

MGM v. Grokster: The Supreme Court Showdown

The U.S. Supreme Court is currently considering the potential liability of providers of peer-to-peer file-sharing software for copyright infringement. The attention MGM v. Grokster has garnered in both legal and mainstream media reflects the high stakes involved, as the IT and entertainment industries both anxiously await the Court's decision.

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Over twenty years ago, the U.S. Supreme Court in *Sony v. Universal*, 464 U.S. 417 (1984) (“*Betamax*”) established the principle that a device manufacturer is not liable for contributory copyright infringement if the device is capable of a substantial noninfringing use. Today, the scope of *Betamax*’s safe harbor is front and center as the Court reviews the Ninth Circuit’s controversial decision in *MGM v. Grokster*, 380 F.3d 1154 (9th Cir. 2004). The central question is how the “*Betamax* Rule,” forged in the era of the video tape recorder, should apply to today’s digital network technology.

The *Betamax* Rule

Under U.S. copyright law, a person who knowingly makes a material contribution to another’s copyright infringement is liable for that infringement. The Supreme Court in *Betamax* fashioned an exception from that rule: the sale of copying equipment does not constitute contributory infringement if the product is merely capable of commercially significant noninfringing uses. The legal certainty provided by this standard has been critical to the development of the IT industry in the U.S., encouraging investment in technologies such as PCs, MP3 players, and the Internet.

The *Grokster* Controversy

The entertainment industry, defeated in *Betamax*, has more recently declared war on peer-to-peer (P2P) software that allows users to share files with others over the Internet. Its latest battle, *MGM v. Grokster*, has landed on the steps of the Supreme Court.

In *Grokster*, the Ninth Circuit affirmed its earlier decision in *A&M Records v. Napster*, 239 F.3d 1004 (9th Cir. 2001), which had taken a step back from the bright line drawn in *Betamax*. Rather than finding that *Betamax* provided a complete defense to contributory liability, the Ninth Circuit held in both cases that the existence of a substantial noninfringing use for a product meant only that “constructive knowledge” of infringement could not be presumed. While the *Napster* defendants were found to have actual knowledge of and ability to block infringing material, *Grokster*’s software allows users to search other users’ computer directly, without relying upon a central server. Based on this technological difference, the court found the *Grokster* defendants did not

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have actual knowledge of infringing material on their system at a time they could do anything about it.

This rationale differed from the Seventh Circuit's even narrower reformulation of *Betamax* in another P2P case, *In re Aimster*, 334 F.3d 643 (7th Cir. 2003), *cert. denied*, 540 U.S. 1107 (2004). In *Aimster*, Judge Posner adopted a complex balancing test that looks at an "estimate of the respective magnitudes" of the infringing and noninfringing uses. If the infringing uses are substantial, "to avoid liability as a contributory infringer the provider of the service must show that it would have been disproportionately costly for him to eliminate or at least substantially reduce the infringing uses."

The Supreme Court Briefing

Pointing to this circuit conflict, the entertainment industry (songwriters, music publishers, record companies and motion picture studios) successfully petitioned the Supreme Court to hear its appeal from the *Grokster* decision. By the time *Grokster* was fully briefed by the parties, the Supreme Court saw the filing of 55 *amicus* (friend of the court) briefs: 23 supporting the petitioning entertainment industry, 25 supporting the responding *Grokster*, and 7 in support of neither party. The diversity of both the interests represented and the views presented is indicative of the potentially far reaching effect of the Court's ruling.

Round One

Among the initial briefs filed by Petitioners and *amici* supporting Petitioners (or neither party), five interpretations of *Betamax* emerged.

