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Deciding Whether to Prosecute an Intellectual Property Case

David Goldstone

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David Goldstone
Trial Attorney, Computer Crime and Intellectual Property Section
Team Leader, Intellectual Property Team

Federal prosecutors know that deciding whether to prosecute a particular case requires the exercise of judgment and discretion, which can take years of experience to develop. But what if you are presented with an intellectual property ("IP") case and you have not done many of them before, if any? How should you decide whether a particular case of counterfeit computer chips, pirated music or software sold (or given away for free) over the Internet, or stolen satellite signals should be charged, even if an investigator provides evidence to prove all the elements? What special considerations, if any, come into play?
Even experienced federal prosecutors should reconsider first principles in evaluating the merits of an IP case, because of a few characteristics of such cases, including:

- IP crime always has a direct victim (the IP holder) and undermines the IP system as a whole (like counterfeiting of money), in addition to any fraud perpetrated on the recipient of the counterfeit good or pirated work;
- Because IP crime can be perpetrated without any direct contact with the victim IP holder (such as counterfeiting goods without asking the permission of the trademark holder), the direct victim of IP crime is basically defenseless against IP theft;
- IP rights, such as trademark and copyright, are in part created by federal law and administered by federal agencies and are thus of special federal interest;
- Effective enforcement of IP laws is essential to the foundation of the growing information economy; and
- The May 2000 revision to the Sentencing Guidelines more accurately recognizes the loss caused by IP crime.

The recently published manual, Computer Crime and Intellectual Property Section, Department of Justice, *Prosecuting Intellectual Property Crimes* (2001), can be a valuable resource for

evaluating these, as well as the other issues that arise in IP cases. Generally, federal prosecutors should take into account the same considerations in determining whether to charge an IP crime as they would with respect to all federal crimes. *See, e.g., U.S. Attorneys' Manual§*9-27.220. Thus, the prosecutors should evaluate all the considerations normally associated with the sound exercise of prosecutorial discretion. In exercising this discretion, *U.S. Attorneys' Manual§*9-27.220 notes three situations in which the prosecutor may properly decline to take action despite having admissible evidence sufficient to obtain and sustain a conviction for a federal crime: "when no substantial federal interest would be served by prosecution;" when [t]he person is subject to effective prosecution in another jurisdiction; "or when [t]here exists an adequate non-criminal alternative to prosecution." While individual U.S. Attorney's Offices may evaluate these factors with different standards, each of these grounds is discussed below with particular attention paid to IP crimes. Also, special considerations may arise when considering IP charges against corporations. *See Prosecuting Intellectual Property Crimes* §VI.A.4 (2001).

1. The Federal Interest in IP Crimes

In determining the substantiality of the federal interest that would be served by a prosecution, the attorney for the government should weigh all relevant considerations, including:

(1) [current] federal law enforcement priorities; (2) the nature and seriousness of the offense; (3) the deterrent effect of prosecution; (4) the person's culpability in connection with the offense; (5) the person's history with respect to criminal activity; (6) the person's willingness to cooperate in the investigation or prosecution of others; and (7) the probable sentence or other consequences if the person is convicted.

*U.S. Attorneys' Manual§*9-27.230.

All of these factors will be discussed below with specific attention to IP crimes. The last factor – the probable sentence – is especially noteworthy in light of the May 2000 revision to sentencing guideline § 2B5.3 to more accurately reflect the loss caused by IP crime. This new provision will be discussed in detail below.

a. Federal Law Enforcement Priorities

The importance of IP to the national economy, and the scale of IP theft, led the Department of Justice to designate IP crime as a "priority" for federal law enforcement. As the *U.S. Attorneys' Manual* recognizes, "from time to time the Department establishes national investigative and prosecutorial priorities. These priorities are designed to focus Federal law enforcement efforts on those matters within the Federal jurisdiction that are most deserving of Federal attention and are most likely to be handled effectively at the Federal level." *U.S. Attorneys' Manual §* 9-27.230(B)(1) (cmt).

