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Search. Download. Share. But don't authorise infringement: Universal Music v Sharman

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The peer-to-peer (P2P) file sharing community is no longer the safe haven it once thought it was.

On 5 September 2005, Justice Wilcox of the Federal Court of Australia delivered a judgment¹ which has been hailed by the music industry and copyright owners alike as a "victory for common sense".² The landmark decision stands as one of the most important copyright decisions in recent times and turns on its head the widely held misconception within the internet industry that P2P file sharing systems are an unregulated phenomenon existing beyond the reach of Australian copyright law.

Kazaa

The case concerned a P2P file sharing system known as Kazaa. The system was operated out of premises in Sydney and was made available to users free of charge. It enabled one user to share files with other users by placing the files in a folder called "My Shared Folder". A user interested in obtaining a copy of a particular sound recording could use the Kazaa Media Desktop (KMD) software to search the "My Shared Folder" of other users on the network. Once a particular work was located, it could be downloaded through the KMD onto the user's computer or other hardware.

Upon issuing a search request, a user would be presented with two types of search results:

- "blue files" (being files made available by other users on the network free of charge through their "My Shared Folder" and which were often infringing copies of sound recordings); and
- "gold files" (being files requiring payment before they could be accessed and which were claimed to be properly licensed).

At the time the judgment was

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delivered, the Kazaa system was the most popular P2P file sharing system on the internet. At the beginning of 2004, the Kazaa website claimed that it had over 317 million users worldwide - a number which, as Justice Wilcox put it, "equates to about 5% of the world's human population".³

The sheer popularity of the Kazaa system, and the volume of traffic going through it, made it apparent to the Court that the system was harbouring copyright infringement on a massive scale.

The music industry fights back

Some 30 Australian and international record companies (including Sony BMG, Universal, Warner, EMI and Festival Mushroom) took action against the owners and operators of the Kazaa system.⁴ Action was taken on several grounds⁵ but the primary issue to be decided by the Court was whether the respondents were liable for authorising copyright infringement under the authorisation provisions of the *Copyright Act 1968 (Cth) (Act)*.

The Court ruled that six out of the ten respondents⁶ were liable for infringing copyright by:

- authorising users of the Kazaa system to make copies of sound recordings; and
- authorising the communication by Kazaa users of sound recordings to the public,

in each case, without a licence from the copyright owner.

The decision comes not long after the US Supreme Court decision in *MGM Studios v Grokster*,⁷ which also considered P2P file sharing. In that case, Grokster was held to have induced copyright infringement by distributing its software "with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement".⁸ Although this case was not relied upon in the Kazaa judgment, there are certainly similarities in terms of the outcome of both cases, and it may not be too far a stretch to say that there is a

growing tendency by courts to find entities that encourage file sharing liable for promoting or authorising copyright infringement.

The law on authorisation

A number of provisions of the Act were relevant to deciding the case.

The rights of a copyright owner in a sound recording are enshrined in section 85(1) of the Act. It states that a copyright owner in a sound recording has the exclusive right to do all or any of the following acts:

- (a) to make a copy of the sound recording;
- (b) to cause the recording to be heard in public;
- (c) to communicate the recording to the public;
- (d) to enter into a commercial rental arrangement in respect of the recording.

Under section 101(1), such copyright:

is infringed by a person who, not being the owner of the copyright, and without the licence of the owner of the copyright, does in Australia, or authorises the doing in Australia of, any act comprised in the copyright.

In particular, the Court considered section 101(1A) of the Act (which was introduced by the *Copyright Amendment (Digital Agenda) Act 2000*), which sets out certain factors to be taken into account when determining whether a person has authorised copyright infringement. These factors are:

- (a) the extent (if any) of the person's power to prevent the doing of the act concerned;
- (b) the nature of any relationship existing between the person and the person who did the act concerned; and
- (c) whether the person took any other reasonable steps to prevent or avoid the doing of the act, including whether the person complied with any relevant industry codes of practice.

It should be noted that this list of

factors is not exhaustive and the Court can take into account other factors which it considers relevant.

