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IN PRACTICE

INTELLECTUAL PROPERTY

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Much Ado About Something

Grokster decision affects all tech companies

On June 27, in a closely watched case pitting the intellectual property interests of the entertainment industry against those of the technology industry, the U.S. Supreme Court unanimously ruled that distributors of peer-to-peer (P2P) file-sharing software can be held liable for their users' copyright infringement. In *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, the Court found that when P2P providers such as Grokster and StreamCast distribute "a device with the object of promoting its use to infringe copyright," the P2P providers are "liable for the resulting acts of infringement by third parties." The entertainment industry has hailed the decision as a victory for content creators, artists and copyright owners. Many technology providers have been critical, though they have taken solace in the fact that the Court's decision rests on the manner in which a P2P provider promotes its specific services, not on any broad indictment of P2P technology itself.

Aside from its obvious impact on providers of P2P software, the *Grokster* decision also affects all businesses that design, develop and distribute new technologies that involve copyrighted content. The Court's decision articulates a new standard under which all technology providers, not just distributors of P2P software, must operate to avoid being held responsible for copyright infringement on theories of so-called "secondary liability." Indeed, some of the emerging technologies that will likely be tested under the *Grokster* ruling will not involve P2P software at all, but will be technologies such as the Slingbox, a device designed for "place shifting," which will allow users to route a live television signal from their homes to a portable device anywhere in the world via a broadband connection. The decision may also have a direct impact on pending cases that do not directly involve new technology, such as *Marvel v. NcSoft*, in which Marvel Comics has sued the maker of a massively multiplayer online game in which players can create their own virtual "superheroes," some of which may be imitations of well-known Marvel Comics superheroes.

The Backstory

Grokster and StreamCast distribute free P2P software that allows individuals to share electronic files without the need of a centralized server. This decentralized process distinguishes these companies from Napster, which relied on a centralized file-management system. Although the software enables users to share any type of digital content, most files transmitted using Grokster's and StreamCast's products are copyrighted music and video files. MGM and a host of other copyright holders sued Grokster and StreamCast, seeking to hold them liable for their end-users' copyright infringement, alleging that the companies knowingly and intentionally distributed P2P software to permit users to copy and distribute these copyrighted works.

The *Grokster* case was litigated after the *Napster* case. In the *Napster* litigation, the courts had found Napster liable for its users' infringement, because: (1) Napster had actual knowledge that specific infringing material was available using its system; (2) Napster's centralized file-management system enabled it to prevent suppliers of the infringing material from using its system; and (3) Napster failed to remove the material. By contrast, the same California federal courts ruled in favor of *Grokster* and *StreamCast*, because their decentralized file-sharing architecture did not provide them with actual knowledge of specific acts of infringement. The lower courts in both the *Grokster* and *Napster* cases relied on the famous "Sony Betamax" case from 1984, in which the Supreme Court ruled that Sony was not liable for its end-users' infringement of copyrights using then-new VCRs, because VCRs, though capable of being used to infringe copyrights, were also "capable of substantial noninfringing uses."

The "Inducement Rule"

To the surprise of many observers, the Supreme Court unanimously

Leit and Savare are with Lowenstein Sandler of Roseland.

reversed the lower court's decision, finding that the federal appellate court in California had misapplied *Sony*. Unlike the Patent Act, the Copyright Act does not expressly recognize secondary liability. In *Grokster*, as it had done more than twenty years ago in the *Sony* case, the Court borrowed concepts of secondary liability from patent law and applied them to copyright. In *Sony*, the Supreme Court had borrowed patent law's concept of "contributory infringement," outlined in 35 U.S.C. § 271(c), which states that anyone who sells a device that is especially made to infringe a patent, and which has no substantial noninfringing uses, is liable for infringement. The *Sony* case extended this concept to copyright law, but found that VCRs did have a "substantial noninfringing use," namely time-shifting of television programs.

In *Grokster*, the Court adopted patent law's "inducement rule," outlined in 35 U.S.C. § 271(b), which states, "whoever actively induces infringement of a patent shall be liable as an infringer." Extending the patent statute to copyright law, the Court held 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."

The Court highlighted four types of evidence illustrating that Grokster and StreamCast distributed their P2P software with the intent to promote copyright infringement: (1) both StreamCast and Grokster advertised through online ads and newsletters that their software could access popular copyrighted music; (2) both companies actively courted former Napster users; (3) neither company attempted to develop filtering tools to prevent infringing activity; and (4) the business models of both companies are predicated on advertising revenue, which is driven by high-volume use of their software.

The Import of *Grokster*

In light of both *Sony* and *Grokster*, there are now at least two ways to establish secondary liability for copyright infringement: (1) selling a device that has no substantial noninfringing uses, or (2) inducing infringement. The *Grokster* ruling reaffirms the core holding of *Sony*, that mere knowledge of potentially infringing or actually infringing uses is not enough to subject a distributor to liability, provided the device is capable of substantial noninfringing uses. However, the inducement rule leaves open questions of what type of conduct by a technology company will cause a court to find that the company has the "object of promoting [a device's] use to infringe copyright." Although patent cases may provide some guidance, the prospect that a company's liability turns on its intent, rather than on its actions, creates significant risks for distributors of new technologies that can be used for both infringing and noninfringing purposes.

Grokster will certainly have an impact on pending cases such as the *Marvel v. NcSoft* case. In that case, Marvel sued NcSoft on a theory of contributory infringement, alleging that the fact that NcSoft's "City of Heroes" game allows users to create imitations of Marvel characters is sufficient to impose copyright liability on NcSoft. NcSoft has moved to dismiss, relying heavily on the *Sony* and *Napster* cases for the proposition that the contributory infringement count cannot be sustained because the game is capable of a "substantial non-infringing use" — the creation of other on-line "heroes" that do not resemble Marvel characters. In light of *Grokster*, it appears that neither party is entirely correct. NcSoft cannot rely solely on the fact that the game is capable of a substantial noninfringing use to render itself immune from liability (as it has argued in court). However, Marvel cannot rely solely on the fact that NcSoft has provided software tools that enable the creation of allegedly infringing characters, and "turned a blind eye" to infringing characters on the system, without demonstrating that NcSoft has actively encouraged the creation of infringing characters.

In light of the decision, all companies promoting technologies that may be used to infringe copyrights should, at a minimum, consider adopting practices designed to minimize the risks of secondary liability. Companies need to be sure that there are substantial noninfringing uses for their products. Companies should not promote their products, either internally or to the public, as facilitating the unauthorized reproduction of copyrighted works. Rather, these companies should make direct public statements that the technology should not be used to infringe copyrights. Companies should consider adopting technical measures to block copyright infringement. Some companies may even have to change their business models, particularly if the company's plan is to rely solely on advertising revenue generated from products whose main use is to infringe copyrights.

Innovation After *Grokster*

For the entertainment industry, *Grokster* is a clear win. Authorized online music providers such as Apple (iTunes) and RealNetworks (Rhapsody) are poised to gain, as P2P becomes perceived as a riskier way to share music, and entertainment companies, particularly record labels, continue to sue individual computer users.

For the technology industry, *Grokster*, while clearly a defeat for Grokster and StreamCast, is also judicial confirmation at the highest level that P2P technology can be used for noninfringing uses, and is therefore not inherently legally suspect. Still, the ruling significantly alters the legal landscape concerning technology, entertainment, and copyright law. The legal risks imposed by *Grokster* will force companies not only to adopt new marketing practices, but also to consider re-evaluating their business model and the fundamental purpose and use of their products. ■