IP crimes were formally designated a "priority" by Deputy Attorney General Eric Holder on July 23, 1999. Deputy Attorney General Eric Holder, *Remarks at Press Conference Announcing the Intellectual Property Rights Initiative* (Jul. 23, 1999) *available at* (http://www.cybercrime.gov/dagipini.htm). In announcing the Intellectual Property Rights

Initiative, Deputy Attorney General Holder stated that the Department of Justice, the Federal Bureau of Investigation and the United States Customs Service had concluded that they must make investigating and prosecuting IP crime "a major law enforcement priority." In making the announcement, he noted the following:

As the world moves from the Industrial Age to the Information Age, the United States' economy is increasingly dependent on the production and distribution of intellectual property. Currently, the U.S. leads the world in the creation and export of intellectual property and IP-related products.

Deputy Attorney General Holder also observed that "[a]t the same time that our information economy is soaring, so is intellectual property theft." Since IP theft undermines the federally established copyright and trademark systems, it is especially appropriate that investigation and prosecution of these crimes be a federal law enforcement priority.

The IP Initiative is aimed at combating the growing wave of piracy and counterfeiting offenses, both domestically and internationally, with the participation of U.S. Attorney's offices in New York, New Jersey, California, Florida and Massachusetts. The initiative has focused on training activities, improved coordination among law enforcement agencies, increased cooperation with industry, and highlighting IP internationally. In September, 2000 following the first-ever meeting of law enforcement experts from G-8 countries, a group of leading industrialized nations, to discuss trends in trafficking in counterfeit and pirated merchandise, it was agreed to address trends in trans-border IP crime.

In recent years, Congress has taken an especially strong interest in IP crimes as well as IP law generally. Congress has recently enacted stiffer penalties for IP crimes, and has made many IP crimes a predicate offense under the money laundering and RICO statutes. Moreover, Congress took the unprecedented step of singling out IP crimes for detailed accounting in the Attorney General's Annual Accountability Report. In enacting the Anticounterfeiting Consumer Protection Act of 1996, Pub. L. No. 104-153, 110 Stat. 1386, Congress required the Attorney General to include in the annual report, on a district-by-district basis, the following four criteria: (1) the number of open investigations; (2) the number of cases referred by the United States Customs Service; (3) the number of cases referred by other agencies or sources; and (4) the number and outcome, including settlements, sentences, recoveries, and penalties, of all prosecutions brought under sections 2318, 2319, 2319A, and 2320 of Title 18.

The federal interest in IP is no recent or transitory development. It has been recognized since the ratification of the Constitution. *See* U.S. Const. art. I,§8, cl. 8. Longtime Congressional interest in providing a sound federal basis for IP law is further demonstrated by two comprehensive bodies of statutes: the Copyright Act of 1976 (codified as amended at Title 17); and the Lanham Act (codified as amended at 15 U.S.C.§§1051-1127). In fact, the Copyright Act in 1976 established federal preemption over state law because of the importance of a uniform federal copyright law. *See* 17 U.S.C.§301.

b. The Nature and Seriousness of the Offense

IP crimes, like other crimes, vary in their nature and seriousness and it is therefore essential to consider each case on its own facts. Limited federal resources should not be diverted to prosecute inconsequential cases or cases in which the violation is only technical. Prosecutors may consider any number of factors to determine the seriousness of an IP crime, including:

1. Whether the counterfeit goods or services present potential health or safety issues (*e.g.*, counterfeit medications or airplane parts);
2. The scope of the infringing or counterfeiting activities (*e.g.*, whether the subject infringes or traffics in multiple items or the infringes upon multiple industries or victims), as well as the volume of infringing items manufactured or distributed;
3. The scale of the infringing or counterfeiting activities (*e.g.*, the amount of illegitimate revenue and any identifiable illegitimate profit arising from the infringing or counterfeiting activities based upon the retail value of the infringed item);
4. The number of participants and the involvement of any organized criminal group;
5. The scale of the victim's loss or potential loss, including the value of the infringed item, the size of the market for the infringed IP that is being undermined (*e.g.*, a best-selling software package or a famous trademark), and the impact of the infringement on that market;
6. Whether the victim or victims took reasonable measures (if any) to protect against the crime; and
7. Whether the purchasers of the infringing items were victims of a fraudulent scheme, or whether there is a reasonable likelihood of consumer mistake as a result of the subject's actions.

