

INTELLECTUAL PROPERTY UPDATE

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The Likely Impact of *MGM v. Grokster* (and an Australian Echo) on Technology Companies

The recent unanimous Supreme Court decision in *MGM v. Grokster* adds to our understanding of secondary liability under copyright law. But does it really strike the right balance between copyright protection and innovation?

The Court in *Grokster* considered whether companies that distribute software allowing computer users to share files through peer-to-peer networks should be held indirectly liable for copyright infringement occurring by use of that software. The peer-to-peer networks enabled by the software allow the user computers to communicate directly with each other. In particular, users locate a work on another's computer and cause a copy of the work to be made (downloaded) by transmission from one user computer to another. The software providers did not participate directly in any acts of infringement. However, they marketed and distributed the software.

There are two generally recognized types of secondary or indirect infringement: contributory infringement and vicarious infringement. Contributory infringement occurs when a party intentionally induces or encourages

direct infringement. Vicarious infringement occurs when a party profits from direct infringement while declining to exercise a right to stop or limit the infringement. The *Grokster* decision has its basis in contributory infringement and borrows the standard of active inducement from patent law.

The appellate decision below had granted the software distributors summary judgment based on *Sony Corp. v. Universal City Studios*, 464 U.S. 417 (1984). The Supreme Court's opinion characterized Sony as follows:

Sony's rule limits imputing culpable intent as a matter of law from the characteristics or uses of a distributed product. But nothing in *Sony* requires courts to ignore evidence of intent if there is such intent.

Thus, the Court signaled that it was not basing its decision solely on product capabilities as in *Sony*.

For a party to be liable for third party infringement under *Grokster*, two elements must be shown. First, there must be intent to bring about infringement. Knowledge alone that

infringement is occurring, however, is insufficient to find active inducement. Instead, there must be "purposeful, culpable expression and conduct." As Justice Souter writes in the opinion: "Proving that a[n inducing] message was sent out [by the alleged infringers], then, is the preeminent but not exclusive way of showing that active steps were taken with the purpose of bringing about infringing acts, and of showing that infringing acts took place by using the device distributed." Second, there must be evidence of actual infringement. In *Grokster*, the Court found "evidence of infringement on a gigantic scale."¹

The Court's opinion in *Grokster* focuses on three "particularly notable" features of the intent evidence. First, the respondents (*Grokster* and *StreamCast*) were attempting to satisfy a demand for copyright infringement. Both respondents had sent e-mails to former *Napster* users inviting the users to try out the *Grokster* software. Second, neither respondent attempted to develop filtering tools or other mechanisms to diminish the infringing activity. In fact, *StreamCast* had actually turned down offers from companies who were developing software that would filter

out copyrighted content. Finally, the respondents made commercial gain on advertising revenue by keeping the use of their software at high volume levels. The Court was careful to note that only the first feature on its own would be sufficient to infer intent to induce infringement. The second two elements can only be used to find intent to induce when viewed in context with other elements.

In general, the Court left untouched the standard set by the influential *Sony* decision. As noted in an amicus brief submitted by law professors in favor of *Grokster*, the *Sony* standard has been very amenable to summary judgment and has prevented confusion and instability in copyright.² The law professors were concerned that any reworking of *Sony* or any new standard introduced could become unwieldy and could lead to unpredictable results. The concurring opinion of Justices Breyer, Stevens and O'Connor, while not questioning the main holding, thoughtfully addresses the issue raised by a possible modification or strict interpretation of *Sony*. It thereby reveals the importance of the current *Sony* rule for protecting technology innovation and the difficult questions raised by any changes to it. In particular, the concurring opinion states that *Sony*'s "clarity allows those who develop new products that are capable of substantial non-infringing use to know, *ex ante*, that a distribution of their product will not yield massive monetary liability."

Even with the *Sony* rule preserved, technology developers must proceed with caution under the new framework

for secondary liability represented by *Grokster*. Certainly, the marketing program and other messages to users will need to be free of suggestions or directions encouraging infringement. But the concern remains that, during lawsuits, opposing parties will conduct extensive discovery to find any evidence, no matter how small, that shows some intent to infringe. Such intent would always arguably be present if a product distributor is aware that infringement is occurring and that the ability to infringe is one attraction of the product. This awareness can become complicated by doubt as to what is "fair use." Another concern is that courts, having seen some evidence of intent, will move on to consider the difficult question of whether a product could be supplemented "with filtering tools or other mechanisms to diminish the infringing activity." As Justice Breyer's concurring opinion argues, it is difficult for a court to balance evidence on the extent to which such tools are truly available and should be part of the duty of the designer and/or distributor. If a court requires such measures, this in effect forces additional product development – but for the benefit of copyright holders, not users. The statements in *Grokster* about when and how a court should consider evidence similar to the second and third categories of evidence it considered "notable," but insufficient in themselves, will have increased importance.

