GROKSTER v. SONY:
THE SUPREME COURT'S REAL DECISION

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1. Introduction

On June 26, 2005, the Supreme Court handed down the long-awaited decision of *MGM v. Grokster*, which considered the legality of the two file-sharing networks Grokster and Streamcast [1] The two respondents were charged with contributory and vicarious copyright infringement for distributing software that enabled computer users to make unauthorized reproduction and distribution of copyrighted material that contributing donors had previously uploaded to the network. In a 9-0 verdict, the Court reversed two lower court decisions that held that Grokster and Streamcast had "significant, noninfringing uses" and therefore qualified for protection under the Supreme Court's 1983 *Sony v. Universal City Studios*.[2] The majority opinion, written by Justice Souter, found that the respondents indeed were entitled to no such protection because they had actively promoted their software through clear expression and engaged in ther affirmative steps as a considerable means for infringing copyright.[3] Notable also is the concurring opinion of Breyer, Stevens, and O'Connor, which strongly endorsed the *Sony* view; while Grokster and Streamcast were improperly advanced for their ability to permit infringement, technologies that display the potential for "significant noninfringing uses" may continue to qualify for an exemption from secondary liability.[4]

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[1] 545 U.S. ___. (2005)

[2] Id. 1.

[3] "We hold that one who distributes a device with the object of promoting its use to infringe copyright, as shown by clear expression of other affirmative steps taken to foster infringement, is lability for the resulting acts of infringement by third parties." Id. at 1,

[4] Concurring opinion, Breyer. "Sony's rule, as I interpret it, has provided entrepreneurs with needed assurance that they will be shielded from copyright liability as they bring valuable new technologies to market. Sony's rule is clear. That clarity allows those who develop new products that are capable of substantial noninfringing uses to know, ex ante, that distribution of their product will not yield massive monetary liability. At the same time, it helps deter them from distributing products that have no other real function than or that are specifically intended for copyright infringement, deterrence that the Courtís holding today reinforces (by adding a weapon to the copyright holder's legal arsenal) … {The Sony rule] is strongly technology protecting. The rule deliberately makes it difficult for courts to find secondary liability where new technology is at issue. It establishes that the law will not impose copyright liability upon the distributors of dual-use technologies (who do not themselves engage in unauthorized copying) unless the product in question will be used almost exclusively to infringe copyrights (or unless they actively induce infringements as we today describe)." At http://www.eff.org/IP/P2P/MGM_v_Grokster/key_quotes.php (retrieved June 30, 2005)

The Supreme Court here fashioned a decision where demonstrated intent appears to be a supplemental determinant of contributory or vicarious liability. This intent can apparently be discerned in court through discovery and deposition. However, the Court's decision therefore skirts more general economic issues implicated in the digital economy; it fails to reconsider any issues in *Sony* should the intent test fail. Sooner or later these issues will need to be addressed

As it now stands, the *Grokster* standard will have little effect upon the distribution of file-sharing software and the trafficking of infringing works by their enthusiasts. With a careful reading of the decision, P2P lawyers and network operators may come to embrace a new strategy – avoid showing intent. This can be done by promoting file-sharing software through third-party word-of-mouth -- blogs, email, instant messages, chatrooms, journalists, and popup ads. The collection of instruments will expectedly widen as others willingly provide communications techniques as part of the communitarian ethos that justifies copyright infringement.

Pyrrhic battles won in the ether of the courtroom may lead to a war lost in a market that is far more complex than present legal constructs may grasp. What the *Grokster* Court failed to consider is the need to maintain clear property rights that can be unambiguously supported regardless of whether a lawbreaking intent can actually be demonstrated on the part of the presumed infringer. . In this respect, the Court's conduct-based standard contrasts with the California District Court in *A&M Records v. Napster*, where the centralized file-sharing network was ordered to avoid providing directory assistance to users who sought copyrighted works. With a stronger defense of property rights, Napster attempted to devise its own filtering system, and the service might reasonably have used other third-party services if they were available at the time..

2. Peer to Peer Technology and Consumer Behavior

Peer-to-peer file sharing networks now provide to web users the ability to find and download files from other computer hard drives by typing an appropriate title, word, or phrase. For example, a student interested in the Civil War can find uploaded material on other user hard drives by entering the phrase "Abraham Lincoln". In its concept, P2p technology evidently has great potential benefit for both users and content owners, as the technology allows listeners to sample works that they otherwise might not experience and develop interests that might otherwise not exist. P2P enables direct links for communication of legitimate documents, music, and photographs among users who do not have websites, a considerable benefit to a real semiotic democracy oriented around the presentation of new expression. .

While P2P technology enables a number of interesting uses, the same technology can enable the unauthorized transfer and copying of copyrighted music, books, and movie files that can be "ripped" from CDs or otherwise loaded to donor hard drives without authorization. The unauthorized reproduction of any copyrighted material can displace original sales and licensing opportunities, and therefore presents concerns for copyright owners who might otherwise sell product or enter into licensing arrangements. .
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The process of peer-to-peer file-sharing works as follows. Users either create original files or copy music, movies, etc. from store-bought product to computer hard drives. Users then download enabling software

from a central server, and use the software to upload files from their hard drives to network folders. Material on network folders is available for free copying by others, who request files by entering a typed phrase. Users with P2P software may also receive copies of tracks uploaded to network folders located on other computers. Any recipients can make any taken file immediately available for further distribution to others on the network.

