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SPECIAL ISSUE
The *Grokster* Decision

Inside *Grokster*

An *Internet Law & Strategy* Virtual Roundtable

[Editor's Note: The Internet industry has had a little time to sit back and examine the U.S. Supreme Court's decision in the Grokster *case (*Metro-Goldwyn-Mayer Studio v. Grokster*, 125 S. Ct. 2764 (2005)), pondering its true meaning and its impact on technology and software developers as well as the entertainment industry. (The other articles in this special 12-page issue serve as a nice summary of the decision as well as adding to the commentary.) In this virtual roundtable discussion, members of* Internet Law & Strategy*'s Board of Editors and other Internet law experts chime in with their thoughts. I think you'll find these comments insightful and raise the issues that the industry faces in the wake of* Grokster*. I am very grateful to the participants for their generous contributions. We welcome your comments and further thoughts on the case and its ramifications. — Steven Salkin, Esq., Managing Editor]*

TECHNOLOGY COMPANIES AND SOFTWARE DISTRIBUTORS

Joseph V. Norvell (Chair, Copyright Practice Group, Brinks, Hofer, Gilson & Lione, Chicago; jnorvell@usebrinks.com)**:** This decision involved peer-to-peer file sharing providers, but it will have much broader implications in the technology industry. Technology companies of all types that transfer digital data, including computer companies, data transfer providers and software companies, will need to review their products and policies to ensure that they are not exposed to potential liability for copyright infringement. The technology companies may appeal to Capitol Hill for more clarification to ensure they are insulated from liability.

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'Unanimous' Vote In *Grokster* Has Split Views

By Susanna Frederick Fischer

The future direction of digital technologies was on the line when the U.S. Supreme Court heard arguments in March over peer-to-peer (P2P) file-sharing software. And few were predicting that the Justices would easily reach their decision. Given the difficult copyright law and policy issues in the case, it seemed highly unlikely that the Justices could all agree. But 3 months after oral arguments, the Court surprised many observers by issuing a unanimous decision — at least as to the main holding. *Metro-Goldwyn-Mayer Studios Inc. v. Grokster Ltd.*, 125 S. Ct. 2764 (2005).

In its opinion, the Supreme Court clearly focused the test for copyright infringement liability on the subjective question of the purpose of the software's distribution — an approach that better comports with basic notions of fairness than that of the courts below. But read together, the plurality opinion and two concurring opinions raise a new set of disquieting questions.

The plaintiffs — motion-picture studios, recording companies, songwriters and music publishers — who sued Grokster and StreamCast Networks Inc., in California federal court, alleged that the defendants were liable for two types of secondary copyright

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Jeffrey D. Neuburger (Chair, Technology, Media and Communications Department, Brown Raysman Millstein Felder & Steiner, New York; jneuburger@brownraysman.com)**:** The iPod is safe under *Grokster*, but technology distributors that intentionally seek profit by encouraging infringing acts are not. The Court overturned the Ninth Circuit opinion that let the distributors of peer-to-peer file-sharing software off the hook for liability for copyright infringement by users of its software, concluding that the distributors had "a purpose to cause and profit from third-party acts of copyright infringement." The Court aimed its opinion squarely, but also very narrowly, at the distributors, giving the distributors very little ability if any to avoid liability on remand. The Court took pains to carefully detail the specific actions by the distributors from which, the Court said, "a patently illegal objective" could be inferred. But on the other hand, the Court made it very clear that simply manufacturing and distributing technology that can be used for infringement is not enough to result in liability, if the traditional "Sony Betamax" test of a "substantial non-infringing use" is met. This gives content owners an important new avenue for protecting their intellectual property rights.

Cydney A. Tune (Chair, Copyrights Practice and Media & Entertainment Industry teams, Pillsbury Winthrop Shaw Pittman LLP, San Francisco; cydney.tune@pillsburylaw.com)**:** While the decision may result in increased litigation against technology companies, it is unclear to what extent companies will incur heightened liability. Other good news for technology companies is that the Court made clear that "mere knowledge" of the potential to infringe or of actual infringing uses is not enough to create liability. The Court focused on the conduct of the players, rather than on the technology, and a distributor would need to take active steps to encourage infringing uses or have a clear intent to induce infringement to be liable under this new theory. The decision was also helpful in that it provided guidance as to the type of conduct that can lead to liability for inducement of copyright infringement. Future decisions by lower courts should provide further guidance with respect to the type of conduct that can give rise to liability and the steps that a company can take to protect itself from liability.

Sean F. Kane (Drakeford & Kane LLC, New York; skane@drakeford-kane.com)**:** On the consumer electronics front the decision will not likely have a wide impact and most of these products should be in the clear. However, the *Grokster* case will likely cause certain manufacturers to play it safe in the future by ensuring that their advertising and primary appeal of their devices is not specifically to foster infringement. Moreover, certain manufacturers will likely modify devices to allow initial downloads, but to prevent further unlimited copying or require other coding to ensure that content is being consumed only by the original consumer.

John T. Aquino (Attorney, Consultant, Washington, DC; johnaquino@usa.net)**:** The decision does not restrict technology but focuses on the intent of the users, which is as it should be. The Court felt there was clear evidence of Grokster and StreamCast promoting infringement, and there seems to be. I think this is a very big deal. It's a wakeup call. It's a reality check. It says the copyright law is relevant and functioning. It says technology must work WITH the law and not hope it goes away.

Robert J. Ambrogi (Lawyer and Media Consultant, Rockport, MA; ambrogi@legaline.com, blawg: www.legaline.com/lawsites.html)**:** For companies involved in developing technology-based products and services, the immediate lesson of this case is to watch what you say. Focus on the product's legitimate commercial applications. A more troubling issue arises from between the lines of the

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Grokster decision — that of whether a company is obliged to act when it suspects its product is being used for unlawful purposes. Here, the Court finds evidence of the companies' unlawful objectives in their failure to develop filtering tools or other mechanisms to reduce copyright infringement. This failure to act underscores the companies' intent, the Court said. However, the Court quickly adds, in a footnote, that a company's mere failure to act to prevent infringement, absent other evidence of intent, is not grounds for liability.

