

## Legally Speaking: Did MGM Really Win the *Grokster* Case?

By Pamela Samuelson

MGM's media blitz has given the impression that the entertainment industry won an overwhelming and broad victory against peer to peer (p2p) file sharing and file sharing technologies when the Supreme Court announced its decision in the *MGM v. Grokster* case on June 27, 2005. MGM can, of course, point to the 9-0 vote that vacated the Ninth Circuit Court of Appeals' decision that Grokster could not be charged with contributory infringement because it qualified for a safe harbor established by the Supreme Court in 1984 in its *Sony v. Universal* decision (see my Legally Speaking column of June 2005). The safe harbor protects technology developers who know, or have reason to know, that their products are being widely used for infringing purposes, as long as the technologies have, or are capable of, substantial noninfringing uses (SNIUs). The Court in *Grokster* saw no need to revisit the *Sony* safe harbor. However, it directed the lower courts to consider whether Grokster actively induced users to infringe copyrights, a different legal theory.

MGM didn't really want to win *Grokster* on an active inducement theory. It has been so wary of this theory that it didn't actively pursue the theory in the lower courts. What MGM really wanted in *Grokster* was for the Supreme Court to overturn or radically reinterpret the *Sony* decision and eliminate the safe harbor for technologies capable of SNIUs. MGM thought that the Supreme Court would be so shocked by the exceptionally large volume of unauthorized up- and downloading of copyrighted sound recordings and movies with the aid of p2p technologies, and so outraged by Grokster's advertising revenues—which rise as the volume of infringing uses goes up—that it would abandon the *Sony* safe harbor in favor of one of the much stricter rules MGM proposed to the Court. These stricter rules would have given MGM and other copyright industry groups much greater leverage in challenging disruptive technologies, such as p2p software. Viewed in this light, MGM actually lost the case for which it was fighting. The copyright industry's legal toolkit to challenge developers of p2p file-sharing technologies is only marginally greater now than before the Supreme Court decided the case.

The *Grokster* case will now be sent back to the lower courts for further proceedings consistent with the Supreme Court's opinion. But so what? Even if the Court had ruled in Grokster's favor, further proceedings would have happened anyway. The only issue on which the courts have thus far ruled was whether Grokster qualified for the *Sony* safe harbor defense to MGM's contributory infringement claim as to *current* versions of its software. Liability theories predicated on earlier versions of its software or other conduct have not yet been considered.

Moreover, had Grokster won before the Supreme Court, MGM and copyright industry groups would have gone immediately to Congress to insist on technology-hostile legislation akin to last year's INDUCE Act (see my Legally Speaking column of March 2005). There would have been a big fight between the technology industry and the

entertainment industry over what the legislation should look like, but legislation would almost certainly have ensued. Frankly, any law that would have come out of that sausage factory would have been a lot less technology-friendly than the *Grokster* decision the Supreme Court issued. Thus, the narrow victory MGM won before the Supreme Court has deprived it—for now—of its strongest argument for legislation to put p2p and other disruptive technology developers out of business. Insofar as MGM's goal in the *Grokster* case was to persuade the courts or the Congress to give it much stronger legal protection, it has not succeeded.

## SOUTER FOR THE COURT

All nine Justices joined the *Grokster* opinion written by Justice Souter. The opinion begins with the Court's statement of the question presented by the case: "under what circumstances [is] the distributor of a product capable of both lawful and unlawful use liable for acts of copyright infringement by third parties using the product." (Compare this to the question that MGM had asked the Court to address: "Whether the Ninth Circuit erred in concluding...that the Internet-based 'file sharing' services Grokster and Streamcast should be immunized from copyright liability for the millions of daily acts of copyright infringement that occur on their services and that constitute at least 90% of the total use of the services." MGM had been hoping that the Court would say that the *Sony* defense didn't apply to "services" such as Grokster's and that the estimated 90% of infringing uses on Grokster's p2p system attested to by MGM's expert was intolerable.)

