

Can The Grokster Settlement Close Pandora's Box?

By Sean F. Kane

On Nov. 7, 2005, Grokster LTD (Grokster) filed documents in a Los Angeles federal court reporting that it had reached a settlement in its lengthy legal case with the nation's largest record companies, motion picture studios and music publishers (as represented by the Recording Industry Association of America (RIAA)).

As part of the reported settlement, Grokster admitted monetary liability in the amount of \$50 million dollars and agreed to immediately shutter its popular peer-to-peer (P2P) file sharing service. Grokster's Web site was changed the same day to state that its existing file-sharing service was illegal and no longer available. Specifically, the site states that: "There are legal services for downloading music and movies. This service is not one of them." However, the Web site notes that Grokster hopes to have a "safe and legal" replacement available soon apparently under the proposed name "Grokster3G."

This settlement comes closely on the heels of the Supreme Court's decision in June, in the highly watched matter of *Metro-Goldwyn-Mayer Studios Inc. et al. v. Grokster, LTD., et al.* The Supreme Court held that the underlying evidence in the case was sufficient to demonstrate that the defendants' intent of distributing the product was to promote, and or induce, copyright infringement by stepping in where P2P pioneer and early copyright enforcement victim Napster left off. Citing various factors underlying its holding, the Court opined 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." However, the Court did not say that file-sharing itself was a problem, but the way Grokster and StreamCast marketed it, was.

The *Grokster* decision leads many Internet law experts to believe that a distributor of P2P technology with a legitimate intent not to infringe others' rights would not be liable for a third party infringing use of the technology. This being said, the Court failed to create a bright line test as to what is a "clear expression or other affirmative steps taken to foster infringement" which, as Justice Breyer stated in his concurring opinion and as discussed further herein below, will potentially have a chilling effect on others creating or advancing file swapping and other possibly legitimate technologies. Future litigation will necessarily turn on a case-by-case basis — not as to the nature of the technology but potentially as to the business plans of the distributors.

Grokster's settlement does not affect the other defendants in the underlying action or the various others currently pending, including cases against StreamCast Networks Inc. and Sharman Networks Ltd, which distribute Morpheus and Kazaa, respectively. Attorneys for both companies have already come out and reaffirmed their intention to continue their legal fights in the U.S. courts and internationally.

FEE-BASED ONLINE DIGITAL CONTENT

According to a press release issued by the RIAA simultaneously with the Grokster settlement announcement:

"The settlement includes a permanent injunction prohibiting infringement — directly or indirectly — of any of the plaintiffs' copyrighted works. This includes ceasing immediately distribution of the Grokster client application and ceasing to operate the Grokster system and software." This clearly is the death knell for the Grokster business model in its current format, but leaves open a Grokster return in some form. Reports have already surfaced that a deal is in the works for MashBoxx to buy all the remaining holdings of Grokster, and while the specific terms of the deal, if any, are not immediately clear, it would assumedly include purchasing Grokster's directory of registered users and folding the file-sharing network's operations into MashBoxx's soon-to-be-launched download service. Since MashBoxx's service will incorporate a fee-based download element in cooperating with the copyright owners, there should not be the same infringement concerns that have plagued the P2P industry since Napster went live.

Certain market watchers have already observed that it will be difficult for legal P2P services such as MashBoxx and iMesh to convince experienced file-sharers to begin paying for content they've been getting for free; and, furthermore, to convince content producers that their software is capable of thwarting piracy. Many people have been using P2P networks primarily because they're easy to navigate and the content has been free, and if those benefits are eliminated, P2P networks may not seem as beneficial to music consumers. Moreover, given the other currently existing pay services, such as iTunes, Rhapsody,

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and the relaunched Napster — that have had time to develop relationships with copyright holders, gain customers and tweak their software under a pay model — it is difficult to judge whether MashBoxx's service will be novel enough to convert free file sharers to a paid service or, alternatively, to gain market share in the numbers that will ensure profitability.

PUBLICITY STUNT?

It is possible that the settlement with Grokster is more a publicity stunt by the film and recording industries than an actual agreement to put a contentious litigation behind them. As stated above, the Supreme Court decision was not the all-out victory that many in the industry thought and hoped it would be. Since it was based on the individual facts of the case, it did not set a clear precedent against P2P file sharing that could be touted in other litigations against the remaining file sharing services. Furthermore, many industry and legal scholars question whether Grokster has the assets to actually pay a \$50 million settlement. It is possible that this settlement, the press release and the numerous articles that have appeared in its wake, make up a clever attempt by the film and record industries to scare P2P file-sharing services and providers of other potentially infringing technology into shutting their digital doors. In support of this position is the fact that many settlements contain confidentiality provisions that the terms, especially the amount of any payments, will not be made public. Moreover, most settlement agreements contain language under which neither side admits any wrongdoing, which is markedly different from the statements of culpability Grokster has made in interviews and posted on its Web site. Without a judicial determination that

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P2P is inherently infringing, a huge settlement amount could be very effective in convincing many companies and their executives that protecting technological creativity and inventiveness is one thing but possibly loosing your home is quite another.

CHILLING EFFECT

It is very possible that the Grokster settlement will have the chilling effect that Justice Breyer feared, and not just on the P2P market. In a culture where innovation and emerging technology is generally prized for its potential to mold and impact the future, individual entrepreneurs and small companies have often made discoveries or marketed products that have had significant impact on society. Infringement suits, like the one at issue, and the substantial settlement that has been reported, may very well act to dampen the creative entrepreneurial spirit. If a new idea or technology has the possibility to infringe — or to be used to infringe — another's copyright, then the same potential liability may exist.