There are four alternative topologies for distribution of content on file-sharing networks. In the first generation, Napster, Scour, Aimster/Madster, Audiogalaxy, and iMesh routed user requests for content through central directories that contained address information for files located on donor computers. In a second generation of decentralized topology, KaZaa and Grokster came to use Fast Track software to route file requests through intermediate directories, called supernodes, that are configured on large user computers near the requesting computer.. However, if either service were to deactivate all computers under their control, users could continue to trade files on software that had already been distributed.

In yet a third variation, BearShare, Limewire, and Morpheus have used open source Gnutella programs to pass request information directly from machine to machine. Certain personal computers on the network operate here as "ultra peers" that perform intermediary tasks that are comparable to those activities performed by supernodes. Gnutella networks are considerably slower than Fast Track networks, and the available neighborhood of donors is confined to a much smaller universe of machines located in the local neighborhood of the requesting party. .

As the last variation, BitTorrent and eDonkey now allow their networks to distribute chunks of shared content files on different computers in the network. In these networks, a facilitating server allows the requester to download whole files by locating disaggregated components near her machine. By decomposing content, BitTorrent and eDonkey technologies are particularly efficient for delivering across the network movies, games, and other materials that require large bandwidth. Both systems also avoid the use of spyware and can detect the spoofing, interdiction, and other prophylactic measures that content owners have adopted to discourage the taking of copyrighted files on Fast Track systems.

As measured by deployed bandwidth, BitTorrent replaced KaZaa in 2004 as the most popular p2p protocol worldwide. Its market share of total traffic has doubled in the first six months of 2004, moving from 26 to 53% of the overall traffic surveyed. EDonkey is now in second, while KaZaa fell from 46 to 19 percent of market share to move to third lace. The Gnutella systems together occupy four place.[5]

P2P supports three general types of business models. For example, respondents Grokster and Streamcast, *inter alia*, have allowed unrestricted uploading and trading of files among users. These services profit by distributing pop-up advertising and personalization files on host computers. Altnet, Trymedia, and Intent restrict their trading to protected files, but deliver content over capacity purchased on the larger P2P networks. Finally, stand-alone P2P networking is possible; e.g., Wurld Media will soon offer an independent network that will be confined to protected content.

[5] P2Pnet.net, "Bit Torrent Usurps Kazaa", at http://p2pnet.net/story/1911 (retrieved July 15, 2004)

Content owners are directing their attention to the first group of models. Some 90 percent of the files traded on these P2P networks are copyrighted works produced by record labels and movie studios.

3. The Napster Lesson

The recording industry won a summary judgment against Napster in July, 2000 for contributory and vicarious infringement of member copyrights. The District (N.D.Ca.) and Circuit (9^{th}) Court affirmed owner property rights; Napster was obliged to stop directing users to tracks identified previously by the plaintiffs as copyrighted material. Napster then attempted to implement a filtering technology. Once the system began to filter out copyrighted works, its user base dwindled rapdily from 18.7 million to 150,000 people The network implemented a technical shutdown in July, 2001 and filed for bankruptcy in the following year.

However, the RIAA's victory over Napster did not deter file-sharing in the least. As Napster activity wound down, an installed base of 64 million users was released for other sharing services that came to fruition. Indeed, the three billion files that were downloaded in the first month after Napster shut down (August, 2001) exceeded Napster's monthly maximum of 2.8 billion (February, 2001). Three service providers -- KaZaa BV, Grokster, and Music City (nka Streamcast) – became the new leading distributors of file-sharing software. As described above, these services provide directional information and sharing without need for a central directory under the control of the network operations.

4. Supreme Court Litigation

On October 2, 2001, twenty-nine record and movie companies filed suit against KaZaa, Grokster, and Streamcast for contributory and vicarious infringement. After Kazaa sold its desktop technology to Sharman Networks in 2002, the plaintiffs settled with Kazaa and sued Sharman. The matter against Streamcast and Grokster reached an unexpected moment in April, 2003, when District Court Judge Stephen Wilson ruled in summary judgment for the defendants.

Invoking the Supreme Court's 1984 decision *Sony v. Universal Studios*,[6] the District Court found that Grokster and Streamcast lacked the immediate knowledge of infringement that was required to establish secondary liability.[7] Moreover, the contested software was a staple article of commerce that was capable of a "significant noninfringing use", i.e., "defendants distribute and support software, the users of which can and do choose to employ it for both lawful and unlawful ends. Grokster and StreamCast are not significantly different from companies that sell home video recorders or copy machines, both of which can be and are used to infringe copyrights." Unlike Napster's centralized directory service, Streamcast and Grokster had no ability to supervise the use of software that they previously distributed; "if either defendant closed their doors and deactivated all computers within their control, users of their products could continue sharing files with little or no interruption."

[6] Sony v. Universal City Studios, 464 U.S. 417 (1984).
[7] MGM. v. Grokster, 259 F. Supp. 2d 1029 (2003).

The cited *Sony* decision considered the legality of the videocassette recorder (VCR), which could videotape copyrighted television programs for a wide category of purposes, including later playback, commercial skipping, and unauthorized collecting of a program library for home use. The District Court found the VCR to be a staple item of commerce and held for Sony; the Ninth Circuit Court reversed, and the Supreme Court reversed again. Writing for the majority, Justice Stevens found the VCR to be a "staple article of commerce" that could be used for a significant noninfringing purpose – the time-shifting of recorded programs for later playback within the home.[8]

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After the Ninth Circuit upheld the lower court in *Grokster*, the industry appealed to the U.S. Supreme Court in late 2004.[9] On June 27, 2005, the Supreme Court vacated and remanded the Circuit Court's decision with a unanimous decision. The Supreme Court's ruling now obliges the trial Court to look at the relevant facts concerning the likelihood that the respondents actively encouraged their users to infringe on copyrights.

