

Testimony of
The Honorable Mary Beth Peters

U.S. Register of Copyrights
Copyright Office
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STATEMENT OF MARYBETH PETERS
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Chairman Specter, Senator Leahy, and distinguished members of the Committee, thank you for the opportunity to appear before you to testify on protecting copyright and innovation in a post-Grokster world. The Supreme Court's recent ruling in *Metro-Goldwyn-Mayer Studios v. Grokster* was one of the most significant developments in copyright law in the past twenty years. While technological progress can bring societal advances, it can also beget legal quagmires, as the emergence of online music distribution demonstrated. In its ruling in *Grokster*, the Court clarified that those who offer products and services in a way that induces others to engage in copyright infringement can be held secondarily liable for that infringement. By establishing these boundaries, the *Grokster* ruling appears to have encouraged productive negotiations and agreements within the music industry, ultimately benefitting the music consumer by making it easier to legitimately obtain music online. Subsequent U.S. and foreign court decisions demonstrate a growing acceptance of the *Grokster* ruling that those who induce infringement can be held responsible for what they have unleashed. This high-profile case also helped to raise the public consciousness as to the legal status of unauthorized peer-to-peer file-sharing of copyrighted works. Coupled with the increasing availability of legitimate online music services, we can hope that this will lead to a decline in illegal file sharing.

Although the *Grokster* decision contributed immensely to the world of legitimate online music distribution, it did not, and could not, resolve all of the difficulties facing this industry. One area which poses the most hurdles to efficient and affordable distribution is the process of licensing the underlying musical works. Because this process is constrained by practical and statutory antiquities, it creates an incentive and opportunity for piracy to flourish. I commend you for considering the necessity of legislation in the wake of *Grokster*, and I would suggest that the one

topic on which legislation should be presently considered is the reform of the process for licensing online distribution of musical works.

The Grokster Decision

Given the amount of publicity *Metro-Goldwyn-Mayer Studios v. Grokster* has received, a very brief and simplified recounting of its facts seems sufficient. Defendants Grokster, Ltd. ("Grokster") and StreamCast Networks, Inc. ("StreamCast") distributed software that permitted computer users to share electronic files through peer-to-peer networks. The Plaintiffs, who included all of the major movie studios and record companies as well as a large number of music publishers and songwriters, claimed not only that the software enabled the unauthorized transfer of copyrighted works such as movies and music, but that the Defendants intended, promoted and profited from these very acts of infringement. Therefore, they argued, the Defendants should be able held secondarily liable for the direct infringement of the copyrighted works by their users. Although the technology at issue could facilitate the transfer of any type of electronic file, the Plaintiff copyright owners presented evidence that users of the Defendants' software did in fact use it predominantly and illegally to distribute copyrighted works, without authorization from the copyright owners and without remunerating them. The copyright owners also presented evidence of the Defendants' active steps to encourage this massive infringement as well as the dependency of the Defendants' business models on such infringement.

The district court granted summary judgment for the Defendants, finding that no secondary liability could attach where the Defendants did not have actual knowledge of specific acts of infringement. The Ninth Circuit affirmed, based predominantly on its misreading of *Sony Corp. of Am. v. Universal City Studios, Inc.* In *Sony*, the Court ruled that the manufacturer of a VCR could not be faulted solely on the basis of its distribution of its product, even if some consumers used the product to infringe copyrights, because the VCR was capable of commercially significant noninfringing uses. The Ninth Circuit erroneously interpreted *Sony* to mean that contributory liability could not attach if a product had any substantial noninfringing use and the producer did not have specific knowledge of the infringement at a time at which it contributed to the infringement, regardless of any intent to promote infringement which might be imputed from the producer's actions or the attendant circumstances.

The Supreme Court's ruling, though, made it clear that one who offers a product designed to infringe could indeed be held liable for copyright infringement under a theory of secondary liability. Prior to *Grokster*, the availability of secondary liability under such circumstances was a source of confusion and hotly debated. The Court settled that issue by stating, "We hold 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."