Souter succinctly stated the Court's conclusion: "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." The Court accepted that the *Sony* decision had limited technology developer liability insofar as it was predicated on the design of an infringement-enabling technology, its distribution, and uses made of it, but "where evidence goes beyond a product's characteristics and uses, and shows statements or actions directed to promoting infringement, *Sony*'s staple-article rule will not preclude liability."

(The Court drew upon patent law for this principle. Active inducers of patent infringement cannot escape liability by showing that they are selling a technology suitable for non-infringing uses. However, merely selling a technology suitable for non-infringing uses does not establish active inducement of patent infringement. The Court, thus, borrowed patent law's staple article of commerce rule in *Sony*, and its active inducement rule in *Grokster*.)

Concerning evidence of inducement, the Court said that "the record was replete with evidence 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." Streamcast, for example, "monitored both the number of users downloading its [] program and the number of music files they downloaded" and promoted Streamcast's software "as the #1

alternative to Napster.” Streamcast’s executives “aimed to have a larger number of copyrighted songs available on their networks than other file-sharing networks” and provided users with the ability to search for “Top 40” songs. Grokster “sent users a newsletter promoting its ability to provide particular copyrighted materials.”

Grokster and Streamcast sought to avoid liability for “bad” facts such as these by, in effect, bifurcating the lawsuit into “then” and “now” time periods. Grokster and Streamcast asked the lower court to rule that they qualified for the *Sony* safe harbor as to *current* versions of their software. Grokster and Streamcast were hoping that evidence of earlier misconduct wouldn’t spill over to the more recent period during which they had arguably cleaned up their acts. A successful *Sony* safe harbor defense as to current technologies would mean that these defendants could continue to operate while the legal proceedings dragged on as to earlier versions of the software and other conduct. Money damage awards subsequently imposed as to earlier versions of the software might eventually force them to shut down, but a successful *Sony* defense would give them an opportunity to sell ads to feed to their users in the meantime.

During oral argument, Justice Souter expressed skepticism about this legal strategy:

“I don’t understand how you can separate the past from the present in this fashion. One, I suppose, could say, ‘Well, I’m going to make inducing remarks Monday through Thursday, and I’m going to stop Thursday night.’ The sales of the product on Friday are still going to be the result of inducing remarks Monday through Wednesday. And you’re asking [us], in effect,...to ignore Monday through Thursday.”

Grokster’s lawyer responded that the trial court could consider whether “past acts were themselves illegal” and whether “the causal consequences of those past acts should somehow reach forward into the current acts.” Justice Souter then questioned the point of the lower court’s ruling and characterized as “bizarre” the bifurcated theory of the case.

It was, as a consequence, not at all surprising that the Court sent the case back to consider an active inducement theory of liability. Insofar as the Ninth Circuit’s ruling in favor of Grokster could be construed as precluding liability for current versions of the defendants’ software on any secondary liability theory because Grokster’s software was capable of SNIUs, the Court decided that the Ninth Circuit had interpreted *Sony* too broadly.

## WILL INDUCEMENT SOLVE MGM’S PROBLEMS?

MGM is not all that keen to pursue inducement claims against developers of p2p and other infringement-enabling technologies. Although copyright law does not have a secondary liability provision, it was foreseeable that when presented with an appropriate copyright inducement case, courts would borrow an inducement liability standard from patent law, just as the Supreme Court had borrowed the safe harbor for SNIU technologies from patent law in *Sony*. The burden of proof that standard requires will often be difficult for the entertainment industry to meet. Patent law requires proof of

overt acts of inducement, such as advertising that actively promotes infringing uses or instruction manuals that show users how to infringe, as well as proof of a specific intent to induce infringement. Plus, there must be underlying infringing acts that were induced by this defendant. Merely making or selling an infringement-enabling technology will not suffice, even if the technology is widely used for infringing purposes. The public interest in access to its non-infringing uses is protected by the SNIU safe harbor. Moreover, some caselaw and commentary support the proposition that active inducers can continue to sell technology with SNIUs after they stop overt acts of inducement.