Written by Justice Souter, the Court's opinion focused on behavior of the respondents in promoting their software. Grokster and Streamcast were found to have purposely and actively promoted their software as a means of infringing copyright; the presence of *purposeful* inducement to infringe on copyright was held to be a legal standard that was analogous to the *staple article* doctrine of Sony.

> "For the same reasons that Sony took the staple-article doctrine of patent law as a model for its copyright safe-harbor rule, the inducement rule, too, is a sensible one for copyright. We adopt it here, holding 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 inducement rule, instead, premises liability on *purposeful, culpable expression and conduct*, and thus does nothing to compromise legitimate commerce or discourage innovation having a lawful purpose."[10] [emphasis mine]

This intent was found largely in the behavior of the respondents to actively solicit former users of Napster, for much of the original purpose of Napster.[11] This behavior here of Grokster and Streamcast was found

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[8]Id., at 451-3 (1983) . "The sale of copying equipment, like the sale of other articles of commerce, does not constitute contributory infringement if the product is widely used for legitimate, unobjectionable purposes. Indeed, it need merely be capable of substantial noninfringing uses." At 442

[9]Pet. for Cert., at http://www.eff.org/IP/P2P/MGM_v_Grokster/

[10] At http://www.eff.org/IP/P2P/MGM_v_Grokster/key_quotes.php (retrieved June 30, 2005)

[11]"Three features of this evidence of intent are particularly notable. First, each company showed itself to be aiming to satisfy a known source of demand for copyright infringement, the market comprising former Napster users. StreamCast's internal documents made constant reference to Napster, it initially distributed its Morpheus software through an OpenNap program compatible with Napster, it advertised its OpenNap program to Napster users, and its Morpheus software functions as Napster did except that it could be used to distribute more kinds of files, including copyrighted movies and software programs. Grokster's name is apparently derived from Napster, it too initially offered an OpenNap program, its softwareís function is likewise comparable to Napsterís, and it attempted to divert queries for Napster onto its own Web site. Grokster and StreamCastís efforts to supply services to former Napster users, deprived of a mechanism to copy and distribute what were

to be quite different than Sony's, which at no point displayed any comparable intent in infringing copyright.[12] In this narrow context, Grokster and Streamcast lost the day in Court, while the *Sony* decision was left fundamentally untouched.

From an economic perspective, it is difficult to imagine how anyone could quibble with the immediate verdict against Grokster and Streamcast. Had the promotional activities of Grokster and Streamcast been upheld, a distributor of any copying product could have legally designed and actively promoted – *through direct advertisement in every form of print, broadcast, and online media* – any software or hardware with a forthright statement of its ability to promote law-breaking activity. The Court's decision here seems like a judicial enactment of the Induce Act,[13] which would have placed secondary liability upon a technology after considering the perceived intent of the designers to induce copyright infringement.

While it is surely sensible to stop networkers from actively promoting the instruments of copyright infringement in order to build their businesses, the delineated actions of Grokster and Streamcast were largely related to soliciting the former customers of Napster. It is difficult to imagine file-sharing ceasing to any great degree as a consequence of the *Grokster* decision. Rather, inventors and promoters of new technologies and their emerging contemporaries can now be expected to find subtler or more circuitous means of generating interest in new techniques for infringing copyright. Indeed, Prof. Terry Fisher conjectures that BitTorrent – now the largest user of bandwidth in the P2P space – would now probably survive the *Grokster* test.[14] Also claiming exoneration under the *Grokster* standard is KaZaa, a co-defendant in the original suit and the largest of the three networks. [15]

Whether Fisher and Kazaa are right or not, the Court's ruling would allow more circumspect pronouncements and the use of market channeling to ensure that word of new devices gets out through chatrooms, e-mails, instant message, independent web sites, blogs, online newspapers, journalists, and

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overwhelmingly infringing files, indicate a principal, if not exclusive, intent on the part of each to bring about infringement." At http://www.eff.org/IP/P2P/MGM_v_Grokster/key_quotes.php (retrieved June 30, 2005)

[12]"There was no evidence that Sony had expressed an object of bringing about taping in violation of copyright or had taken active steps to increase its profits from unlawful taping.... Although Sony's advertisements urged consumers to buy the VCR to 'record favorite shows' or 'build a library' of recorded programs, ... neither of these uses were necessarily infringing." At http://www.eff.org/IP/P2P/MGM_v_Grokster/key_quotes.php (retrieved June 30, 2005)

[13]Officially known as the Inducing Infringement of Copyrights Act (SB2560),

[14] W.T. Fisher, "The Road to Grokster", presented at Boston Bar Association, June 30, 2005.

[15]"While the Supreme Court apparently found 'substantial evidence... on all elements of inducement" by other P2P providers Grokster and Morpheus, Sharman has never encouraged or assisted users of Kazaa software to share copyrighted material in violation of copyright law. In fact, our Kazaa web site and its End User License Agreement (EULA) have always contained explicit direction to users to respect their national copyright laws. And, from day one, Sharman's alliance with Altnet offered copyright owners a means by which licensed and protected copyrighted content could be distributed in a lawful and compensated manner, yet major content owners engaged in a coordinated boycott of that opportunity that we have asserted was in violation of U.S. antitrust laws. We believe that further legal review of this case will also show that Sharman was diligent and aggressive in its lawful efforts to distribute copyrighted music and movies through peer-to-peer distribution, and was thwarted in its efforts to do so by the music and motion picture industries" At http://www.eff.org/IP/P2P/MGM_v_Grokster/sharman.php (retrieved July 1, 2005)

third-party editorials.. To expedite the process, a great amount of facilitating activity by disgruntled users who are proudly adverse to the content industries can now be expected; a network of enthusiastic town criers will now come to hearken each new software development.

