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Special Grokster Edition

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Note to readers: On November 7, 2005, the Recording Industry Association of America issued a press release announcing settlement of the longstanding file-sharing dispute with Grokster. Grokster's home page now carries a simple message: "The United States Supreme Court unanimously confirmed that using this service to trade copyrighted material is illegal. There are legal services for downloading music and movies. This service is not one of them." At the same time, co-defendant StreamCast's website expressly "Vows to Continue its Fight for Freedom to Operate."

This special edition of the Fenwick & West *Intellectual Property Bulletin* offers perspectives on the Supreme Court's landmark copyright decision in *MGM v. Grokster*. Now that one defendant has settled and the initial statements of the various interest groups have subsided, we begin to see what the long-term effects of this decision are likely to be. Over the course of the summer and early fall of 2005, the affected interests, pundits and legislators have all provided insights, and it will be important to continue watching how this post-Grokster world evolves.

The Supreme Court Speaks to Technology Companies on Ethics—*MGM v. Grokster*

BY STUART MEYER

It has been just a few months since the Supreme Court released its much-anticipated opinion in the *MGM v. Grokster* case, holding that technology companies providing peer-to-peer software could be liable for inducing copyright infringement. The June 27, 2005, ruling was expected to impact the technology industry, record companies and college students alike, and the past few months suggest that it has had that effect. The decision in the *MGM v. Grokster* case was unanimous: all nine justices agreed that it was copyright infringement for a company to target potential infringers as a customer base, while failing to develop mechanisms to reduce infringement and while knowing that the overwhelming use was to engage in copyright infringement. Much ink was spilled shortly after the decision about how this was a "record company win" and would be remembered as the event that closed the "Napster era." However, the lasting impact of the Grokster case will likely be for another, far more general, teaching: that genuine business ethics are still of the greatest importance.

The reaction to the Grokster case was what one might have expected. The companies that generate and market copyright-protected content expressed vindication, and the technologists warned that the ruling might stifle innovation. For example, in a September 28 Senate hearing, Cary Sherman, president of the Recording Industry

In This Bulletin

Association of America, testified that "[T]he absurd notion that, somehow, it's okay to take someone else's property just because you can, has been shown to be precisely that—absurd." On the other hand, the Consumer Electronics Association issued a statement that "The immediate impact of today's ruling is twofold: massive uncertainty and the likelihood of massive legal bills." Lawrence Lessig gave his September 2005 column in *Wired* magazine the simple title, "A Rotten Ruling." He opined that "The Grokster case revealed the worst in Supreme Court ivory towerism."

A September 16 article from redherring.com reports that since the Grokster ruling, the Recording Industry Association of America has brought some 1700 lawsuits against individuals for using Grokster and similar services to distribute music. It will be some time before these cases, other cases brought against peer-to-peer software providers and indeed the remaining StreamCast litigation sent back to the lower courts on remand are decided. However, we are already beginning to see some second-generation critical thinking about the long-term ramifications of the Grokster decision.

Of primary importance to most readers of this bulletin is that real corporate ethics will be in a spotlight in the intellectual property area, much as the Sarbanes-Oxley Act has put a spotlight on corporate governance, finance and accounting. The reason for this is that the Supreme Court has authorized copyright plaintiffs to seek discovery in Grokster-like cases into the internal motives and decision-making of defendants. It may not matter that the user documentation of a peer-to-peer software program warns against copyright infringement, if the internal e-mail history shows that the developers intended to build a product that would be used as a mechanism for illegal copying.

To be sure, there are many other important lessons that Grokster teaches us. One of them, important for all lawyers to remember, is that the Supreme Court does not merely hear two arguments and decide which one is correct. In this case, the main ruling was not, as expected and argued, whether the "Sony Betamax" decision of 1984 should survive and continue to shield producers of products that are "capable of substantial noninfringing uses." Instead, the Supreme Court largely sidestepped that issue and focused on framing a doctrine of liability via inducement of infringement—a theory well developed in patent law but not in copyright law.