- **Primary Noninfringing Use.** The petitioning motion picture and recording industries and several entertainment industry *amici* (e.g., the collection societies ASCAP and BMI) argued that the *Betamax* safe harbor applied *only if* lawful uses predominate over unlawful uses, *i.e.*, only if a majority of actual uses were noninfringing.
- ***Aimster*.** Petitioning songwriters and a few *amici* (e.g., the major sports leagues) appeared to support *Aimster*'s interpretation that liability attaches if there are substantial infringing uses *and* the provider of the technology fails to implement available means to block infringement that are not disproportionately costly. Several *amici* (e.g., Snocap) argued that filtering technology already exists that could reduce infringement without interfering with legitimate uses of P2P software.
- **Plain Language.** Trade association *amici* representing technology companies (e.g., Digital Media Association and NetCoalition) argued that "capable of substantial noninfringing use" means exactly that: "if there exists a reasonable possibility that there will be substantial current or future use of a technology for noninfringing activities, the provider of the technology is not secondarily liable."

This interpretation recognizes that current or future noninfringing uses might well be well the minority of actual uses.

- **Willful Blindness.** Several *amici* (e.g., the National Association of Broadcasters) argued that the *Betamax* defense should not apply when a provider took affirmative acts to evade responsibility for infringement or had actual knowledge of the infringing activity and profited from it.
- **Sliding Scale.** The U.S. Solicitor General advocated determining liability based on the amount of infringement. At one extreme, liability should attach when a technology is overwhelmingly used for infringing purposes and the commercial viability of the product depends on these unlawful uses. Conversely, there should be no liability if the primary use of the product is noninfringing. In between these extremes – when infringing uses are predominant but not overwhelming – a court should consider “subsidiary indicia,” such as what steps the seller could have taken to eliminate infringement.

Despite their different interpretations of *Betamax*, these entities all assumed that *Betamax* was good law that applied to the case. Several prominent law professors and economists, however, argued that *Betamax* was wrongly decided, or at the very least should be limited to its facts. In its place, these *amici* urged the Court to adopt a comprehensive balancing test or to perform a cost-benefit analysis regarding design choices.

The first round of briefing also addressed two other theories of liability: vicarious liability and active inducement. Under U.S. copyright law, a person who receives a direct financial benefit from infringing activity that he has the right and ability to control is vicariously liable for the infringement. The Business Software Alliance and the American Intellectual Property Law Association argued that *Betamax* provides a defense to vicarious liability as well as contributory infringement; Kids First and the Christian Coalition argued the opposite. A brief filed by 40 state attorneys general suggested that the ability to redesign a product to prevent infringement satisfies the “right and ability to control” prong for vicarious liability because a provider can control misconduct that it can reasonably foresee and which it can reasonably combat with available technology.

The concept of active inducement gained attention in the U.S. during the summer of 2004, when Senators Hatch and Leahy introduced the Inducing Infringements of Copyrights Act, which mimicked the active inducement provision of the Patent Act. Although the bill died with the end of the Congressional session in December 2004, the discussion continued before the Supreme Court. Many first round briefs asserted that certain conduct that induces infringement falls outside of the scope of the *Betamax* defense and should expose the technology provider to liability. There was little agreement, however, concerning the type of conduct that should trigger such liability.

Several of the technology associations advocating a plain language reading of *Betamax* (e.g., the Business Software Alliance) asserted that a provider could incur liability for acts *other than the design and distribution of the technology* that encouraged

infringement. For example, instructing a subscriber on how to use the technology to engage in specific acts of infringement could lead to inducement liability. Petitioners and entertainment *amici* argued more broadly that if a provider engaged in a *pattern* of encouraging or assisting infringement, *including* designing and distributing a technology with certain infringing functionalities, liability could attach. In the same vein, various *amici* (e.g., the National Association of Recording Merchandisers) argued that a business model based on encouraging mass infringement should lead to liability.

