

# Metro Goldwyn Mayer Studios v Grokster Ltd and Streamcast Networks Inc

In this article, Clare Cunliffe examines the United States District Court of Central California decision in *Metro Goldwyn Mayer Studios v Grokster Ltd and Streamcast Networks Inc*.

## INTRODUCTION

The development of copyright law is a record of changing technology and the judicial policy of attempting to balance existing copyright against the potential for new innovation. In the context of the law on contributory copyright infringement, case law in Australia and overseas has demonstrated judicial recognition of the need to encourage the development of new technology where technology which is used for infringing purposes also has substantial non-infringing uses, present or potential.

To paraphrase the Supreme Court in *Sony Betamax* case,<sup>1</sup> major technological innovations alter the market for copyrighted materials, and raise permutations of competing interests that are inevitably implicated by this technology:

*"In a case ... [where the legislature] has not plainly marked our course, [courts] must be circumspect in construing the scope of rights created by a legislative enactment which never calculated such a calculus of interests."*<sup>2</sup>

The impact of the internet and simultaneously developing digital technologies on copyright law has posed a whole new series of issues for the judiciary, intellectual property lawyers and academics. In *A & M Records v Napster Inc (A & M Records v Napster Inc)* (114 F Supp 2d 896 (ND Cal 2000)), the District Court held that the defendants were liable for contributory infringement for their provision of an innovative software. The software enabled file sharing between users' computers, but was used predominantly to exchange compressed music files (MP3s) which infringed the plaintiffs' copyright. The decision was affirmed on appeal in *A & M Records v Napster Inc (Napster)* (239 F 3d 1004).

*Metro Goldwyn Mayer Studios v Grokster Ltd and Streamcast Networks Inc* (US District Court of Central California 25 April 2003) (*Grokster*) also considered the issue of contributory copyright infringement in the context of file sharing software made available by the defendants and widely used by end users for infringing purposes. However, important technological developments between *Napster* and *Grokster* which differentiated the software which was

the subject of the proceedings led to a finding in *Grokster* that the defendants were not liable for contributory or vicarious infringement (although it is likely that the decision will be appealed by the plaintiffs).

In light of these developments to the law of contributory infringement, this article will consider:

- The development of the law of contributory infringement in the United States;
- The likely outcome if *Grokster* were litigated in Australia; and
- The possible ramifications, legal and otherwise, of *Grokster*.

## BACKGROUND: THE US STORY SO FAR

The so called 'staple article of commerce' doctrine, developed in *Sony Corp v Universal City Studios Inc* 464 US 417 (*Sony Betamax*), can be seen as consonant with copyright's underlying objective of 'Promot[ing] the progress of Science and Useful Arts'.<sup>3</sup> The doctrine applies in cases where contributory infringement is alleged.

Generally, a finding of contributory, material or vicarious infringement under US law will be made only where:

- A third party is found to directly infringe<sup>4</sup>; and
- In the case of contributory infringement: a defendant, who knows or has reason to know of the infringing activity, induces, causes or materially contributes<sup>5</sup> to the infringing conduct.<sup>6</sup>

In *Sony Betamax*, the US Supreme Court (*the Supreme Court*) rejected contributory infringement claims brought by movie studios against the manufacturers and distributors of the Sony Betamax video tape recorder. The video tape recorder allowed users to record movies from television. The Supreme Court found that the video tape recorder was used in order to facilitate 'time-shifting' (recording now to watch later, which was found to be a non-infringing use) and as a method of archiving movies (which was accepted to be an infringing use).

The Supreme Court held that there was no precedent for the applicant's attempt to impose copyright liability upon the

distributors of copying equipment, nor for the imposition of vicarious liability on the basis that manufacturers and distributors sold the technology with the *constructive* knowledge that customers could use the equipment to make unauthorised copies of authorised material.

The Supreme Court held that the exercise of copyright rights did not justify limitations on the distribution of technology which might facilitate copyright infringement, since relief of this kind 'would enlarge the scope of the respondent's statutory monopoly to encompass control over an article of commerce that is not the subject of copyright protection'.<sup>7</sup> Where an article is capable of substantial non-infringing uses, sale of that article will not be contributory infringement (*the Sony Betamax doctrine*).