MGM is concerned that developers of p2p software will articulate a plausible substantial non-infringing use, such as downloading open source software, for their technologies and will be careful not to say anything that directly encourages infringing uses. MGM believes that they will nonetheless secretly intend to benefit from infringing uses that ensue. If there are no overt acts of inducement and no proof of specific intent to induce infringement, and if the *Sony* safe harbor continues to shield technology developers from contributory liability, MGM will find itself on the losing side of challenges to technology developers for infringing acts of their users. That is why MGM didn't really want to win the *Grokster* case on this theory.

#### WHAT FUTURE FOR THE *SONY* SAFE HARBOR?

Although the Court was unanimous about remanding the case to consider active inducement, the Justices appear to be in three camps about the *Sony* safe harbor for technologies with SNIUs. Justice Ginsburg, writing a concurring opinion for herself and Justices Kennedy and Rehnquist, questioned whether there was sufficient evidence in the record to conclude that *Grokster*'s software had or was capable of SNIUs. Her opinion suggests that she construes the *Sony* safe harbor more narrowly than other Justices. Justice Breyer, writing for himself and Justices Stevens and O'Connor, used his concurrence to explain why he supports preserving the *Sony* safe harbor. Justice Souter's decision for the Court says some positive things about the *Sony* safe harbor, such as that "it leaves breathing room for innovation and vigorous commerce." But whether Justices Souter, Scalia and Thomas would be willing to revisit the *Sony* safe harbor in a different case remains to be seen.

Justice Ginsburg agreed with MGM that *Sony* was a very different case than *Grokster* and that the *Sony* decision did not unequivocally establish blanket immunity for technologies capable of SNIUs. Should the *Grokster* case not be resolved on an active inducement theory, Justice Ginsburg thinks the lower courts should consider whether *Grokster* and *Streamcast* should be held contributorily liable for user copyright infringements because their products "were, and had been for some time, overwhelmingly used to infringe copyrights" and "infringement was the overwhelming source of revenue from the products." Justice Ginsburg questioned whether the evidence really established, as the lower courts had opined, that *Grokster* had and was capable of non-infringing uses. While she did not endorse the "primary use" standard of contributory liability for which MGM argued, Justice Ginsburg seems willing to leave less breathing room for developers of infringement-enabling technologies than other members of the Court.

Justice Breyer accepted that Grokster had qualified for a *Sony* safe harbor defense to charges of contributory infringement because of the SNIUs the technology had and was capable of. His concurrence mainly considered whether “MGM has shown that *Sony* incorrectly balanced copyright and new-technology interests.” He posed three further questions to inform his answer to the larger question: “(1) Has *Sony* (as I interpret it) worked to protect new technology? (2) If so, would modification or a strict interpretation significantly weaken that protection? (3) If so, would new or necessary copyright-related benefits outweigh such weakening?”

Justice Breyer concluded that *Sony* did indeed protect new technologies “unless the technology in question will be used *almost exclusively* to infringe copyrights.” The *Sony* safe harbor “shelters VCRs, typewriters, tape recorders, photocopiers, computers, cassette players, compact disc burners, digital video recorders, MP3 players, Internet search engines, and peer-to-peer software,” although not cable descramblers. The latter may be theoretically capable of non-infringing uses, but they do not have and are not capable of plausible SNIUs. The *Sony* safe harbor is good in part because it is clear and in part because it is forward-looking. “It does not confine its scope to a static snapshot of a product’s current uses (thereby threatening technologies that have undeveloped future markets),” citing VCRs as an example of a technology whose uses evolved considerably over time. Moreover, the *Sony* safe harbor avoids ill-informed judicial second-guessing of technology design decisions.

Justice Breyer concluded that modifications of the *Sony* safe harbor “would significantly weaken the law’s ability to protect new technology.” Requiring technology developers to produce “business plans, profitability estimates, projected technological modifications, and so forth” would increase “the legal uncertainty that surrounds the creation or development of a new technology capable of being put to infringing uses.” Innovators “would have no way to predict how courts would weigh the respective values of infringing and non-infringing uses; determine the efficiency and advisability of technological changes; or assess a product’s future market.” Because copyright law requires imposition of statutory damages, even in the absence of actual damages—which range from \$750 to \$30,000 per infringed work—“the price of a wrong guess” could be so costly that technological innovation would be chilled by the prospect of immense damage awards.