Round Two

In general, the briefs filed in Grokster's round were far more consistent with one another than the Petitioners' briefs. Rather than endorsing the Ninth Circuit's peculiar interpretation of *Betamax*, the Respondents and their *amici* universally adopted a plain language interpretation of the "capable of substantial noninfringing use" rule. They then argued that:

- A plain language interpretation of *Betamax* is good for innovation, free expression, democracy, and education;
- The plain language interpretation of the *Betamax* rule is consistent with international copyright law;
- Other interpretations advanced by Petitioners and their *amici* have no basis in law;
- The other interpretations would harm innovation and free expression;
- Using rigorous economic analysis rather than anecdotal evidence, the overall harmful impact of P2P software is far from clear; and
- Reinterpreting *Betamax* would have little positive impact on unlawful P2P uses, while it will have a significant negative impact on lawful file sharing.

After asking the Court to respect *stare decisis* and not overturn or modify the *Betamax* rule, Respondents and their *amici* argued that because Grokster's software, and P2P software generally, is capable of substantial noninfringing uses, the Ninth Circuit's decision should be affirmed. A group of law professors also questioned the underlying assumption that file trading constituted infringement in the first instance. They argued that in all the P2P cases, no direct infringers had been named as defendants and thus the issue of whether file trading was infringement had never been fully explored.

With respect to inducement and vicarious liability, Respondents and some *amici* argued that only Congress has the institutional competence and the legal ability to modify and expand principles of secondary copyright liability. A few *amici* (e.g., the Consumer Electronics Association) argued that the inducement liability advocated in the first round did not exist under current copyright principles. Other *amici* (e.g., Intel) argued that even if such a theory did exist, Grokster's allegedly inducing acts all related to earlier software releases still before the district court.

Numerous *amici* (e.g., the U.S. Telecommunications Association) asserted that *Betamax* provided a defense to vicarious liability. Others rejected the argument that the ability to redesign constitutes the “right and ability to control” infringement. A group of computer scientists also observed that existing filtering technologies are easily circumvented and thus would have little impact on infringement.

Round Three

In their reply briefs, the entertainment industry petitioners contended that “capable” in *Betamax* “might be best understood as referring to those situations in which a product or service has not yet been brought to market at all, and thus is not in wide use for any purpose. In that narrow set of circumstances, it may be appropriate to consider whether the product *will* be *widely* put to such use when introduced.” They also stressed that their only target was the business model built on infringing uses of P2P technology, not the technology itself, and that Grokster continued to expand a network used for mass infringement while knowing “to a moral certainty” that virtually every new user was joining for the same illegitimate purpose. The petitioning songwriters argued that the lower courts had never interpreted *Betamax* as the bright line, plain language rule advocated by Respondents and yet the technology industry had still managed to prosper.

The Big Show: Oral Argument

Oral argument before the Supreme Court was held on March 29, 2005. The argument focused on two issues: the proper interpretation of *Betamax*’s “capable of substantial noninfringing use” rule and active inducement liability. Despite extensive vetting in the briefs, there was *no* discussion of vicarious liability and Judge Posner’s *Aimster* decision was mentioned only in passing.

Counsel for the entertainment industry argued that (1) a company should be liable for contributory infringement if its business was substantially related to infringement and (2) whether a business was substantially related to infringement should turn on the proportion of infringing to noninfringing uses. Grokster was an easy case, counsel argued, because the vast majority of uses were infringing. Justices Breyer, Souter, and Scalia all expressed concern that this standard could have a chilling effect on innovation. Justice Breyer noted that the inventors of the photocopier, the VCR and the iPod could all foresee a large number of infringing uses of their device. Justice Scalia wondered how much time a company would have for the lawful uses of its product to outweigh unlawful uses. Justice Souter also asked whether it would be possible for an inventor to know in advance whether he would be liable: “How do you give the inventor the confidence to go ahead?”

Justices Scalia and Souter pursued the same line of questioning with the Solicitor General, who argued in support of the entertainment industry. Justice Scalia speculated that perhaps a developer should be given 10 years to demonstrate substantial noninfringing uses. Justice Souter suggested a “flexible ripeness doctrine” in which cases could be dismissed if they were brought too early in a technology’s life cycle. The

Solicitor General replied that the Court should consider a standard that is more forgiving of new technologies than mature ones, such as P2P software.

