

Pricing information

Eric Blair

30 April 2007

Since it's interesting, we'll begin with extradition. Extradition is not trivial. It's an infringement upon a state's sovereignty to forcibly remove a person, so there are treaties that allow extraditions only under certain conditions. The Australia/USA treaty lists 29 types of crime for which a person can be extradited, and they ain't pretty:

1. Murder [...].
4. Unlawful throwing or application of any corrosive or injurious substances upon the person of another.
5. Rape; indecent assault, including unlawful sexual acts with or upon children.
6. Illegal abortion.
7. Procuring, or trafficking in, women or young persons for immoral purposes; living on the earnings of prostitution.
9. Bigamy.
10. Kidnapping; child stealing; abduction; false imprisonment.
13. Larceny.
14. Embezzlement.
17. Extortion.
18. Receiving any property, money or valuable securities knowing the same to have been unlawfully obtained.
22. Arson.
25. Piracy, by statute or by law of nations; revolt on board a vessel against the authority of the master of the vessel.
29. Dealing in slaves.

So your average shoplifter is safe; we're talking about people who are selling women and children into slavery or are true and honest pirates (a breed which still exists in the seas between Australia and Asia). Major financial affronts like 17 & 18 are in there too.

Mr. Hew Raymond Griffiths¹ is a UK citizen living in Australia, and as far as I understand it, he's never been to the Western Hemisphere. But he's just won himself a 'round the world ticket with accommodations for up to ten years, because a court in Virginia found him guilty of copyright infringement, and the Australian government has agreed to extradite him.

[I'm not sure if the Australia/USA treaty applies here, since the guy's a UK citizen, but you get the gist.]

As you can imagine, this guy wasn't just making mix tapes for his pals. He was running a warez site with heaps of software free for the taking. If you're not familiar

¹<http://ipkitten.blogspot.com/2007/04/copyright-extradition.html>

with warez sites, they're one of the dark corners of the web, mostly inhabited by adolescents trying to prove their abilities by cracking security codes, hosting big files (like an operating system or Photoshop), or just putting up lots of porn. This is where 'leet-speak came from, and everything about warez sites and their denizens is a turn-off. They also tend to pick black backgrounds and tiny fonts.

So let this be a lesson for any of you who have CSS that specifies less than a ten-point font for your body text: the courts have no sympathy at all. It's an easy win for the prosecution, because warez sites are so unattractive to normal folk like judges and juries.

Pricing nothing But as above, extradition doesn't happen for being a punk—it takes big money crimes, with dollar figures up around seven or eight digits. And here we run in to a problem. How do you evaluate intellectual property?

Let me give you another example: my think tank is a 501(c)3 nonprofit, so contributions and donations are tax deductible. Microsoft, Inc. donates server software to the think tank, which is one factor in why we have a famously slow and messy web site. At the maximum, it cost Microsoft maybe \$100 to send us the software, what with the jewel cases and little holograms on the licenses and the bubble wrap. Given that, how much do you think they're deducting from their taxes for mailing us those CDs?

I'm not in the mood to check right now, but last time I looked at Microsoft's annual report, their intellectual property was one or two percent of their assets, where one percent of Microsoft is more than I'll ever be worth. How did they come up with that? They are reporting to shareholders, the SEC, and anyone else who cares that their asset base is 1% larger than their physical plant. There are accountants over in Redmond right now trying to work out how they can claim as large an asset base as possible, and intellectual property (IP) is just a gimme for them.

And not to pick on Microsoft, there are companies where IP is up there around 50 or 90 percent of their asset base.

IP is not the first thing in the world where evaluation is difficult. I had a job that involved evaluating infrequently-traded options for a brokerage firm, and there were yelling matches over it. The equations require an estimate of the volatility of an asset's price, and there are several ways to make that estimate. But at least there are generally-accepted methods to do it, albeit a few too many.

The only method for pricing intellectual property is by current market rate. This is common enough in asset pricing, but it's problematic in this case, because the distance between market rate and cost of production is so large. If Microsoft sent the think tank ten copies of the server software instead of one, it'd be sending ten times the market value, so it should be able to deduct ten times the amount from their taxes. Gosh, why not just send a case of CDs and take the year off from paying taxes.