Justice Breyer found most difficult his third question about whether benefits to copyright owners from a modification of *Sony* outweighed the new technology interests that the *Sony* safe harbor had thus far protected. While “a more intrusive *Sony* test would generally provide greater revenue security for copyright holders,” it was less clear that “the gains on the copyright swings would exceed the losses on the technology roundabouts.” Because *Sony* has been the law for more than two decades, Justice Breyer thought that its longevity “imposes a serious burden upon copyright holders like MGM to show a need for change in the current rules of the game, including a more strict interpretation of the test.” Although unauthorized p2p copying probably had diminished copyright industry revenue, Breyer noted that studies of the effects of p2p file sharing

were unclear on the extent of harm and on whether creative output had diminished. Moreover, lawsuits against individual file-sharers appear to be having some deterrent effects, and there is evidence of a steady migration of users to licensed services such as iTunes. In view of these factors, Breyer concluded that MGM had not made a persuasive case for modifying the *Sony* safe harbor.

## CONCLUSION

The Court's decision not to revisit the *Sony* safe harbor for technologies having or capable of SNIUs is very good news for the technology community. This aspect of the Court's decision is, in itself, a considerable defeat for MGM and the entertainment industry which believed the "bad" facts of the *Grokster* case would be compelling enough to induce the Court to reinterpret *Sony*.

Concomitant defeats for MGM were the Court's disinclination to adopt any of the numerous alternative tests for secondary that MGM and those who supported its position had proffered for the Court's consideration, such as whether the primary use of a technology was for infringement, whether it had been intentionally designed for infringement, whether *Grokster* had a duty to build technology to thwart user infringement, whether technology developer liability should depend on cost/benefit analyses weighing how much infringement could have been averted by alternative designs, whether *Grokster* could be held liable because its business model was infringement-driven, and whether to use multi-factor balancing tests in secondary liability cases. Although Justice Souter's opinion indicates that when there is other evidence of inducement, courts can consider technology design and business models in considering whether active inducement of infringement has occurred, it also makes clear that technology design and business models alone will not establish inducement liability. Hence, I believe that as long as technology developers do not actively induce user infringements, they can continue to innovate and rely on the *Sony* safe harbor.

Larry Lessig, among others, has suggested that the Court's decision will have a chilling effect on innovation. I respectfully disagree. The *Grokster* decision borrowed from the patent law the active inducement liability concept just as in 1984 the Court in *Sony* borrowed the safe harbor for technologies with substantial non-infringing uses. Technology developers who induce copyright infringement should not expect to be treated any differently than those who induce patent infringement.

As long as the courts apply high standards for inducement liability—requiring proof of overt acts of inducement, underlying acts of infringement, and a specific intent to induce infringement—there should be ample room for innovative technologies to continue to thrive. Engineers will need to watch what they say during the development process, and firms will need to think carefully about how they should go about building markets for their products and services. But shouldn't they be exercising such care even without the Court's guidance about inducement liability?

Of course, the entertainment industry will try to make as much out of some loose language in the Court's opinion as it can, for example, as to inferring intent to induce infringement from technology design choices and from revenue sources that can in some way be linked to infringement. I submit that these efforts will fail in the absence of strong evidence of intent from other sources. Judges are not well-suited to second-guess technology design decisions, nor are they well-suited to decide what business models firms should have adopted. It would be inconsistent with patent caselaw and *Grokster's* reaffirmation of *Sony* for courts or juries to infer intent to induce from the provision of technologies or services that have or are capable of SNIUs, even those widely used for infringement. (See footnote 12 of the Court's opinion.) Justice Souter's opinion has many positive things to say about the advantages of p2p technologies and about the *Sony* safe harbor, even if not about *Grokster* and *Streamcast*.

In view of these considerations, I question how much of a "win" *Grokster* really was for MGM. It certainly did not win the case in the way and to the extent it hoped. The *Sony* safe harbor survived a tough challenge before the Supreme Court, and this is good news for the technology community and for the public.

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