BEFORE THE OFFICE OF MANAGEMENT AND BUDGET
EXECUTIVE OFFICE OF THE PRESIDENT

SUPPLEMENTAL COMMENTS OF NETCOALITION AND THE COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION TO THE INTELLECTUAL PROPERTY ENFORCEMENT COORDINATOR'S REQUEST FOR COMMENTS ON THE JOINT STRATEGIC PLAN

In response to the Intellectual Property Enforcement Coordinator's request for comments on the Joint Strategic Plan, associations representing rightsholders provided a wide variety of policy recommendations, many of which would require amendment of the U.S. Code, impose new costs on taxpayers, interfere with the functionality of the Internet, or impede the development of new digital technologies. These diverse policy recommendations generally derive from a single chain of stated or unstated assumptions. These assumptions include that:

- estimates of intellectual property infringement can be reliably linked to an equivalent loss of sales by rightsholder industries;
- these "lost sales" figures can be causally connected to a negative effect on profits and employment in these industries and thereby the U.S. economy;
- more stringent substantive intellectual property laws will reverse these negative effects without causing any off-setting harm; and
- the federal government accordingly should undertake various intellectual property initiatives.

Underlying this string of conjecture is poor data. In our opening comments, we noted that the rightsholder-commissioned studies of the cost of IP infringement to the U.S. economy lacked analytical rigor. This lack of analytical rigor, exemplified by nine fallacies we identified, led these studies to grossly overstate the cost of infringement.

In these supplemental comments, we will address three studies relating to the impact of IP infringement that have been released since the March 23, 2010 deadline for comments. These studies are: the Government Accountability Office's *Intellectual Property: Observation on Efforts to Quantify the Economic Effects of Counterfeit and Pirated Goods*; *The Impact of Innovation and the Role of IP Rights on U.S. Productivity, Competitiveness, Jobs, Wages and Exports,* commissioned by the U.S. Chamber of Commerce; and *Fair Use in the U.S. Economy*, commissioned by the Computer & Communications Industry Association. Although the IPEC no doubt is aware of these studies, we wish to provide the IPEC with our views on the impact these studies' conclusions should have on the Joint Strategic Plan.

I. The GAO Report

On April 12, 2010, the GAO issued a report required by the PRO-IP Act on "the quantification of the impacts of counterfeit and pirated goods on the economy and industries of the United States to help the U.S. Government better protect the IP of rightsholders."[1] The report reviewed the literature in the field, including the surveys produced by rightsholders, and came to this startling conclusion: "it is difficult, if not impossible, to quantify the net effect of counterfeiting and piracy on the economy as a

[1] Government Accountability Office, *Intellectual Property: Observation on Efforts to Quantify the Economic Effects of Counterfeit and Pirated Goods*; *The Impact of Innovation and the Role of IP Rights on U.S. Productivity, Competitiveness, Jobs, Wages and Exports,* GAO-10-423 (April 12, 2010) at 1. The PRO-IP Act actually mandated a study with a narrower focus: "quantification of the impacts of imported and domestic counterfeit goods on – (1) the manufacturing industry in the United States; and (2) the overall economy of the United States." P.L. 110-403, § 501(a). In other words, the GAO broadened the scope of its report from "counterfeit goods" to "counterfeit and pirated goods."

whole."[2] The GAO also stated that the "net effect" of infringement on the economy "cannot be determined with any certainty."[3] This conclusion goes even further than the position we took in our opening comments. We stated that the quantification of the costs of infringement to the U.S. economy "is extremely difficult."[4] The GAO, in contrast, found that accurate quantification is impossible.

The GAO's conclusion flowed from its identification of serious methodological flaws in the studies performed to date, particularly studies commissioned by rightholder interests. These methodological flaws correspond to the fallacies we identified in our opening comments.

Lack of Data on the Extent of Infringement. The GAO asserted that the lack of data is the primary challenge for quantifying the impact of infringement. The GAO report quoted a 2008 OECD study that found that "available information on the scope and magnitude of counterfeiting and piracy provides only a crude indication of how widespread they may be…."[5] The OECD study further stated that "data have not been systematically collected or evaluated and, in many cases, assessments 'rely excessively on fragmentary and anecdotal information; where data are lacking, unsubstantiated opinions are often treated as facts.'"[6] The GAO observed that the U.S. government has relied upon rightsholder statistics on infringement, but "industry associations do not always disclose their proprietary data sources and methods, making it difficult to verify

[2] GAO Report at 16.
[3] GAO Report at 28.
[4] NetCoalition-CCIA Comments at 7 and 33 n. 95.
[5] GAO Report at 16.
[6] *Id.*

their estimates."[7] In other words, the GAO confirmed the "objectivity fallacy" identified in our opening comments.