Lisa M. Tittemore (Co-chair, Copyright Practice Group, Bromberg & Sunstein LLP, Boston; LTittemore@bromsun.com): The Supreme Court's decision in the *Grokster* case means that companies distributing products that may be used for copyright infringement by third parties seeking to avoid secondary liability should also take care to avoid making statements (including statements that are purely internal to the company) or taking action that could be seen as fostering infringement.

Tune: I agree that companies need to be careful to avoid making statements or taking actions that appear to encourage infringing uses of their products or technology. Of course, future decisions interpreting *Grokster* should shed further light on the factors used to determine whether there is liability for inducement of copyright infringement in any particular case, and provide further guidance regarding the steps that a company can take to protect itself from liability. In the meantime, there are other steps that can be taken when new technologies are created, to protect creators and distributors from potential liability. These include, for example, keeping excellent records during the invention and development process that make clear the lawful purposes for which the technology and/or product is intended. Companies should not promote potentially infringing uses of the technology or product, especially in their advertising. Reasonable steps to avoid or reduce infringing uses by third parties should be taken, if such steps are available.

Sony Case Comparisons

[Editor's Note: The references to the Sony *case in these comments are to* Sony Corp. v. Universal Studios Inc.*, 464 U.S. 417 (1984), also known as the Betamax case.]*

Ambrogi: Unlike the *Sony* case, this is not a case about technology, per se. The court makes abundantly clear that the facts of this case take it beyond the characteristics of the product and instead focus on how the product was promoted. While Sony's marketing of its VCR technology focused on how it could be employed within the boundaries of fair use, these companies, the court said, actively promoted the use of their technologies for infringement.

Norvell: This is a tightening of the Sony Betamax case, where the Supreme Court held that sellers of VCRs were not liable for users' copyright infringement. Proponents of technology will see this a potential stifling of the technological development permitted by the Sony Betamax decision."

John Delaney (Partner, Morrison Foerster, New York; jdelaney@mofo.com)**:** The Supreme Court appears to dramatically narrow the reach of the "substantial noninfringement uses" holding in its landmark *Sony* case — this aspect of the case is good news for entertainment companies but must be causing some anxiety among companies that manufacture computers and hand-held devices used to facilitate the unauthorized online distribution of movies and music.

Kane: Justice Souter, writing for a unanimous Court, made it very clear that the decision in *Sony* was not being revised by the *Grokster* opinion and is still an applicable rule of law. Therefore, the general rule that a manufacturer of a device that is "capable of commercially significant noninfringing uses" cannot be liable merely on the basis of distribution, continues to stand. However, the Court opined that nothing in *Sony* hampered it from looking to the intent of the distributing party to determine whether liability existed for promoting infringement under common law theories. The Court determined that the underlying evidence was sufficient to demonstrate that the *Grokster* defendants' intent of distributing the product was to promote and or induce copyright infringement by stepping in where Napster left off, failing to include software that filters or bars swapping of copyright protected materials and otherwise profiting from advertising revenue connected to infringing file swapping between individuals. All of these factors led the Court to opine that: "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."

Aquino: The *Grokster* decision called to mind a recent television commercial for Sierra Mist Free in which a man is in a police station for having stolen a bottle of the soft drink. He's keeps saying, "But it says it's free!" Of course, millions of people utilizing Grokster, StreamCast, and Morpheus have been acting as if use of copyrighted material is free, and the Supreme Court, like the policeman in the commercial, said that that was a misreading. The real misreading, though, was, according to the Court, of *Sony*.

The unanimity of the Supreme Court's decision makes us wonder why anyone expected otherwise. But it was as if there was a great freight train of new technology bearing down too fast to stop, too fast for the law of copyright to hold it back, that was for sure. But the Supreme Court simply yelled, "Stop!", asserting that copyright holds and rules.

"Nothing in *Sony* requires courts to ignore evidence of intent to promote infringement if such evidence exists,"

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the Court wrote, also indicating that it was not going to accept lip service that there were other non-infringing uses. The Court replied that "while there is doubtless some demand for free Shakespeare," the evidence showed that the bulk of the use was "a function of free access to copyrighted material." In a concurring opinion, Justice Ginsberg wrote that, unlike the situation for the *Sony* decision, there was no finding of fair use beyond anecdotal evidence of noninfringing uses.

Tune: I agree that new technologies will greatly affect this developing area of the law. Even today, the facts have shifted. File-sharing technology in the peer-to-peer world has evolved far beyond that which is used by Grokster and Streamcast. Independent, ad-free networks and facilitated multiple individual connections, like Bittorent, have been developed. These technologies make it extremely difficult to ascertain when files have been shared, which files have been shared, and who has done the sharing. Thus, while the Court in *Grokster* may have handed content owners something of a victory, it is questionable how useful this will be in the future as a practical matter.

Tittemore: The Supreme Court's decision in the *Grokster* case means that the Supreme Court's 1984 landmark decision in *Sony* lives to be interpreted (and perhaps reconsidered) another day. Many people hoped — and others feared — that the *Grokster* case would be the end of *Sony*. This did not happen.

Justice Ginsburg's concurring opinion suggests that, given a case with the right facts, she, Chief Justice Rehnquist and Justice Kennedy might reconsider *Sony* to require evidence sufficient "to demonstrate, beyond genuine debate, a reasonable prospect that substantial or commercially significant noninfringing uses were likely to develop over time." Thus, it is possible that the Supreme Court might in the future interpret the *Sony* rule to make avoiding liability more difficult.

A Win for the Entertainment Industry?