Besides clarifying that such liability is appropriate, the Court also explained that courts may consider all relevant factors and circumstances when evaluating whether or not to impose this type of liability. The Court gave examples of certain factors that a court might choose to consider, but it did not exclude any individual item or category of evidence. Finally, the Court preserved the holding of *Sony*, which the Court's grant of certiorari had led some to fear would be eviscerated, threatening to incapacitate the technology industry.

However, although the Court did not disturb its *Sony* ruling, it did not address a key issue that

was presented to it: the scope of, in the Court's words, "the Sony rule and, in particular, what it means for a product to be 'capable of commercially significant noninfringing uses.'" Instead, the Court stated, "because we find below that it was error to grant summary judgment to the companies on MGM's inducement claim, we do not revisit Sony further, as MGM requests, to add a more quantified description of the point of balance between protection and commerce when liability rests solely on distribution with knowledge that unlawful use will occur. It is enough to note that the Ninth Circuit's judgment rested on an erroneous understanding of Sony and to leave further consideration of the Sony rule for a day when that may be required." And in separate concurrences, Justices Ginsburg and Breyer (each joined by two additional justices) articulated very different views as to the scope of the "Sony rule" and how it ought to be applied to the facts of Grokster.

Although Grokster arose in the context of the movie and recording industries' dispute with a particular technology, its implications reach much further. The theory of secondary liability for the inducement of infringement can apply to the unauthorized use of any creative work, not just music or movies. The Court's forethought in not excluding any category of evidence from the determination of liability means that the holding is sufficiently flexible to withstand the test of time and evolution of technology. Ultimately, the copyright law is better able today to address widespread infringement and provide a level playing field for all - authors, copyright owners and legitimate services and users - than it was a year ago. Authors and copyright owners can rely upon an express inducement of infringement theory of liability, legitimate services can obtain some relief from unfair competition from unlawful services that offer copyrighted works for free, and would-be defendants who might have once cavalierly hid behind what they thought was an impenetrable shield of Sony will be forced to evaluate their developing products more carefully.

Recognizing the broad influence this case would have on numerous industry sectors, the Justice Department submitted an amicus brief to the Supreme Court urging reversal of the Ninth Circuit's decision. This brief argued, in part, for a clear statement that secondary liability is appropriate for the inducement of copyright infringement. The Copyright Office not only actively participated in the formulation of the Government's position, but was a signatory to the brief. I am pleased that the Supreme Court adopted many of the views and analysis set forth in the Government's brief.

The Aftermath

Just three months after the Supreme Court's ruling, it may be premature to predict what permanent effects Grokster will have. Initial indications are that it could have many positive ones. However, much of the Copyright Office's knowledge on the practical impact thus far has been garnered from the popular press. We are very much interested to hear what industry representatives testifying today have to say about how this case has actually affected their operations. I can also state that internationally, the Grokster decision promises to be very helpful in our efforts to combat online piracy throughout the world.

Grokster coincides with, and in some cases precedes, a surge in negotiations, agreements and launchings of new legitimate online music services or supporting technologies. For example, Yahoo! recently launched its Yahoo! Music Unlimited subscription service. Mashboxx is beta testing its new peer-to-peer service which will compensate copyright owners for their works. Two days after the Court ruled in Grokster, Mashboxx announced a license agreement it had entered into with Sony BMG Music Entertainment. iMesh, another peer-to-peer service, states on

its website, "In an effort to create and promote a legal file sharing Internet environment, we are entering into distribution agreements with copyright holders." iTunes of course continues to flourish.

Ironically, it appears that some parties who used to be at cross purposes are now becoming partners. SNOCAP, founded by one of the creators of the infamous Napster, has entered into agreements with Sony BMG Music Entertainment, Universal Music Group, EMI Music and various independent record labels to provide copyright management technologies and database services to enable the online distribution of the copyright holders' music catalogs through authorized peer-to-peer services and online retailers. Meanwhile, the copyright-supportive Mashboxx is reportedly in discussions to acquire Grokster, whose former CEO is coincidentally Mashboxx's current CEO. The Court's decision in Grokster is likely to encourage further constructive and conciliatory measures from those who might once have ignored copyright owners' demands that they respect copyrights.

