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INTERNET ISSUES

Copyright Liability After *Grokster*

BY JOHN TEHRANIAN

The peer-to-peer (P2P) file-sharing revolution has heightened scrutiny of our intellectual property regime and its ability to protect content creators in cyberspace. To many observers, P2P networks have threatened the viability of the entertainment industry by facilitating unauthorized duplication of millions of copyrighted works each day. The industry has consequently launched an attack featuring statutory reforms, educational efforts directed at norm transformation, and litigation targeting both P2P entities and individual file sharers.

The progeny of the U.S. Supreme Court's decision in *MGM Studios v. Grokster*, a lawsuit by the entertainment industry aimed at shutting down several leading P2P networks, will determine the copyright system's ability to respond to future technological exigencies.

In *Grokster* the Court unanimously reversed a Ninth Circuit opinion that had immunized P2P networks from liability on secondary theories of copyright infringement for facilitating noninfringing uses. The popular press immediately hailed the decision as an unequivocal victory for the entertainment industry. A closer look at competing theories of infringement, however, reveals the decision's shortcomings in laying a template for intellectual property protection in the digital era.

THEORIES OF SECONDARY LIABILITY

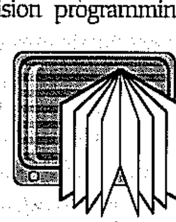
Two common law theories of secondary liability—contributory and vicarious—have traditionally assisted content creators in legal battles against those who develop new technology that facilitates copyright infringement. Both theories require that the technology enable an underlying act of direct infringement. Contributory liability attaches when the defendant also knows of the infringement and materially contributes to it. Vicarious liability requires that the defendant must directly financially benefit from the infringement and have the right and ability to control the infringer's actions.

SUPREME DIRECTION: *SONY V. UNIVERSAL*

The U.S. Supreme Court first assessed the applicability of secondary-liability theories to modern technology providers more than two decades ago in *Sony Corp. of Am. v. Universal City Studios, Inc.* (464 U.S. 417 (1984).) In that case, the major motion picture studios sued Sony for contributory and vicarious copyright infringement stemming from its development of the Betamax technology. The studios argued that the advent of the Betamax—and, ultimately, the VHS—would devastate both the television and motion picture industries by dramatically reducing audiences for television programming. Consumers could simply record programs, especially movie reruns aired on television, and watch them later. (*Universal City Studios, Inc. v. Sony Corp. of Am.*, 480 F. Supp. 429, 466 (D.C. Cal. 1979).) The studios also contended that the Betamax's recording features would dilute the potential market for film rentals by enabling consumers to record movies from television.

In 1983 Jack Valenti, the president of the Motion Picture Association of America (MPAA), testified before the House of Representatives that "the VCR is to the motion picture industry and the American public what the Boston Strangler is to the woman alone." The U.S. Supreme Court, however, disagreed.

The Court found that the existence of potential infringing uses should not



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render particular technology illegal per se. Specifically, the Court in *Sony* barred liability based on imputed intent to cause infringement when a "staple article of commerce" used in infringement had "substantial noninfringing uses." (*Sony*, 464 U.S. at 442.) The Court also held that consumers are entitled under the fair use doctrine to engage in time shifting—recording a televised program for personal and private viewing at an alternate time. Therefore, because the Betamax possessed significant noninfringing uses, Sony could not be held liable for acts facilitated by its technology.

THE WAR AGAINST P2P FILE SHARING

The entertainment industry's recent legal battles have focused on Internet file sharing. The industry won its high-profile battle against the leading first-generation file-sharing system, Napster. But its success was ephemeral; users rapidly turned to more sophisticated P2P technology. Second-generation systems such as Gnutella, Grokster, and KaZaa have dramatically expanded the gamut of infringing activity. Rather than merely enabling the exchange of audio mp3 files as Napster did, these systems also allow users to swap commercial software, movies, graphics, and text files. The networks have also adopted superior file organization and retrieval techniques, enabling users to access copyrighted materials with greater agility.

Meanwhile, legal enforcement against the second-generation networks has grown more arduous. Unlike Napster, the second-generation networks use decentralized architecture. Without delving too deeply into technological niceties, Napster housed a centralized index of files on servers it owned and operated. As a result, it could filter the types of files traded on its network. By contrast, on second-generation networks, indexes are not maintained on the P2P providers' servers. Thus, these systems have attempted to shield themselves from liability by precluding their own abilities to control or monitor infringing activities on their networks.

