Criminal Copyright Law

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UNTIL recently, while the illegal copying of Rambo videotapes was a federal felony, large-scale piracy of Word for Windows or Lotus 1-2-3 software was not. Congress has just changed all that.

In a move designed to deter and punish the multi-billion dollar business of computer software copyright infringement, Congress recently broadened the scope of the criminal copyright law and lowered the numerical thresholds for felony penalties. Although the legislation was driven by the perceived problem of software piracy, the felony copyright infringement statute is now, for the first time, generic in its protection of "copyrighted works" rather than focused on particular categories such as sound recordings, motion pictures or audiovisual works.

The new statute, which will amend 18 U.S.C. §2319(b), provides a maximum prison term of five years for any person who, within a 180-day period, willfully makes at least 10 copies of one or more copyrighted works, with a retail value of more than $2,500. As with most other federal felonies, the maximum fine per count is $ 250,000 for an individual, $ 500,000 for an organization,[1] or twice the gross gain from the offense.[2] The new statute became effective on Oct. 28, 1992, when the President signed the bill, S. 893.[3]

The new statute increases the penalties for violation of the criminal copyright law, 17 U.S.C. §506(a), the terms of which remain unchanged: "Any person who infringes a copyright willfully and for purposes of commercial advantage or private financial gain shall be punished as provided in §2319 of title 18."

The key provision of the new statute, entitled "Criminal Penalties for Copyright Infringement," amends 18 U.S.C. §2319(b)(1) to provide that any person who violates 17 U.S.C. §506(a):

> shall be imprisoned not more than five years, or fined in the amount set forth in this title, or both, if the offense consists of the reproduction or distribution, during any 180-day period, of at least 10 copies or phonorecords, of one or more copyrighted works, with a retail value of more than $2,500; . . .

The statute provides a maximum prison term of 10 years for repeat offenders[4] and a misdemeanor sentence of up to one year for any criminal copyright violation that does not meet the numerical thresholds of §2319(b)(1).[5] In addition, under existing law, the sentencing judge in a criminal copyright prosecution is required to order the forfeiture of

[1] 18 U.S.C. §357(b), (c).
[2] 18 U.S.C. §3571(d).
[3] 45 Patent Trademark & Copyright J. (BNA) No. 1104, p. 4 (Nov. 5, 1992)
[4] 18 U.S.C. §2319(b)(2).
[5] 18 U.S.C. §2319(b)(3).

all infringing copies and of all "implements, devices or equipment used in the manufacture" of the infringing items.[6]

Scope and Purpose

The prior version of the criminal copyright penalty statute set forth felony sanctions for criminal infringement of copyrights for only phonorecords, sound recordings, motion pictures or other audiovisual works.[7] Under the old law, computer software piracy—no matter how flagrant or massive—was never more than a misdemeanor copyright violation.[8]

Prior to the recent amendment, the statute was last amended in 1982 when the computer software industry has now grown up: the world market for computer software is currently estimated at $ 70 billion per year, and the Commerce Department has predicted that this figure could increase to $1 trillion by the year 2000.[9]

Congressional supporters of tougher criminal copyright provisions cited studies indicating that for every authorized copy of software programs in circulation, there is an illegal copy also in circulation. Losses to the personal computer software industry in 1989 from an illegal copying were estimated to be $ 1.6 billion.[10]

Responding to the threat that piracy posed to the legitimate software market, the Senate originally passed a bill that specifically added "computer programs" to the criminal copyright infringement statute.[11] The House version, which was enacted, did not simply add "computer programs" to the list of specific categories of protected copyrighted material, but rather was generic in applying the criminal provisions to all "copyrighted works."[12]

The new statute also lowers the numerical thresholds for felony copyright offenses. Under the old law, the floor for felony offenses was set at 1,000 copies of

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[6] 17 U.S.C. §506(b).

[7] For a description of the slow evolution over the last century of broader and stiffer criminal penalties for copyright infringements, see *Dowling v. United States*, 473 U.S. 207, 221-26 (1985).

[8] If in addition to infringing the copyright, the defendant also engaged in fraud or theft to obtain the infringed work, then other felony statutes, such as mail fraud, wire fraud, or interstate transportation of stolen property, might apply.

[9] S. Rep. No. 268, 102d Cong., 2d Sess. 2 (1992).

[10] 138 Cong. Rec. S17958 (102d Cong., 2d Sess. Oct. 8, 1992) (remarks of Sen. Hatch).

