

# MYTH OF THE DIGITAL DILEMMA: DECIPHERING THE LEGAL ANTAGONISM TOWARDS ONLINE PIRACY

HAIDEE LEUNG\*

## I. INTRODUCTION: PIRACY ON THE CYBER SEAS

Since the invention of the printing press a few centuries ago, owners of literary and artistic works have been confronted by unendorsed replications of their 'fruits of labour'.<sup>1</sup> From the 1960s onwards content publishers and distributors were challenged by the prevalence of photocopiers and cassette dubbing machines. The last decade saw the onslaught of the digital revolution in which perfect copies of CDs can be 'burnt' within minutes.<sup>2</sup> However, the latest evolution of internet technology has spawned a new species of intermediaries known as Peer-To-Peer ('P2P') file-sharing. Unlike the underground hawker selling cheap CD copies of the latest chart topper, these intermediaries do not actually distribute copyrighted material themselves but, rather, give users the ability to share digital formats of works with others worldwide.<sup>3</sup> The trading of files on P2P networks is extremely popular, accounting for nearly half of all internet traffic.<sup>4</sup> Despite the majority of files found on P2P networks being illegitimate, this 'dual purpose' technology can also be used for legitimate purposes such as distributing works with permission or that are non-copyrighted.<sup>5</sup>

The legal issues surrounding P2P file-sharing have undoubtedly posed novel challenges for copyright regimes worldwide. Before 1996, the World Trade Organisation's intellectual property protections largely ignored the internet.<sup>6</sup> Since then, the World Intellectual Property Organisation ('WIPO') has been established to extend international copyright laws to address the internet age. Currently, there exists a range of internet-related international treaties;<sup>7</sup> the main ones that New Zealand and most of its major

\* LLB(Hons), BA. The author is currently a corporate advisory and commercial litigation graduate at Russell McVeagh, Wellington. The law discussed in this article is as at 31 January 2009.

1 S Frankel & G McLay, *Intellectual Property in New Zealand* (2002) 160.

2 A Chen, 'Copy Locally, Share Globally: A Survey of P2P Litigation around the World and the Effect on the Technology Behind Unauthorised File Sharing' (2007) 19 *Intellectual Property & Technology Law Journal* 2.

3 J Ginsburg, 'Separating the Sony Sheep From the Grokster Goats: Reckoning the Future Business Plans of Copyright-Dependent Technology Entrepreneurs' (2008) *Columbia Public Law & Legal Theory Working Papers (Paper 08143)* 2-3.

4 H Schulze & K Mochalski, 'Internet Study 2007' (2007) *ipoque* <<http://www.ipoque.com/resources/internet-studies/internet-study-2007>> at 24 January 2009. See also R Singel, 'Internet Mysteries: How Much File Sharing Traffic Travels the Net?' *Wired Blog Network*, 5 May 2008 <<http://blog.wired.com/27bstroke6/2008/05/how-much-file-s.html>> at 24 January 2009.

5 Ginsburg, above n 3, 3.

6 R Bates, 'Communication Breakdown: The Recording Industry's Pursuit of the Individual Music User, a Comparison of US and EU Copyright Protections for Internet Music File Sharing' (2004) 25 *Northwestern Journal of International Law & Business* 238.

7 Ibid 235. See also I Finch, *James & Wells Intellectual Property Law in New Zealand* (2007) 171.

trading partners are signatories to are the 1996 *WIPO Copyright Treaty* and *WIPO Performances and Phonograph Treaty* (known as the ‘internet treaties’), which came into force in 2002. Their chief focus is on preventing the circumvention of built-in protections for copyrighted material.<sup>8</sup> Notably, especially in an era of global digital networking, international conventions to which New Zealand is a signatory state provide equivalent copyright protection in New Zealand for works originating overseas.<sup>9</sup>

Disparities still exist between various legal systems around the world though. Much of the litigation action is of course found in the United States, where the world’s largest entertainment moguls are based. But file-sharing is very much a massive global phenomenon, which is why the entertainment industry perceives it as such a colossal threat. The ongoing grievance of copyright owners is that the present law insufficiently protects their property rights in the face of an unprecedented copying-technology boom along with an ever-increasing participation of internet users.<sup>10</sup> Arguably, though, the current levels of copyright protection are already tipped in the entertainment industry’s favour; the fact that copyright owners are still dissatisfied might suggest that the problems they confront have deeper roots than which the law is capable of weeding out. This article will first set out and evaluate the current legal position of different jurisdictions towards P2P file-sharing and, in particular, dissect the Supreme Court’s latest stance on secondary liability for P2P software developers in the United States, and assess the liability of internet service providers (‘ISPs’) in New Zealand’s latest copyright reforms. The second half will undertake a more critical analysis of these current legal trends towards file-sharing from an economic, social and moral perspective, before offering some alternative solutions.