Another, sometimes frustrating lesson is that just because an issue is briefed to the Supreme Court, one can never be sure that the issue will be settled by the Supreme Court. Here, the Court did not resolve the longstanding question of what the Sony decision meant by the phrase "substantial non-infringing use." Instead, we see that the Supreme Court justices, though unanimous in the overall outcome of the case, differ widely on that issue. It is uncertain when we will see judicial interpretation of the debate laid out in the various concurring opinions. We may not even see any commentary in decisions on remand in the Grokster litigation, as settlement may call a halt to the Grokster litigation before further opinions issue.

The primary concern, though, is how to address the issue of true ethical behavior in a technology company. Is it proper or not for a software developer to discuss with the R&D team possible product designs, some of which might be more "friendly" to unauthorized copying than others? What is the appropriate tradeoff between providing a "Swiss army knife" product capable of many uses and turning off features particularly helpful to copyright infringers? How much can warnings, disclaimers and alert windows indicate good ethics when they accompany a product that is, in effect, a highly efficient copyright infringement machine?

How are technology companies to handle the new and obvious opportunities for abuse that can come about from the "intent" standards taught by the Grokster ruling? Departed employees have always posed risks for technology companies for reasons ranging from recruiting their co-workers to revealing trade secrets. Now, those departed employees might also be sought out by plaintiff-side counsel to help establish that the defendant company intended for its new product to be used to enable infringement by customers. Even for employees who are still with the company, what can it do to “cure” an unfortunate statement in a product manager’s e-mail that the company knows will look bad when brought up by the plaintiff in deposition or at trial? Some early commentary on the Grokster decision suggested that companies gear up for continual shredding of R&D and marketing e-mails and other documents to address this issue. The realities of e-discovery and the modern-day perils of spoliation quickly tempered such knee-jerk reactions.

Viewed with this perspective, the practical impact of Grokster on technology companies likely will be an increased sensitivity to the ethics associated with the technologies they develop. In fact, this effect began to be felt almost immediately after the Supreme Court’s decision was handed down. On July 28, at a hearing of the Senate Committee on Commerce, Science and Transportation, two members of the Committee, representing both sides of the aisle, cautioned industry witnesses that failure to consider the ethics of their offerings would result in legislative action. Senators Barbara Boxer (D-Cal) and Theodore Stevens (R-Alaska) warned the witnesses that the industry had to think seriously about issues such as exposing minors to pornography and promoting piracy. Senator Stevens noted that he and Senator Boxer “rarely agree” on issues, so when they do it should be taken seriously. He went on to admonish that “We’re sending a message that we are going to be watching.” Likewise, the Senate Judiciary Committee hearings held on September 28, 2005, under the title “Protecting Copyright and Innovation in a Post-Grokster World,” addressed the importance of ethics, with the ranking member Patrick Leahy (D-Vermont) noting that the abuse of technology was the problem, and that the “people side” of the issue had to be addressed, with technology being neither the problem nor the solution.

The debate will rage for many years whether the Grokster decision is helpful or harmful for innovation and for society overall. Corporate leaders must continue thinking about how their world has been impacted by the Grokster decision and must strive to develop new strategies to minimize corporate exposure to post-Grokster claims.

Does Aimster Survive Grokster? The Supremes’ File Sharing Decision and the Circuit Split on Sony and Contributory Infringement

BY MITCHELL ZIMMERMAN

The Supreme Court’s decision on file sharing and copyright infringement strengthened the hand of content owners and sent shivers down the backs of technology developers. The music industry hailed *MGM v. Grokster* as a striking affirmation of the rights of creative artists, and fair-use advocates bewailed the asserted cost: 10 years of chilled innovation.

But will the decision save the music industry, which has blamed falling sales on unrestrained “sharing” by users of peer-to-peer file-sharing technologies? And what will the impact of the revised legal regime be on innovation?

The answers may turn in significant part on an issue not expressly addressed in the court’s opinion—namely, whether Grokster in fact rejected the Seventh U.S. Circuit Court of Appeals’ analysis and holding in an earlier file-sharing, contributory-infringement case, *In re Aimster Copyright Litigation*, 334 F.3d 653 (2003), and resolved the split between the Ninth and Seventh circuits.