[11] S. 893, 102d Cong., 2d Sess. (1992); *see* 44 BNA Patent, Trademark & Copyright J. 121, 138 (1992).

[12] Unauthorized reproduction of written works is thus covered by the statute as well, allowing, in theory, for a felony prosecution of a company making 10 or more copies for internal circulation of journals or other written works with a combined subscription value of $ 2,500 or more. That a prosecutor would exercise his or her discretion to prosecute in this manner seems highly unlikely, however, although copying of journals for internal use was recently held not to be a "fair use" of copyrighted materials in a civil suit alleging infringement. *See* *American Geophysical Union v. Texaco Inc.*, No. 85 Civ. 3446, 23 U.S.P.Q.2d 1561 (S.D.N.Y. July 22, 1992) (Leval, J.), *certified for §1292(b) review*, 1992 U.S. Dist. LEXIS 16411 (S.D.N.Y. Oct. 26, 1992).

sound recordings or 65 copies of motion pictures or other audiovisual works.[13] Under the new statute, the defendant need have made only 10 copies of a copyrighted work (provided that all other elements of the offense have been proved) to be prosecuted on felony charges.

By lowering the felony threshold, the new statute is likely to attract federal law enforcement resources that are typically not expended on investigating and prosecuting misdemeanors. The FBI and U.S. Attorney's Offices have actively investigated and prosecuted criminal infringement cases in the sound recording and motion picture industries (which offenses attained felony status only as recently as 1982),[14] but have not done the same for the computer software industry.

The new statute's numerical thresholds -- 10 copies with a retail value of $ 2,500 within 180 days—have been set high enough so that the felony provisions will not reach casual copying by high school computer jocks or friends in the workplace. The requirement of 10 copies should also prevent felony charges from being brought in cases of "reverse engineering," where a business works backward from a competitor's finished, copyrighted work in order to learn the ideas or processes behind the work.[15] (Reverse engineering may in any case not result in copyright infringement because the practice of discerning the unprotectable ideas behind the copyrighted work constitutes fair use.)[16]

Typically, no more than a few copies of copyrighted software are needed for reverse engineering purposes. Reverse engineering may still provoke bitter civil litigation among competitors, but federal prosecutors will likely stay out of the fray given the 10-copy threshold of the new felony statute.

Elements of Offense

While the new statute broadens the scope of the criminal copyright statute and lowers the numerical thresholds for felony penalties, it does not alter the basic elements of a criminal copyright offense. The government must still prove that: (1) the defendant infringed a valid copyright; and (2) that the defendant did so willfully and (3) "for purposes of commercial advantage or private financial gain."[17]

If the government can prove that the numerical thresholds—"at least 10 copies" of "one or more copyrighted works" with a "retail value of more than $ 2,500"—have been met, then the offense is a felony; if not, it is a misdemeanor. In a civil copyright case, the plaintiff need only prove infringement by a preponderance of the evidence; in a criminal case, by contrast, the government must prove every element—including the elements of copyright infringement—beyond a reasonable doubt.

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[13] 18 U.S.C. §2319(b)(added by Pub. L. No. 97-180, §3, May 24, 1982, 96 Stat. 92), superseded by S. 893 (1992).
[14] S. Rep. No. 268, 102d Cong., 2d Sess. 2 (1992).
[15] *See Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 476 (1974).
[16] *See, e.g., Sega Enterprises Ltd. v. Accolade, Inc.*, 1992 WL 293141, at 7-14 (9th Cir. Oct. 20, 1992); *Atari Games Corp. v. Nintendo*, 24 U.S.P.Q.2d 1015, 1023-24 (Fed. Cir. 1992).
[17] 17 U.S.C. §506(a).

Infringement. Since the government must prove the validity and infringement of the copyright, all of the defenses available in a civil infringement suit are equally available to the criminal defendant. Thus, as in a civil action, the government's case will fail it, for example, the allegedly infringed work lacks originality, the statutory term has expired or the defendant has been granted a license, directly or indirectly, by the copyright owner.[18]

State of Mind. Under the second and third elements of a criminal copyright offense, the government must show that defendant committed copyright infringement (i) willfully and (ii) for purposes of commercial advantage or private financial gain. These state-of-mind requirements create a wide gulf between a criminal and a civil copyright action; the latter is a strict liability offense where the defendant's willfulness and purpose are irrelevant.[19] In a criminal action, these elements must be proved beyond a reasonable doubt.