## II. COPYRIGHT LAW AROUND THE WORLD

### *United States: War Against Piracy*

#### **Introduction: The American Statutory Regime**

In the United States, the main copyright statute is the *Copyright Act 1976*, which gives copyright holders exclusive rights to do various acts in relation to its work, including reproduction and distribution to the public.<sup>11</sup> The Act does allow some restricted ‘fair uses’ by consumers, such as for educational, research, news reporting and commentary purposes.<sup>12</sup> When deciding whether the fair use exception applies, four factors need to be considered. These are the purpose of the use, the nature of the work, the amount and substantiality of the work used, and the effect of the use on the

8 Bates, above n 6, 239.

9 Finch, above n 7, 171.

10 Ministry of Economic Development, *Summary of Submissions Received on the Digital Technology Discussion Paper* (July 2002) 3.

11 Bates, above n 6, 232.

12 *Ibid* 233.

potential market for the work.<sup>13</sup> Overall, the Courts have been reluctant to allow the fair use exception, especially for P2P file-sharing cases. Using a VCR machine to ‘time shift’ was considered a fair use by the Supreme Court, however the District Court in *A&M Records Inc v Napster Inc*<sup>14</sup> thought the creative nature of music, as well as the fact that users could copy entire songs, weighed against the application of the fair use doctrine for the Napster P2P music-sharing software. Moreover, the Court opined that taping shows from free broadcasts was quite different from obtaining permanent copies of songs, which users otherwise had to pay for; while VCR users only enjoyed their tapes at home, Napster users made copyrighted songs available to millions of other users.<sup>15</sup> Notwithstanding that Napster users mainly downloaded for personal uses, such as for listening at home or in the car, rather than engaging in commercial activity, the Court still considered it economic in nature.<sup>16</sup> The Court also found the software had adverse effects on CD sales as well as prevented the potential for a legitimate digital downloads market.<sup>17</sup> The difficulty in establishing fair use is further illustrated in *UMG Recordings Inc v MP3.COM Inc*,<sup>18</sup> where users were required to have purchased the original CD before they could upload or download songs. There, the argument that fair use applied for users who were using their service for listening to their purchased music in different locations, also known as ‘space shifting’, was rejected. Curiously, the plaintiffs actually failed to show harm in the market for CD sales or digital downloads; it might even be argued that the defendant’s service actually enhanced these markets.<sup>19</sup> Yet, the Court held that the defendants had no right to enter the potential market for space shifting without the permission of copyright owners.

Of interest is the *Audio Home Recording Act 1992*, which actually gives consumers the right to make copies of music for private non-commercial use, but establishes a royalty fund to compensate copyright owners.<sup>20</sup> The *Audio Home Recording Act* also mandates the use of copyright controls in a ‘digital audio recording device[s]’ in order to deter mass copying.<sup>21</sup> However, the Act does not cover P2P downloads since a computer falls outside the definition of a ‘digital audio recording device’, which requires that the device’s ‘primary purpose’ is to make digital copies of recordings for private use.<sup>22</sup>

A more relevant statute for our purposes is the *Digital Millennium Copyright Act 1998* (‘DMCA’), which implements the WIPO treaties<sup>23</sup> and provides for a ‘safe harbour’ limitation on an ISP’s strict liability for copyright

13 R Tushnet, ‘Copy This Essay: How Fair Use Doctrine Harms Free Speech and How Copying Serves It’ (2004) 114 *Yale Law Journal* 544.

14 (2001) 239 F.3d 1004 (9th Circ).

15 R Shih & R Ku, ‘The Creative Destruction of Copyright: Napster and the New Economics of Digital Technology’ (2002) 69 *University of Chicago Law Review* 288-9.

16 *A&M Records Inc v Napster Inc* (2001) 239 F.3d 1004 (9th Circ) 1015.

17 Shih & Ku, above n 15, 287-8.

18 (2000) 92 F Supp 2d 349 (S D NY).

19 Shih & Ku, above n 15, 290-91.

20 *Audio Home Recording Act 1992*, 17 USC § 1004 (2000 & Supp. IV 2004).

21 *Audio Home Recording Act 1992*, 17 USC § 1002(a) (2000).

22 Bates, above n 6, 234.

23 *Digital Millennium Copyright Act 1998, Title I: WIPO Copyright and Performances and Phonograms Treaties Implementation Act*, 17 USC § 1201-5.

infringements in certain circumstances.<sup>24</sup> An ISP may be eligible for the safe harbour provided it has no actual knowledge or reason to know that a sound recording is infringing a copyright and did not receive 'direct financial benefit'. It would not be disqualified from the safe harbour unless they also had the 'right and ability to control infringing activity'.<sup>25</sup> Under the DCMA, 'service provider' has a very broad definition and most likely encompasses P2P file-sharing services.<sup>26</sup> Whilst ISPs have no duty to monitor users, 'awareness' triggers a proactive obligation to block access in order to qualify for statutory immunity.<sup>27</sup> Although the case law discussing this statutory 'red flag' is scant, it seems unlikely that the files need to be conclusively illegal before action is required, otherwise ISPs can simply turn a blind eye to infringement by claiming legal uncertainties such as the possibility of fair use.<sup>28</sup> Essentially, ISPs in the United States may fall under one of two regimes. Those that qualify for the safe harbour exemption only have a passive obligation to block access after a valid 'take-down' notice is served. Everyone else, as will be discussed below, is required to undertake proactive anticipation of its users' infringement through filtering to avoid liability for secondary infringement.<sup>29</sup> It appears that ISPs who are liable for secondary infringement will most likely fall outside the safe harbour as its threshold is quite limited, akin to the tests for immunity under secondary liability.<sup>30</sup>