Grokster and StreamCast, the two defendants in the case, established extraordinary file-sharing networks. These networks included 100 million Internet users who had downloaded the Grokster and StreamCast software in order to make music, video and other files available to one another for copying. (For convenience, I’ll refer to the two Grokster defendants collectively as “Grokster” after this.)

The Grokster file-sharing technologies were “peer-to-peer,” meaning that the billions of shared files were neither stored on nor passed through any central computer system or server operated by the defendants. No central index was required for Grokster users to identify or communicate with one another to copy works. Rather, the downloaded software enabled direct communications among the tens of millions of users who often were online at the same time.

Once the enabling software had proliferated sufficiently, no further action by Grokster was needed for the file-sharing network to operate, and nothing Grokster could do could stop its operation.

Contributory liability for copyright infringement requires knowledge of and material contribution to an underlying infringement. In *Sony Corp. v. University City Studios*, 464 U.S. 417 (1984) (the Betamax VCR case), the Supreme Court held that those who sold devices that were "capable of substantial [or of "commercially significant"] noninfringing uses" were not liable for the infringing uses to which their customers might put their devices.

The capacity for such uses negated secondary liability, whether treated as an independent, policy-driven exception to contributory infringement or as a gloss on the "knowledge" element (on the theory that knowledge of infringing acts would not be imputed when buyers could use the product either for innocent or for infringing purposes).

For a generation, these principles provided relatively clear guidance for emerging technologies, and the legal security and predictability afforded by the Sony defense arguably contributed to the explosion of innovation in Internet, information and communications technologies in the last decade of the 20th century.

In the view of many, however, the Sony regime also encouraged the design of technologies intended for infringement and protected them as long as they sported even the smallest fig leaf of potential noninfringing uses.

In the digital, online environment, in their view, with its potential for exponential, perfect copying, and near-instantaneous worldwide distribution of copies, the Sony defense threatened the overall copyright regime.

In Grokster, it was undisputed that the file-sharing technologies at issue were used largely to copy protected works, typically music, and that such "sharers" were therefore direct infringers. It was also undisputed that Grokster's peer-to-peer technology was capable of substantial noninfringing uses. On this basis, the U.S. District Court for the Central District granted summary judgment that Grokster was not liable, and the Ninth Circuit Court of Appeals affirmed, 380 F.3d 1154 (2004).

Under the Ninth Circuit's reading of Sony, if a technology is capable of substantial noninfringing uses, the plaintiff must show that the contributory-infringement defendant had reasonable knowledge of specific infringing files and failed to act on that knowledge to prevent infringement. Owing to the decentralized nature of Grokster's peer-to-peer software and the fact that the software was capable of substantial noninfringing uses, the Ninth Circuit reasoned, Grokster had no knowledge of any infringing activity at a relevant time—when Grokster could do anything about it—and for the same reason did not materially contribute to its users' infringements.

The Ninth Circuit's reading of Sony was at odds with that adopted by the Seventh Circuit a year earlier in *In re Aimster Copyright Litigation*. In its 2003 decision, the Seventh Circuit upheld a preliminary injunction against another file-sharing service, also widely used for infringing copyrighted material, stating, "We do not buy Aimster's argument that ... all Aimster has to show in order to escape liability ... is that its file-sharing system could be used in noninfringing ways."

Judge Richard Posner, writing for the panel, looked back and read into Sony a "prescient" "cost-benefit trade-off in favor of Sony." For the Sony defense to apply, then, the defendant would have to show that (1) actual or potential noninfringing uses were substantial, (2) a cost-benefit comparison favored the defendant (in some undefined way) and (3) the technology at issue had been designed to avoid or minimize infringement, unless it would have been disproportionately costly to do so.