Delaney: Although the Supreme Court's decision has remanded the case back to the Ninth Circuit for further proceedings, the Court's decision is undoubtedly a victory for the entertainment industries and a setback for peer-to-peer networking companies such as Grokster. The unanimous decision reinforces traditional copyright doctrine that, if one encourages or takes affirmative steps to help others infringe, one can be held liable for copyright infringement — even if one did not directly engage in unauthorized copying.

This is a significant victory for the entertainment industries. Although the case is remanded for further proceedings, the issue on remand will be whether summary judgment should in fact be granted for the content providers. This is a crushing defeat for the Groksters of the world.

Kane: The result of this decision is somewhat unclear and may ultimately be a very hollow victory. In a nutshell, the Court did not say that file-sharing itself was a problem, but the way Grokster and StreamCast marketed it was. Some would advance that the P2P sharing industry was handed a win by the Court since the technology has not been struck down altogether, but others would see that the industry has suffered a potentially significant blow. The Court apparently found that the *Sony* factors did protect the underlying technology allowing the swapping of files, some of which were noninfringing; however, determined that the distributors had acted badly and intended to promote or induce infringement. This decision would seem to indicate that a distributor of P2P technology with a legitimate intent not to infringe others' rights would not be liable for third party infringing use of the technology. This being said, the Court failed to create a bright line test as to what is a "clear expression or other affirmative steps taken to foster infringement" which, as Justice Breyer stated in his concurring opinion, will potentially have a chilling effect on others creating or advancing file swapping and other possibly legitimate technologies for fear of future liability. Future litigations will necessarily turn on a case-by-case basis, not as to the nature of the technology but as to the business plans of the distributors. Therefore, "fair use" technology companies will be left with the burden of proving that their business plan is not founded on an intent to induce others to infringe, or otherwise to advertise and promote in a manner to sufficiently hide this intent. The courts may be swamped with determining these questions as *Grokster* will initiate a new era of uncertainty for technology innovators.

Richard S. Levick (President, Levick Strategic Communications, Washington, DC; rlevick@levick.com)**:** My firm represented the music industry in the early days of Napster. At that time, the message was, "We're going after Napster because it is a business based on infringement. We do not approve of individual usage, but we would never take action against individual citizens."

Of course, they changed that tune pretty dramatically. They realized that, if they were to win — and they had every intention of winning — even the people they sued would still buy their products. It's the entire music industry, after all.

Their aggressiveness was draconic, but it was effective. *Grokster*, it would seem to me, only justifies that aggressiveness and may possibly encourage more. The case is a victory for the music industry — not because the ruling is absolutely clear as to its future implications — but because the questions that *Grokster* leave open can fuel a lot of litigation. The music industry can afford that litigation and, I'll bet, prove with graphs that the litigation is a good investment in assuring renewed revenue.

I think the music industry has handled this entire issue just fine.

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Inducement Theory In *Grokster* Leaves Unanswered Questions

By Howard J. Shire, Michael Kelly and Daniel P. Margolis

In *MGM Studios, Inc. v. Grokster*, the Supreme Court decided that the defendants could be held liable for copyright infringement perpetrated by the users of their respective software. Rather than clarifying the "significant non-infringing use" standard from *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417 (1984), to determine whether the defendants could be held liable for distributing a product with knowledge that it could be used to infringe, the Court utilized an alternative approach of finding liability. Turning to common law precedent and patent law, the unanimous Court held that liability may be based on purposeful, culpable expression under an inducement theory of secondary infringement. While some of the potential implications of this decision can be predicted, the full effect will not likely be clear for some time.

Background and Lower Court Decisions

The defendants distribute free software for the purpose of sharing data files over the Internet. This software permits users to exchange files over a peer-to-peer network that connects computers together in the absence of a centralized server. It is virtually undisputed that the majority of the file transfers involve illegal acts of copyright infringement, such as the transfer of copyrighted music or movies. The plaintiffs are owners of various copyrights that have been allegedly infringed through such file sharing. Based on the fact that the defendants had distributed the software that enabled the infringing activity, a claim was brought against them under a theory of indirect infringement. In the district court, both sides moved for summary judgment.

The two theories under which a defendant may be held indirectly liable for another's infringement are contributory infringement and vicarious infringement. Contributory infringement may be shown by proving that the defendant had knowledge of, and materially contributed to, direct infringement. *MGM Studios, Inc. v. Grokster, Ltd.*, 259 F. Supp. 2d 1029, 1035 (C.D. Cal. 2003). Since the defendants' software allows users to transfer files without the use of a centralized server via a peer-to-peer network, actual knowledge of specific acts of infringement could not be established as it was in *Napster. See, A & M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001). Constructive knowledge may be imputed to the alleged contributory infringer, but according to Sony this is only permitted if the product is not "capable of substantial non-infringing uses." 464 U.S. at 442. Finding that the software was capable of transferring non-copyrighted works, the district court declined to impute the requisite level of knowledge to the defendants even though they had been aware that significant amounts of infringing activity were taking place. Without the knowledge requirement having been met, the defendants could not be held liable as contributory infringers. The defendants also could not be found liable as vicarious infringers, because vicarious infringement requires a showing of both financial benefit and a defendant's right and ability to supervise the infringing conduct. The lower court found that the infringing activities took place independently of the defendants and that they had no affirmative duty to design their products to disallow the transfer of copyrighted material.

On appeal, the Ninth Circuit followed the same approach as the district court. Once again, liability for contributory infringement was considered to be dependent upon an interpretation of *Sony*. Even though the majority of the software use was for copyright infringement, it could potentially be used in a non-infringing manner. Therefore, the Ninth Circuit agreed that the software was capable of substantial or commercially significant non-infringing uses.