### Secondary Liability According to the Supreme Court

The entertainment industry has largely relied not on statute but on judge-made law in its battle against P2P developers and individual users.<sup>31</sup> Under United States common law, persons can be liable for copyright infringement, even if they did not themselves illegally duplicate copyrighted works, through the secondary liability concepts of contributory infringement and vicarious liability.<sup>32</sup> In the landmark case of *Sony Corporation of America v Universal City Studios*,<sup>33</sup> which concerned Sony's distribution of a proto-VCR device known as the 'Betamax',<sup>34</sup> the Supreme Court recognised the possibility of contributory liability if a defendant's technology enabled an underlying act of direct copyright breach that they had knowledge of and had materially

24 *Digital Millennium Copyright Act 1998, Title II: Online Copyright Infringement Liability Limitation Act*, 17 USC § 512. The four 'safe harbour' categories are (1) conduit functions; (2) system caching; (3) user storage; and (4) information location tools.

25 Bates, above n 6, 236-7.

26 Ginsburg, above n 3, 16-17.

27 *Ibid* 20.

28 *Ibid* 22. See also S Corbett, 'Going Grey: the Copyright Debate' (2004) *New Zealand Law Journal* 386 and R Carnachan, 'Sampling and the Music Industry: A Discussion of the Implications of Copyright Law' (1999) 8 *Auckland University Law Review* 1052-6.

29 Ginsburg, above n 3, 18.

30 *Ibid* 15-16, 25.

31 D Kemp, 'Peer To Peer File Sharing, Copyright, and Grokster' (2007) 10 *Journal of Legal, Ethical and Regulatory Issues* 82.

32 P Menell & D Nimmer, 'Legal Realism in Action: Indirect Copyright Liability's Continuing Tort Framework and Sony's De Facto Demise' (2007) 55 *UCLA Law Review (Full journal title please)* 10-11.

33 (1984) 464 US 417.

34 Menell & Nimmer, above n 32, 2.

contributed to.<sup>35</sup> Furthermore, the defendant may also be liable vicariously if they benefitted from the infringement and had the right and ability to control the infringer's actions.<sup>36</sup> However, the Supreme Court in *Sony* limited the application of contributory infringement by employing the 'staple article of commerce' doctrine. Borrowed from patent law, the doctrine absolves the defendant of liability if the product is proven to be capable of 'substantial non-infringing use'.<sup>37</sup> This patent law concept rests upon the hallowed status of 'dual-use' technology because it encourages free competition. Quite often it left the patent owner with no remedy except through an action against the direct infringer.<sup>38</sup> Sony was saved from liability by the doctrine, notwithstanding Sony's awareness that their device would be put to at least some infringing uses, namely the copying of protected television programmes. The Court found that the 'primary use' of the VCR was for time-shifting free broadcast television programmes, which was a legitimate fair use.<sup>39</sup> On those facts, however, the question of whether a minority non-infringing use could still amount to 'substantial' was left undetermined by the Court.<sup>40</sup>

After a hiatus, the substantial non-infringing use doctrine resurfaced again in the *Napster* case, one of the first mass-market copying cases since *Sony*. Napster users were able to search the computer hard drives of other users through a centralised database and copy MP3 music files onto their own computers.<sup>41</sup> As it did not perform any of the actual copying or distribution of music files, Napster did not commit direct infringements. However, the software and centralised system of indexing facilitated the uninhibited copying of music. Napster was therefore held to have vicariously and contributorily infringed copyright,<sup>42</sup> and consequently the District Court issued a preliminary injunction.<sup>43</sup> Although the defendant attempted to invoke the *Sony* doctrine, pointing out that not all files transferred infringed copyright and that its P2P technology had potential lawful uses, it was ultimately rejected by the Ninth Circuit.<sup>44</sup> In doing so, the Court recognised that *Sony's* substantial non-infringing use defence could be evoked against contributory liability for file-sharing cases, and agreed that non-infringing uses should be considered when the device's distributor has neither actual knowledge nor control over specific infringements. However, it thought the defence was inapplicable in situations where the defendant had the ability to segregate and prevent infringing uses.<sup>45</sup>

35 *Kalem Co v Harper* (1911) 222 US 55, 62; *Gershwin Publishing Corp v Columbia Artists Management* (1971) 443 F.2d 1159 (2d Cir). See also Menell & Nimmer, above n 32, 10.

36 *Shapiro, Bernstein & Co v H L Green Co* (1963) 316 F.2d 304 (2d Cir). See Kemp, above n 31, 84 and Menell & Nimmer, above n 32, 10.

37 *Sony Corporation of America v Universal City Studios* (1984) 464 US 417, 442.