c. The Deterrent Effect of Prosecution

Deterrence of criminal conduct is one of the primary goals of the criminal law. Experience demonstrates that many infringers will not be deterred by civil liability, which can be treated as a cost of doing business. For example, even when a permanent injunction or consent decree is in force, they do not necessarily deter some defendants. Some defendants may respond to such civil remedies by changing the item upon which they are infringing, such as counterfeiting shirts bearing marks of Major League Baseball teams after being the subject of an injunction obtained by the National Football League. Others close shop only to quickly reopen under a different corporate identity. Criminal prosecution can better deter a violator from repeating his or her crime.

Criminal prosecution of IP crimes is also important for general deterrence. Many individuals may commit intellectual property crimes not only because they can be relatively easy to commit (such as copying music) but also because the subjects believe they will not be prosecuted. Criminal prosecution plays an important role in establishing public expectations of right and wrong. Even relatively small scale violations, if permitted to take place openly and notoriously, can lead other people to believe that such conduct is tolerated in American society. While some cases of counterfeiting or piracy may not result in provable direct loss to the holder of the IP right, the widespread commission of IP crimes with impunity can be devastating to the value of such rights. The importance of general deterrence is easily understood with regard to counterfeiting of United States currency. Even though some counterfeit bills can be "passed" without any harm to the monetary system of the United States, widespread commission of counterfeiting would be devastating to the value of the dollar. Today's brands have currency

only to the extent that anticounterfeiting laws are enforced.

Vigorous prosecutions can change the counterfeiter's calculus. If individuals believe that counterfeiters will be investigated and prosecuted, they will be deterred. Industry groups representing victims of IP crimes are acutely aware of their need for law enforcement protection for IP. These victims will vigorously publicize successful prosecutions. The resulting public awareness of effective prosecutions can have a substantial deterrence effect.

d. The Individual's Culpability in Connection with the Offense

IP crimes are often committed by multiple individuals working in concert, such as a company that traffics in counterfeit goods or pirated software. *See Prosecuting Intellectual Property Crimes §* VI.A.4 (2001) (discussing special considerations for cases involving corporations). The individuals in such an organization are not necessarily equally culpable. For example, a prosecutor may reasonably conclude that some course other than prosecution would be appropriate for a relatively minor participant. In considering the relative culpability of specific individuals within a group of people who commit IP crimes in concert, a number of non-exclusive factors have proven helpful, including: (1) whether the person had oversight responsibility for others; (2) whether the person specifically directed others to commit the offense; (3) whether the person profited from the offense; (4) whether the person was specifically aware of the wrongful nature of the activity, as evidenced by the receipt of a warning such as a "cease and desist" letter or by a statement to collaborators admitting wrongfulness, but nonetheless continued to engage in the activity; and (5) whether the person took affirmative steps, such as creating misleading records, to deter investigation, and thereby facilitate commission of the offense. Other factors may also be relevant in particular cases.

e. The Individual's History with Respect to Criminal Activity

The subject's history with respect to criminal activity will of course be extremely fact dependent. Experience with IP crime cases teaches that defendants often have a history of engaging in a pattern of fraudulent conduct not necessarily limited to IP crimes. It should not be assumed that commission of an IP crime is an exception to an otherwise law-abiding life. It is appropriate to consider whether there is a reasonable basis to believe that the person has engaged in previous IP violations. A prosecutor, an investigator or a victim may be aware of a permanent injunction or consent decree in any civil case against the defendant.

f. The Individual's Willingness to Cooperate in the Investigation or Prosecution of Others

A defendant's willingness to cooperate will depend on the individual. Nevertheless, it is important to recognize that in IP cases, defendants often have a substantial capacity for cooperation, if they are, in fact, willing. Since IP crimes often require special materials, equipment, or information, and can involve multiple participants, defendants often can provide substantial assistance. This cooperation can take at least three forms. Most commonly, a defendant might cooperate in the investigation or prosecution of others directly involved in the same criminal scheme.