The *Sony Betamax* doctrine, which is borrowed from patent law, has been applied particularly to new technologies. It can be seen as a kind of extension to the general principle, articulated throughout intellectual property law, that in the absence of clear legislative guidance courts will be cautious before finding that protection of existing intellectual property rights should be favoured at the expense of innovation tomorrow. The importance of future uses and development of technology is a principle reflected by the fact that the doctrine will protect even those technologies which are 'merely' capable of substantial non-infringing use.<sup>8</sup>

However, an important limitation to the *Sony Betamax* doctrine was articulated in *A & M Records v Napster Inc*. The defendant in *A & M Records v Napster Inc* offered a set of interrelated services. In combination, the services offered 'peer to peer' digital transfer of compressed musical files, or MP3s, between users over the internet. It did so by providing users with a free download of Napster software, which enabled individual users to indicate MP3 files they were willing to share with other users. This information and user details were uploaded into Napster's databases. The databases were constantly updated as users logged on and off to reflect those users on the Napster network at any given time. All users could access all available MP3 files on the database. Users could identify MP3 files held by host users by use of a proprietary search engine or by use of a hotlist. Users would then 'request' MP3s from a host user holding the relevant MP3,

the Napster network would identify the internet protocol address of the host user, and forward through the details to the requesting user. The requesting user's software used this information to establish a direct connection with the host user and download the MP3. That is, Napster acted as a dispatcher, introducing a person looking for a song to the person with that song available. Once the introduction was made, the actual transfer of the song was handled directly between users.

Napster was sued by eighteen record companies, including A&M Records, for contributory and vicarious copyright infringement. The plaintiffs sought an interlocutory injunction preventing Napster from engaging or facilitating others in copying, downloading, uploading, transmitting or distributing the plaintiff's copyrighted works. The plaintiffs were successful at first instance (before the District Court) and Napster appealed to the Ninth Circuit.

Importantly, the Ninth Circuit also held that the *Sony Betamax* doctrine could not apply because Napster, unlike the defendants in the *Sony Betamax*, exercised ongoing control over its services. The Court held that Napster had actual knowledge of direct infringement by reason of a notification by the plaintiffs<sup>9</sup>, and by providing the site and facilities (ie the network, proprietary software, search engine, servers, and means of establishing a connection between computers) for the infringement,<sup>10</sup> materially contributed to the infringement. In failing to prevent the unauthorised trading of copyright music, the District Court held that Napster facilitated infringement. It was significant that Napster had actual and not merely constructive knowledge of direct infringement *at a time* during which the defendant materially contributed to the infringement.<sup>11</sup> A finding of contributory infringement against Napster therefore had real ramifications for the direct infringers using the service, since, as the court in *Grokster* noted, 'Napster ... served as the axis of the file-sharing network's wheel. When Napster closed down, the Napster file-sharing network disappeared with it.'<sup>12</sup>

The decision in *Napster* turned on the finding that the defendant exercised ongoing control over the services it offered. *Napster* left open the possibility that provision of a similar peer to peer file sharing service, which did not rely on a centralised database and which could therefore not be controlled with the same ease by a software provider, would not constitute contributory infringement. This possibility was litigated in *Grokster*.

### **THE EVOLUTION OF PEER TO PEER: GROKSTER**

In *Grokster*, both defendants distributed free software, which could be downloaded by users free of charge and which enabled the free exchange of copyrighted music, movies, and other digital media over the internet.<sup>13</sup> It

was also accepted by the court that the software was used to locate and transfer a variety of non-copyrighted material.<sup>14</sup> The plaintiffs argued that the defendants were liable for contributory and vicarious copyright infringement by reason of their provision of software.

Although the different defendants used different software platforms, there were some important similarities between the services offered by all defendants and the services offered by Napster. In particular, users could download software from servers operated by the defendants. Once installed, users could elect to share files (not limited to MP3 files) located on the user's computer. When the downloaded software was launched, users were automatically connected to a peer to peer network and their nominated files made available to any other users on the network. Users could then search the pool of shared files by various means. Users could request specific files from other users who 'host' that file, by clicking on a file and initiating a direct transfer of those files between the host computer and the requesting computer.

However, there were also important distinguishing factors between the package of services offered by the defendant in *Napster* and those at issue in *Grokster*. In particular, whereas Napster hosted a central list of files available on each users' computer 'and thus served as the axis of the file sharing network's wheel', *Grokster* did not operate any centralised file sharing network. Rather, users' access to files occurred by means of connection to a 'supernode', or endpoint on the Internet, typically a user's computer. Individual users' computers would automatically self select a supernode, which might change from day to day. After connection to a network, a user's queries would be relayed among supernodes, maximising the breadth of the search. While Napster searches all utilised a single 'supernode' owned and operated by Napster, users of *Grokster* software could search for and initiate transfers of files without any information being transmitted through *Grokster*'s computers. In the case of the defendant *Streamcast*, the network was even more decentralised. Each users' computers would connect by identifying another peer-to-peer network user by means of a public directory (which was not operated by *Streamcast*), and connecting to the other user. Search requests would be passed from user to user, until a match was found or the search expired. File transfer would take place directly between the requesting user's computer and the host user's computer.