Also, shell corporations that can easily relocate their systems and operations to venues with more favorable laws now operate many second-generation networks. Epitomizing the viability of such legal arbitrage, the Dutch owners of KaZaa responded to an adverse judgment in the Netherlands by selling their software and service to the nebulous Sharman Networks Ltd. A corporation shrouded under a notorious veil of secrecy, Sharman is officially incorporated in the South Pacific tax haven of Vanuatu, which recognizes no copyright laws, rendering the enforceability of any judgment against KaZaa in doubt.

THE CIRCUIT SPLIT

Despite these challenges, the entertainment industry has remained undaunted in seeking legal recourse against second-generation P2P networks. In 2002 it filed suit in the Central District of California against the Grokster, StreamCast, and KaZaa networks. The defendants earned partial summary judgment absolving them of secondary liability for acts of infringement occurring on their networks, and the Ninth Circuit affirmed. (*Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 380 F.3d 1154 (9th Cir. 2004).) However, the entertainment industry succeeded elsewhere. In 2003 the Seventh Circuit affirmed a lower court judgment that helped shut down the Aimster network. (*In re Aimster Copyright Litig.*, 334 F.3d 643, 651 (7th Cir. 2003).) With the circuits split in their treatment of file-sharing technology, the issue was ripe for review in the *Grokster* case.

ACTIVE INDUCEMENT ELUCIDATED

Most significantly, *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.* (125 S. Ct. 2764 (2005)) establishes parameters for an active-inducement theory of secondary liability in copyright law. To impose contributory liability, a court must generally find that a defendant intended to induce infringement. *Sony* held that courts could not impute this intent to manufacturers of technologies with "commercially significant" or "substantial noninfringing uses." (*Sony*, 464 U.S. at 442.) In *Grokster* the Ninth Circuit construed *Sony* as immunizing from secondary liability any technology capable of substantial or commercially viable noninfringing uses, unless the distributor of that technology had actual knowledge of specific instances of infringement and failed to act. (*Grokster*, 380 F.3d at 1160.)

In a unanimous reversal, the Supreme Court disagreed with this interpretation of *Sony*. The Court clarified that a defendant distributing a product used for copyright infringement faces contributory liability under two circumstances: active inducement to infringe, or developer knowledge of infringing uses. Active-inducement liability attaches if the defendant distributes a product "with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement," regardless of whether the product is capable of commercially significant noninfringing uses. (*Grokster*, 125 S. Ct. at 2780.)

Significantly, under the reaffirmed *Sony* defense, mere knowledge of potential or actual infringing uses is insufficient to establish liability. Absent active inducement to infringe, liability might still attach to a developer that merely has knowledge that its product is used for infringing purposes; however, the product must be incapable of substantial or commercially significant noninfringing uses.

According to the Court, three factual considerations rendered "unmistakable" the *Grokster* defendants' "unlawful" intent to actively induce infringement. First, both the creators of Grokster and StreamCast "voiced the objective that recipients use [their programs] to download copyrighted works, and each took active steps to encourage infringement." (*Grokster*, 125 S. Ct. at 2772.) Specifically, the defendants held themselves out as Napster substitutes, trying to capture users of a known source of demand for copyright infringement. Second, they failed to develop any filtering tools to reduce rates of infringement on their networks. Third, the defendants made money through advertising. Because close to 90 percent of volume on the networks involved the unlawful exchange of copyrighted works, the defendants' business model thrived on infringement.

GROKSTER AND ITS DISCONTENTS

Despite much fanfare and *Grokster*'s unequivocal embrace of intent as a factor in liability, there are several critical shortcomings in the practical import of the decision. First, sophisticated technology companies, both in the mainstream and at the legal margins, will respond to *Grokster* by assiduously avoiding statements that courts might read as inducing infringement. To some observers, this aspect of the decision provides a blueprint for future technologists to avert liability, even if their products facilitate substantial infringing uses.

Without better legal guidance, it is also unclear what types of statements constitute inducement. For example, *Grokster* calls into question the continued viability of a number of recent advertising campaigns, including Apple's "Rip. Mix. Burn." slogan. Additionally, a company might market a product it believes facilitates fair use of copyrighted works by its consumers. But if that use is ultimately deemed unfair, it is unclear whether that company's statements amount to inducement, or whether a good faith belief in a product's fair use capacity shields its creator from contributory liability.