5. Economic Analysis: Grokster v. Sony

In its focused reading, the Court then untouched any real consideration of its *Sony* standard.. which “barred secondary liability based on presuming or imputing intent to cause infringement solely from the design or distribution of a product capable of substantial lawful use, which the distributor knows is in fact used for infringement." Had the decision been more sweeping, the court might well have considered the differences between the contrasting nature of the Sony and Grokster/Streamcast technologies. A careful analysis would go considerably beyond calling checking for the presence of “significant noninfringing uses”.

First, each Sony VCR was primarily capable of making *reproductions* of broadcast television programs for later home viewing. Due to quality degradation, it was highly impractical for a taken work to be copied again and distributed to another recipient. A number of these uses – i.e., time-shifting of a “no fee” over-the-air program by noncommercial viewers – were included among a number of presumptive fair uses. By enabling time-shifting, the VCR did not displace any legitimate provider that offered a comparable service. Finally, there was no practical way at the time to monitor use and charge a price for the taking of a time-shifted program.

By contrast, file-sharing software is primarily a *distribution* technology – all works are copied from material at some other location on the network, and some 90 percent of these takings entail a copyrighted work that can be purchased elsewhere. Since *Sony*, the U.S. has strongly restricted distribution across different points of a network while accommodating noncommercial reproduction by any one member. For example, it is now illegal to operate a store to provide rental CDs – an evident distribution that could usurp record sales. Per the terms of the Audio Home Recording Act of 1992, the record industry will not take action against users of digital tape recorders who make home tapes of CDs; however, digital tape recorders are required now to implement a code management technology so to eliminate the threat of making serial copies from the first tape At the same time, legal technologies -- such as the VCR, photocopier, iPod, and tape recorder -- are used each day to make reproductions that may be infringing or not.

Internet distribution is particularly beyond the issues in the VCR. Once a work is distributed through the Internet, a P2P user has the ability to make available for subsequent distribution all taken content for free and immediate acquisition by countless other viewers on the network (i.e., viral reproduction.) Whether such viral copies actually displace a prospective sale (an arguable point) or avoid paying a negotiated license fee for a related service (a virtual certainty), the unauthorized reproduction and distribution of complete original works displaces a business opportunity for the content owner. The relation between unpaid licensing revenues and copyright infringement – a predominant concern in the contemporary digital economy -- was a point entirely missed by respondents, but not by two District Courts in related music cases.[16]

As a second distinction between *Sony* and *Grokster,* the VCR displaced no comparable service, while file-sharing networks now compete with streaming and downloading services that now offer fully licensed copyrighted works for distribution through central servers. In an amicus brief in support of the petitioners in Grokster.[17] these competing providers point out that their services took several years and hundreds of millions of dollars to develop, license, and refine. File-sharing networks preempt their market space.

Third, there is no compelling economic reason to treat Grokster and Streamcast with any standards different from Napster, which had a centralized directory that could arguably have been more efficient. Whatever the difference in location and transmission technique, the original Napster, Grokster, and Streamcast services basically enabled the same end-user service -- unrestricted file-sharing. Had they prevailed, the respondents' primary enabling excuse – no immediate awareness – was then based solely on a legal construction that incorporated no concept of relative efficiency among different P2P topologies. This capacity for enabling excuse may now enter another generation, as providers attempt to prove that they are not personally responsible for inducing illegal use.

6. Filtering

As new file-sharing technologies continue to emerge, the Supreme Court may have to decide whether to whether to modify *Sony.* As a primary extension, the bench may consider whether filtering by a particular dual-use technology is a legitimate concern.

Quite famously, the *Sony* Court itself declined to impose any rule that would mandate any change in the design of a product, such as the implementing of filtering.[18] By contrast, the *Napster* Court imposed upon labels the responsibility to provide notice of the title of the copyrighted work, the name of the featured recording artist, the names of one or more files on the Napster system containing the work, and a certification that plaintiffs own the claimed copyright. The respondent Napster then bore the responsibility to eliminate the copying and distributing of infringing works.

In *Grokster*, the Court found that respondents' apparent refusal to implement filtering technologies is evidence of infringing conduct.[19] However, a challenging footnote (# 12) states that the absence of

[16] A&M Records, Inc. v. Napster, Inc., 114 F. Supp. 2d 896, 910 (N. D. Cal. 2000); UMG Recordings, Inc. v. MP3.Com, Inc., 92 F. Supp. 2d 349, 352 (S.D.N.Y. 2000).

[17] Amicus Brief, Napster LLC, et. al., Section I.B, 6 At http://www.eff.org/IP/P2P/MGM_v_Grokster.

[18] "It is not our job to apply laws that have not yet been written", at 453. supra note 7.