Willfulness. In enacting the new criminal copyright statute, Congress intended to leave undisturbed the courts' construction of the element of willfulness, which requires that the government prove that the defendant engaged in the infringing conduct with knowledge that such conduct was prohibited by law.[20]

The required element of willfulness means that the statute will generally be reserved for cases that have a criminal "feel" to them. The House Committee expressly stated that "[in] cases where civil liability is unclear—whether because the law is unsettled or because a legitimate business dispute exists—the Committee does not intend to establish criminal liability."[21]

As a practical matter, the proof of willfulness will often overlap with the government's proof of the numerical thresholds under the new law, because the best proof of willfulness in a criminal copyright case is usually the size of the operation—hardware for copying disks; van loads of blank floppy disks and counterfeit floppy disks; and counterfeit packaging and labels.[22] Absent a defense to infringement, it will be difficult for a defendant confronted with evidence of a large-scale copying operation credibly to argue an innocent state of mind.

Commercial Advantage or Financial Gain. The government must prove not only that a valid copyright was willfully infringed, but that the defendant did so for "purposes of commercial advantage or private financial gain."[23] If the government cannot prove a willful infringement for the proscribed purpose, no criminal liability will

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[18] *See* II P. Goldstein, *Copyright* §11.4.1 (1989); *e.g.*, *United States v. Larracuente*, 952 F.2d 672, 673-74 (2d Cir. 1992) ("If the accused infringer has been licensed by a licensee of the copyright owner, that is a matter of affirmative defense.").

[19] *See Buck v. Jwell-La Salle Realty Co.*, 283 U.S. 191, 198 (1931); 3 *Nimmer on copyright* §13.08, at 13-137 to 13-139 (1992).

[20] H. Rep. No. 997, 102d Cong., 2d Sess. 5 (1992); *see, e.g.*, *United States v. Cross*, 816 F.2d 297, 300 (7th Cir. 1987).

[21] H. Rep. No. 997, 102d Cong., 2d Sess. 5 (1992).

[22] *See, e.g.*, *United States v. Larracuente*, 952 F.2d at 673.

[23] 17 U.S.C. §506(a).

lie, regardless of the number of copies made or their retail value. As Senator Orrin Hatch, R.-Utah, the floor sponsor of the final version of the bill, stated in highlighting the "purpose" requirement, "Simply put, the copying must be undertaken to make money, and even incidental financial benefits that might accrue as a result of the copying should not contravene the law where the achievement of those benefits were [sic] not the motivation behind the copying."[24]

10 Copies. Reverse engineering and casual copying are protected from felony persecutions by the requirement that the defendant have made at least 10 copies of the infringed work. The typical criminal target will well exceed this threshold, since like many crimes, meaningful gain through copyright infringement is possible only through a substantial, obvious violation. Of course, higher volume of production and sales—involving more machines, more employees and more illicit customers—also tends to increase the likelihood of detection and prosecution.

One or More Works. In providing felony penalties for at least 10 copies of "one *or more* copyrighted works," Congress has made it possible for prosecutors to draft indictments that aggregate copies of different copyrighted works to reach the 10-copy and $ 2,500 "retail value" felony threshold. Thus, if an unscrupulous software vendor has made eight unauthorized copies each of the entire Microsoft line of software, the government can reach its numerical thresholds even though the copies of no single copyrighted work alone would reach those thresholds.

Retail Value. The term "retail value" is "deliberately undefined," according to the Senate Report, which noted that "in most cases it will represent the price at which the work is sold through normal retail channels."[25] Senator Hatch of Utah (home of the WordPerfect Corporation) stated that retail value means "the suggested retail price of the legitimate copyrighted work at the initial time of its release, and not the market price of the pirate copy."[26] However, if the copyrighted works are infringed before they have established a retail value—such as beta-test versions of software or motion picture prints made for theatrical release only—then some alternative measure of value will be used: "In such cases, the courts may look to the suggested retail price, the wholesale price, the replacement cost of the item or financial injury caused to the copyright owner."[27]

The statutory treatment of retail value is different from the Federal Sentencing Guidelines' treatment of retail value for copyright offenses. The guidelines provide a "points" system that grades offense severity and a defendant's culpability to yield a sentencing range that limits the sentencing judge's discretion. Under the guidelines, criminal copyright infringement is treated essentially as a fraud offense.[28]

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[24] 138 Cong. Rec. S17958 (102d Cong., 2d Sess. Oct. 8, 1992) (remarks of Sen. Hatch).
[25] H. Rep. No. 997 at 6.
[26] 138 Cong. Rec. S17958 (192d Cong., 2d Sess. Oct. 8, 1992)(remarks of Sen. Hatch).
[27] H. Rep. No. 997 at 7.
[28] The base offense level for criminal copyright offenses is six, U.S.S.G. §2B5.3, and offense-level increases are determined by the dollar amounts in the fraud table, U.S.S.G. §2F1.1.