Additionally, copyright owners seem to have become more assertive in protecting their rights since the June ruling. Just last week, the International Federation of the Phonographic Industry ("IFPI") and the Motion Picture Association of America ("MPAA") released Digital File Check, a free software program that parents, employers or others in Europe can use to uninstall or disable illegal file-sharing programs and to remove unauthorized music and movies on computers within their control. The press has given much attention this month to the cease and desist letters the RIAA apparently sent to prominent illegal peer-to-peer services. I am not in a position to judge whether these tactics are working. However, I would note that there are reports that some illegitimate or questionable services have simply closed their doors, although it is possible that they will reemerge in some other location or incarnation.

It is tempting to say that there must be a causal relationship between Grokster and all this activity. By articulating some boundaries on the development of products used to infringe copyrights, the Grokster ruling may have helped to frame these negotiations and agreements. Presumably some actors who felt that the prior state of law gave them complete freedom to offer products designed to facilitate infringement - and to do so with impunity - are now having second thoughts in light of the fact that the Court has clarified that there is a basis for holding them accountable for the consequences of what they purvey. However, at this early stage, it is mere speculation to say whether these business decisions were driven by Grokster or were simply a determination that in order to enter or solidify their positions in the marketplace, emerging technologies needed to partner with the established music industry. Regardless of the impetus, I am encouraged by the current climate, as it is steadily providing more opportunities for consumers to enjoy music in a manner that appropriately compensates copyright owners, and creating a level playing field among all competing online music services, such as the new Napster, iTunes, Rhapsody, and others, who no longer have to compete with rogue services like Grokster whose incorrect interpretation of the law actually discouraged the building of legitimate entertainment services that respect copyright and try to minimize infringing activity. Moreover, the sharp divisions in the Court over precisely how to interpret the "Sony rule" may have a salutary effect of causing developers of technology to take steps to ensure that their products and services truly have substantial noninfringing uses and are not used primarily as infringement tools. While we were hopeful that the Court's ruling would add clarity to this area of the law, it may be that the lack of clarity causes more socially responsible behavior by those

who previously might have been tempted to rely on what they perceived as a "bright-line test" that absolved technology providers from any responsibility whatsoever for the uses to which their offerings are put.

Not surprisingly, the lower courts have begun incorporating the Grokster ruling into their decisions, although thus far that case law is sparse. In *MEMC Elec. Materials v. Mitsubishi Materials Silicon Corp.*, the Federal Circuit applied Grokster in a patent context. Although a well-developed body of law provides guidance on the Patent Act's express cause of action for active inducement of infringement, set forth in section 271(b), the court specifically looked to Grokster's analysis of the evidence of active steps taken to encourage direct infringement, particularly a defendant's "instructing how to engage in an infringing use." The court concluded that genuine issues of material fact existed as to the subject inducement claim based on the defendant's knowledge of the patent, knowledge of the potentially infringing activity and the substantial product and technical support it provided to the alleged direct infringer. Similarly, although *Monotype Imaging, Inc. v. Bitstream, Inc.* ultimately found that the defendant had not intentionally induced copyright infringement, it appropriately incorporated the Grokster decision into its reasoning.

While a U.S. Supreme Court decision of course has no binding precedential value outside of this country's borders, it is probably no coincidence that since Grokster, three courts spanning the globe have reached results consistent with the result in Grokster. In Australia, the Federal Court ruled this month that Sharman Networks and its principals are liable for copyright infringement based on the unauthorized peer-to-peer file sharing that its Kazaa application enables. Although the Australian court noted that there were substantial factual and legal differences between Grokster and the case before it, it found liability against Sharman and Kazaa for reasons very similar to the U.S. Supreme Court's rationale, noting, for example, that:

- (i) Sharman's website promotion of KMD as a file-sharing facility . . . ;
- (ii) Sharman's exhortations to users to use this facility and share their files . . . ; [and]
- (iii) Sharman's promotion of the "Join the Revolution" movement, which is based on file-sharing, especially of music, and which scorns the attitude of record and movie companies in relation to their copyright works 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.