In exercising its right to consider other factors, the Court turned to the definition of "authorise" as used in section 101(1) of the Act and drew upon Justice Gibbs' conclusion in *University of New South Wales v Moorhouse*⁹ that the word "authorise" ought to be given its dictionary meaning of "sanction, approve, countenance".¹⁰ Further, the Court agreed with Justice Gibbs that the act of sanctioning, approving or countenancing does not necessarily require any express or formal permission to be given in respect of an infringing act. On the contrary, "inactivity or indifference, exhibited by acts of commission or omission, may reach a degree from which an authorisation or permission may be inferred".¹¹

The Court then considered the application of section 112E of the Act. This section operates as an exception to section 101 of the Act. It states:

"A person (including a carrier or a carriage service provider) who provides facilities for making, or facilitating the making of, a communication is not taken to have authorised any infringement of copyright in an audio-visual item merely because another person uses the facilities so provided to do something the right to do which is included in the copyright."

The Court found that the owner of the Kazaa system was a person to whom this exception might apply because:

- it was a person;
- it provided P2P facilities;
- the P2P facilities were "for making, or facilitating the making of a communication" (i.e. an internet file sharing transaction); and
- the P2P facilities were used by other persons to infringe copyright.

The Court went on to say:¹²

"If the most that can be said

against Sharman [i.e. Sharman Networks Ltd, the owner of the Kazaa system] is that it has provided the facilities used by another person to infringe copyright, Sharman is not to be taken to have authorised infringement.”

However, upon an analysis of the facts and following consideration of a number of factors (including those set out in section 101(1A) of the Act), the Court determined that "something more" could be said of Sharman. In the Court's view, Sharman had transgressed beyond being a mere facilitator and was, therefore, liable for authorising copyright infringement.

When does a facilitator of copyright infringement become an authoriser of copyright infringement?

This question was central to determining the liability of the respondents.

The Court based its decision on a number of findings of fact. It looked at:

- the respondents' knowledge of copyright infringement;
- the respondents' active encouragement of copyright infringement;
- the ineffectiveness of certain website warnings and disclaimers;
- the respondents' ability to curtail the infringements;
- the financial interests of the respondents; and
- the nature of the P2P technology.

Knowledge of copyright infringement

The Court found that each of the respondents had knowledge that a predominant use of the Kazaa P2P system was the transmission of copyright material. This knowledge was evident from the sheer volume of people using the Kazaa system. The Court said:¹³

“I do not doubt that some people

use Kazaa only in a non-infringing way. However, it seems unlikely that the non-infringing uses would sustain the enormous Kazaa traffic claimed by the respondents. The explanation of that volume of traffic must be a more populist use.”

This observation was supported by the results of a commissioned focus group study into the perception of users of the Kazaa system (which was, somewhat ironically, commissioned by one of the respondents¹⁴). The results of this study were submitted as evidence during the trial. According to the results, the general perception amongst the public was that the Kazaa system was thought of as "a free music downloading search engine".¹⁵ Having considered the findings of the study, the Court concluded:¹⁶

“Nobody could read the Syzygy report without realising that, in May 2003, Kazaa was being predominantly used for music file-sharing. A reader who had even a general understanding of copyright law would also have realised this necessarily involved copyright infringement on a massive scale.”

Whilst knowledge (or lack of knowledge) was considered an important factor in determining whether a person has authorised an infringement, the Court was careful to stress that "mere knowledge is not enough".¹⁷ In this regard, it relied on the words of Justice Sackville in *Nationwide News Pty Ltd v Copyright Agency Limited*¹⁸ where His Honour said:¹⁹

“Nonetheless, a person does not authorise an infringement merely because he or she knows that another person might infringe the copyright and takes no step to prevent the infringement.”

The Court found that, in addition to having knowledge of the infringements taking place, Sharman had taken active steps to encourage infringement.

Active encouragement of copyright infringement

The Court identified a number of

positive acts which Sharman had undertaken which had the effect of encouraging copyright infringement. These acts included:

- the promotion on Sharman's website of Kazaa as a file sharing facility;
- Sharman's exhortations to users to use the facility and share files; and
- Sharman's promotion of the "Join the Revolution" movement, which encouraged file sharing and scorned the attitude of record companies in relation to works protected by copyright.

In respect of the latter act, the Court made the following comment:²⁰

“Especially to a young audience, the 'Join the Revolution' website material would have conveyed the idea that it was 'cool' to defy the record companies and their stuffy reliance on their copyrights.”

These acts, coupled with the finding that Sharman knew copyright infringements were taking place, were significant factors in assisting the Court to reach its verdict. Interestingly, these acts may also have been likely to satisfy the test set out in the *Grokster* case (had that test been applied in the present case) in that they manifested "a clear expression or other affirmative steps taken to foster infringement".