Assumptions for Substitution Rate and Value of Infringing Goods. The GAO report stated that in the absence of real data on infringement, methods for calculating estimates of economic losses involve assumptions that have a significant impact on the resulting estimate. Two key assumptions are the rate at which a consumer is willing to switch from an infringing good to a genuine product (substitution rate); and value of the infringing good. The GAO suggested that assuming a one-to-one substitution rate at the manufacturer's suggest retail price could lead to lead to a dramatic overstatement of economic loss. This corresponds to the "lost sale fallacy" discussed in our opening comments. The GAO noted that some copyright industry studies made precisely this problematic assumption.[8] In other instances, the studies failed altogether to reveal their assumptions.[9] The GAO stated that "[u]nless the assumptions about substitution rates and valuations of counterfeit goods are transparently explained, experts observed that it is difficult, if not impossible, to assess the reasonableness of the resulting estimate."[10]

Economic Multipliers to Estimate Effects on the U.S. Economy. To develop an estimate of the effect of infringement on the overall U.S. economy, rightsholders have applied RIMS II economic multipliers[11] to the estimates of economic loss for specific

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[7] *Id*.
[8] *Id*. at 21 (referring to a Business Software Alliance survey).
[9] *Id*. (referring to a Motion Picture Association survey).
[10] *Id*. at 18.
[11] The Department of Commerce's Bureau of Economic Analysis make multipliers available through its Regional Input-Output Modeling System (RIMS II). These

copyright industries, which we discussed in the previous section. The GAO report found that "using the RIMS II multipliers in this setting does not take into account the two fold effect: (1) in the case that the counterfeit good has similar quality to the original, consumers have extra disposable income from purchasing a less expensive good, and (2) the extra disposable income goes back to the U.S. economy, as consumers can spend it on other goods and services."[12] Similarly, the GAO report referred to an expert's view that the "effects of piracy within the United States are mainly redistributions within the economy for other purposes and that they should not be considered as a loss to the overall economy. He stated that 'the money does not just vanish; it is used for other purposes.'"[13] This fundamental problem with deriving harm to the U.S. economy from losses to the copyright industries corresponds to the "silo fallacy" discussed in our opening comments.

In short, the GAO report raises serious questions about the accuracy of copyright industry studies concerning: 1) the amount of infringement; 2) the copyright industry losses resulting from the infringement; and 3) the effect of copyright industry losses on the U.S. economy as a whole. Because several of these studies build on one another, the inaccuracies at each stage are compounded, resulting in estimates of economic harm that have limited credibility. Significantly, the industry studies criticized by the GAO report

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multipliers allow the estimation of the impact of a specific change in one sector on the entire economy.

[12] GAO Report at 23 (referring to an Institute of Policy Innovation study).

[13] *Id*. at 28.

are precisely the same studies the rightsholders rely upon in their comments to the IPEC.[14]

There is no doubt that infringement occurs or that this infringement has had a negative impact on some rightsholders.[15] If nothing else, infringement has unintended distributional consequences within and outside of the U.S. economy. Intellectual property is not the only tool in the government's innovation toolbox, but robust protection for rights – concurrent with robust exceptions where necessary – is widely accepted as one important component of innovation policy. Nevertheless, the GAO report confirms that there is presently no credible data that justifies the federal intervention on the scale proposed by the rightsholders in their comments.[16]

In questioning the accuracy of the data concerning infringement generally, the GAO also casts doubt on the studies concerning the amount of counterfeiting. Notwithstanding the difficulty in quantifying the extent of counterfeiting, we fully support devoting more federal resources to the prevention of counterfeiting, particularly with respect to counterfeiting that harms public health, security, and safety. These harms to the public are qualitatively different from the general economic harm that tends to be

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[14] *See, e.g.*, comments of the Copyright Alliance, the Institute of Policy Innovation, Motion Picture Association of America, and Business Software Alliance.
[15] *See* GAO Report at 11-12.
[16] Perhaps even more alarming than the GAO's conclusion that the net effects of infringement on the U.S. economy cannot be measured are the extraordinary measures the U.S. government has taken over the past two decades to protect copyright owners in the complete absence of concrete evidence that such protection would benefit the U.S. public. Congress has extended the term of protection by twenty years, prohibited the circumvention of technological protection measures, treated exportation as an infringement, trebled the maximum award of statutory damages from $50,000 to $150,000, and imposed new criminal penalties for a variety of activities, including camcording films in movie theatres and distributing works without financial motive.

associated with infringement. The counterfeiting of pharmaceuticals, spare parts, and information technology products also is qualitatively different from the counterfeiting of luxury goods, particularly when the consumer knows he or she is purchasing a low-priced knock-off. We strongly recommend that the IPEC make the reduction of counterfeiting that endangers public health, security, and safety the top priority of the Joint Strategic Plan.