On the basis of the information flow and the method of file transfer, the Court did not implicate the defendant proprietors of *Grokster* and *Streamcast* as materially involved in infringement, since neither facilitated the exchange of files as Napster did:

If either Defendant closed their doors and deactivated all computers within their control, users of their product could continue sharing files with little or no interruption ... [by comparison,] If Napster deactivated its computers, users would no longer be able to share files through the Napster network.<sup>15</sup>

The District Court also rejected an argument that the defendants were vicariously liable for infringement, since it found that there was no evidence indicating that the Defendants had the ability to supervise and control the infringing conduct (all of which occurred after the product had passed to end users). The Court rejected an argument by the plaintiffs that the defendants should be liable because the software could have been designed so as to be less susceptible to unlawful use.<sup>16</sup>

### **HOW WOULD GROKSTER BE DECIDED IN AUSTRALIA?**

Under the *Copyright Act 1968* (Cth) (*The Copyright Act*), owners of copyright works (literary, dramatic, artistic and musical works) and other subject matter (sound recordings, films and broadcasts) have an exclusive right to communicate to the public<sup>17</sup>. 'The public' is a broad term which will encompass individuals in private circumstances, or small groups of people, where the facility would be available to the public if they chose to avail themselves.<sup>18</sup> Communicate is defined broadly as:

*"make available online or electronically transmit (whether over a path, or a combination of paths, provided by a material substance or otherwise) a work or other subject matter."*<sup>19</sup>

Section 22(6) of the Copyright Act specifies that it is the person responsible for determining the content of the communication who is responsible for making the communication.

On the basis of section 22(6), it is unlikely that Australian Courts would find that *Grokster* and *Streamcast* themselves are responsible for infringement by way of unauthorised communication, since it is the users of the software who select the content of files which are made available for transfer. However, it is likely that Australian Courts would find that users of the *Grokster* and *Streamcast* services who make copyrighted material available online to other users without the authorisation of the copyright owner are communicating within the meaning of the Copyright Act, and thus infringing the copyright owner's exclusive rights.

Sections 36 and 101, in relation to literary and musical works and sound recordings, respectively, provide that copyright is infringed by a person who, not being the owner of the copyright, does in Australia, or authorises the doing in Australia of an act

comprised in the copyright.<sup>20</sup> In considering whether there has been an authorisation of an act comprised in the copyright, sections 36(1A) and 101(1A) list a number of factors to be taken into account. These include:

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

Although the application of these factors (which are a codification of principles articulated by pre-existing case law) will be at the discretion of the Court, it is clear that where a party is aware of a clear likelihood of infringement, and adequate steps are not taken to limit or avoid this likelihood, the party's inactivity may be found to constitute authorisation.<sup>21</sup>

However, this test is clearly dependent on the extent of the alleged infringer's power to prevent the doing of the infringing act. It has been held that some degree of connection or control must exist between the alleged contributory infringer and the direct infringer.<sup>22</sup> While Australian courts have refrained from speculating what degree of control must exist for authorisation to be found, it has been noted that there may be a distinction between infringement on the defendant's premises and that undertaken elsewhere.<sup>23</sup> If Australian Courts were to adopt analogous reasoning to that of the District Court in *Grokster*, it would clearly be open to the Court to find that although the defendants in *Grokster* were aware of the potential for infringement, the design of the peer-to-peer sharing system (unlike the design of the Napster network) was such that they did not have the requisite power to prevent unauthorised usage of copyright materials, and therefore that no action in authorisation could be sustained. This conclusion would be supported by the facts found by the District Court in *Grokster*, that the Defendants undertook efforts to avoid assisting users who were using the software for improper purposes,<sup>24</sup> although it could be argued that the defendant should be required to inform users of their obligations under copyright law in order to fulfil all 'reasonable steps to prevent or avoid the doing of the act'.

In summary, there is a probability that the decentralised design of the specific peer to peer filing systems at issue in *Grokster* would mean that Australian Courts would, by a process of reasoning analogous to that adopted by the District Court in *Grokster*, conclude that authorisation of infringement was not made out.

This raises the issue of how copyright owners can protect their copyright in the face of new technological innovations. The options are canvassed below.

### **PUTTING THE GENIE BACK IN THE BOTTLE: HOW THE ANTI-PIRACY BATTLE IS BEING FOUGHT**

In some senses, the evolution of peer-to-peer file sharing systems to a more decentralised model might be seen as an inevitable concomitant of the *Napster* decision. As the District Court in *Grokster* stated:

*"The Court is not blind to the possibility that Defendants may have intentionally structured their businesses to avoid secondary liability for copyright infringement, while benefiting financially from the illicit draw of their wares. While the Court need not decide whether steps could be taken to reduce the susceptibility of such software to unlawful use, assuming such steps could be taken, additional legislative guidance may be well-counselled."*<sup>25</sup>

It may be that the decision in *Grokster* will spark legislative reform aimed at ensuring that software designers and manufacturers undertake all necessary steps to minimise the possibility of copyright infringement by users.