Website warnings and the End User Licence Agreement (EULA)

In its defence, Sharman sought to rely on the notices which appeared on the Kazaa website warning users against the sharing of copyright files. One such example was a notice that Sharman does not "condone activities and actions that breach the rights of copyright owners" (albeit that such notice appeared in small print on the website). Sharman also sought to rely on the fact that its users were made to click a box whereby they agreed to be bound by the EULA, which contained (amongst other things) terms requiring them not to infringe copyright.

The Court dismissed both of these measures, claiming that they were

completely ineffective in preventing or curtailing the infringing activity.²¹ In reaching its conclusion on this matter, the Court drew upon the findings of the focus group study which proved that neither the website notices nor the EULA had any effect on the behaviour of the focus group participants.

Ability to curtail copyright infringement

The Court found that, even though Sharman could not entirely prevent the infringement of copyright, it did have the ability to curtail the infringing activity.

In this regard, the Court pointed to a number of technological controls which were available to Sharman to implement. The most obvious example of a technological control was the use of keyword filtering (along the lines of the current adult content filter used by Sharman to limit the amount of adult content which could be transmitted via the Kazaa system). The Court acknowledged that there were obvious difficulties about a system of keyword filtering. However, it went on to say:²²

“I am not persuaded it would have been beyond the ability of Sharman to overcome those difficulties. I accept any keyword filter will not be totally effective. I also accept it may sometimes produce false positives. However, the fact that a protection is imperfect is not a sufficient objection to its adoption.”

The Court found that Sharman's ability to curtail infringing activity meant that Sharman was in a position to "control" the behaviour of Kazaa users. Although "Sharman was not able to control the decision of users as to whether or not they would they would engage in file-sharing",²³ it was in a position to implement technological controls in order to restrict a user's access to copyright works and "in that sense, Sharman could control users' copyright infringing activities"²⁴ This concept of "control" finds its genesis in the *Moorhouse* decision. In that case, the fact that the University of New South Wales had power to control what was done by way of copying was decisive in establishing the liability of

the University.

Financial interests

Having determined that Sharman had failed to take reasonable steps to prevent or avoid infringements, the Court delved into the reasons why this was the case.

The Court concluded that it would not have been in the financial interests of Sharman to prevent or curtail the infringements. It acknowledged that "advertising revenue is the life-blood of the Kazaa system"²⁵ and the only way to ensure sustained profitability from advertising is to continue to maintain and build upon the level of traffic passing through the Kazaa system. Put in simple economic terms:²⁶

“The more shared files available through Kazaa, the greater the attraction of the Kazaa website. The more visitors to the Kazaa website, the greater its advertising value and the higher the advertising rate able to be demanded by Sharman.”

Consequently, there was no incentive on Sharman to take any steps to curtail the use of the Kazaa system for infringing purposes. To do so would have had a negative impact on the amount of revenue which Sharman would have been able to generate from advertising.

The nature of the technology

Much time was spent in the course of the judgment considering the nature of the Kazaa P2P file sharing system and, in particular, whether or not there was a central server which controlled the system. It was contended by Sharman during the hearing that, because of the decentralised nature of the system, it had no control over the copyright infringement activities of the users of the Kazaa system and could not, therefore, be liable for authorising infringement.²⁷

Although the Court found that there was insufficient evidence to suggest that there was a central server, it was not prepared to accept this as a defence to a finding of authorisation of infringement. Instead, the Court found

that the architecture of the Kazaa system had been modified during its history and that the resulting decentralisation of the system was presumably an attempt by certain of the respondents to enable Sharman to argue that it had no control over the activities of its users.²⁸

It follows that operators of P2P file sharing systems may no longer be able to hide behind the architecture of their systems in asserting immunity from the authorisation provisions of the Act.

Kazaa defences

Sharman raised a number of unsuccessful defences to the claim of authorisation of infringement, specifically:

- that it could not be liable where the identity of the infringing users was unknown;
- that a digital music file was not a copy of a sound recording;
- that it was simply providing the facilities used by others to infringe copyright; and
- that it could not be liable where a significant number of infringements were taking place outside of Australia.

The Court's analysis of these defences offers some useful insights and clarifications on the application of copyright law to the online environment.

