Litigation Alert: No End of Trouble? *Perfect 10 v. Visa International* and Secondary Liability

July 17, 2007

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On July 3, 2007 the Ninth Circuit issued its decision in *Perfect 10 v. Visa International Service Association*, No. 05-15170, which addressed the secondary liability of credit card companies, affiliated banks, and data processing services under copyright, trademark, and various state law claims for processing credit card payments for websites that allegedly infringe Perfect 10's copyright and trademark rights.

Dismissal of All Claims Affirmed

The Court affirmed the district court's decision, which dismissed all causes of action under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted. Here the majority concluded that credit card processors had too attenuated a connection to the infringing activity to be found secondarily liable. The majority refused to water down what amounts to a "material contribution" to contributory copyright infringement or to hold vicariously liable those with only the practical ability to limit infringement, but not the right and ability to *control* infringement. The majority viewed these results as consistent with the Ninth Circuit's prior secondary liability decisions.

In a strongly-worded dissent, Judge Kozinski wrote that the decision will "prove to be no end of trouble." The dissent's only point of agreement with the majority was that two state law claims, barred by the applicable statutes of limitations, should be dismissed. His dissenting views on the issues of secondary liability are of particular note, for if they prevailed, far more companies could find themselves secondarily liable. Consequently, the dissenting opinion will also be discussed below.

This decision completed a trilogy of Perfect 10 decisions from the Ninth Circuit which began on March 29th of this year, with its decision in *Perfect 10, Inc. v. CCBill LLC*, 481 F.3d 751, *amended and superseded*, 2007 WL 1557475, 2007 U.S. App. LEXIS 12508 (9th Cir., May 31, 2007), which addressed the liability of CWIE, a web hosting provider, and CCBill, an online credit card processor, under both the safe harbors of the Digital Millennium Copyright Act (17 U.S.C. § 512) and the Communications Decency Act (47 U.S.C. § 230). *See* Fenwick's previous litigation alert: Playing by the Notice & Takedown Rules: Protection for Online Service Providers.

More recently the Ninth Circuit decided *Perfect 10 v. Amazon.com, Inc.*, 487 F.3d 701 (9th Cir. 2007), which addressed Google's and Amazon search engine subsidiary A9's copyright liability for "framing" infringing websites and for using thumbnail images in image search results, as well as their secondary copyright liability for contributory and vicarious infringement. *See* Fenwick's Copyright Alert: *Perfect 10 v. Google*.

Perfect 10 is the publisher of an adult magazine and the owner of a subscription website of the same name. Perfect 10 alleges in all of its suits that numerous websites infringe its various rights in the copyrighted images it produces. But here, as in its other suits, Perfect 10 sued corporations who it alleges contribute to and vicariously profit from this infringement, rather than suing the direct infringers themselves, who are often harder to find.

Key Holdings:

- Defendants could not be liable for contributory copyright infringement because providing payment services did not amount to a "material contribution" to the infringement and was distinguishable from cases where the contributory infringer had provided the "site and facilities" for the infringement.

- Defendants also could not be liable for contributory copyright infringement as they did not induce the infringement because there was not "clear expression" or "affirmative acts" of specific intent by the Defendants to foster infringement.

- Defendants could not be liable for vicarious copyright infringement because the right and ability to indirectly affect the degree or ease of infringement did not amount to the right or ability to *control* the infringing activity, rejecting the notion that any party with the practical ability to limit the infringement is potentially a vicarious infringer.

- Defendants could not be liable for contributory trademark infringement, again because they neither induced the infringement nor had "direct control" of it.

- Defendants could not be liable for vicarious trademark infringement because they were not in any apparent or actual partnership with the infringers and lacked the authority to bind one another in transactions with third parties or to exercise joint ownership or control over the infringing products.

- Finally, Defendants were not liable for unfair competition, false advertising, aiding and abetting violations of rights of publicity, libel, and intentional interference with prospective economic advantage because unfair competition claims under California Business and Professions Code Section 17200 must be based on personal participation in the unlawful practices, not vicarious liability, the aiding and abetting theory was supported by neither case law nor the facts, and the other claims were time-barred.

Contributory Copyright Infringement

The majority, surveying various formulations of the test for contributory copyright infringement, including the inducement theories under *Grokster*, concluded that these tests articulated non-contradictory variations on the same basic standard:

> One contributorily infringes when one
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> (1) has knowledge of another's infringement and
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> (2) either
>
> (a) materially contributes to or
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> (b) induces that infringement.