This focus on "positive acts by Sharman that would have had the effect of encouraging copyright infringement" is consistent with the Grokster Court's discussion of marketing material and other overt acts that encourage infringement. The Australian court banned the file sharing system until the defendants modify the software to include filtering technology that would exclude copyrighted works from searches. Similarly, a Korean court essentially ordered the complete shut-down of Soribada, a free Internet file trading services, and its CEO has now been indicted for copyright infringement. An earlier ruling had found that the Soribada website encouraged users to commit copyright infringement. A Taiwanese court has also fined and sentenced to jail several executives and a prolific user of Taiwan's largest music file-swapping Internet site, Kuro, after it found that the peer-to-peer interface violated copyright laws. As the IFPI stated, "All four [cases] - including [the Taiwanese ruling,] the ruling against Kazaa in Australia, the unanimous

US Supreme Court ruling against Grokster, and then the injunction against Soribada in Korea - establish there is no defence for file-sharing services that build their businesses on the back of unauthorised trading of copyrighted material."

In fact, the Grokster decision should be very helpful to the United States as it continues its discussions with other countries about bringing their copyright laws up to date to meet the challenges of the digital networked environment that connects people around the world. Peer-to-peer infringement is not just a problem in the United States; it is a major problem abroad as well. In fact, to the extent that the Grokster decision provides new legal tools to stop massive peer-to-peer infringement, those tools will be of limited use if unlawful peer-to-peer services simply relocate abroad to jurisdictions where United States law has no applicability and local laws do not reach such conduct. The Grokster decision will assist us greatly in explaining how rules of secondary liability can play a key role in combatting massive peer-to-peer infringement. In fact, if our Supreme Court had upheld the lower courts' rulings of no liability, it likely would have made our task immeasurably more difficult: how could we urge other countries to take action if our own legal system is not up to the task?

A beneficial side effect of the publicity given to the Grokster decision is that it has helped to bring the issue of illegal file sharing to public consciousness and made it much more difficult for defenders of the practice to claim that it is lawful. After the Ninth Circuit ruled that Grokster and StreamCast could not be held secondarily liable copyright infringement, Streamcast's website for its Morpheus file-sharing software featured the following statement: "Morpheus is the only American P2P File Sharing software ruled legal by the US Federal Courts." Presumably many of Streamcast's customers interpreted that statement to mean that it was legal for them to use Streamcast's file-sharing software to download and make available copyrighted music and movies without the copyright owner's authorization. As defenders of unauthorized file-sharing of copyrighted works argued that the practice was lawful and as the law seemingly provided no effective remedy against the practice, members of the public could be excused for being unclear about the legal status of unauthorized file-sharing. While Grokster did not directly address first party liability of the person actually engaging in the file sharing, the Court's decision and the media attention it has garnered mean that no member of the public can reasonably make the argument that he or she is unaware that unauthorized file sharing is illegal. As I stated in my testimony before the Subcommittee on Intellectual Property in July, I believe that the majority of consumers who have engaged in illegal peer-to-peer "file-sharing" of music would choose to use a legal service if it could offer a comparable product, and more fundamentally, if they knew which services were legal. The recent Supreme Court decision in Grokster affords legitimate music services an opportunity to make great strides in further educating the public and penetrating the market.

A Need for Legislation?

At this time last year, this Committee was considering S. 2560, the Intentional Inducement of Copyright Infringements Act (the "Induce Act"). At that time, online piracy seemed unstoppable, and copyright owners were clamoring for some clear boundaries for peer-to-peer technology to be established. I testified in support of the proposed legislation and, at the request of the bill's sponsors, my Office played a leading role in efforts to craft an approach that met the needs and interests of copyright owners, the technology sector, and consumers. I was disappointed that those discussions reached no resolution as the 108th Congress came to a close. However, I think

the Supreme Court's ruling this year may well have resolved the issues that were so extensively debated in deliberations over the Induce Act - at least for the time being. In fact, it probably is not much of an overstatement to say that in effect, the Court enacted its own judicial version of the Induce Act when it clarified 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." The Court's ruling struck an appropriate balance between the rights of copyright holders and the flexibility necessary to enable and encourage technologists to continue to develop new products. It is perhaps because of this balance that I have not heard of any parties advocating a resumption of discussions on the proposed Induce Act. The Supreme Court seems to have found within existing law sufficient authority and flexibility to accommodate all parties, thereby obviating the need for new legislation. I use the word "seems" because with only three months having passed since the ruling, it is simply too early to tell whether Grokster will provide sufficient guidance for the years and circumstances to come.