38 Menell & Nimmer, above n 32, 15.

39 *Sony Corporation of America v Universal City Studios* (1984) 464 US 417, 493.

40 Ginsburg, above n 3, 6.

41 Menell & Nimmer, above n 32, 35-6.

42 *Ibid* 36.

43 *Ibid*.

44 Ginsburg, above n 3, 6.

45 *Ibid* 6.

A different interpretation of *Sony* was used by the Seventh Circuit in the case of *In re Aimster Copyright Litigation*.<sup>46</sup> The complaint here targeted a file-sharing service that allowed users to instantaneously swap files in chat rooms.<sup>47</sup> Unlike Napster, however, this file-sharing technology was not reliant on a central server. In arguing the substantial non-infringing use defence, the defendant stressed its lack of control over users and the versatility of its technology which allowed the sharing of any file type.<sup>48</sup> Here, the Court rejected the argument that the *Sony* defence could be relied on when in reality the product was wholly used to facilitate copyright infringement, even if their product was theoretically capable of non-infringing use.<sup>49</sup> Hence, in determining whether there was substantial non-infringing use, evidence of actual non-infringing use was given more weight over the potential for non-infringing use, contrasting the Ninth Circuit's opinion in *Napster*.<sup>50</sup> The Seventh Circuit also drew a distinction between machines and service providers when they examined the issue of control. They observed that the sellers of the VCRs in *Sony* lost control once the unit was sold, but in relation to internet services the provider retained control through their ability to monitor and maintain their systems.<sup>51</sup>

The decisive difference between the outcome of *Napster* and *Sony* is thus the defendant's ability, or lack thereof, to disable infringing uses. In effect, this added another layer to the *Sony* inquiry, namely the knowledge and ability of the defendant to prevent specific infringements.<sup>52</sup> Subsequently, software developers attempted to circumvent the decision by designing highly decentralised systems, such as those used in Gnutella, Morpheus, and Kazaa.<sup>53</sup> The absence of a central index server meant that once the software was released publicly, the developer lost control of client access and shared files, notwithstanding that they knew their users were probably spreading unauthorised material.<sup>54</sup> This arguably made such developers analogous to the distributors of VCRs in *Sony*.<sup>55</sup> Notably, these 'second generation' file-sharing systems were even more versatile than their Napster predecessor because they allowed the searching and downloading of any file types, not just music.<sup>56</sup> Because they were capable of even more legitimate uses, for example, uploading home videos, government documents, and open source software, there was an expectation that they would surely fall within the *Sony* protection.<sup>57</sup>

46 (2003) 334 F.3d 643 (7th Circuit).

47 Menell & Nimmer, above n 32, 36.

48 Ibid 40.

49 Ibid 36.

50 Kemp, above n 31, 84.

51 Ibid 84.

52 Ginsburg, above n 3, 6-7.

53 Menell & Nimmer, above n 32, 41-2.

54 Kemp, above n 31, 83.

55 C Stuart & M Lapple, 'MGM v Grokster: Multimillion-Dollar Questions That the Supreme Court Did Not Answer' (2005) 17 *Intellectual Property & Technology Law Journal* 13-14.

56 Menell & Nimmer, above n 32, 42.

57 Stuart & Lapple, above n 55, 13.

The strung-out battle between developers and the entertainment industry climaxed in the case of *MGM Studios Inc v Grokster Ltd*.<sup>58</sup> Against the tide of judicial disinclination to apply the *Sony* doctrine in file-sharing cases, both the District Court and Ninth Circuit found that the P2P developers, Grokster and StreamCast, qualified for the substantial non-infringing use immunity. The defendants in *Grokster* were perhaps prime examples of developers crafting their P2P systems with the intention of defeating copyright enforcement; they did not shy from making public their aim of filling the vacuum left by Napster's demise.<sup>59</sup> However, the Ninth Circuit said it could not find them liable for contributory or vicarious infringement solely because they did not prevent specific infringements.<sup>60</sup> Moreover, they lacked the requisite actual knowledge of their users' direct copyright infringement, albeit aware that they were probably engaged in such unlawful activities.<sup>61</sup> The Ninth Circuit discarded *Aimster*, and in particular, any 'blind eye' theory of liability.<sup>62</sup>

Unluckily for the P2P community, their triumph was short-lived. As expected, the divergence between the Ninth Circuit's ruling in *Grokster* and the Seventh Circuit's opinion in *Aimster* inevitably required the Supreme Court to enter the arena.<sup>63</sup> Whilst not directly overruling the Ninth Circuit, it unanimously reversed the lower court's decision by finding the defendants guilty of infringing copyright, although it was through an astonishingly new route. Scrounging from yet another patent law concept, the Supreme Court manoeuvred around *Sony* by utilising the 'inducement theory' to extend indirect liability for copyright infringement.<sup>64</sup> Under this judicial patent law doctrine, liability could fall on defendants if they caused others to infringe, even if they did not themselves directly commit the act of infringement.<sup>65</sup> In applying this to copyright cases, developers of P2P software could incur secondary liability if they are found to have 'actively induced' infringement, even if they lack actual knowledge of specific direct infringements by its users.<sup>66</sup> Active inducement requires firstly that the inducer intended to cause infringement, and distributed a device used for infringement. Secondly, actual infringement by users of such a device needs to be proven.<sup>67</sup> Thus, the Courts noticeably shifted their focus from the technicalities of the P2P software, where it lay in the past, to the behaviour and intent of the defendant.<sup>68</sup>

Even in the context of patent law, however, the *mens rea* requirement of 'actively induce' had not received clear judicial definition.<sup>69</sup> The Supreme Court sought to clarify this in *Grokster*. There, it said the three

58 (2003) 259 F.Supp.2d 1029 (DC); (2004) 380 F.3d 1154 (9th Cir); (2005) 545 US 913 (SC).