Perfect 10 sent notices to Defendants regarding the infringement by the third-party websites whose payments Defendants processed, but the Court did not address the knowledge factor because it concluded that Defendants neither materially contributed to nor induced that infringement.

Material Contribution

In addressing material contribution the Court focused on *Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259 (9th Cir. 1996), *A&M Records v. Napster*, Inc., 239 F.3d 1004 (9th Cir. 2001), and its recent *Amazon* decision.

In *Fonovisa*, a swap meet operator was found contributorily liable for sales by vendors at the swap meet of unauthorized copies of copyrighted works. In *Napster*, the operator of an electronic file sharing system was found contributorily liable for the unauthorized exchange by its users of copyrighted music files. In *Amazon* the Court merely remanded the issue, stating that Google *could* be held contributorily liable for infringement by third-party websites to which Google links, "if it had knowledge that infringing Perfect 10 images were available using its search engine, could take simple measures to prevent further damage to Perfect 10's copyrighted works, and failed to take such steps." 487 F.3d at 729.

The majority distinguished the Defendants here from those in *Fonovisa* because in *Fonovisa*, the infringing material was physically located in and traded at the defendant's market. The swap meet operator provided "space, utilities, parking, advertising, plumbing, and customers" and failed to respond to a notice of infringement even after agreeing to do so. Slip Op. at 7844. By providing the "site and facilities" for the infringing activity, the defendant was in a "mutual enterprise of infringement" that distinguished that situation from Defendants here providing payment services for websites with infringing content. *Id*.

The majority distinguished the Defendants here from those in *Napster* because Napster allowed users to locate, obtain, and distribute infringing material. The majority characterized a document by a Napster co-founder as providing evidence that the system was "expressly engineered to enable the easy exchange" of infringing content. Slip Op. at 7844. And since Napster too was held to provide the "site and facilities" for infringement which, as in *Fonovisa*, "increased the level of infringement by providing a centralized place… where infringing works could be collected, sorted, found, bought, sold, or exchanged" this served to set those cases apart from Defendants' payment processing services. *Id*. at 7845.

The majority likewise distinguished the Defendants here from those in *Amazon*. There, the defendants' systems were used to locate the infringing images, and provided a link to specific infringing images. The majority wrote that "Google's search engine itself assists in the distribution of infringing content to Internet users, while Defendants' payment systems do not." Slip Op. at 7841, and later wrote that the distinction it was drawing was between "location services and payment services. Because location services lead Internet users directly to infringing images and often display them on the website of the service itself, we find that location services are more important and more essential—indeed, more "material"—to infringement than payment services are." Slip Op. at fn 8.

The Court acknowledged that Defendants made infringement more profitable which could increase the likelihood that third parties would engage in infringement, but reasoned that this extra step in the causal chain put Defendants outside of the scope of one who "materially contributes" to infringement.

The Court also expressed concerns about the implications of a contrary ruling. If payment processors were required to guard against secondary liability, they could be persuaded to stop accepting payments by a bogus notice sent by a website's competitor. Slip Op. at fn 9. The majority also suggested that Perfect 10's interpretation of "site and facilities" was alarmingly overbroad as it would encompass countless third-parties with a peripheral connection to the infringement "such as computer display companies, storage device companies, and software companies that make the software necessary to alter and view the pictures and even utility companies that provide electricity to the Internet." Slip Op. at 7847. The majority declined to descend down such a slippery slope.

In dissent, Judge Kozinski argued that Defendants were more analogous to Google, and suggested replacing "search engine" with "payment systems" in the recent language from the *Amazon* case to better see the analogy. According to the dissent, a defendant such as Visa could be liable "if it had knowledge that infringing Perfect 10 images were available using its *payment systems*, could take simple measures to prevent further damage to Perfect 10's copyrighted works, and failed to take such steps." In a footnote, the dissent also subtly paraphrases the *Amazon* court in a way many might find controversial. The dissent writes that "Amazon held that [Google] would be guilty of contributory infringement if it could modify its service to avoid helping infringers." Slip Op. at 7867, fn 4. Amazon held Google *could*—not "would"—be guilty if it could take *simple* measures—not "modify" its service to *prevent*—not "avoid helping" infringement. Many would argue that any one of these words makes all the difference and hence the dissent's paraphrase of *Amazon* should be noted carefully.