This broad interpretation of *Sony* precluded a finding of constructive knowledge on the part of the defendants. Since the plaintiffs were likewise unable to demonstrate that the defendants had actual knowledge of specific infringing activity at a time when they had the ability to prevent it from occurring, no contributory infringement could be found. Similarly, the defendants were not shown to have the right and ability to supervise the users' infringing activity, so they could not be found to be vicarious infringers. *See, MGM Studios, Inc. v. Grokster, Ltd.*, 380 F.3d 1154 (9th Cir. 2004).

Supreme Court Decision

When the case finally reached the Supreme Court, both parties once again argued for different interpretations of Sony. The defendants suggested that the Supreme Court should read the case broadly, as the Ninth Circuit had, and find that even a relatively small amount of non-infringing use of a product would qualify as being "capable of substantial non-infringing uses." The plaintiffs, however, argued that "substantial" implies that a greater percentage of the use must be for non-infringing purposes for the product to fall under the protection of the staple article of commerce rule described in Sony, and that the defendants could therefore be considered to have constructive knowledge of the direct infringement.

The Supreme Court concluded that *Sony* was factually distinguishable from this case in that it dealt with imputing intent, based upon a product's uses, to a defendant that could not be shown explicitly to have intended the acts of direct infringement. Because there was some evidence of the defendants' intent to cause direct infringement with their software, including statements and actions directed to promoting infringement, there was no need to decide whether intent could be imputed based on the design and functionality of the product itself. The Court therefore refused to determine the appropriate application of

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the *Sony* rule, and instead proceeded to apply a different theory of indirect liability, namely inducement of infringement.

According to the Supreme Court: "[o]ne infringes contributorily by intentionally inducing or encouraging direct infringement." No. 04-480, *slip op.* at 12. Though the lower courts had assumed that in the absence of specific knowledge of infringement *Sony* should always apply to bar liability if the product is capable of substantial non-infringing uses, the Court made it clear that *Sony* "did not displace other theories of secondary liability" and "was never meant to foreclose rules of fault-based liability derived from the common law." *Id.* Accordingly, in much the same way that the *Sony* Court had taken the staple-article of commerce rule from 35 U.S.C. §271(c) of the patent laws, Section 271(b), which codified the inducement rule, was adopted here. As expressed by the Court: "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." No. 04-480, *slip op.* at 19.

Having decided to analyze the defendants' liability in terms of an inducement theory, the Court proceeded to detail several examples of evidence of unlawful objectives that tended to prove that there was an intent to induce infringement. In addition to the evidence of solicitation of users through advertising and other methods by implying that copyrighted material could be downloaded using the defendants' software, three other important types of evidence were noted. First, the defendants could be shown to have directly targeted a market for copyright infringement by attempting to replace Napster. This was demonstrated by, among other things, defendants' internal memos making reference to such a goal and the fact that Grokster's name sounds like Napster. Second, the fact that neither defendant attempted to design its software to prevent the transfer of copyrighted material buttressed the inference of an intent to foster infringement. Finally, since the defendants make more money based on the number of users they have, their business model demonstrates that the more infringers are using their software, the more money they will make. Though the Court clearly states that much of this evidence alone would be insufficient to demonstrate unlawful intent, the record as a whole allows such a conclusion. Since the defendants can be shown to have had a "purpose to cause and profit from third-party acts of copyright infringement," they may be held liable for those acts of infringement upon the distribution of the product.

The Supreme Court vacated the lower court's finding of summary judgment for the defendants and ordered reconsideration of the plaintiffs' motion for summary judgment based on an inducement theory of liability. Based on the Court's analysis of the evidence in support of inducement liability, it appears likely that the plaintiffs' motion will be granted.

Possible Implications

A close examination of the Supreme Court's *Grokster* opinion provides some indication of how the inducement theory may be applied to future cases. Notably, Sony is still applicable, and if a product is not "capable of substantial non-infringing uses," then intent may be imputed and there is no need to resort to the inducement theory. However, since Sony was only addressed in the concurrences, the exact meaning of the rule remains an open question. Therefore, it can be expected that the inducement theory will be employed by plaintiffs, unless an accused product clearly has no potential non-infringing uses.

To prove inducement of infringement, a plaintiff must prove that a defendant had an intent to cause infringement, distributed a device suitable for infringing use, and that infringement actually occurred. There seems to be nothing novel about proving that infringement occurred or that a device is suitable for infringing use, so the important question is how future courts will determine if a defendant had an intent to induce infringement.

The Supreme Court stated that there must be clear expression or other affirmative steps indicating an intent to promote direct infringement to support a finding of liability under an inducement theory. Once such evidence has been accepted, however, more ambiguous evidence may be used to support a finding of intent. Stronger evidence is needed than simply knowledge of infringing potential or "ordinary acts incident to product distribution, such as offering customers technical support or product updates," but these factors may be utilized to support a finding of intent if, in combination with other statements or actions, they demonstrate "purposeful, culpable expression and conduct." The standard for finding clear expression or affirmative steps is not clearly articulated, although the threshold does not appear to be that difficult to reach.

Evidence of the product's characteristics or potential for infringing use is obviously insufficient, but it is not necessary to prove that a message was sent out to users that encouraged them to infringe. In fact, it is suggested in the opinion that an internal memo describing the unlawful objective would be sufficient as a clear expression, while targeting a market of known infringers would qualify as an affirmative step. No. 04-480, *slip op.* at 21-22 (explaining that intent to induce infringement may be proven by active steps that demonstrate such a purpose, even in the

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GETTING CONGRESS INVOLVED

Delaney: I think that we're going to see this battle shift away from the courts and to Congress. The online distribution industry has increasing political clout, and the content industries have never been shy about seeking legislative redress for threats to their business. Look for Congress to get more involved in finding a solution that strikes the right balance between respect for intellectual property rights and online access to music and movies.