59 Ginsburg, above n 3, 7.

60 Ibid 8. See also Menell & Nimmer, above n 32, 42-3.

61 Kemp, above n 31, 85.

62 Menell & Nimmer, above n 32, 43.

63 Ibid 36.

64 Kemp, above n 31, 85.

65 S Buckingham & M Savare, 'Grokster's Impact on Patent Law: Does It Resolve a Federal Circuit Split?' (2006) 18 *Intellectual Property & Technology Law Journal* 17.

66 Menell & Nimmer, above n 32, 43.

67 Ginsburg, above n 3, 8.

68 Chen, above n 2, 1-2.

69 Buckingham & Savare, above n 65, 17-18.

features probative to finding intention to induce infringement are if the defendant promoted the infringement-enabling virtues of its device, failed to filter out infringing uses, and its business plan depended on a high level of infringement.<sup>70</sup> Realistically though, it is unlikely that an internet entrepreneur would implement a filter if it is not economically beneficial, meaning the last two elements are somewhat interdependent.<sup>71</sup> The Supreme Court noted that the developers in *Grokster* had not only failed to build any safeguards or deterrents against copyright infringement by users, but even stated publicly their objective of disseminating copyrighted works.<sup>72</sup> Along with the fact that they had actually profited from their P2P software through advertising revenues, the defendants fell squarely within the three markers of having an intention to induce. So, *Grokster* illustrates that a service provider's business behaviour through its marketing, interaction with its users, how its revenue is generated, and whether it endeavoured to curtail copyright infringement may now be relevant factors.<sup>73</sup> The Court did stress, however, that inducement liability may only be imposed when a party has 'acted with the object of promoting copyright infringement' as shown by 'clear expression or other affirmative steps taken to foster infringement'.<sup>74</sup> In other words, there needed to be purposeful and culpable conduct.<sup>75</sup> Further, the Court cautioned that evidence pointing to any of the three intent indicators in isolation was not enough to establish active inducement.<sup>76</sup> Commentators have suggested that a finding of intent to facilitate infringement is more likely where a device or service assists massive-scale infringement, although such interpretation means the *Grokster* test is actually about 'bad results' rather than 'bad intentions'.<sup>77</sup>

In deciding the above, the Supreme Court insisted that they were not creating a new standard of secondary liability since active inducement is a pre-existing and codified form of liability.<sup>78</sup> Rather, they were only appreciating that *Sony's* substantial non-infringing use defence does not necessarily bar liability for inducement.<sup>79</sup> Accordingly, the Ninth Circuit's error was not in its interpretation of *Sony*, but in their failure to recognise the irrelevance of the *Sony* standard where a defendant actively induced copyright infringement.<sup>80</sup> This reveals a glaringly unsatisfactory aspect of the Supreme Court's decision in *Grokster*, that is the lack of resolution over the meaning of 'substantial' in the *Sony* enquiry.<sup>81</sup> Justice Ginsburg and Chief Justice Kennedy thought the Ninth Circuit misinterpreted the substantial non-infringing use defence,

70 Ginsburg, above n 3, 8.

71 Ibid 10-11.

72 *MGM Studios Inc v Grokster Ltd* (2005) 545 US 913 (SC) 924.

73 Chen, above n 2, 1-2.

74 *MGM Studios Inc v Grokster Ltd* (2005) 545 US 913 (SC) 937.

75 Buckingham & Savare, above n 65, 18.

76 Ginsburg, above n 3, 8.

77 Ibid 9.

78 Inducement as codified in the *Patent Act 1952*, see 35 USC § 271 and *MGM Studios Inc v Grokster Ltd* (2005) 545 US 913 (SC) 936.