[19] This evidence of unlawful objective is given added significance by MGMís showing that neither company attempted to develop filtering tools or other mechanisms to diminish the infringing activity using their software. While the Ninth Circuit treated the defendants' failure to develop such tools as irrelevant because they lacked an independent duty to monitor their users activity, we think this evidence underscores Grokster's and StreamCast's intentional facilitation of their users' infringement.

filtering is not sufficient to prove any wrongdoing. Moreover, filtering is clearly cabined by *Sony*; "in the absence of other evidence of intent, a court would be unable to find contributory infringement liability merely based on a failure to take affirmative steps to prevent infringement, if the device otherwise was capable of substantial noninfringing uses. Such a holding would tread too close to the Sony safe harbor."[20]

If presented with a later direct challenge to *Sony*, the Court may yet prefer to reaffirm its decision and leave the resolution to the U.S. Congress, which Congress has "the institutional ability to *accommodate fully the varied permutations of competing* interests that are inevitably implicated by such new technologies".[21] [emphasis mine, sic] Congress has indeed legislated to modify copyright policy after particular Court decisions. For example, the Congress instituted compulsory licensing for secondary uses of musical compositions and distant rebroadcasts of cable programs after the Court found earlier that such takings were not covered by existing copyright law. However, these legislative actions implicated narrow extensions of copyright law into small domains of media and art. The compulsory licensing of secondary compositions only implicated those musical works which had been recorded previously, while the licensing structure for cable transmissions only implicated that small number of local television broadcast that were retransmitted for cable use *outside* of the local broadcast region – e.g., WTBS sports games rebroadcast from Atlanta into Mississippi. .

The file-sharing matter, which implicates reproduction and distribution across all of the accoutrements of the entire Internet, is far more complex. The necessary technical solution to digital piracy conceivably could include the software, browser, broadband connections, ISP facilities, backbone providers, operating systems, disk manufacturers, and microchips. A comprehensive solution to impose proper filtering could take years to unfold; it will involve taking new technologies "on the fly" and responding to a considerable number of technical failures. It is doubtful that any legislature could possibly provide the necessary guidance or flexibility of an ongoing system. Furthermore, Congressional misdirection could predictably lead to irreversible decisions that will weight the internet with a large anchor.

For example, the very restrictive Consumer Broadband and Digital Television Promotion Act of 2002 (CBDTPA) would have imposed government-selected DRM standards upon the content and electronics industries if these industries failed to enter a collective agreement on standards on their own within 18 months of passage of the legislation. If adopted, the legislation would evidently have shortened or curtailed entirely the operation of market and related voluntarily cooperative forces throughout the content and electronics industries. Moreover, no advocate could reasonably have suggested what to do if the imposed government standards were later demonstrated to be surpassed or simply ineffective, as could reasonably have been expected.

These reservations concerning the dangers of legislative direction can be broadly related to the academic research of Elinor Ostrom, who finds that "getting the institutions right" in complex policy-making is often too far removed from awareness of the real issues at hand, and the feedback and flexibility that could yet be useful in correcting course. It is then a difficult and uncertain process that consumes time, invokes conflict, and leads to traps in the wrong corners. Prof. Ostrom's general view reflects a political

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[20]At http://www.eff.org/IP/P2P/MGM_v_Grokster/key_quotes.php (retrieved June 30, 2005)
[21] Supra note 7, at 431.

scientist's appreciation of the importance of incrementalist procedure in guiding policy, and an economist's similar vision of a free market as a cybernetic process that allows learning by doing and adaptation through local search and mutual adjustment. Rather than configuring the course of a new system, the incrementalist plays chess – he thinks about the logic behind the all-important "best next move".

Courts may then come to think of property rights as the enabling catalysts for market engagement; these rights constitute the "best next move". As a market lubricant, the exchange of property rights leads to the prices that can guide decisions, mediate interactions, and provide ongoing feedback to active participants. In combination, these court appointments can stimulate the development of new ideas and activate their commercial application.

The proper definition of property rights is particularly important when new technologies come to market; Wendy Gordon in this regard argued that fair use should be restrained for new technologies, so that behaviors, institutions, and procedures have the opportunity to evolve naturally in a market penumbra.[22] With defined property rights, the institutions of the copyright complex -- licensing consortia, subscription agents, copyright collectives, rights clearance centers, and "one-stop shops"[23] – can emerge to perform their roles. Beginning with the formation of ASCAP and the Copyright Clearance Center and continuing through to Sound Exchange and Snocap, intermediary institutions form to monitor use, negotiate complex contracts, and facilitate collection after the constituent rights were clearly defined by courts or legislatures.[24]

7. Strategy by Incrementalism

How does one determine the "right next move" in *Grokster*? By defining, as had the *Napster* court, the appropriate property rights -- what content can be taken and what cannot. As explained above, the *Napster* Courts defined rights carefully by requiring copyright owners to identify their proprietary material, and requiring Napster to determine the means to filter it out. In this construction, intent is of minimal importance.

Defining property rights is particularly practical when a filtering technology is available to discern legal and illegal uses. In this regard, parties on both sides of *Grokster* now concur that filtering is technically possible in file-sharing networks. For the petitioners, a distinguished computer scientist Leonard

[22] W. J. Gordon, "Fair Use as Market Failure: A Structural and Economic Analysis of the Betamax Case and Its Predecessors", 82 COL.L. REV. 1600 (1982).

[23] University consortia are teams of libraries that negotiate collectively on behalf of a group of individual members. Subscribing agents are commercial agents who negotiate usage contracts on behalf of one or many licensees. Copyright collectives negotiate contracts on behalf of their rights holders, e.g., in photo-reproduction or musical performances. Rights clearance centers grant licenses based on individual terms specified by the owner. "One-stop-shops" are a coalition of separate collective management organizations which offer a centralized source for a number of related rights, e.g. photos and music, that would be particularly useful in multimedia production. At http://www.wipo.org/about-ip/en/about_collective_mngt.html. (retrieved June 26, 2001).