Identity of infringing users

Sharman claimed that it could not be found liable for authorising copyright infringement in circumstances where the users of the Kazaa system (i.e. the actual copyright infringers) were not capable of identification.

Whilst the Court acknowledged that there was a lack of evidence as to the identity of the infringers, it was enough that witnesses were able to give uncontested evidence of being able to download the infringing sound recordings. The fact that "somebody must have done so [i.e. downloaded infringing sound recordings]"²⁹ was sufficient to establish that Sharman had

authorised copyright infringement.

Is digital music a copy of a sound recording?

Another argument put forward by Sharman was that the act of downloading a music file did not constitute copyright infringement because a digital music file was not a copy of a sound recording for the purposes of the Act.

The Court dismissed this technical argument, finding that a copy of a sound recording covered the "digital transmission of the aggregate of sounds contained in a sound recording into a computer's data storage system".³⁰

Facilitator or something more?

A third defence asserted by Sharman was the statutory protection afforded by section 112E of the Act. Sharman alleged that it was entitled to claim immunity in circumstances where it was simply providing the facilities used by others to infringe copyright. However, for the reasons stated above, the Court held that this defence was invalid and that section 112E of the Act did not grant general immunity in circumstances where "Sharman is and was more than a 'messenger'".³¹

Jurisdictional issues

In reaching its verdict, the Court looked at whether it was entitled to make a finding of authorisation under the Act in circumstances where a significant number of users resided outside of Australia. Section 101(1) only renders copyright infringed where a person "does in Australia, or authorises the doing in Australia of" an act comprised in the copyright.

The Court held that the presence of Kazaa users outside of Australia was immaterial to its decision.³²

"If the respondents, or any of them, authorise Kazaa users generally to infringe copyright, they authorise the doing of the infringing acts both within Australia and outside Australia. It does not matter that the latter activity is outside the scope of section 101 of the Act."

What was important, therefore, was that copyright infringement was also taking place within Australia.

Liability of joint venture principal

In addition to taking action against Sharman, the music industry also took action against Altnet Inc. (Altnet) claiming that it was jointly responsible for the operation of the Kazaa system.

The Court agreed with this allegation and found Altnet to be a joint venturer with Sharman. In reaching this finding, the Court had regard to a joint enterprise agreement which Sharman and Altnet had entered into in June 2003. This agreement, among other things, addressed matters such as the sharing of revenue between Sharman and Altnet and the recognition of joint commercial goals through the use and contribution by each party of their respective technologies. In the Court's opinion, this relationship evidenced a technological and financial association between Sharman and Altnet which was so far intertwined that it would be wrong not to conclude that each of them was dependent on the other for its commercial success.³³

On this basis, Altnet was found to be a "co-principal" and liable on the same grounds as Sharman.³⁴

Lifting the corporate veil

The Court also analysed the application of the authorisation provisions of the Act to certain individuals involved in the operation of the Kazaa system, namely Nicola Hemming (CEO of Sharman), Kevin Bermeister (CEO of Altnet), Philip Morle (Sharman's chief technical officer) and Anthony Rose (Altnet's director of technology).

The Court found that, whilst all of these individuals had knowledge of the infringing activity and had failed to take any steps to curtail such activity, only Nicola Hemming and Kevin Bermeister were liable for authorising copyright infringement. The Court reached this decision by applying the test laid down by Justice Finkelstein in *Root Quality Pty Limited v Root Control Technologies Pty Ltd*.³⁵ That

test states that a director will be liable for the acts of the company if that director's conduct is such that "it can be said of him that he was so personally involved in the commission of the unlawful act that it is just that he should be rendered liable".³⁶

The claims against Philip Morle and Anthony Rose were dismissed on the basis that they occupied a "subservient" role in, and were not in control of, the respective companies for which they worked.³⁷

Filtering ordered

Having established liability for authorisation of copyright infringement, the Court issued an injunction restraining the continued use of the Kazaa system in its current form.

However, the Court was careful not to rule out use of the system altogether. On the contrary, the Court determined that the system could continue to be used without breaching the Act provided Sharman introduced appropriate filtering mechanisms which were satisfactory to the record companies or the Court. In particular, the Court identified the following types of filtering mechanisms:

- keyword filters;
- upgrade prompts (being pop-up dialogue boxes which effectively locked a user out of the Kazaa system until they agreed to accept upgraded software containing keyword filters); and
- gold file flood filters (being software which floods the user's computer or other hardware with licensed (i.e. non-infringing) works and messages or warnings not to infringe copyright).