79 Buckingham & Savare, above n 65, 19.

80 Ginsburg, above n 3, 7.

81 Stuart & Lapple, above n 55, 13.

which in their opinion required substantial *actual* non-infringing use.<sup>82</sup> Hence, their focus was more on the current quantity of non-infringing use, rather than the potential quality of non-infringing use.<sup>83</sup> Justice Ginsburg did not equate the *Sony* rule to immunity against contributory liability for products capable of substantial non-infringing use. Rather, with contributory liability being fault-based, substantial non-infringing use only limits the finding of culpable intent for active inducement.<sup>84</sup> Therefore, even if the P2P software is capable of non-infringing uses, which might suggest a lack of culpable intention, the Court is still free to weigh that against other evidence pointing to the existence of such intention.<sup>85</sup>

On the other hand, Justice Breyer, who also gave judgment on behalf of Justices Stevens and O'Connor, agreed with the Ninth Circuit's interpretation. In doing so, he found three facts in the case before them that they thought were analogous to those in *Sony*.<sup>86</sup> Firstly, defendants in both situations had not themselves illegally copied a copyrighted work; they merely provided a machine or service that could be used for such an activity. Secondly, the defendants in *Sony* knew the machines would be used by many buyers to make unauthorised copies, which parallels the knowledge of the defendants in *Grokster*; that alone was insufficient to make defendants in *Sony* an infringer. Finally, the evidence in *Sony* showed around 9% of VCR owners used the machine for non-infringing use, but in the present case the percentage was actually slightly higher, notwithstanding that the amount of copying by Morpheus users was much greater.<sup>87</sup> In concluding that the defendant's software had uses other than non-infringing uses, Breyer J thought allowing P2P file-sharing to continue would encourage even more lawful uses,<sup>88</sup> which is a desirable result, never mind if such uses were not developed by the defendants themselves.<sup>89</sup> Since Breyer J would find the defendants in *Grokster* satisfied the substantial non-infringing use defence if left in its current state, for him the next question was whether the *Sony* standard should be made stricter so as to avoid its applicability in the cases like the one before him.<sup>90</sup> His Honour devised a three-point inquiry based on social and economic considerations. To summarise, Breyer J thought *Sony* had been effective in promoting the technological progress by assuring that developers would be safeguarded from copyright claims provided they brought 'valuable new technologies' to the market. A stricter interpretation would cause a chilling effect on such progress.<sup>91</sup> Moreover, such hindrance of technological advancement would not be outweighed by any additional benefits to copyright owners, since there are other ways via which owner's rights can be protected.<sup>92</sup>

82 Kemp, above n 31, 86.

83 Stuart & Lapple, above n 55, 17.

84 *MGM Studios Inc v Grokster Ltd* (2005) 545 US 913 (SC) 935.

85 Stuart & Lapple, above n 55, 15-16.

86 See Kemp, above n 31, 86.

87 *Ibid.*

88 *Ibid.*

89 Stuart & Lapple, above n 55, 17.

90 *MGM Studios Inc v Grokster Ltd* (2005) 545 US 913 (SC) 957 per Breyer J.

91 *Ibid* 958-9 per Breyer J.

92 *Ibid* 960-2 per Breyer J.

Nevertheless, from a practical perspective, the lack of clarity regarding what level qualifies as non-infringing use under the *Sony* doctrine may matter little, since it has effectively been displaced by *Grokster's* inducement doctrine.<sup>93</sup> For file-sharing cases, it seems that *Sony* will only come into play if an intention to induce is unproven. Conversely, where *Sony's* threshold for contributory liability is not crossed then active inducement seems unlikely to be found either.<sup>94</sup> Plaintiffs seem to prefer either attacking individuals for direct infringement or pursuing developers through active inducement liability in order to avoid confronting the possibility of non-infringing uses of P2P technology altogether.<sup>95</sup> Meanwhile, defendants are fairly aware by now of *Sony's* poor success rate, and would probably consider their resources better spent in arguing the applicability of DMCA's safe harbour provisions.<sup>96</sup> Indeed, given the failure of the *Sony* doctrine to successfully immunise any defendants for the past two decades, the defeat of the *Grokster* defendants should hardly come as a surprise.<sup>97</sup> It is plausible that Sony would have been liable under the inducement theory as well, if argued today, since it promoted the VCR for building a library of copied programmes and refused to install 'jammers' preventing unauthorised copying.<sup>98</sup> Yet, the Supreme Court back then favoured allowing the technology. One might wonder why the Courts have since had such a hasty change of heart towards 'infringing technology' in contemporary P2P file-sharing cases.<sup>99</sup>

### **The Injunction: an Obligation to (Imperfectly) Filter?**

After the Supreme Court reversed the case it was remanded to the Federal District Court.<sup>100</sup> In the meantime *Grokster* had settled with the plaintiffs, leaving StreamCast as the sole defendant. The District Court granted a permanent injunction against StreamCast requiring it to design and implement a filter to safeguard against copyright infringement by its users, as well as encourage its subscribers to install the filter through software updates.<sup>101</sup> In granting the injunction, the Court said it hoped to curb the infringement capabilities of the defendant's software as effectively as possible, without destroying its core non-infringing functions,<sup>102</sup> however, the Court refused to grant the 'perfect filter' that was sought by the plaintiffs.<sup>103</sup> Not only was filtering out all infringing content technically unattainable, but doing so would effectively ban the defendant's software, which the Court considered unattractive given the software had potential to be used for legitimate file-sharing.<sup>104</sup> Interestingly though, the Court appointed a

93 Ginsburg, above n 3, 9.

94 Ibid.

95 Menell & Nimmer, above n 32, 44.

96 Ibid 43.

97 Ibid 35.

98 Ginsburg, above n 3, 9.

99 Kemp, above n 31, 88-9.

100 D Blood & K Ngiam, 'A Focus on Filters: Latest Developments in *MGM v Grokster*' (2008) 20 *Intellectual Property & Technology Law Journal* 7-8.