Our intuition is that the recipients value the items at less than full retail cost. Maybe they'd buy the first copy for full price, but the willingness-to-pay falls precipitously from there. But now we're back to unobservable value, since we can't ask the recipients what a second or third license is worth to them. But it also seems unfair to say that Microsoft can only deduct the price of printing and shipping.

The standard for damages in cases like that of Mr. Griffiths, as I understand it,

is to claim full retail price for downloads, which is why Mr. Griffiths's web work is sufficient to merit extradition proceedings usually reserved for child molesters: the plaintiffs claimed \$50 million in damages². The nice people at the RIAA often cite lost sales figures that assume full retail price for every downloaded CD when arguing that the Department of Justice should allocate its scarce resources to enforcing copyright laws. Especially with the losers on the warez sites, this is a false assumption. If a kid who makes a few thousand a year from part-time at the Seven-Eleven can't get a free copy of Photoshop, he wouldn't buy it retail (it's very pricey). He'd just get Linux.

This is not to say that none of the people who downloaded from a warez site would ever buy retail. Sales were surely lost, but there is really no way to know whether lost sales make up 1% of the downloads or 99%.

By the way, the operators of warez sites rarely make any money. They just do it to be a leader among maladjusted adolescents. But, you figure, this has nothing to do with whether the thief profits—if a gent steals some jewels to give to his gal, it's still theft. The Supreme Court commented on this very argument in its ruling in *Sony v Betamax*³, which was a case over whether recording a TV show was theft of intellectual property. Since it is mostly applicable to the situation at hand, here is footnote 33 in full (minus citations; VTR = video tape recorder):

It has been suggested that “consumptive uses of copyrights by home VTR users are commercial even if the consumer does not sell the homemade tape because the consumer will not buy tapes separately sold by the copyrightholder.” Furthermore, “[the] error in excusing such theft as noncommercial,” we are told, “can be seen by simple analogy: jewel theft is not converted into a noncommercial veniality if stolen jewels are simply worn rather than sold.” The premise and the analogy are indeed simple, but they add nothing to the argument. The use to which stolen jewelry is put is quite irrelevant in determining whether depriving its true owner of his present possessory interest in it is venial; because of the nature of the item and the true owner's interests in physical possession of it, the law finds the taking objectionable even if the thief does not use the item at all. Theft of a particular item of personal property of course may have commercial significance, for the thief deprives the owner of his right to sell that particular item to any individual. Time-shifting does not even remotely entail comparable consequences to the copyright owner. Moreover, the time-shifter no more steals the program by watching it once than does the live viewer, and the live viewer is no more likely to buy prerecorded videotapes than is the time-shifter. Indeed, no live viewer would buy a prerecorded videotape if he did not have access to a VTR.

Pricing IP at market rates is based on metaphor to physical goods, but as our intuition and the Supreme Court observe, this metaphor doesn't really work out, partly because consuming information without paying does not prevent the owner from continuing to sell that information elsewhere, while the owner can't sell stolen physical

²http://www.theregister.co.uk/2007/04/25/copyright_plea/

³<http://www.law.cornell.edu/copyright/cases/464-US-417.htm>

goods.

As usual, I have no conclusion. You can decide for yourself whether running a warez site is on par with throwing acid on a person. But be aware of the huge open question that is the pricing of IP, and there's a small industry built on trying to come up with a passable (but self-serving) number.

On behalf of the IP experts of the world, let me say: we have no idea how to price intangible assets. But despite our cluelessness, the number eventually made up matters to us humans. After Enron, there have been many volumes written on how to tighten accounting standards so companies can't do what Enron did, even on a smaller scale—but then IP gives companies an exception big enough to drive a truck through. By tricks like the one above, the US government loses what is no doubt tens or hundreds of millions in tax revenue. Market pricing of IP is sending Mr. Griffiths around the globe, and market pricing allows media producers to have so much pull in Congress that they can use the USA's finite political capital to initiate extraditions.