The Court gave Sharman until 5 December 2005 to put the appropriate mechanisms in place.

The future of P2P

Although copyright law has made its presence felt in the P2P community, it has not been to such a degree as to render P2P file sharing systems extinct. Indeed, the Court has tread cautiously

to seek to achieve a careful balance between protecting the rights of intellectual property owners and protecting the use of P2P file sharing systems into the future. In issuing the Court orders, Justice Wilcox said:³⁸

“I am anxious not to make an order which the respondents are not able to obey, except at the unacceptable cost of preventing the sharing of files which do not infringe the applicants' copyright. There needs to be an opportunity for the relevant respondents to modify the Kazaa system in a targeted way, so as to protect the applicants' copyright interests (as far as possible) but without unnecessarily intruding on others' freedom of speech and communication.”

Whilst being careful to preserve the future of P2P technology, the case nevertheless raises important implications for owners and operators of P2P file sharing systems as well as website operators and software developers more generally. In particular, it calls upon owners, operators and developers to engage in greater governance by closely monitoring the technologies and services which they provide to ensure that they are not seen to be taking steps to encourage infringement and, if they could be seen to be so doing, to change the way in which they operate to reduce instances of infringement.

What is more is that the case demonstrates that certain attempts to circumvent the application of the authorisation provisions - such as decentralisation of the architecture of a system or the inclusion of website copyright warnings or online terms - may not be effective to prevent liability in circumstances where there is knowledge of infringing activity and a failure to take steps to, at least, limit its occurrence.

The message from the Court seems clear enough - if you are an owner or operator of technology such as P2P file sharing systems, you should take steps to monitor the way in which you market and operate your business so as to ensure that you are not acting as "something more" than a mere facilitator. If you are, you may be

required to implement technological controls to help curtail infringement and to defend against an allegation of authorisation.

Notice to appeal has been lodged by the respondents.

1 *Universal Music Australia Pty Ltd & Ors v Sharman Licence Holdings & Ors* [2005] FCA 1242. Also online at URL www.austlii.edu.au/au/cases/cth/federal_ct/2005/1242.html.

2 see ARIA news feature "Record Industry Welcomes Kazaa Verdict" at URL www.aria.com.au/pages/recordindustrywelcomeskazaverdict.htm.

3 see note 1 at 182.

4 The respondents to the action were Sharman License Holdings Ltd, Sharman Networks Ltd, LEF Interactive Pty Ltd, Nicola Anne Hemming, Philip Morle, Altnet Inc, Brilliant Digital Entertainment Inc, Brilliant Digital Entertainment Pty Ltd, Kevin Glen Bermeister and Anthony Rose.

5 The record companies alleged breach of copyright on a number of grounds (including primary and secondary infringement and authorisation liability), breach of the *Trade Practices Act 1974 (Cth)* and liability for the tort of conspiracy.

6 The infringing respondents were Sharman Networks Ltd, LEF Interactive Pty Ltd, Nicola Anne Hemming, Altnet Inc, Brilliant Digital Entertainment Inc and Kevin Glen Bermeister.

7 545 US (2005).

8 see note 5. Grokster's website has since been changed to display a message that its file-sharing service is illegal and no longer available.

9 (1975) 133 CLR 1.

10 see note 1 at 366.

11 see note 1 at 367.

12 see note 1 at 396.

13 see note 1 at 184.

14 The study was commissioned by Altnet Inc.

15 see note 1 at 185.

16 see note 1 at 186.

17 see note 1 at 370.

18 (1996) 65 FCR 399.

19 see note 18 at 422. Both Jenkinson and Burchett JJ concurred with Sackville J.

20 see note 1 at 405.

21 see note 1 at 407.

22 see note 1 at 294.

23 see note 1 at 414.

24 see note 22.

25 see note 1 at 309.

26 see note 1 at 191.

27 see note 1 at 195 to 235.

28 see note 1 at 445.

29 see note 1 at 415.

30 see note 1 at 413.

31 see note 1 at 418.

32 see note 1 at 388.

33 see note 1 at 121 to 123.

34 see note 1 at 468.

35 [2000] FCA 980.

36 see note 32 at 146.

37 see note 1 at 487.

38 see note 1 at 520.