A September 5, 2005 decision from the Federal Court of Australia (*Universal Music Australia Pty Ltd v. Sharman License Holdings Ltd*) shows

dramatically how a court decision may be affected by the availability of technology that is capable of diminishing infringing activity. In a 138 page decision, the court spent over 30 pages discussing evidence on available "Technological controls." Exhibiting none of Justice Breyer's reticence, the court issued an injunction against the Kazaa file sharing system that was at issue, but in its order stated that the system would not be regarded as violating the injunction if the system were modified in certain ways. One way was to include certain keyword filtering technology that would use lists of copyrighted works provided periodically by copyright owners and would exclude the sharing of a copy of any identified copyrighted work. While the Australian case clearly has no force as precedent in the U.S., it certainly shows U.S. judges that a remedy might be fashioned that would put the judge in the position of product designer.

More importantly, the effect of a remedy such as the one in Australia is to alter the playing field against which *Sony* was decided. In effect the Australian court is looking beyond the substantial non-infringing use of the product to address the admittedly infringing uses. It is saying that the infringing uses must be effectively stopped, largely at the product maker's obligation and expense, in order for the product to be acceptable. It is unclear if this would be required in all cases (for all products with an infringing use), or just in those cases where additional facts of contributory or inducing infringement are found.

The Authors

Stuart Hemphill

Minneapolis
612.340.2734
hemphill.stuart@dorsey.com

A partner in the Intellectual Property group, Stuart practices in the area of intellectual property, including acquisition and evaluation of patent, trademark, copyright and trade secret rights; licensing or other transfers of technology and intellectual property rights, particularly for computer hardware and software businesses, publishing businesses; and litigation concerning intellectual property rights and unfair competition.

Paul Mussell

Minneapolis
612.492.6853
mussell.paul@dorsey.com

An associate in the Trademark, Copyright & Brand Management group, Paul's practice focuses on U.S. and international trademark clearance and enforcement. Additional practice areas include copyright registration, trademark licensing, portfolio management, and domain name acquisition and enforcement.

Jeff Cadwell

Minneapolis

Jeff was a 2005 summer associate at Dorsey. He attends Santa Clara University School of Law, where he expects to receive his J.D. in 2006. He will join Dorsey as an associate in 2006.

Conclusion

A key factor in many new computer products is the ability to "move" information to new locations for storage and /or performance (display or listening). Where the works moved are copyrighted and all or a substantial portion of the work is involved, absent fair use or authorization, an act of infringement may occur (because the original copy persists). Technology developers and their investors need to make decisions based on the *Grokster* opinion. They are now forewarned that evidence of overt intent to encourage infringement will lead to a costly and possibly losing battle over the legitimacy of a product that enables electronic files to be reproduced and/or transmitted.³ The Australian decision, adds another concern, suggesting that judicial decisions will lead technology companies to modify product designs. While the *Grokster* decision shows a

shifting and new clarity in the minds of the Supreme Court Justices on this issue, it remains to be seen how the balance in the risk-reward analysis in the minds of technology developers and investors will be altered. Society needs the contributions of both copyright creators and technology innovators. We should hope that neither is strongly deterred from its creative efforts by the rebalancing of risks in *Grokster*.

- 1 In fact, both respondents conceded that most of the files downloaded using their software were copyrighted files.
- 2 Br. of *Amici Curiae* Intellectual Property and Technology Law Professors at 2-3, available at http://www.eff.org/IP/P2P/MGM_v_Grokster/.
- 3 For some protected files, they must also consider the implications of the Digital Millennium Copyright Act, which, among other provisions, forbids circumventing technological measures used to protect copyrighted works.

For further information regarding our intellectual property law practice, please contact any group leader.

Trademark, Copyright & Brand Management Group

Elizabeth Buckingham, Minneapolis
612.343.2178
buckingham.elizabeth@dorsey.com

Patent Group

Lee Osman, Denver
303.629.3434
osman.lee@dorsey.com

IP Litigation Group

Peter Lancaster, Minneapolis
612.340.7811
lancaster.peter@dorsey.com

Tucker Trautman, Denver
303.629.3409
trautman.tucker@dorsey.com

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Toni Byard, Minneapolis
612.340.7824
byard.toni@dorsey.com

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Dorsey & Whitney LLP
Suite 1500
50 South Sixth Street
Minneapolis, MN 55402-1498