Tune: Some players, particularly those on the technology side of the debate, are advocating that Congress adopt a collective licensing system, similar to that used when licensing music for use on traditional radio. They believe that these licenses would remove the pressure and uncertainty from technology companies, while at the same time providing for compensation to the artists and copyright owners. It does not seem that legislation of this type, if adopted, would do away with the new "inducement" theory established by *Grokster*, at least to the extent that music files would be shared using software from entities that had not obtained such a statutory license and that were encouraging infringing activities.

Kane: On this point I have to respectfully disagree with Mr. Delaney. I believe the film and record industries' connections and political acumen will be used to keep the post-*Grokster* status quo or to lobby Congress to enact further copyright protections. I just do not see the P2P industry having the funding or influence to compete with the film and record juggernaut in this regard. Additionally, I find it very difficult to believe that Congress will be able to find a solution that would strike an appropriate balance of allowing free access to content while not severely undercutting copyright owner's protection.

BALANCING ACT

Tune: Overall, the Supreme Court appears to have attempted to take a balanced approach that takes into account the need to establish liability for those who induce massive copyright infringement while at the same time trying to avoid stifling new technological innovation.

THE *GROKSTER* DECISION ITSELF

Aquino: People who say that the decision was ambiguous and that they were looking for a clearer path may be shell-shocked. I don't see much ambiguity. The court said promoting infringement is wrong. Technology companies are going to have to be careful and police ALL advertising.
But what's wrong with that? It's time-consuming, it's expensive, but so is losing a copyright infringement case. We'll see what the lower court does with this specific case on the facts, but the Supreme Court ruling itself is very important.

Tittemore: The *Grokster* decision is notable because of its unanimity, but it is also worth noting that Justice Ginsburg (joined by Chief Justice Rehnquist and Justice Kennedy) and Justice Breyer (joined by Justice Stevens and Justice O'Connor) wrote concurring opinions that make clear that had the Justices not been able to distinguish the *Grokster* case from the *Sony* case on the facts, there would not have been a unanimous decision, and *Sony* indeed may have been modified to reduce the "safe harbor" it provides.

Ambrogi: It is important to understand two key aspects of what this case did not do. First, it did not say that peer-to-peer technology is illegal or that file sharing is illegal. Second, it did not say that either Grokster or StreamCast violated the law — that

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absence of consumer contact). Once clear expression or affirmative steps have been found, even product design decisions or the defendant's desire to attract customers may be used to support a finding of inducement.

Once a clear expression or affirmative step is found, there will typically be sufficient other evidence to support a finding of inducement. If a product can be used to infringe, the fact that it was not designed to suppress this capability will be questioned. If the defendant makes more money because of the infringement, the profit incentive will be questioned. Future findings of liability for inducement will likely depend on how the courts interpret the finding of a clear expression or affirmative step toward fostering infringement. Many arguments will likely revolve around whether a particular act of a defendant will qualify under this vague standard.

It is possible that the courts will interpret *Grokster* narrowly and require a strong showing of a clear expression or affirmative step toward fostering infringement. However, *Grokster* suggests that virtually any statement or action related to copyright infringement, whether made directly to consumers or internally, may be considered to demonstrate an intent to promote infringement.

By avoiding the *Sony* safe harbor rule, and instead deciding *Grokster* under a theory of inducement to infringe, the Supreme Court has left open more questions than it has answered. It remains unclear what qualifies as "capable of substantial non-infringing uses" once a defendant is within the protection of *Sony*. Also unclear is what is required to stay within the *Sony* rule and avoid a detailed analysis of business plans and product design decisions in finding liability for inducement.

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Unanimous Vote

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infringement: Contributory infringement, where a defendant induces or materially contributes to direct infringement with knowledge of that direct infringement; and vicarious infringement, where a defendant profits from direct infringement and has the right and ability to supervise the direct infringer.

The defendants conceded that most users of their software downloaded copyrighted files, but contended that the defendants themselves were protected from liability by the Supreme Court's 1984 decision, *Sony Corporation of America v. Universal City Studios Inc*., 464 U.S. 417, 104 S. Ct. 774 (1984) (the Betamax case). In *Sony*, the Court refused to impose liability for secondary copyright infringement on distributors of Betamax videotape recorders, who supplied the means to infringe with knowledge that some users would infringe, because the recorders were also capable of "substantial" or "commercially significant" noninfringing uses.

Under the Betamax rule, the trial court granted summary judgment in favor of Grokster and StreamCast. The U.S. Court of Appeals for the Ninth Circuit affirmed, finding that *Sony* required reasonable knowledge of specific acts of infringement, as well as a failure to act on that knowledge, before a distributor of a commercial product capable of substantial noninfringing uses could be found liable for contributory infringement. Grokster and StreamCast lacked the requisite knowledge and material contribution. The Ninth Circuit and the trial court also agreed that the defendants' distribution of their software didn't give rise to vicarious infringement.

The *Grokster* plaintiffs petitioned the U.S. Supreme Court for *certiorari*, contending that there was a split between the Ninth Circuit's reading of the Betamax decision and the Seventh Circuit's 2003 decision in *In re Aimster Copyright Litigation*, 334 F.3d 643 (7th 2003.) (Aimster was another variety of P2P software.)

Justice David Souter's opinion for the unanimous Supreme Court was limited to the inducement theory and didn't even consider vicarious liability. Shifting the focus from the objective issue of software design to the

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remains for the trial court to decide on remand. The one clear holding of this case is simply this: When a company actively promotes the use of its product for the purpose of infringing copyrights, it can be liable as a contributor to the infringement. The court expressly says that mere knowledge of infringing potential or even of actual infringing uses is not enough to subject a company to liability. Rather, the company's inducement of infringement must involve "purposeful, culpable expression and conduct," the Court said.

Facts make or break a case. As the Supreme Court painted them in its opinion, the facts were not kind to Grokster or StreamCast. This was not a case of well-intentioned companies whose technologies were put to bad use by third parties. The Supreme Court made clear that, as it saw the facts, Grokster and StreamCast did not just provide the tools to violate the law, they aggressively encouraged the tools' unlawful use. The court described these companies as effectively having built their business plans around promoting their technologies for the precise purpose of copyright infringement.