[24] R. P. Merges, "Compulsory Licensing vs. the Three Golden Oldies: Property Rights, Contracts, and Markets", 10, POLICY ANALYSIS (Cato Institute: Washington), January 15, 2004.

Kleinrock wrote: "There is nothing inherent in the technology … of peer-to-peer system[s] that would prevent [them] from taking steps to prevent or greatly diminish the volume of copyright infringement on their systems."[25] Three amicus supporters of the petitioners contended that that filtering through software is now available and that the failure to utilize filtering technologies now represents a deliberate choice by respondents.[26] Another amicus, Macrovision (a provider of copy protection services), also concurred that filtering is readily possible but not employed due to the business interest of the respondents.[27]

The validity of the petitioner amici was confirmed, perhaps unwittingly, by the former CTO of Morpheus, Darrell Smith: "Peer to peer file sharing applications already filter those things that their users do not want, such as bogus music files and viruses. They could very easily adopt and implement a filter to eliminate unauthorized copyrighted works as well, but user levels and revenues could decline if popular music or movie files were filtered."[28]

From the P2P community itself, the practicality of filtering was yet confirmed in an amicus brief submitted by iMesh, which had agreed in 2004 to integrate fingerprinting and watermarking into its P2P software program that has almost identical functionality to the respondent programs. Concurring fully with Audible Magic and Macrovision, the P2P provider stated:

"By integrating technology into their software, P2P companies can readily prevent users from unlawfully exchanging unauthorized copyrighted content. Moreover, implementation of such a digital fingerprinting and filtering mechanism in no way changes the nature of the underlying P2P technology or vitiates the efficiencies that such P2P technology conveys to users and businesses that use it."[29]

Bringing thought to action, a legitimate P2P music provider, Intent MediaWorks, announced in March, 2005 a software program called MyPeer that had a filtering component that allows only family friendly and legally authorized content to be traded between P2P users.

Arguing for the respondents, an amicus brief submitted by eighteen professors of computer science argued that no proposed filtering technology was publicly tested, some users may learn to deactivate the filters or disconnect the upgrade, and some users may learn to encrypt and decrypt content in order to avoid the filters.[30] As Audible Magic has provided filtering since its acquisition of IPArchive in 2002, the first claim is incorrect. The last two, which advanced the possibility of encryption and off-network "darknets", are valid points that are not legally compelling in the least... Indeed, one could use the same academic diversion to oppose the installation of radar guns on public highways; i.e., some speeding drivers can install detectors. Monitoring is reasonable nonetheless in order to deter some law-breaking.

The professors would have received an appreciate ear from Justices Breyer, O'Connor, and Stevens, authors of a concurring opinion that strongly endorsed *Sony* :

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[25] Amicus Brief, Leonard Kleinrock,.at At http://www.eff.org/IP/P2P/MGM_v_Grokster/
[26] Amicus Brief, Audible Magic, Summary of Argument, at At http://www.eff.org/IP/P2P/MGM_v_Grokster/
[27] Amicus Brief, Macrovision, Section 1c, 8, at At http://www.eff.org/IP/P2P/MGM_v_Grokster/.
[28] K. Hafner,"Is it Wrong to Share your Music?", Katie Hafner, The New York Times, September 18, 2003.
[29] Amicus Brief, iMesh, Statement of Interest, 1-2, at http:// at At http://www.eff.org/IP/P2P/MGM_v_Grokster/
[30] Amicus Brief, Eighteen Professors of Computer Science, at At http://www.eff.org/IP/P2P/MGM_v_Grokster/At http://www.eff.org/IP/P2P/MGM_v_Grokster/

> "Judges have no specialized technical ability to answer questions about present or future technological feasibilility or commercial viability where technology professionals, engineers, and venture capitalists themselves may radically disagree and where answers may differ depending upon whether one focuses upon the time of product development or the time of distribution. Consider, for example, the question whether devices can be added to Grokster's software that will filter out infringing files. MGM tells us this is easy enough to do, as do several amici that produce and sell the filtering technology. Grokster says it is not at all easy to do, and not an efficient solution in any event, and several apparently disinterested computer science professors agree. Which account should a judge credit? Sony says that the judge will not necessarily have to decide."[31]

While judges may have no special technical knowledge, experts, amici, and court-appointed special masters do. If Chinese walls between technology and the bench were firmly established, it would have been improper for the District and Circuit Courts in the Microsoft antitrust action to have considered any technical evidence regarding the presumed complementarities of the Windows operating system, the Explorer browser, and Microsoft software that were the arguable justification for Microsoft's tying arrangements. More generally, judges or administrators are called upon to adjudicate upon technology with regard to patent disputes as a common judicial practice.

Respondents may claim that any court weakening of the strict *Sony* doctrine could create more uncertainty and therefore chill innovation. Three are five failings with this point. First, while a fact-based position would create uncertainty; to what degree this would actually chill innovation is unsubstantiated. As a general rule, innovations entail great uncertainty in several more immediate domains – potential market demand, financing ability, and managerial capacity. Second, government agencies often add great uncertainty by regulating innovations in order to enforce a higher public good (e.g., drugs, children's toys, occupational safety, power plant technology). Third, new institutions and technologies would emerge if a market for filtering were established; a potential market entity now under development is Snocap, an intermediary service (founded by Napster's original founder Shawn Fanning) that can provide filtering to any P2P provider.

Fourth, respondents may become more realistic negotiating partners once property rights are clearly established. At the present juncture, there is a general blinding rhetoric that avoids discussing the need for licensing content from a for-profit recording industry. It is not likely that the Court's current opinion will this change this perspective much.