II. The Chamber of Commerce Study

On April 26, 2010, the U.S. Chamber of Commerce released a study it commissioned from Dr. Nam Pham of NDP Consulting. The study reviewed the performance of "IP-intensive industries" in the United States between 2000 and 2007. The study found that IP intensive industries, defined as industries with high research and development spending and employed scientists, outperformed non-IP intensive industries in terms of job creation, sustained growth, exports, and wages. Based on this finding, the Chamber study concluded that "the creation of intellectual property is the key factor in sustaining economic growth."[17] The Chamber study further concluded that "[p]olicies that enhance law enforcement's ability to detect, investigate, and prosecute IP theft are essential for better protecting intellectual property rights and thereby promoting further innovation."[18]

In reaching its conclusions, the Chamber study made a series of questionable assumptions. First, it assumed that the success of the IP-intensive industries could be

[17] Nam Pham, *The Impact of Innovation and the Role of IP Rights on U.S. Productivity, Competitiveness, Jobs, Wages and Exports* (2010), at 52.
[18] *Id*. at 53.

attributed to the existence of intellectual property. The study, however, produced no evidence that IP protection was "the key factor" in the success of these industries. Even if one accepts that innovation contributed to these industries' success by enabling them to offer consumers new products at low cost, there is no reason to assume that IP protection was the primary driver of this innovation.[19]

Second, building on the previous assumption, the Chamber study assumed that more IP protection will lead to more innovation. But as discussed in greater detail in our opening comments, over-protection is as dangerous as under-protection. Too much protection prevents competition from follow-on innovation.[20] Balance between protection and competition is the salient feature of our IP system, and a major reason for our global leadership in the development of innovative technologies.[21]

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[19] Other factors that spur innovation include preservation of market-share against competitors and government-funded research. A May 11, 2010 announcement by the Federal Trade Commission, the Department of Justice, and the Patent and Trademark Office of a joint workshop stated: "In recent years, federal agencies and the courts have recognized that patents and competition share the overall purpose of promoting innovation and enhancing consumer welfare. Timely, high-quality patents promote investment in innovation. The competitive drive of a dynamic marketplace fosters the introduction of new and improved products and processes. By contrast, delay, uncertainty, and poor patent quality can create barriers to innovation. Additionally, where standards for violating antitrust law are unclear, or where the threshold for antitrust violations is set too low or too high, innovation can be stifled. The workshop will address ways in which careful calibration and balancing of patent policy and competition policy can best promote incentives to innovate."

[20] *See* Simon Waterfall, "Investigation: Apple vs Nokia vs Google vs HTC vs RIM," *Wired.Co.UK* (May 12, 2010), for a discussion of how the "patent thicket" on smartphones is causing litigation and impeding innovation in the smartphone industry.

[21] The EU Database Directive demonstrates that more protection does not necessarily lead to more innovation. In 1996, the European Union adopted *sui generis* protection for the investment in the assembly of facts in databases. The EU's objective was to increase its global market share of this important industry relative to the United States, which does not provide a similar form of protection. In 2005, the European Commission performed

Third, even if enhanced IP protection will encourage more innovation, we question why that protection should come from taxpayer-funded law enforcement authorities. The primary responsibility for the enforcement of IP rights lies with the rightsholders. The Chamber study amply demonstrated that the IP-intensive industries are out-performing the rest of the economy. This success suggests that these industries do not need increased federal law enforcement assistance.[22]

III. The Computer & Communications Industry Association Study

On April 27, 2010, the Computer & Communications Industry Association released a study it commissioned on the contribution of fair use to the U.S. economy.[23] The CCIA study, performed by Thomas Rogers and Andrew Szamosszegi of Capitol Trade, Inc., employed the WIPO methodology for measuring the contribution of a given

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a study on the effectiveness of the Directive. The study found that since the adoption of the Directive, the European share of the global database market had actually decreased. The Commission concluded that the Directive did not have a positive impact on database creation.

[22] The Copyright Alliance comments similarly cited statistics that cast doubt on the need for an increased federal role in the protection of intellectual property: Expenditures on books, recorded audio, and video media grew in current dollars from $108 billion in 1998 to $169 billion in 2007, a 44% growth rate. Copyright Alliance Comments at 6. The online music industry grew by 27% in 2009. *Id*. at 8. Core copyright sales in foreign markets increased by 8% from 2006 to 2007. *Id*. at 10. Between 2000 and 2005, creative industries achieved an annual growth rate in international trade of 8.7%. *Id*. The number of U.S. independent artist-entrepreneurs increased from 509,000 in 2000 to 680,000 in 2007. *Id*. The number of professionals belonging to arts unions in the U.S. increased by 26.4% between 2004 and 2008. *Id*. at 12. There was a 33.6% increase in individual artists in the U.S. from 2000 to 2007. *Id*. Royalties for the performance of musical compositions increased 20% between 2003 and 2008. *Id*. This robust growth indicates that federal dollars are better spent elsewhere.