Second, a defendant might also provide valuable cooperation concerning the source or destination of counterfeit goods or pirated works. For example, if a defendant is investigated for selling counterfeit watches on a retail basis, he could provide information as to the wholesaler of those counterfeit watches. The wholesaler, in turn, could provide information regarding the manufacturer, or about other retailers.

Third, a defendant might also provide information concerning the trafficking of counterfeit packaging materials in which counterfeit goods may be sold. This information is easy to overlook since the price of the packaging may be relatively low in comparison to the price of the goods, particularly for high-technology items. However, such information can be invaluable. For example, a defendant accused of trafficking 2,000 counterfeit computer chips for $200 each for a total of $400,000 may also have sold 10,000 counterfeit boxes for that same kind of chip at three dollars each for a total of $30,000. Though the $30,000 in box sales may seem like a small part of a $400,000 case, it can provide an important lead concerning the purchaser of the counterfeit boxes. Since the boxes serve no other purpose than to facilitate the trafficking in counterfeit goods, a reasonable inference is that the box purchaser may also be trafficking in the counterfeit chips. Therefore, what was a simple $30,000 worth of boxes could lead to $2 million worth of counterfeit chips.

g. The Probable Sentence or Other Consequences if the Person is Convicted

The consequences that may be imposed if an IP prosecution is successful include imprisonment, restitution, and forfeiture. In *Prosecuting Intellectual Property Crimes*, the sentencing provisions are discussed at § VII.A, whereas restitution (which is generally mandatory in IP cases) is discussed at §VII.B and forfeiture (which is generally available in IP cases) is discussed at §VII.C. The probable sentence is worthy of attention in light of the May 2000 revision to sentencing guideline § 2B5.3 (which is the relevant guideline for most IP crimes) to more accurately reflect the loss caused by IP crime.

Under revised guideline §2B5.3, the base offense level is 8. This level is increased by reference to the "fraud table" at §2F1.1 with a calculation where "loss" is based on the "infringement amount." It is important to understand that the "infringement amount" is calculated, in many IP cases, based on the retail value of the *infringed* (legitimate) item multiplied by the number of infringing items. This calculation can profoundly affect the sentence in an IP case.

For example, if a defendant sold, for five dollars each, 100 pirated CDs each containing 20 pirated software programs worth one hundred dollars each, that defendant may have profited only $500. Nevertheless, for sentencing purposes in such a case, the loss would probably be measured by the value of the intellectual property infringed upon by the defendant, which is $2,000 per CD for a total of $200,000.

Since the new sentencing guidelines now recognize in many IP cases that the value of the legitimate property is the proper basis for a loss calculation, prosecutors should be aware of this value in deciding whether to proceed with an IP case. Other important factors that can affect the offense level by 2 points each, are:

1.Whether the offense involved the manufacture, importation, or uploading of infringing items;
2. Whether the offense was not committed for commercial advantage or private financial gain;
3. Whether the offense involved (a) the conscious or reckless risk of serious bodily injury; or (b) possession of a dangerous weapon (including a firearm) in connection with the offense; or
4. Whether the offender took steps to circumvent encryption or other security measures in order to gain initial access to the infringed item.

Other factors that the Sentencing Commission has specifically recognized as possible grounds for an upward departure in an IP case under sentencing guideline § 2B5.3 are:

1. If the reputation of the trademark or copyright owner was substantially harmed by the offense in a way that is not accounted for in the monetary calculation; or
2. If the offense was in connection with or in furtherance of a national or international organized criminal enterprise.

2. Whether the Person is Subject to Prosecution in Another Jurisdiction

The second situation noted by the *U.S. Attorneys' Manual*§9-27.220 in which the prosecutor may properly decline to take action despite having sufficient admissible evidence occurs when the person is subject to effective prosecution in another jurisdiction. In IP cases, as in other cases, "[a]lthough there may be instances in which a Federal prosecutor may wish to consider deferring to prosecution in another Federal district, in most instances the choice will probably be between Federal prosecution and prosecution by state or local authorities." *U.S. Attorneys' Manual*§9-27.240 (cmt). In determining whether prosecution should be declined because the person is subject to effective prosecution in another jurisdiction, prosecutors should weigh all relevant considerations, including: (1) the strength of the other jurisdiction's interest in prosecution; (2) [t]he other jurisdiction's ability and willingness to prosecute effectively; and (3) [t]he probable sentence or other consequences if the person is convicted in the other jurisdiction. *U.S. Attorneys' Manual*§9-27.240. *See United States v. Coffee*, 113 F. Supp.2d 751 (E.D. Pa. 2000) (granting defendants' motion to transfer venue on the basis of the convenience of the parties and witnesses and the interests of justice where the impecunious defendants' home and the alleged criminal operations were in Dayton, Ohio and only five of fifty-seven proposed government witnesses were in Philadelphia, where an undercover operation had purchased counterfeit airplane parts).