Finally, the adjudicating standard that *Grokster* does admit – promotional intent engaged through common law – may add more legal uncertainty in the mind of a prospective software developer less technically equipped to judge common law standardsg. In this respect, Consumer Electronics Association President Gary Shapiro may have correctly characterized the new ambiguity of intent as a "full employment act for lawyers" who will be inevitably called in to construct and shepherd arguments regarding the additional

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[31] At http://www.eff.org/IP/P2P/MGM_v_Grokster/key_quotes.php (retrieved June 30, 2005)

legal issue of proving intent.[32] By forsaking a presumably murky design test for its clearer intent test, the Court actually might actually have put innovators on less firm ground.

Smith expresses well the nub of the problem; much like the original Napster, each file-sharing provider is caught in a Prisoner's Dilemma. That is any individual provider is made worse off by restricting access to copyrighted material, but the system in the long run may indeed be better off if all were to do so. The only apparent means of resolution is to impose a system of clear property rights upon all players simultaneously. If rights can be so asserted, new software providers will understand that the game does not revolve primarily around their ability to avoid showing intent. Rather, there are deeper issues of propriety and fiduciary support for investment that cannot be so readily skirted.

8. Conclusion

The content industries are now evolving into innovative systems that test new arrangements for production, distribution, and retailing. This rapid innovation – which implicates processes, relationships, business models, organizational structures, and methods of presentation -- involves the interaction of agents with limited information. The market is a means for managing the complexity of this system. The market enables a continual feedback that permits agents to learn more, correct course, and reconfigure their experiments.

In this regard, the potent and reactive forces unleashed and filtered in the market crucible will be weakened considerably if infringing services are permitted to preempt licensing space from rightful content owners and market space from new services. For its part, the government should not distort the outcome by unevenly taxing, subsidizing, or allowing takings in any chosen part of the market. For any asymmetric entitlement creates an uneven playing field and an outcome that may have little to do with actual costs or consumer preferences. If permitted to take copyrighted material, unrestricted P2P technologies will unavoidably kill in the cradle the birth and development of other significant noninfringing innovations -- new ideas, business models, relationships, and organizational structures -- that may actually have even greater appeal to some number of listeners. It is difficult to ignore the analysis of the present market by reciting a precedent from a previous Supreme Court decision.

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[32] "The immediate impact of today's ruling is twofold: massive uncertainty and the likelihood of massive legal bills. The Court has done little to provide a clear path for legitimate innovators and manufacturers to avoid lawsuits related to copyright infringement over legitimate products and services. With this ruling the Supreme Court has handed a powerful new tool to litigious content creators to stop innovation. Innovators must now consider new murky legal rules and potentially overwhelming legal costs before bringing their product to market - or even moving forward with an innovative idea. It is essentially a 'full employment act' for plaintiff's attorneys and a guarantee for further lawsuits. While the Court appears to have sought to narrowly tailor this decision to protect technological development and provide some guidance to promote innovation, the intent test established under this ruling stands as a heavy burden. Content creators may potentially find any act as an 'infringement to induce' and shut down a new product or service with the threat of a lawsuit. Who knows how many innovative products and services now face a premature death as the result of this ruling?" At http://www.eff.org/IP/P2P/MGM_v_Grokster/cea.php (retrieved July 1, 2005)

A market-based approach that combines private agencies, government administration, and judicial and legislative oversight should permit matters time to evolve and new information to surface. Market rules designed to meet specific emerging needs of individual players can potentially be open-ended enough to allow modification as more information becomes available. The incrementalist approach is purposely and wisely limited -- restricting considerations, limiting classifications, forsaking measurement, leaving options open, and learning-by-doing. Incrementalists then forsake the spectacular imagined gains from an immediate fix for the prosaic benefits of slow judgment and reversible errors.

APPENDIX: DOES FILE-SHARING SUPPRESS RECORD SALES?

On June 13, 2005, the Organization for Economic Co-operation and Development (OECD) released its *Report on Digital Music: Opportunities and Challenges*, which explores a number of issues related to the future of music.[33] The report is agnostic regarding the relationship between file-sharing and CD sales and seems to conclude that other factors -- the emergence of other forms of entertainment, changing demographics, declines in the number of releases, a growing inferiority of music product, and changing customer tastes – are possibly the real culprits behind the overall decline in CD sales in its 29 member countries.[34] In this respect, the OECD takes a position found among copyright opponents in the U.S., who often list these and other plausible sounding causes that cannot be reasonably measured or quantified.

However, a cross-sectional analysis of different OECD countries may be useful to shed some light on the correlation between record sales and broadband.[35] The three western European countries with the largest decline in record sales in 1999-2003 are Denmark (down 44.3%), Germany (-30.3%), and Belgium (-28.1%); the western European countries with the largest increase are the U.K. (up 32.2%), Australia (+18.1%), and Ireland (+9.1%). Here we actually have an interesting laboratory of diverse data points to test some relationships.

Surely these differences in business volume cannot occur because of differences in the number of releases; i.e., there is no reason to suspect that an album will be released in Ireland and Australia but not in Belgium or Denmark. Nor is it evident that these differences occur because Danes, Germans, and Belgians have migrated their entertainment dollars to alternative forms of digital entertainment that they found more appealing than had citizens of Australia, Ireland, and the U.K. Nor should the continentals be more readily turned off to new sounds coming out of the major labels and their foreign distributors.