Grokster's counsel argued that *Betamax* provided a bright line rule that was easily satisfied here because its P2P technology is capable of many noninfringing uses. Justice Ginsburg responded that the *Betamax* holding could not be reduced to one sentence. Justice Scalia added that "[t]his Court is certainly not going to decide this case based on *stare decisis*," suggesting that the Court was not bound by its *Betamax* precedent (observers disagree whether Justice Scalia was joking with this comment; it seems likely he was). Justice Breyer observed that the technology industry has relied on *Betamax* since 1984, with good results. Justice Kennedy, conversely, expressed concern that unlawfully expropriated property could be used as part of the start-up capital for a new product. Grokster's counsel replied that *Betamax* is the best policy balance the Court can strike.

The Court also explored the active inducement theory of secondary liability in some depth. Close to the beginning of the argument, Justice O'Connor specifically asked whether this case could be resolved solely by considering inducement, without reaching the *Betamax* question. In other words, if the Court found that Grokster induced infringement, would it need to consider whether its software was capable of substantial noninfringing uses? Counsel for the entertainment industry agreed that Grokster was liable as an active inducer, but urged the Court to clarify *Betamax* as well. He posited that in the future, companies would be more careful not to leave the paper trail Grokster had, making it impossible to prove inducement. For these future cases, counsel argued, the Court should clarify that *Betamax* does not provide a free pass to build businesses based on infringement.

Grokster's counsel raised a complicated procedural argument with respect to inducement, noting that the allegedly inducing conduct all occurred in connection with earlier software releases and that the summary judgment order on appeal concerned only the current version of the software. Because issues relating to the earlier releases are still before the district court, counsel argued that the Court could only decide whether the distribution of the current version of the software is infringing, *i.e.*, the *Betamax* issue. Grokster's counsel further argued that distribution of the current software could not be enjoined as a remedy for alleged unlawful conduct associated with earlier releases – that the only remedy available would be damages. Justice Souter in particular had difficulty accepting that there was no causal relationship between inducement relating to earlier releases and distribution of the current releases.

Predictions

It is difficult, of course, to predict what the Supreme Court will do based on one hour of oral argument. However, the limited range of issues discussed during that one hour is good news for technology companies. Judge Posner in *Aimster* interpreted *Betamax* as imposing liability on a technology company if the company could have designed the product differently to reduce infringement. Likewise, the entertainment industry argued in its briefs that a company has the right and ability to control infringing

activity if it has the ability to redesign its product to prevent infringement. The absence of discussion of either concept suggests that the Court is not seriously considering holding a technology company responsible for failing to design its product differently.

Additionally, the Justices appeared keenly aware that a dramatic recalibration of the *Betamax* rule could have a serious negative impact on technological development. Several Justices seemed receptive to an evolving standard. Before a product is released on the market, the term “capable” would be broadly interpreted because the developer would have no way of predicting the future balance between infringing and noninfringing uses. Once the market is mature, the term “capable” would be defined more narrowly; if a company was aware that the vast majority of actual uses were infringing, it could not reasonably argue that a substantial portion of future uses were likely to be noninfringing. While preferable to *Aimster*’s interpretation, this flexible standard is still problematic for emerging technology. A lawful product could, for example, become an illegitimate product after several years on the market, for reasons completely beyond the manufacturer’s control.

The Justices also seemed interested in an active inducement theory of liability. Given *Grokster*’s peculiar posture, the Court has several procedural options for applying inducement to the facts before it, but far more important is the substantive issue of how the Court would define active inducement. A broad definition could be problematic for the technology industry, raising the same concerns of impeding innovation as would a narrowing of *Betamax*. Alternatively, the Court might simply acknowledge the existence of inducement liability and leave it to the lower courts to determine its contours on a case-by-case basis.

Conclusion

The Court probably will decide *Grokster* before it adjourns at the end of June. The decision will have enormous consequences for the entertainment and technology industries, and the losing side almost certainly will seek redress from Congress.