IP cases represent a rare species where a prosecutor arguably may not be able to defer to a prosecution in the location of the primary victim. For example, a individual in one state may traffic in counterfeit sports wear bearing the counterfeited mark of a sports team located in a second state, and he might do so without ever physically entering that second state. Because of the defendant's constitutional and statutory right to be tried in the state and district in which their crime was "committed," U.S. Const. art. III§2 cl. 3; U.S. Const. amend. 6; 18 U.S.C.§3237, a prosecutor based in that second state—the home state of the victim—arguably may not have proper venue over the counterfeiter unless he or she can show that the "locus delecti" of the counterfeiting took place in the second state. This determination must be made "from the nature of the crime alleged and the location of the act or acts constituting it." *United States v. Rodriguez-Moreno*, 526 U.S. 275, 280 (1999).

Although this subject has not been vigorously litigated in the criminal infringement context, ordinarily the analysis turns on the locations of the actions of the defendant, rather than the district where the harm is felt. For example, in *UnitedStates v. DeFreitas*, 92 F. Supp.2d 272, 276-77 (S.D.N.Y. 2000), the district court found New York venue proper in a case under 18 U.S.C.§2320 where the counterfeit Beanie Babies were shipped from China to Canada, trucked to New York and then to New Jersey because "the very nature of the offense of 'trafficking' contemplates a continuing offense, one which begins with obtaining control over the counterfeit goods, continues with the transport, and ends with the transfer or disposal of such goods." *Cf. United States v. Muench*, 153 F.3d 1298, 1303 (1998) (finding venue for failure to pay child support to be proper in Florida, where victim child lived, even though Texas was where the defendant lived and where his child support checks were due); *United States v. Reed*, 773 F.2d 477, 483 (2d Cir. 1985) (considering factors such as the site of the criminal acts, the elements and nature of the crime, the locus of its effects, and the suitability of the various districts for accurate factfinding and concluding that perjury in one district in a proceeding ancillary to a proceeding in another district may be prosecuted in either). *See generally* Donna A. Balaguer, *Venue*, 30 Am. Crim. L. Rev. 1259 (1993).

Thus, in IP cases, it is common that the federal prosecutor will be called upon to vindicate the rights of a victim IP holder based in another district, another state, or even another country. Prosecutors should therefore be cognizant that the defendant may not be subject to prosecution in the victim's district, state or nation. Federal prosecutors should also recognize that local or state authorities may not have a great interest in punishing violations of the rights of out-of-state victim IP holders. By contrast, ensuring uniform and reliable national enforcement of the IP laws is an important goal of federal law enforcement.

This goal takes on added significance for federal prosecutors when the victim is based in a foreign country because of the importance of IP in modern international trade. With consistent enforcement of IP rights, America will continue to set an example of vigorous IP rights enforcement and to be perceived as hospitable to foreign firms that would register their IP and engage in business here.

Local and state authorities may also believe that since many IP rights are conferred by the federal government, they do not have the ability to prosecute any IP crimes. There is a provision for federal preemption for copyright infringement, 17 U.S.C.§301, although this preemption permits prosecution for other kinds of crime.

Even if the local or state authorities express a strong interest in prosecution, they may not have the ability or willingness to prosecute the case effectively. IP cases may not be a priority for some state or local authorities. They may have limited resources to devote to IP cases. For example, a particular office may not have space to store the large inventory seized from the warehouse of a counterfeiter. Some state or local authorities may not be interested in vindicating the IP rights of a distant victim. For a further discussion of state and local authority to prosecute IP crimes and a listing of state criminal IP statutes, see *Prosecuting Intellectual Property Crimes* § VI.A.2 & App. D (2001).