The dissent also rejects the concern that other third parties would be caught in this newly-enlarged contributory net, stating that they would "doubtless be absolved of liability because their contribution to the infringing activity is insufficiently material." Slip Op. at 7874. Kozinski would rely on the absentee landlord and the dance hall cases from the first part of last century for guidance. In these cases landlords who lacked knowledge of infringing acts by their tenants and who exercised no control over the leased premises were not held liable for infringement committed by their tenants, while operators of dance halls were held liable for infringing performances when the operator could control the premises and obtained a direct financial benefit from a paying audience. However, it is not clear that even guidance from these cases always answers the difficult question of what is a mere incidental service and what rises to the level of material contribution to infringement. Clearly this is a fact-intensive inquiry about which there will often be disagreement.

Inducement

Here the majority held that Perfect 10 had failed to allege "affirmative steps taken to foster infringement" required for a finding of contributory liability on an inducement theory. That Defendants promote their payment services, which have substantial non-infringing uses, did not entail that Defendants also promoted every product which their cards and payment services could be used to purchase. Without a "clear expression" or "affirmative acts" of a specific intent to foster infringement, Defendants could not be contributorily liable under the inducement test.

Oddly the dissent does not specially address the majority's inducement analysis, and primarily discusses *Grokster* in connection with vicarious infringement.

Vicarious Copyright Infringement

To state a claim for vicarious copyright infringement, a plaintiff must allege that the defendant has

> (1) the right and ability to supervise the infringing conduct and
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> (2) a direct financial interest in the infringing activity.

Relying primarily on its *Amazon* decision, the majority explained that Google was not vicariously liable for third-party infringement that its search engine facilitates because Google's ability to control its own index, search results, and web pages does not give Google the right to control the infringing acts of third parties even though that ability would allow Google to affect those infringing acts to some degree. Even when the *Amazon* court considered Google's AdSense partners, over whom Google arguably has greater control, the *Amazon* Court wrote,

> Google's right to terminate an AdSense partnership does not give Google the right to stop direct infringement by third-party websites. An infringing third-party website can continue to reproduce, display, and distribute its infringing copies of Perfect 10 images after its participation in the AdSense program has ended. 487 F.3d at 730.

Similarly here, though Defendants could suspend their payment services and thereby indirectly reduce infringing activity, the majority held that they have no right and ability to stop direct infringement by third-party websites.

In an analogy destined to be oft-quoted, the Court wrote that "the mere ability to withdraw a financial "carrot" does not create the "stick" of "right and ability to control" that vicarious infringement requires." Slip Op. at 7852-53.

The majority explained its view that its holding was consistent with holding Napster vicariously liable because the majority claimed that Napster's involvement with and "policing" power over the infringement was "much more intimate and directly intertwined with it than Defendants' payment systems are" because "Napster provided users with the tools to enable the easy reproduction and distribution of the actual infringing content and to readily search out and identify infringing material…" and because "Napster also had the right and ability to block user access to its program and thereby deprive particular users of access to their forum and use of their location and distribution tools." *Id*. at 7853.

In the spectrum between an absolute right to stop and a practical ability to limit the infringement, the majority held that a right and ability to *control* the infringement lies somewhere in between these two extremes and that Defendants here were much closer to having a mere practical ability to limit infringement, which cannot give rise to vicarious liability. Otherwise "software operators, network technicians, or even utility companies" could also limit infringement by withholding their services, and it cannot be that Perfect 10 should next sue Pacific Gas and Electric.

In dissent, Judge Kozinski argued that the contracts Defendants have with merchants provide them with the right to control the goods and services paid for with Defendants' payment services. Further, exercising that right by withholding payment services when notified of infringing activity would effectively amount to the ability to control the infringement because, in the dissent's view, credit card payments are so ubiquitous and so essential to the infringement identified by Perfect 10, the complained of infringing websites would cease to exist. Even if such sites did not cease to exist, infringement would be significantly limited, and the dissent further argues that limiting infringement is all that is necessary to meet the standard set in *Amazon*.

But in analogizing from the *Amazon* court's analysis, it is critical to recall that the *Amazon* court provided an important reminder regarding the distinctions between contributory and vicarious infringement, writing that "in general, contributory liability is based on the defendant's failure to stop its own actions which facilitate third-party infringement, while vicarious liability is based on the defendant's failure to cause a third party to stop its directly infringing activities." 487 F.3d at 731. The dissent here complains that Defendants could withhold services and thereby stop or limit infringement. As in the *Amazon* case, this sort of argument is better suited to the contributory liability analysis, as it does not address whether Defendants here failed to cause a third party to stop its directly infringing activities.