The Court portrayed this as a case of copyright infringement on a massive scale in which these companies were knowing and active participants. The court seemed impressed by evidence from MGM that nearly 90% of the files available for download were copyrighted works. Working through the math, Justice Souter said that more than 100 million copies of the software were known to have been downloaded and billions of files shared, adding up to a scope of infringement he called "staggering." In fact, according to Souter, Grokster and StreamCast conceded the infringement in most downloads.

But the facts most harmful to Grokster and StreamCast had to do with their encouragement of infringement. The Court found that, "from the moment Grokster and StreamCast began to distribute their free software, each one clearly voiced the objective that recipients use it to download copyrighted works, and each took active steps to encourage infringement." Among other evidence, the Court cited an internal e-mail from a StreamCast executive saying that the company was positioning itself to capture the anticipated flood of users after Napster's free service was shut down. Another e-mail, from the company's chief technology officer, said that the company's goal was to get in trouble with the law in order to get in the news.

THE MARKETING ANGLE

Levick: Grokster made a crucial early mistake by associating itself with Napster. Grokster was not in the business of facilitating file sharing, as was Napster, but its promotional materials showed copyrighted songs as examples of available files.

So you have to measure the language you use and the signals you're sending. We're a communications firm that works with lots of law firms, and we're constantly integrating legal and media strategies. We are constantly advising, in our articles and books, that crisis and litigation teams be peopled with both lawyers and communications professionals, and that those professionals must find a way to work together and balance their differing priorities.

Grokster underscores that need. It means that marketing people must

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Grokster: Money For Nothing

By Eriq Gardner

The recording industry was dancing to the sweet music of victory in June, when the U.S. Supreme Court unanimously ruled in its favor in *MGM Studios Inc. v. Grokster*. But a post-verdict depression may be on the way, if the results of *IP Law & Business*'s informal survey of 38 IP lawyers and professors are any indication. *[Editor's Note:* IP Law & Business *is published by ALM, publishers of* Internet Law & Strategy*.]*

In *Grokster*, the Court ruled that Grokster, Ltd., and Streamcast Networks, Inc., can be held liable for distributing software that allows users to share copyrighted music. The case now goes back to the trial court, where a jury will determine whether Grokster and Streamcast actively encouraged users to infringe copyrights.

How much money will this and future court battles cost the recording industry in its continued attempts to eradicate piracy? (That includes the 784 lawsuits the Recording Industry Association of America filed in June against individuals.) Will the industry be able to recoup those costs now that Grokster and Streamcast have been blown out by the Supremes? Or is the *Grokster* decision a money pit, a dressed-up invitation to spend money on lawyers?

To get an idea, *IP Law & Business* asked around, eliciting unscientific guesses on how much added revenue the music business will see in *Grokster*'s wake, compared with the amount they will need to spend on attorneys' fees.

By a wide margin — more than 4 to 1 — IP lawyers and scholars cite law firms as the true financial beneficiaries of the *Grokster* decision. Most scoff at any positive revenue impact for the music biz. Fifteen of the surveyed IP lawyers and professors said the music business would not see as much as a dime, while just ten said "very little."

Not everyone is so dour. Thirteen of those questioned guessed that the record business would see significant sales gains. Temple Law School professor David Post provided the highest estimate, predicting $500 million in added yearly revenue.

Ka-ching? Not so fast.

"The *Grokster* decision presumably sounded the death knell for these [peer-to-peer file-sharing] types," says Fish & Richardson's J. Kevin Gray, who believes the music industry will stave off losing hundreds of millions of dollars a year to online piracy.

But new file-sharing services will emerge, he says: "The music industry

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now vet their messages with lawyers. It's an opportunity for lawyers to really tyrannize the marketers but they'll be doing their clients a grave disservice if they veto every promotional effort just to be absolutely on the safe side. These companies have got to find a balance between saying nothing and promoting theft in their marketing.

It's important to remember that *Grokster* was remanded to a lower court to decide if the company actually did induce theft and the company's lawyers are at least sounding pretty confident. But the point is, in many cases, there will still be arguments on both sides.

Win or lose, *Grokster* underscores the need for prophylaxis in marketing. On the other hand, former FTC Commissioner Michael Powell said (in *The Seattle Times*, June 28) that there is no way to determine from the Supreme Court's ruling at what point, if there is conspicuous high-volume thievery, a company will still face liability. It may, as I read Powell's comment, still need to prove that its marketing is not responsible for the epidemic or that it is not obliged to take additional steps to prevent infringement.

Grokster suggests a "don't ask, don't tell" marketing standard, but that may therefore change. Who knows, they may be forced in the future to both ask and tell.

From a marketing standpoint, new companies and new related industries face another challenge — the Napster mystique. Paying even a nominal fee might not attract people who loved the iconoclastic chic of getting something for nothing, of a communal music. The spirit of rock music encourages that iconoclastic sensibility in the first place. Mozart-lovers might not balk at paying $5 per month to download. But hip-hoppers might balk.

Paid file sharing has a future if it can survive the potential legal burden, but here too there's an interesting marketing question. How can they attract the Napsterites without violating the [*Sony*] and *Grokster* standards?

It's interesting that nobody pays much attention to Napster in its legitimate incarnation. That's because it relinquished its bad-boy mystique.

Implications of the Case and the Future of P2P

Delaney: The real story here is that, even before this decision, the P2P industry has already been moving away from the Grokster model of unauthorized music distribution toward business models that involve working with artists, record labels and music publishers to ensure a more satisfactory experience for consumers. Users of unauthorized P2P networks experience many frustrations — "spyware" products being downloaded on their computers without their knowledge, viruses being introduced through corrupt files, poor sound quality, and so forth. Companies like SnoCap and Mashboxx are seeking to transform the P2P environment by creating so-called "filtered" P2P networks that are built upon respect for copyrights. And, like Apple's iTunes online store, the filtered P2P networks are establishing that one can compete with "free" if one offers a more reliable product and a higher-quality service

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— consumers are willing to pay to avoid their hard drive crashing or their desktop being turned into a spam-generating zombie.