3. The Adequacy of a Noncriminal Alternative in an IP Case

Prosecutors may consider the adequacy of noncriminal alternatives when addressing an IP case. Some civil remedies, including *ex parte* seizure of a defendant's infringing products and punitive damages, may be available for certain violations of copyright and trademark rights. 15 U.S.C.§1116(d) (trademark remedies); 17 U.S.C.§§502-505 (copyright remedies). Also, for importers of trademark-infringing merchandise, the Customs Service may assess civil penalties not greater than the value that the merchandise would have were it genuine, according to the manufacturer's suggested retail price for first offenders, and not greater than twice that value for repeat offenders. These civil fines may be imposed in the U.S. Custom Service's discretion, in addition to any other civil or criminal penalty or other remedy authorized by law. 19 U.S.C.§1526(f). The availability and adequacy of these remedies should be carefully considered when evaluating an IP case.

Yet civil remedies may be futile under various circumstances. For example, IP crimes are unusual because they generally are committed without the victim's knowledge, even after the fact. The victim usually has no direct relationship with the infringer—before, during, or after the commission of the crime. If a victim is unaware of a violation by a particular defendant, civil remedies generally will be unavailing. Furthermore, without criminal sanction, infringers or counterfeiters might treat the rare case of the victim's civil enforcement of its rights as a cost of doing business.

Another important factor to consider when contemplating civil remedies is that infringers may be judgment proof. In most cases, the infringer traffics in counterfeit items worth far less than the authentic ones. By the time law enforcement identifies the unlawful activity, the value of the infringing items that the defendant has distributed often far exceeds the funds to which the defendant has access. This phenomenon is particularly common in software infringement cases, since an infringer can reproduce large numbers of high quality copies with only minimal investment. In Internet and computer bulletin board cases, a relatively modest expenditure in a personal computer and a modem can result in the reproduction and distribution of hundreds or even thousands of exact duplications of copyrighted works. In such instances, a criminal sanction may be the only meaningful deterrent.

There are a number of other circumstances where existing civil remedies may simply be an insufficient deterrent. For example, there may be cases where there have been prior unsuccessful efforts by a victim to enforce IP rights against the defendant or the existence of circumstances preventing such efforts. Criminal charges may also be necessary if counterfeiting continues despite the entry of a permanent injunction or consent decree in a civil case. As these scenarios illustrate, there are numerous situations where civil remedies may not deter the infringement, particularly where the defendant regards civil penalties as a cost of doing business. Another option to keep in mind in civil cases where there is a "repeat infringer" is that the existence of a civil order may provide a basis for a petition to the court for contempt.

Finally, civil remedies may not fully capture the wrongfulness of the defendant's criminal conduct. Counterfeiting or infringement of IP threatens the very integrity of the federal IP system, just as counterfeiting of currency jeopardizes the currency system. A meaningful threat

of criminal prosecution is necessary to safeguard the public's confidence in IP.

Conclusion

Because defendants in IP cases can have several victims, including the IP holders, society at large, and the recipients of the infringing goods or works, and because reliable enforcement of federally created IP rights is so important to the growing information economy, federalprosecutors should carefully consider whether to prosecute an IP case. Since the enactment in May 2000 of the new sentencing guideline that more accurately reflects the loss caused by IP crime, the punishment that can arise from a conviction is now more appropriate to the crime. Prosecutors should be aware of these special characteristics of IP cases when evaluating them against traditional principles and exercising their prosecutorial discretion. Further guidance is available from the recently published manual, *Prosecuting Intellectual Property Crimes* (2001), or from the IP Team at the Computer Crime and Intellectual Property Section (CCIPS) at (202) 514-1026.

ABOUT THE AUTHOR

David Goldstone has been a Trial Attorney in the Computer Crime and Intellectual Property Section for four years. He is the Team Leader for the Intellectual Property Team, and the primary author and editor of Prosecuting Intellectual Property Crimes (2001). Mr. Goldstone has been an instructor at the National Advocacy Center and is an adjunct professor of cyberspace law at the law schools of Georgetown University and George Washington University.

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