In the meantime, a move towards prosecution of direct infringers - ie the users of software systems - is emerging in Australia and internationally. In April, three Australians were arrested on criminal charges for online music piracy.<sup>26</sup> The recording industry in America has made similar moves to identify and prosecute users who are engaging in piracy.<sup>27</sup> Music industry representatives have suggest that high profile prosecutions of infringing users may have a deterrent effect on would-be infringers.<sup>28</sup>

Finally, it has been suggested that the development of the law will lead to a non legal resolution of the issues, as copyright holders are spurred to adopt and adapt technological mechanisms so as to either invest more in the development and technological mechanisms to stop copyright infringement from occurring,<sup>29</sup> or to enable accessible and inexpensive authorised online access to copyright materials.<sup>30</sup> If this materialises, innovation may beget innovation, as copyright holders take the opportunity to control their copyrighted materials through technological rather judicial means.

**Clare Cunliffe is a solicitor at Allens Arthur Robinson.**

- 1 *Sony Corp v Universal City Studios Inc* 464 US 417
- 2 *Sony Betamax* 431
- 3 US Constitution, Article 1, 8, clause 8
- 4 *Sony Betamax* at 464

5 Material contribution will be found where it would be difficult for infringing activity to take place without the support services provided by the defendant: *Cable/Home Communication Corp*. 902 F 2d, 846; *Sega Enter Ltd v MAPHIA* 948 F. Supp 923, 933.

6 *Gershwin Publishing Corporation v Columbia Artists Management Inc* 443 F 2d 1159, 1162; *Fonovisa Inc v Cherry Auction Inc* 76 F 3d 259, 264 (9th cir 1996).

7 *Sony Betamax* at 421

8 *Sony Betamax* at 442.

9 *Napster* (9th cir) 1020

10 *Napster* (9th cir) 1022. This provision of virtual space was considered to be analogous to providing space, parking, advertising utilities, plumbing and customers for a swap meet where counterfeit goods are sold (see *Fonovisa Inc v Cherry Auction Inc* 76 F 3d 259, 264).

11 *Napster* at 1020 to 1022.

12 *Grokster* at 18-19.

13 *Grokster* at 9-10.

14 *Grokster* at 11.

15 *Grokster* at 24

16 *Grokster* at 33

17 'To the public' is defined to mean the public within or outside Australia, potentially catching both foreign websites providing access to songs to Australians, as well as Australian websites providing access to songs to foreigners, although it will not catch wholly foreign activities.

18 See, in the context of performance and broadcast rights (which were replaced by the technology neutral broadcasting right) *Telstra Corp Ltd v Australasian Performing Right Association* (1997) 191 CLR 140 at 155-156.

19 Copyright Act 1968, Section 10

20 Although determining whether an act occurs in Australia is particularly problematic in relation to the internet where many acts are cross-jurisdictional. However, the implications of the *Gutnick* decision has widened the jurisdiction of Australian Courts over cross jurisdictional acts on the internet. *Gutnick v Dow Jones & Co Inc* (2002) HCA 56) (cf the US Supreme Court case *Young v New Haven Advocate*, (List 538 US), May 19 2003)).

21 See *UNSW v Moorehouse* [1975] 133 CLR 1

22 English case law on the issue of authorisation emphasises that whether inactivity will amount to indirect infringement will depend in part on whether a party has the power to prevent infringement. For example, mere manufacture of a twin tape recording deck which is capable of infringing copyright will not be taken to infringe copyright. Manufacture is not encouragement of infringement: *BCS Songs v Amstrad Consumer Electronics Plc* [1988] AC 1013

23 see *WEA International inc v Hanimex Corporation Ltd* (1987) 17 FCR 274 at 286-287

24 *Grokster* at 25

25 *Grokster* at 33.

26 'Piracy Arrests "First In World" Australian Financial Review, 28 April 2003.

27 'Justice Sides With Record Industry', Australian Financial Review, 22 April 2003.

28 'Entertainment Industry Loses In Web Case', New York Times, 26 April 2003

29 Terence Lau, 'Australia v Napster: how would Australian Courts Respond?' 14(10) Australian Intellectual Property Law Bulletin (2002) 121 at 130.

30 'Entertainment Industry Loses In Web Case' Part II, New York Times, 26 April 2003