This is not to say that the unauthorized P2P networks will disappear — they won't, and they will continue to make their case in the Ninth Circuit on remand. But, over time, as content providers increasingly partner with P2P companies seeking to work with the music and movie industries, I think that you will see the market providing an attractive alternative to consumers for authorized online content.

Susan Crawford (Assistant Professor of Law, Yeshiva University Benjamin N. Cardozo School of Law, New York; scrawford@scrawford.net)**:** District courts will struggle with the language of *Grokster* and seek limiting principles.

It seems clear that mere distribution of technology alone is not contributory infringement, but the question is how much more than mere distribution is needed before inducement can be found.

There will be arguments that corporate statements of intent to encourage infringement are a necessary prerequisite to inducement claims. And, there also will be arguments that business plans need to be exclusively structured around the idea of encouraging infringement.

So both sides of this debate will see *Grokster* as a Rorschach test. The studios will claim that almost any corporate knowledge of infringement by users of the technology amounts to inducement liability. Technology companies will point to other language in *Grokster* saying mere knowledge can never be enough to constitute inducement and much more focused, express corporate acts are necessary.

Kane: I believe that Mr. Delaney and Ms. Crawford make valid points in that the *Grokster* decision's future is somewhat murky. As the current movement of the P2P industry toward a fee-based business model increases, this decision may have less and less specific impact on the current industry issues. Moreover, the lack of a clear distinction concerning what level or the specific nature of activity that may be deemed to contribute to infringement, is likely to result in more and more litigation until this issue is sufficiently defined. Additionally, I believe that Mr. Levick's likening the necessary analysis to that of false advertising is apt; since each set of facts and circumstances will need to be judged independently with no bright line test or factors to point to. All and all, I believe this decision has the unintended potential to allow a deep pocket copyright owner more leeway in filing a suit against an alleged infringer without the fear of incurring sanctions. Since the outcome of any litigation would need to be judged on a case by case basis depending on the specific facts, judge and jury, more individuals may use this tactic to keep small distributors busy and out of the market.

Levick: My perspective is marketing, media, and communications — and, from that perspective, *Grokster* has decisive implications. In the last analysis, this case is all about marketing and communications, not technology.

Generally speaking, false advertising cases are in the same ballpark. But *Grokster* takes it to a new level. Now, it seems, all the marketing that file-sharing companies do in the future will likely be put under a legal spotlight.

The pharmaceutical industry, believe it or not, offers an instructive example. Labels on drugs are cut-and-dried and tailored to conform to regulatory criteria. No one reads them except professionals. Yet drug companies are constantly being challenged in court over the sufficiency of their labels.

Now imagine that those labels are actually read by every teenager in the country. Imagine the legal problems that arise when courts have to assess how those labels will be interpreted by those readers. That's something like what file-share companies may have to worry about in the future.

The *Grokster* decision may finally launch the fee-paid, copyright-kosher file-sharing industry that never did quite get launched in the aftermath of *Napster*. In fact, just 2 days after the *Grokster* ruling, Sony cut a deal with Mashboxx to provide paid sharing of its songs online. Remember too, even Napster resurrected itself as a legitimate music sales company.

But companies will wonder if the rewards justify the risk of legal challenges from competitors, the music industry, and the government. Will new related industries arise as a result of the decision? There could certainly be a new cottage industry for lawyers.

Some companies will go offshore and fly the Jolly Roger. Steve Jobs says his iTunes Music Store will pick up new business. That's interesting because Apple once infuriated entertainment companies with an ad campaign of "Rip, Mix, Burn."

I think there might be a bifurcation between the pirates, on the one hand, and very large companies or smaller companies subsidized by bigger ones that can accept the legal risks as a cost of doing business.

Actually, what I really think is that, by the time the whole thing shakes out, some kind of new technology will render the case irrelevant from a business standpoint. Yet even if that happens, the marketing lessons implicit in *Grokster* are certainly worth learning.

It's interesting to me that none of the legal perspectives offered by these diverse experts resolve the issues that, as I pointed out, may not be resolvable along purely legal grounds. "Intent" will remain the fulcrum, and, based on that, the comments of the other participants encourage me in my belief that: 1) we will indeed see a new species of lawsuits in which intent is argued over in each particular case; 2) such ongoing litigation may be a burden for smaller companies that don't have collaborations with industry leaders to pay their legal fees; and 3) the underlying issue is indeed all about marketing and communications.

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At the same time, I was intrigued by Professor Crawford's point that "[t]here will be arguments that corporate statements of intent to encourage infringement are a necessary prerequisite to inducement claims. And, there also will be arguments that business plans need to be exclusively structured around the idea of encouraging infringement."

If future cases do require something as overt as a corporate statement of intent to induce, then, from a practical standpoint, *Grokster* may be less important than we now perceive. The ultimate question to be settled in the courts is: What are the minimum marketing standards necessary for compliance? If I understand Professor Crawford correctly, technology companies could in the future face no more difficult a marketing threshold than what is implicit in Sony. Grokster's subtle evocation of Napster in its ads, and an imputation that its business plan is "exclusively structured" around encouraging infringement, may in this case have gotten the company in trouble. But if such overt inducements are required by law in future situations, the Groksters of tomorrow may just have to be a wee bit more careful. If that's all they have to worry about, then the Supreme Court's decision is probably not a watershed.