Rather, the reason may be more pedestrian – broadband penetration is generally higher in Denmark (18.8%), Belgium (15.6%), and Germany (8.4%) than in U.K. (10.5%), Australia (7.7%), and Ireland (3.4%). By rapidly hastening the speed by which digital content can be downloaded on the internet, broadband is the primary enabling transmission mode for file-sharers. In 1999-2003, the music services had yet to ramp up to any significant degree; hence broadband was no correlate with their growing popularity. Therefore, if file-sharing has an effect upon record sales, it would seem to follow that *broadband penetration and the decline in sales might be correlated with one another*.

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[33] At http://www.oecd.org/document/46/0,2340,en_2649_201185_34994926_1_1_1_1,00.html (retrieved June 20, 2005)
[34] Id. 75-81.
[35] Id., Annex 3, Table 3.2.

The below chart derives the results of a statistical test derived from OECD data on the decline in record sales in 1999-2003 and broadband penetration in 2004. [36]Column 1 lists the countries in the OECD in alphabetical order. Column 2 lists the percent change in CD sales in each in the years 1999-2003. . Column 3 ranks the countries by the size of their drop in Column 2. Column 4 lists the penetration of broadband in each country in the year 2004; Column 5 lists the corresponding rank.

Columns 6 and 7 are diagnostic columns useful in a statistical test. Column 6 is the difference in the ranks, while Column 7 is that difference in rank squared. The SUM of squares in column 7 is 1966 . The test statistic, termed a Spearman rank correlation coefficient, is estimated:from this sum and the sample size N (= 29): STATISTIC = 1 – 6 * SUM/[N^3 - N]

The statistic is significant at 5%. This means that we can accept -- with no more than 5 percent chance of error – the hypothesis that an *increase in broadband penetration and decline in CD sales are correlated with one another.*

[36]Broadband numbers for the OECD are found at http://www.oecd.org/document/60/0,2340,en_2825_495656_2496764_1_1_1_1,00.html#timeseries (retrieved June 23, 2005).

Country	S	% ch. Sales	Rank	% Pen. BB	Rank	Rank Diff	Diff. Sqrd.
Australia		18.08	26	7.7	20	6	36
Austria		-20.56	9	10.2	15	-6	36
Belgium		-28.13	4	15.6	7	-3	9
Canada		-26.15	6	17.8	5	1	1
Czech		-19.05	11	1.6	25	-14	196
Denmark		-44.32	1	18.8	3	-2	4
Finland		2.97	23	15	9	14	196
France		6.6	24	10.6	13	11	121
Germany		-30.29	3	8.4	16	-13	169
Greece		-5.8	18	0.4	29	-11	121
Hungary		-5.71	19	3.6	22	-3	9
Iceland		-11.11	15	18.3	4	11	121
Ireland		9.09	25	3.4	23	2	4
Italy		-7.65	16	8.1	19	-3	9
Japan		-22.31	8	15	8	0	0
Korea		-24.27	7	24.9	1	6	36
Mexico		1.13	22	0.8	27	-5	25
Netherlands		-26.57	5	19	2	3	9
New Zealand		-4.17	20	4.7	21	-1	1
Norway		-11.64	14	14.9	10	4	16
Poland		-43.89	2	2.1	24	-22	484
Portugal		-14.73	12	8.2	18	-6	36
Slovak		40	28	1.1	26	2	4
Spain		-6.42	17	8.4	17	0	0
Sweden		-0.42	21	14.5	11	10	100
Switzerland		-14.29	13	17.3	6	7	49
Turkey		125.53	29	0.7	28	1	1
U.K.		32.22	27	10.5	14	13	169
U.S.A		-20.11	10	12.8	12	-2	4
SUM							1966
SPEARMAN							**0.51576355**

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Michael A. Einhorn (mae@mediatechcopy.com, http://www.mediatechcopy.com) is an economic consultant and expert witness active in the areas of intellectual property, media, entertainment, damage valuation, licensing, antitrust, personal injury, and commercial losses. He received a Ph. D. in economics from Yale University. He is the author of the book *Media, Technology, and Copyright: Integrating Law and Economics* (Edward Elgar Publishers), a Senior Research Fellow at the Columbia Institute for Tele-Information, and a former professor of economics and law at Rutgers University. He has published over seventy professional and academic articles and lectured in Great Britain, France, Holland, Germany, Italy, Sri Lanka, China, and Japan.

In the technology sector, Dr. Einhorn worked at Bell Laboratories and the U.S. Department of Justice (Antitrust Division) and consulted to General Electric, AT&T, Argonne Labs, Telcordia, Pacific Gas and Electric, and the Federal Energy Regulatory Commission. He has advised parties and supported litigation in matters involving patent damages and related valuations in semiconductors, medical technologies, search engines, e-commerce, wireless systems, and proprietary and open source software.

Litigation support involving media economics and copyright damages has involved music, movies, television, advertising, branding, apparel, architecture, fine arts, video games, and photography. Matters have involved Universal Music, BMG, Sony Music Holdings, Disney Music, NBCUniversal, Paramount Pictures, DreamWorks, Burnett Productions, Rascal Flatts, P. Diddy, Nelly Furtado, Usher, 50 Cent, Madonna, and U2.

Matters involving trademark damages have included the Kardashians/BOLDFACE Licensing, Oprah Winfrey/Harpo Productions, Madonna/Material Girl, CompUSA, Steve Madden Shoes, Kohl's Department Stores, *The New York Observer*, and Avon Cosmetics. Matters in publicity right damages have involved Zooey Deschanel, Arnold Schwarzenegger, Rosa Parks, Diane Keaton, Michelle Pfeiffer, Yogi Berra, Melina Kanakaredes, Woody Allen, and Sandra Bullock.

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