With the Supreme Court's opinion leaving the infringement intent question open for determination on a case-by-case basis instead of enacting a bright-line test, it may leave many individuals or businesses too fearful to spend funds to research or to bring a new idea to the market. With no set standards to follow, many new technologies may be subject to suit for infringement utilizing one legal argument or another. Going forward, the playing field will arguably be weighed heavily in favor of the companies or individuals who have the capital to bring and prosecute a sophisticated suit.

Is there, then, a chilling effect left on technological innovation in general? Does the *Grokster* case and the very public settlement announcement have a greater impact than simply putting a well-known P2P out of business? "In the areas of emerging technology, it may often be difficult to determine precisely what is infringing or not, or even what may violate other laws (*eg*, FDA regulation in the medical device area, or national security issues)," says Stanley Jaskiewicz of Spector Gadon & Rosen, P.C. in Philadelphia, and a *Internet Law & Strategy* Board of

Editors member. "This is even harder for the entrepreneur, who often is not spending money on IP counsel at very early development stages. For those creative types, therefore, who want to create new technologies but do not have funds for ongoing consultation with counsel, perhaps the effect of the *Grokster* case is to create a fear of the *deus ex machina* — a Monty Pythonesque foot that will unexpectedly stamp out their work, for legal reasons that they may never have anticipated. In the face of that risk, individuals and small firms may simply choose to pursue developments in areas of less legal uncertainty, leaving 'cutting edge' development to larger firms that can afford more sophisticated counsel. However, that would be inconsistent with the way that much technological development has occurred."

Jaskiewicz adds, however, that such a tack would be "inconsistent with the way that much technological development has occurred."

The fact that legislators are aware of such a potential effect is exactly what will limit the reach of the Grokster example, says Jonathan Bick, Of Counsel at WolfBlock Brach Eisler in Roseland, NJ, and Adjunct Professor of Internet Law at Rutgers School of Law and Pace University Law School (and also a member of *Internet Law & Strategy's* Board of Editors). "Congress and the courts have consistently chosen to protect innovation at the expense of copyright holders," he says, citing the following language of the Supreme Court in *Grokster*:

The introduction of new technology is always disruptive to old markets, and particularly to those copyright owners whose works are sold through well-established distribution mechanisms. Yet history has shown that time and market forces often provide equilibrium in balancing interests, whether the new technology be a player piano, a copier, a tape recorder, a video recorder, a personal computer, a karaoke machine, or an MP3 player.

"The Internet is such a new technology," Bick continues. "Thus, a fear of the chilling effects of the

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Grokster court or of Grosker's withdrawal from the market are not warranted. Grokster's withdrawal should be read as what happen to those marketing is ill conceived. It should not be read as a court's adverse stand against technical innovation."

FREE P2P FILE SHARING NETWORKS CONTINUE

While it is true that the movie and recording industries have successfully shut down Napster, Grokster and other P2P file sharing services through litigation and other tactics, new ones have continued to emerge. After Napster was crushed in court in 2000, Morpheus, Kazaa and Grokster became popular. Following the Supreme Court ruling against Morpheus and Grokster, an Australian court ruled in September that Kazaa was violating Australian copyright law. (*Universal Music Australia Pty Ltd. v. Sharman License Holdings Ltd.*, [2005] FCA 1242.)

The party line for the film and recording industries is that several years ago illegal acquisition dominated digital music, but due to their high profile legal victories, many of the Grokster-like P2P providers and customers will have reached the conclusion that it is time to "go legitimate." However, there is no real

evidence that the film and recording industries statements are have any basis in truth and that unlicensed file sharing has peaked and will soon be on the decline. In fact, this is belied by the research of BigChampagne Online Media Measurement, which demonstrates that last month alone an average of 9 million people worldwide used file-sharing software simultaneously — which is nearly a 50% increase from only a few years ago — and almost all of the file-sharing was unlicensed. This begs the question has the litigation really had any impact on the end-user unlicensed file sharing?

Regardless of the Supreme Court's decision or the actions of the film and recording industries, certain consumers will continue to want to access free online music. Grokster's file sharing software has been downloaded millions of times already, not to mention the other file sharing options out there. Nothing the settlement did can change that. The software is in the public domain, so to speak, and it can never be eradicated fully. All the settlement did was ensure that Grokster would not continue to update and service the software, with the hope that over time it will loose its functionality and usefulness. If the law evolves to the point that P2P file sharing is held to be an illegal practice,

file-sharing entities will likely follow the example of online gambling sites and move offshore to locations that turn a blind eye to this sort of thing. In fact, some companies are currently headquartered in jurisdictions that make enforcing a U.S. law or judgment difficult, if not impossible.

Even if all national or international commercial sites are litigated or frightened into non-existence, it will do nothing to wholly eliminate the perceived need for free digital content. This niche will likely be filled by different types, or perhaps smaller or more private, of networks that generally may be under the radar of copyright holders or the authorities. As such, they will likely pose a continued threat to paid file-sharing services. However, with file-sharing software so popular among those who are computer savvy (if not even programmers themselves who see it as a challenge to stay one step ahead of the authorities and keep free P2P software going), the copyright holders have few weapons against such a viral (excuse the expression) attack. So, publicity-enhanced or not, the voluntary shutdown and admission of culpability by one of the most known free P2P culprits is a huge victory for the music and film industries.