101 *MGM Studios Inc v Grokster Ltd* (2007) 518 F.Supp.2d 1197, 1235.

102 Ibid 1235-6.

103 Blood & Ngiam, above n 100, 8.

104 Ibid.

permanent technical expert to oversee the filter implementation, depriving StreamCast of any final say over the type of filter it eventually used and how it would be implemented.<sup>105</sup> The Court considered the expenses of the job irrelevant unless it was substantial when the filter was only minimally effective. At the end of the day, the financial health of technology developers appears to be an inferior concern for the Courts when compared with the interests of copyright owners.<sup>106</sup> Perhaps the most important implication from the District Court order, however, is that a failure to filter may possibly be counted as evidence of an intention to actively induce.<sup>107</sup> This raises the question whether the existence of a filtering system would lead to the opposite finding.<sup>108</sup> But a more pressing matter needing judicial deliberation is a determination of the legal standard required of filters. This will likely depend on the technology levels facing the Courts at the time.<sup>109</sup> Filters that react excessively may not only drive away customers, but possibly censor potential 'fair uses'.<sup>110</sup>

### **Aftermath: The Effect of *Grokster* on the P2P Community**

After the *Grokster* injunction, several popular user-generated content websites such as YouTube announced a joint 'Principles of User Generated Content Services' guideline, which recommends pre-upload filtering of content posted to websites by users. No doubt, this move was an attempt to extend an olive branch to the entertainment industry, which had by then intensified its assault on the internet community.<sup>111</sup> Optimists might see *Grokster* as steering technology companies towards a more copyright-friendly route by developing more effective and sensitive filtering technology, arguing that innovation and respect for copyright can sit harmoniously with one another.<sup>112</sup> Notably, notwithstanding the associated expenses, sophisticated filters using 'identification technology' are already surfacing.<sup>113</sup> For example, YouTube recently unveiled a beta-test filter using digital fingerprinting technology called 'YouTube Video Identification',<sup>114</sup> perhaps marking a new era where online content distributors take a more proactive role in protecting copyright.<sup>115</sup>

On the other hand, pundits have protested the stifling effect that *Grokster* may have on the advancement of internet technology as a result of the considerable resources that developers need to employ in order to avoid liability.<sup>116</sup> Whilst the *Grokster* ruling compelled many P2P providers such

105 *MGM Studios Inc v Grokster Ltd* (2007) 518 F.Supp.2d 1197, 1240-1. See also Blood & Ngiam, above n 100, 8.

106 Blood & Ngiam, above n 100, 8, 10.

107 Ibid 8.

108 Ginsburg, above n 3, 11.

109 Ibid 12.

110 Ibid.

111 Blood & Ngiam, above n 100, 9. See also Ginsburg, above n 3, 11.

112 Ginsburg, above n 3, 14.

113 Ibid 12-14.

114 Blood & Ngiam, above n 100, 7. See also YouTube, *YouTube Video Identification Beta* <[http://www.youtube.com/t/video\\_id\\_about](http://www.youtube.com/t/video_id_about)> at 27 January 2009.

115 Blood & Ngiam, above n 100, 7.

116 Ibid 8.

as eDonkey, WinMX, and BitTorrent to attempt 'going legit' by changing their business models to distribute only licensed content, many eventually went out of business.<sup>117</sup> This point was probably in the back of the Supreme Court's mind when, in the course of their judgment, they warned more than once against inferring intent from any individual similar fact. It remains nonetheless worrying that the defendants in *Grokster* were found to indirectly possess an intention to induce merely because its marketing targeted ex-Napster users.<sup>118</sup> A defendant is vulnerable to being impugned for possessing subjective intention to facilitate infringement through its product usage if a claimant can identify some marketing slogan, internal memo, or even customer service involvement, regardless of how *de minimis* it may be.<sup>119</sup> *Grokster* has also been criticised for dampening open and frank discussions about the possible uses of P2P software by developers, since doing so might make them susceptible to creating 'evidence of awareness' that may subsequently be used against them in a copyright infringement claim.<sup>120</sup> It is interesting to note that the *Grokster* injunction goes much further than the DMCA safe harbour notice, requiring a positive hands-on role in identifying, filtering and pre-emptively limiting public access to content.<sup>121</sup> The danger here is that the entertainment industry's demands could be far-reaching, ranging from designing copyright protection mechanisms or altering marketing strategy to abandoning a product initiative altogether.<sup>122</sup>