It may be that in a few years, either copyright owners or technology providers - or both - will conclude that the Grokster decision has not adequately addressed the parameters of secondary liability for inducing infringement or that further clarification of the "Sony rule" is necessary. I think we need to give the lower courts some time to digest the Grokster ruling and give the affected parties time to see how clearly it offers guidance for both copyright owners and technology providers, and how good that guidance turns out to be. What I think is clear is that it is premature to consider the need for any legislation on secondary liability at this time. However, we do know already that Grokster cannot and will not resolve all of the issues that are facing the music industry. Grokster addressed only one facet of the piracy problem, the supply of products that purposefully facilitate infringement. To be able to combat piracy effectively, though, the industry must also be able to satisfy the demand from consumers for legitimate online music services. As I said in my recent testimony before this Committee's Subcommittee on Intellectual Property and before the House Judiciary Committee's Subcommittee on Courts, the Internet and Intellectual Property, one of the most significant hurdles facing the music industry is the inefficient process to license musical works that is engendered by the antiquated provisions of section 115 of the Copyright Act. While the Grokster decision affords legitimate music services an opportunity to make great strides in further satisfying the demands of the marketplace, it is an opportunity that will necessarily be squandered if Congress does not modernize the existing statutory licensing regime so that legitimate music services can take advantage of the blow the Court has struck against illegitimate offerings, before other illegal sources arise.

Section 115 of the Copyright Act governs the compulsory licensing of the reproduction and distribution rights for nondramatic musical works by means of physical phonorecords and digital phonorecord deliveries. However, it has rarely been used as a functioning compulsory licenses, serving rather as a ceiling on the royalty rate in privately negotiated licenses and thereby placing artificial limits on the free marketplace. Moreover, its "one-at-a time" structure for licensing individual musical works is incompatible with online music services' need to acquire the right to make vast numbers of already-recorded phonorecords available to consumers. Moreover, many online activities involve both the public performance right and the rights of reproduction and distribution, rights that usually are controlled by separate sets of middlemen in the case of

musical compositions, but not in the case of sound recordings. The existing system is characterized by tremendous impediments to efficient and effective licensing of the rights needed by a contemporary online music service. Reform is needed to make it possible to clear quickly and efficiently the necessary exclusive rights for large numbers of works.

During several hearings on this topic before both Subcommittees, the Copyright Office and industry representatives explored various means by which to reform section 115, including transforming the section 115 compulsory license into a section 114-style blanket license with royalty payments funneled through a single designated agent, expanding the section 115 license to include certain performances such as those that arguably arise in the context of tethered downloads, abandoning the section 115 compulsory license - at least with respect to digital phonorecord deliveries - and replacing it with a system of collective licensing similar to systems in place in many other countries, and/or simply repealing, but not replacing, the section 115 compulsory license so that reproduction and distribution rights would truly be left to marketplace negotiations.

Regardless of which avenue for reform is selected, it is clear that some kind of reform is needed - urgently, in my view. If the legitimate music industry continues to be saddled with a time-consuming and transactionally-expensive licensing process, then it can never compete effectively with the "pirates" who can offer a wider variety of music faster and cheaper. Thus far, the representatives of various copyright owners and music services have been unable to make substantial progress in settling their differences over the shape a new licensing regime should take and the royalties that should be paid to copyright owners. I believe that if there is to be any hope of a resolution, Congress must either send a clear message to the parties or take action on its own to reform the system.

Conclusion

Thank you, Mr. Chairman and all the distinguished Senators of this Committee, for providing me with the opportunity to update you on this landmark decision. I am hopeful that Grokster represents a turning point for legitimate online music delivery services to secure market dominance. I look forward to working with this Committee and representatives of the music industry on whatever actions are warranted, such as reforming section 115 of the Copyright Act to provide an efficient licensing mechanism for musical works.