In *Metro-Goldwyn-Mayer Studios v. Grokster*, 125 S.Ct. 2764 (2005), the Supreme Court rejected the Ninth Circuit's reasoning that substantial noninfringing uses precluded all secondary liability. Instead, the court held that, irrespective of whether a defendant was liable for contributory infringement, it could be secondarily liable on the new theory of inducement to infringe: “One who distributes a device with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties.”

But the court declined to expressly address how to assess the weight given, under the Sony doctrine, to infringing versus noninfringing uses: “We do not revisit Sony further ... to add a more quantified description of the point of balance between protection and commerce when liability rests solely on distribution with knowledge that unlawful use will occur.”

Some proclaimed the outcome a “sweeping victory for music recording companies and movie studios.” They are plainly wrong: In Grokster, the entertainment industries simultaneously won a battle and lost the campaign. They won a new cause of action: inducing copyright infringement. They lost their long campaign to reverse or cripple Sony.

Grokster did not substantially redefine the battleground for an effective assault on peer-to-peer file sharing. First, of course, on the practical level, even putting Grokster out of business entirely can do nothing to impair the operation of the existing 100 million–strong network of Grokster users, and whether anything can substantially alter either the beliefs or the conduct of these file sharers is dubious.

Second, not only did the court refuse to cut back the Sony doctrine; it also endorsed Sony’s central role in effecting the appropriate balance between breathing room for innovation and protection for existing works of authorship. Third, the new copyright inducement theory, which requires clear proof of intent to foster infringement, cannot obstruct the deployment of new file-sharing programs indefinitely.

If a software developer creates and distributes software that is widely used for infringing copyrights, but the developer does not harbor the purpose of inducing infringement, that developer will not be liable under the new copyright-inducement theory. Even assuming for sake of argument that no such file-sharing network exists today, inevitably a file-sharing network will emerge whose creators and distributors cannot be shown to have had the “object of promoting” copyright infringement.

At that point, the inducement cause of action will be ineffective, even in principle, to stop the further proliferation of peer-to-peer software whose main use in practice may be copyright infringement. What then for the music industry? At that point, if not sooner, the industry will have to return to attacking the sponsors of file-sharing technologies as contributory infringers. When that happens, will the test of liability and of the Sony immunity be that set forth by the Ninth Circuit in Grokster or by the Seventh Circuit in Aimster?

The Supreme Court purported not to decide what scope of noninfringing uses would be sufficient for the Sony defense to protect developers or promoters of new technologies, though this was a matter of vigorous debate between the two concurring opinions (each supported by three justices). But this does not mean that Grokster lacks implications for the Seventh Circuit’s take on Sony.

On the contrary, that Aimster’s framework cannot be reconciled with Grokster’s exegesis of Sony is now reasonably clear.

Grokster emphasizes the need for “breathing room for innovation” and refers to the substantial-noninfringing-use doctrine as the “Sony safe harbor,” a safe harbor which itself requires surrounding protective space. Revealingly, Grokster appears to be the first case to refer to Sony as a “safe harbor,” a formulation which suggests that the court is adjusting copyright’s trade-off between innovation and protection in the direction of more deference to innovation.

Aimster held that it is necessary to “estimate the respective magnitudes of [infringing and noninfringing] uses” in order to determine whether there is liability for contributory infringement. Grokster interprets Sony as “holding that [a] product’s capability of substantial lawful employment should bar the imputation of fault and consequent secondary liability for the unlawful acts of others."

Aimster insisted that "balancing of costs and benefits is necessary," even in cases "in which substantial noninfringing uses, present or prospective, are demonstrated." Grokster says, instead, that "the [Sony] doctrine absolves the equivocal conduct of selling an item with substantial lawful as well as unlawful uses."

The Aimster decision would have courts scrutinize the decisions of technology companies concerning the design of a product or technology and imposes a potential obligation to design to thwart infringement ("if the infringing uses are substantial then to avoid liability ... the provider of the service must show that it would have been disproportionately costly for him to eliminate or at least reduce substantially the infringing uses").

But Grokster warns against "finding contributory infringement liability merely based on a failure to take affirmative steps to prevent infringement, if the device otherwise was capable of substantial noninfringing uses. Such a holding would tread too close to the Sony safe harbor."