But whereas the new copyright penalty statute will look to the retail value of the *infringed*, copyrighted goods, the Sentencing Guidelines increase the sentence based on the retail value of the *infringing* items.[29] If the copies are top quality, there should be little difference in the retail value of the infringed goods and the infringing goods. For instance, in *United States v. Larracuente*,[30] a recent copyright prosecution involving bootleg videocassettes, the Second Circuit upheld the district court's reference under the Sentencing Guidelines to the retail value of the *infringed* goods, but only because the "unauthorized copies [were] prepared with sufficient quality to permit their distribution through normal retail outlets." However, where the infringing items are of clearly inferior quality, then the calculation of retail value for the offense element (infringed goods) and for the Sentencing Guidelines (infringing goods) will diverge.

Since computer software has become an increasingly essential tool for many businesses, and since Congress has now chosen to address unauthorized copying of software in a serious manner,[31] companies should establish and publicize within the company and unambiguous policy against copyright infringement. This could be accomplished either through a stand-alone policy memorandum or by incorporating such a policy into an existing corporate compliance program.

A company can reinforce a clearly and frequently articulated policy against unauthorized copying with an active program of auditing installed software. In these audits, computer directories are printed out and the actual software installed is compared against purchase and licensing records. The Software Publishers Association or the Business Software Alliance can assist a business in the formulation and operation of a software audit.

An explicit policy against unauthorized copying has many benefits. First, it minimizes the exposure to civil lawsuits and liability, which can be expensive and disruptive to the business.

Second, it reduces the likelihood of the adverse publicity that can accompany civil or criminal prosecutions arising out of copyright violations.[32] For instance, a Sunnyvale, Calif., printing company recently garnered unwelcome attention in the national media

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[29] U.S.S.G. §2B5.3(b)(1) ("If the retail value of the infringing items exceeded $ 2,000, increase [the base offense level] by the corresponding number of levels from the table in §2F1.1 (Fraud and Deceit"); *see, e.g.*, *United States v. Kim*, 963 F.2d 65, 67-68 (5th Cir. 1992) (construing identical phrase in companion guideline for criminal trademark infringement).

[30] 952 F.2d at 674.

[31] Although the legislative history of the criminal copyright statute implies that Congress only meant to target copying for the purpose of making money, the statute's language proscribes copying for any "commercial advantage," which could be read to encompass a company's copying for its own internal use in order to save money.

[32] In addition to prosecution under the criminal copyright statute, a company could also face charges under the mail or wire fraud statutes, the National Stolen Property Act, or a 1986 statute which targets unauthorized access to and use of fraud. Application of the National Stolen Property Act to interstate transportation of copied software, without more, is unlikely, *see* *Dowling v. United States*, 473 U.S. 207 (1985), although prosecution under the mail or wire fraud statutes, while untested, is a possibility because these statutes encompass schemes to defraud intangible property rights. *See* *Carpenter v. United States*, 484 U.S. 19 (1987).

when federal agents seized $ 9 million worth of allegedly counterfeit Microsoft software.[33]

Third, a compliance program will permit counsel for the company to ask a prosecutor to exercise his or her discretion not to prosecute a company for the actions of a rogue employee who violated the terms of the compliance program.

Fourth, a compliance program will provide insurance against a punishing criminal fine in the event the company is convicted based on the actions of one or more of its employees. Under the new Federal Sentencing Guidelines for Organizations, a convicted organization can significantly reduce its monetary exposure in a criminal case by having in place an "effective program to prevent and detect violations of law."[34] Under the guidelines' table of fines for organizations, the reduction in "culpability score" for an effective compliance program will reduce the fine by at least one-half.[35]

[33] "Microsoft Corp. Says Federal Agents Seized Counterfeit Software," *Wall Street Journal*, Oct. 8, 1992, at A7; John Markoff, "Microsoft Confiscates Copies of Its Software," *New York Times*, Oct. 8, 1992, at C6.
[34] U.S.S.G. §8C2.5(f) (subtracting 3 points from defendant's "culpability score" that determines the sentencing fine range).
[35] U.S.S.G. §8C2.4(d) ("Offense Level Fine Table").