[23] Thomas Rogers and Andrew Szamosszegi, *Fair Use in the U.S. Economy: The Economic Contribution of Industries Relying on Fair Use* (CCIA: 2010). This study updated a study CCIA had commissioned in 2007. Our opening comments discussed the 2007 study. *See* NetCoalition-CCIA Comments at 16-17.

industry to a particular county's economy. After defining industries dependent on fair use and other exceptions and limitations to copyright, the study measured those industries' contributions in terms of revenue, value added, employment, and international trade. It found that companies benefiting from limitations on copyright-holders' exclusive rights generated revenue of $4.7 trillion in 2007 – a 36 percent increase over 2002 revenue of $3.4 trillion. The most significant growth over this period was in Internet publishing and broadcasting, web search portals, electronic shopping, electronic auctions and other financial investment activity. Fair use industry value added in 2007 was $2.2 trillion, 16.2% of the total U.S. current value GDP. As for jobs, employment in fair use industries grew from 16.9 million in 2002 to 17.5 million in 2007. According to the study, one out of every eight U.S. workers is employed by a company that benefits from protections provided by fair use. Industries relying on fair use and other copyright exceptions make up one-sixth of the U.S. economy.

The CCIA study stated: "the protection afforded by fair use has been a major contributing factor to these economic gains, and will continue to support growth as the U.S. economy becomes even more dependent on information industries."[24] The CCIA study's conclusion that fair use is "a major contributing factor" to the success of the fair use industries is far more supportable than the Chamber study's conclusion that intellectual property protection is "the key factor" in the success of IP-intensive industries. As discussed above, there is no compelling reason to accept the Chamber's assumption that IP protection is essential for innovation in a given industry -- there are many reasons why a company might innovate regardless of the level of IP protection. In

[24] Thomas Rogers and Andrew Szamosszegi, *Fair Use in the U.S. Economy* (2010) at 29.

contrast, it is reasonable to assume that an industry that would be illegal but for an exception would not exist but for that exception. In other words, it is reasonable to assume that without the exception, the industry would face an onslaught of litigation from rightsholders whose IP the industry had infringed.

IV. CONCLUSION

The rightsholders' comments repeatedly referred to "theft of intellectual property." In our opening comments, however, we stated that the Supreme Court in *Dowling v. United States,* 473 U.S. 207 (1985), held that infringement is qualitatively different from crimes relating to tangible property such as theft or shoplifting.[25] Confirming this qualitative difference between infringement and theft is the copyright case the Supreme Court on April 19, 2010, agreed to review: *Costco v. Omega*. This case involves the scope of the first sale doctrine, the exception that allows a person to sell or lend a copy that he owns. The Supreme Court will decide whether the first sale doctrine applies to copies made lawfully anywhere in the world, or only to copies made lawfully in the United States.

[25] Whereas taking a good from a possessor deprives the possessor of the ability to consume that good, the subject matter of intellectual property rights can be used by an infinite number of "rivalrous" users at one time. The theft of a rivalrous good is therefore economically distinct from the appropriation of a non-rivalrous entitlement. Infringement deprives a rightsholder not of possession nor application of the idea or expression at issue, but rather the opportunity to license its exclusivity. The non-rivalrous nature of idea consumption is hardly a novel economic theory; the phenomenon was noted by Thomas Jefferson in his oft-cited letter to Isaac Macpherson. *See* Letter from Thomas Jefferson to Isaac Macpherson, Aug. 13, 1813 ("[an idea's] peculiar character, too, is that no one possesses the less, because every other possesses the whole of it. He who receives an idea from me, receives instruction himself without lessening mine; as he who lights his taper at mine, receives light without darkening me").

In this case, Costco, the discount retailer, purchased legitimate Omega watches from a European distributor and sold them in the United States. The case will turn on the Court's interpretation of an ambiguous clause in 17 U.S.C. § 109(a). Costco certainly is no "pirate" or "thief." At worst, it is an infringer of copyright – a company that has unintentionally violated a technical, complicated, evolving, and largely arbitrary set of rules established by Congress and applied inconsistently by the courts.

Costco v. Omega is the most important copyright case since *MGM v. Grokster* in 2005. In a brief filed with the Supreme Court, Solicitor General Elena Kagan acknowledged that applying the first sale doctrine only to copies made in the United States "could result in adverse policy consequences."[26] She noted that "the potential implications of excluding foreign-made copies of a copyrighted work from Section 109(a)'s coverage are indeed troubling."[27] These statements demonstrate the Solicitor General's awareness that IP enforcement raises complex policy issues; pejorative terms such as "theft" or "piracy" prevent reasoned discourse about these issues.

[26] Brief for the United States as Amicus Curiae, *Costco v. Omega*, at 5.
[27] Id. at 18.

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May 20, 2010