Tittemore: The difficulty with the decision written by Justice Souter is that it does not advance the discussion of how the *Sony* case should be properly interpreted, which was hoped for in this decision, and its holding likely to be of little value in evaluating the more common situation where a product distributor is more discreet than Grokster and StreamCast. Given the way that the Court distinguished the *Grokster* and *Sony* cases on their facts, with the focus on the *Grokster* defendants' "inducement" of infringement by the users of their products, what the Court did can be understood, but we will have to wait for a case minus evidence of the defendant's intent to benefit from infringement to see if/how the Court will modify the *Sony* rule.

Tune: I agree that it is advisable for companies to work with their lawyers in developing their advertising content and other written materials. I hope, however, that we won't "tyrannize" our clients, but rather will work with them in a constructive and positive way.

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subjective issue of the defendants' intent in distributing the software, the court found that the Ninth Circuit had erred in its application of the Betamax ruling. The exception to secondary infringement liability articulated in the Betamax decision, Souter wrote, was limited to cases of products capable of substantial noninfringing uses where intent to cause infringement was imputed only from the distribution or design of the product with knowledge that it is used for infringement. The Betamax safe-harbor rule was not applicable to cases where there was evidence of an actual purpose to cause infringement.

The Court found ample evidence of such intent on the part of Grokster and StreamCast. After the "notorious file-sharing service" Napster was sued for facilitation of copyright infringement by its users, Grokster and StreamCast both sought, through promotion and marketing, to attract the business of former Napster users. Neither company tried to develop filtering tools or other means to limit infringement by users of its P2P software. And the defendants' business model, which derived its profits from selling advertising space rather than the software itself, depended on having a large number of users.

So the *Grokster* case was remanded for trial. Given Souter's assessment of the evidence of unlawful intent as "unmistakable," it seems unlikely that the trial court will ultimately rule in favor of the defendants on this issue.

Justices' Splinter Groups

But the nine Justices split into three groups on the question of whether liability could be imposed without active inducement. Three Justices (Souter, Antonin Scalia and Clarence Thomas) didn't speak to the question of whether there was a triable issue on the Betamax standard because the court's analysis of active inducement was sufficient basis for the reversal of summary judgment.

In the first concurring opinion, however, Justice Ruth Bader Ginsburg, joined by Chief Justice William Rehnquist and Justice Anthony Kennedy, found that the *Sony* standard wasn't satisfied. There was insufficient evidence that the defendants' software was capable of substantial or commercially significant noninfringing uses. Ginsburg chastised the trial court for the inaccurate statement that it was "undisputed that there are substantial noninfringing uses of the defendants'

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might be spending more, much more, in an effort to protect its copyrights."

Most respondents agreed with Davis Munck's Daniel Venglarik, who predicts that the recording industry will go to Sisyphean lengths, filing as many as 4,000 cases a year against Grokster's successors. "During this time, file-sharing will continue to evolve as it did after Napster, such that each victory will be outdated before the ink is dry on the opinion," says Venglarik.

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software." She also criticized the courts below for failing to see how "markedly" *Grokster* differs from the Betamax ruling: The Betamax users were primarily engaged in the fair use of "time-shifting" (that is, recording TV shows at home to watch at a more convenient time). There was no commensurate finding of fair use of Grokster's or StreamCast's software. Moreover, the evidence of noninfringing uses of the software was scanty — and far inferior to the plaintiffs' evidence that the software was "overwhelmingly used to infringe," wrote Ginsburg. If the trial court didn't find against Grokster and StreamCast on summary judgment based on active inducement, Ginsburg emphasized that the Ninth Circuit should reconsider, on a fuller evidentiary record, this aspect of Betamax.

In a separate concurring opinion, Justice Stephen Breyer, joined by Justices John Paul Stevens and Sandra Day O'Connor, strongly disagreed with Ginsburg's analysis, which he viewed as too strict an interpretation of *Sony*. Breyer found that Grokster's software was capable of substantial or commercially significant noninfringing uses. According to Breyer, *Sony* establishes a clear rule allowing courts to find contributory infringement only where a technology with dual uses "will be used almost exclusively to infringe copyrights" or where the technology's distributors actively induce infringement. This rule gave rise to the correct policy balance, Breyer wrote, between giving effective force to copyrights and protecting entrepreneurs as they introduce new products.

Under the *Grokster* ruling, the focal issue for determining active inducement has shifted from software design to "statements or actions directed to promoting infringement." This seems right. To impute a subjective intent by looking only at an objective design while disregarding the purpose underlying that design seems to violate basic principles of common sense and fairness. But the shift in focus also leaves unanswered questions about evidence, the future fate of *Sony* and the practical impact on technological innovation.

Souter's opinion was clear that mere knowledge that a product may be put to infringing uses is insufficient to establish active inducement. It also said that evidence that a defendant has advertised infringing uses or provided instruction on how to use a product to infringe would suffice. But what other types of evidence will support active inducement? Also, how much weight should be given to the supporting evidence that the court described as insufficient by itself to establish a claim — that is, the failure to develop filtering or other tools to stop infringement, and reliance on a business model that profits from infringement?

The court's focus on subjective intent also leaves a big question mark over the fate of the Betamax ruling. Souter's opinion explicitly declined to revisit the *Sony* Betamax decision, despite the plaintiffs' urging that the court more narrowly interpret the Betamax requirement that a product be capable of significant noninfringing uses to gain safe harbor. The two concurring opinions that did address this issue effectively cancelled each other out.

How will the *Grokster* decision affect future technological innovation and the use of P2P software? It is possible, but far from certain, that the ongoing legal uncertainties will impede invention by raising fears of unpredictable litigation. The reaction of P2P users is equally difficult to predict. No one knows yet whether greater numbers of them will seek the safety of paid content services authorized by copyright owners, or whether they will flock to some new technology to download copyrighted files for free. Whether any such new technology can be developed, distributed and successfully evade a legal attack by the content industries is also open to question. The Supreme Court's *Grokster* ruling has done little to create certainty or predictability in this difficult area of the law.

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