Aimster would authorize, in the preliminary-injunction context, placing the burden on the defendant "to demonstrate that its service has substantial noninfringing uses." Grokster, however, is "mindful of the need to keep from ... discouraging the development of technologies with lawful and unlawful potential."

In sum, Aimster embodies an inherently intrusive law-and-economics analysis that requires courts to compare the costs and benefits of existing and potential uses of a technology and of design alternatives and that requires developers to predict whether their new technologies will pass muster at various points in their development and use. Aimster's holdings and approach cannot be reconciled with Grokster's emphasis on the importance of not "discouraging innovation having a lawful promise," its wariness of second-guessing about design alternatives and its repeated reaffirmation that substantial noninfringing uses negate liability.

Whether the entertainment-content industries can, in the long run, succeed in protecting their content through other legal or technological tools is not clear. But the long-term prospects for preventing unauthorized peer-to-peer copying of their works by imposing secondary liability on the distributors of file-sharing programs appear dim in light of the limitations of the Grokster decision.

Grokster Panel Best Practices Summary

The Supreme Court's Grokster decision is significant to those who produce copyrighted content and those who develop software, devices and services that can be used to copy, display and distribute copyrighted content.

Grokster considered the circumstances under which the developers of technologies that can be used for both infringing and noninfringing purposes can be held liable for copyright infringement committed by end users of those technologies. The Court ruled that even if a product is capable of substantial noninfringing uses—the "staple article of commerce" defense that the Supreme Court introduced into copyright law in its 1984 *Sony Corp. of America v. Universal City Studios* decision—companies may be held secondarily liable for copyright infringement when they distribute the products with an intent to induce users of the product to infringe. In reaching this holding, the Court introduced a new theory of secondary liability into copyright: intent to induce infringement. According to the Court, this intent must be shown by "clear expression" or "other affirmative steps" that demonstrate that the developer intended to promote infringement. In applying this standard to the facts in the record, the Court found ample evidence of intent, in internal company documents and business plans to capture Napster's user base, proposed (but never released) advertisements promoting the ability to download unauthorized sound recordings and the apparent derivation of the Grokster name from Napster.

During a July 12, 2005, panel discussion hosted by Fenwick & West, panelists representing technology companies, content owners and service providers identified the following considerations that technology companies should take into account in light of Grokster.

General Concerns

- For some companies, the most reliable method of reducing the risk of liability is to negotiate licenses with content owners for any copyrighted material implicated by the technology at issue.
- Educate employees on issues of corporate compliance as well as potential liability premised on an intent to induce infringement.
- Avoid unnecessary record keeping. By limiting documentation of corporate strategy, marketing decisions and design choices, a company can lessen the likelihood that documents will be taken out of context and viewed as evidence of intent to induce infringement.

Product Design

- If alternative designs that would reduce infringement are considered, but not ultimately adopted on the basis of legitimate engineering, cost or efficiency concerns, document these decisions and the rationale underlying them.
- In the face of other evidence of an intent to induce infringement, seriously consider redesigning the product to minimize potential infringing uses.
- Identify features that are of questionable legality, such as disputed fair uses, and exercise care in maximizing revenue based upon such features.

Marketing

- Avoid statements that invite or encourage infringement. Language that encourages infringing uses of a product provides strong evidence of an intent to induce.
- Emphasize clearly noninfringing uses of the technology.
- To the extent records are maintained, document reasons for rejecting proposed advertisements. The rationale for rejecting an ad, particularly when driven by a legitimate attempt to avoid the encouragement of infringement, may militate against a finding of intent to induce.
- Avoid trademarks, trade names and product names that refer to or are derived from well-known or alleged facilitators of infringement.

Customer Support

- Decline to assist customers who seek support in making known or suspected infringing use of a product. Actively inform those customers that your company does not endorse the use of the product or technology for that infringing purpose.
- Avoid examples, illustrations and screenshots in customer manuals, FAQs and software Help files that depict infringing or potentially infringing uses.

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