Additionally, the dissent argued that the majority misreads the *Grokster* opinion when it worries that hardware manufacturers, software engineers, technical support companies, and utilities will be swept up in a wider view of what counts as material contribution to infringement. The dissent writes, "Those third parties the majority worries about could not be held vicariously liable because they lack the legal right to stop the infringement. So far as I know, utilities are provided by public franchise, not by contract, and a utility has no right to stop providing electricity or phone service because it learns that its electrons are being put to illegal use." While the dissent then cites to two examples of public utilities in northeastern states, it fails to note that Pacific Gas & Electric is a private company (NYSE: PCG), as well as Southern California Edison, a subsidiary of Edison International (NYSE:EIX). Business customers especially tend to enter service agreement contracts with utilities, and many of these contracts provide the utility with a right to terminate service. Consequently, the majority's fear may be more well-founded than the dissent was willing to credit.

Contributory Trademark Infringement

Perfect 10 alleged that the Defendants were also providing critical support to websites that were using the PERFECT 10 mark in a manner that was likely to cause confusion.

To be liable for contributory trademark infringement a defendant must have

> (1) "intentionally induced" the primary infringer to infringe, or
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> (2) continued to supply an infringing product to an infringer with knowledge that the infringer is mislabeling the particular product supplied—or where the direct infringer supplies a service rather than a product, a defendant must have "direct control" and the ability to monitor the instrumentality used by a third party to infringe the plaintiff's mark.

The majority characterized this test as even more difficult to satisfy than those for secondary copyright infringement and again held that Defendants inability to control the infringement of third parties made them innocent of contributory trademark infringement as mere practical ability to reduce infringement was insufficient to constitute the "direct control" required.

The dissent argued in response, "Without defendants' payment systems, the infringers would find it much harder to peddle their infringing goods." Slip Op. at 7885. But even if withholding a service makes a third party's infringement more difficult, this does not address either of the more stringent elements required to state a claim for contributory trademark infringement. Those require intentional inducement or "direct control" which the majority held that Defendants here lacked.

Vicarious Trademark Infringement

Vicarious liability for trademark infringement requires that the defendant and the infringer have "an apparent or actual partnership, have authority to bind one another in transactions with third parties, or exercise joint ownership or control over the infringing product." Slip Op. at 7860.

The majority held that the Defendants had no such relationship with the third-party infringers and instead only processed payments and collected their usual processing fees.

The dissent argued that since procedurally the Court was bound to accept the allegations of the complaint as true, he would credit Perfect 10's claims that the Defendants and the infringing sites exist in a symbiotic relationship. The majority instead emphasized that although a plaintiff's allegations are generally taken as true, the court need not accept conclusory allegations of law or unwarranted inferences, and here saw many of Perfect 10's allegations as mere artful pleading of conclusions of law.

California Statutory and Common Law Claims

Perfect 10 also brought numerous state law claims which sought to use secondary liability and an aiding and abetting theory to hold Defendants liable for other alleged acts of the infringers. The Court held that all these claims were properly dismissed, primarily because *Emery v. Visa International Service Association*, 95 Cal. App. 4th 952 (2002) precluded liability for Defendants on such theories.

Defendants were not liable for unfair competition because claims under California Business and Professions Code Section 17200 must be based on personal participation in the unlawful practices, not vicarious liability. Similarly for the false advertising claims, since it was the third-party infringers who would be primarily liable for false advertising, if anyone, *Emery* stated that even if Visa allowed the use of its logo or trademark, it had no duty to investigate statements made by others, and therefore could not be secondarily liable for false advertising.

Perfect 10's claim that Defendants were aiding and abetting violations of the rights of publicity of its models, rights that had been assigned to Perfect 10, also failed because the Defendants lacked sufficient control or personal involvement in the infringing activities.

Finally, Perfect 10 alleged claims for libel and intentional interference with prospective economic advantage because it had been placed on an industry black list when its own customers disputed charges at such a high rate that it exceeded the contractual limits. The termination of Perfect 10's merchant account had occurred in 2001 and the one and two year statutes of limitations for libel and intentional interference, respectively, had already expired when Perfect 10 brought suit in 2004.

The dissent would have instead distinguished *Emery* because there only Visa, and not the affiliated banks that have a more direct relationship with the direct infringers, were defendants. However, in a single point of agreement, the dissent concurred that the two claims on which the statute of limitations had run were rightly dismissed.

Whether the majority's opinion or the rejected ideas of the dissent "will prove to be no end of trouble" remains to be seen as the law of secondary liability continues to develop, especially in the context of the internet.

The opinion is available at http://www.fenwick.com/docstore/Publications/Litigation/05-15170.pdf.

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