SCRUTINIZING ARCHITECTURE

Despite acknowledging that the defendants' failure to develop filtering tools bolstered its finding of inducement, the Court in *Grokster* refused to place an affirmative duty on defendants to reduce or minimize use of their products for infringing purposes. In language steeped with caution, the Court warned that "[s]uch a holding would tread too close to the *Sony* safe harbor."

The decision therefore appeared to reject the Ninth Circuit's position in *Grokster*—that an inability to control content on a network, even if that inability stems from a technology provider's willful desire to divest itself of such control, is entirely irrelevant to the liability calculus. The Court also rejected the Seventh Circuit's position in *Aimster*—that technology providers categorically cannot turn a blind eye toward infringing activities on their networks. But the relevance of network architecture to the secondary-liability inquiry remains riddled with ambiguity.

THE SCOPE OF *SONY*'S SAFE HARBOR

Grokster applies only to the limited sphere of cases in which defendants have actively induced infringement. More often, however, contentious cases will rest on a claim of liability based not on active inducement but grounded, like *Sony*, in a defendant's knowledge of infringing use. Yet the *Grokster* decision failed to clarify several questions about the ambit of the *Sony* safe harbor, including the availability of the "substantial noninfringing uses" defense in vicarious-liability actions and the meaning of *substantial* or *commercially significant* under *Sony*. In fact, *Grokster* leaves uncertain whether noninfringing uses must be actual or probable. Similarly unknown is the amount of time courts should grant technologies to develop noninfringing uses. The interplay of the magnitudes of infringing and noninfringing uses also remains in doubt.

On these points *Grokster*'s two concurring opinions—the first written by Justice Ruth Bader Ginsburg and joined by Chief Justice William Rehnquist and Justice Anthony Kennedy, and the second written by Justice Stephen Breyer and joined by Justices John Paul Stevens and Sandra Day O'Connor—likely epitomize the locus of future litigation.

To Ginsburg, the sheer volume of infringing uses on P2P networks suggests no "reasonable prospect that substantial or commercially significant noninfringing uses were likely to develop over time." (*Grokster*, 125 S. Ct. at 2786.)

By contrast, to Breyer the *Sony* holding precludes liability against Grokster or StreamCast on any theory beyond active inducement. Specifically, he contends that the *Sony* defense applies to a technology unless it was clear that it would "be used *almost exclusively* to infringe copyrights." (*Grokster*, 125 S. Ct. at 2791.)

WHITHER THE LEGAL FIGHT?

Although the Supreme Court's recent pronouncement resuscitates the entertainment industry's suit against Grokster and StreamCast, some observers have questioned the value of this continued legal assault on P2P networks and their users. After all, P2P networks have grown increasingly amorphous and judgment-proof. Meanwhile, lawsuits against individual users have generated hostility toward and bad press for the industry while providing only mixed results in deterrence.

The potential futility of a continued legal struggle is also highlighted by the realities of technological development. Tellingly, the technology at issue in *Grokster* is already antiquated, and a third generation of P2P networks has already emerged, posing new challenges to the legal regime. For example, BitTorrent has supplanted KaZaa as the world's leading P2P network. Unlike many prior P2P iterations, BitTorrent was developed for the express purpose of facilitating noninfringing transfers of information, and it operates noncommercially. Moreover, it has a far more decentralized architecture than do previous networks. In light of these facts, BitTorrent's creators appear insulated from liability under the standards promulgated in *Grokster*.

Economic developments in the wake of the *Sony* decision also suggest that the entertainment industry might enjoy greater success by embracing and co-opting, rather than fighting, emerging digital distribution channels. *Sony*, of course, paved the way for the VCR to enter almost every American home. Yet the parade of horribles vividly portrayed by Jack Valenti and the MPAA never came to be: Studios now derive more profit from DVD and video rentals and sales than from theater ticket sales.

On the other hand, the unprecedented ease and speed with which P2P networks have enabled copyright infringement vastly exceed that of any prior innovation, including the VCR, and may render any historical analogy thoroughly inapposite. *Grokster*'s progeny will therefore dramatically affect the pace and scope of technological change as courts continue the struggle to balance public rights of access to copyrighted works with the copyright owners' interests in reaping just rewards for creative labors. CL