### *Other Overseas Trends: The Domino Effect*

#### **Europe: the ISP Scapegoat**

American legislation has very much shaped the European copyright regime. The *2001 European Union Directive on Copyright*, incorporating the WIPO anti-circumvention prohibitions and giving owners exclusive rights to authorise or prohibit communication of their works to the public, provides the blueprint for member states.<sup>123</sup> This Directive allows owners to distribute works to the public in a way that permits access from a place and time chosen by the individual, which appears to include all methods of transmitting works online.<sup>124</sup> Although not explicitly required by the 2001 Directive, member states are allowed to provide 'private use' exceptions so long as copyright holders receive 'fair compensation' in return.<sup>125</sup> The *2004 European Union Directive on the Enforcement of Intellectual Property Rights* is more controversial, applying to any 'intentional violations of copyright', which seems to encompass P2P file-sharing.<sup>126</sup> So far this Directive has been labelled the 'nuclear weapon of digital

117 Chen, above n 2, 2.

118 Stuart & Lapple, above n 55, 19-20.

119 Ibid 19.

120 Ibid.

121 Blood & Ngiam, above n 100, 10.

122 Stuart & Lapple, above n 55, 20.

123 Bates, above n 6, 240.

124 Directive 2001/29/EC, article 3(1). See *ibid*.

125 Directive 2001/29/EC, article 5(2)(b).

126 Directive 2004/48/EC, article 2. See Bates, above n 6, 241.

rights law',<sup>127</sup> no doubt indicative of the RIAA and MPAA's advantage in the war against online piracy on the European front. While the Commission says it aims to 'strike a fair balance' between copyright owners and 'legitimate users' of intellectual property by focussing its protective measures on commercial infringements, the Court's power to halt ISP participation in infringement using interlocutory injunctions appears to favour the former.<sup>128</sup> A general DMCA-style safe harbour exists in the context of European e-commerce,<sup>129</sup> but the 2004 Directive goes further by imposing greater affirmative policing duties on European ISPs than their American counterparts.<sup>130</sup> For example, courts may require an ISP to remove infringing files on their network. Interestingly, there is a tendency to dump liability on ISPs rather than on individual users in Europe. This is probably due to the absence of the strong ISP lobbying that is present in the United States.<sup>131</sup>

Overall, European courts have shown more flexibility than American courts when interpreting copyright protections and have been more systematic in determining liability for file-sharing.<sup>132</sup> However, the general animosity towards ISPs is hardly inconspicuous. The Munich Court of Appeal thought it was illogical for ISPs to escape liability merely because they were unaware of the copyright status of the files that their users were uploading to and downloading from their servers.<sup>133</sup> Liability was imposed on anyone who took part in the infringement so long as sufficient causal connection between conduct and infringement could be shown, and in that case the infringement could not have occurred without the connection provided by the ISP.<sup>134</sup> Similarly, Yahoo! was required by a Paris tribunal court of opinion to dissuade user access to an online auction selling Nazi memorabilia.<sup>135</sup> It was held there that liability could be imposed on ISPs for hosting illegal content or activities online. These two cases were not applied in the United States, however, because they fell blatantly outside the DMCA's safe harbour provisions and, apparently, sat uncomfortably with the First Amendment of the United States Constitution.<sup>136</sup>

127 Bates, above n 6, 240-1.

128 Ibid 242-3.

129 Ibid 240. *The European Directive on Electronic Commerce* (Directive 2000/31/EC) does provide for some ISP limited liability in section 4 'liability of intermediary service providers', which is aimed at harmonising ISP liability with the United States. See also M Aris, 'Liability of Service Providers under the European Directive on Electronic Commerce', *Internet Business Law Services*, 18 February 2008 <[http://www.ibls.com/internet\\_law\\_news\\_portal\\_view.aspx?s=latestnews&id=1987](http://www.ibls.com/internet_law_news_portal_view.aspx?s=latestnews&id=1987)> at 28 January 2009.

130 Bates, above n 6, 249-50 gives the example of the 'three strikes' system that would require ISPs to police file-sharing or disconnect users, similar to what is being proposed under s 92A of the *Copyright (New Technologies) Amendment Act 2008* in New Zealand. However, the United Kingdom has recently backed down on implementing such a policy. See P Pilcher, 'UK backs down on three strikes – will sanity prevail here?', *The New Zealand Herald* (Auckland), 29 January 2009 <[http://www.nzherald.co.nz/music/news/article.cfm?c\\_id=264&objectid=10554151](http://www.nzherald.co.nz/music/news/article.cfm?c_id=264&objectid=10554151)> at 30 January 2009.

131 Bates, above n 6, 249.

132 Ibid 247-8.

133 *Hit Bit Software GmbH v AOL Bertelsmann Online GmbH* (2001) 15 ECC 325 (Munich CA).

134 Bates, above n 6, 247.

135 *La Ligue Contre Le Racisme et L'Antisemitisme [LICRA] v Yahoo! Inc* (Paris, Interim Order no. 00/05308, 2 November 2000).

136 Bates, above n 6, 249.

One aspect that is common to both the United States and European copyright jurisprudence is the erosion of fair use protections. The common law and copyright legislation in the United States have traditionally provided for fair uses, and the European *Directive on Copyright* specifically lists exemptions from consumer liability.<sup>137</sup> Peculiarly though, fair use is not mentioned at all in the DMCA or the 2004 Directive. Moreover, as discussed above, the American courts have narrowed the doctrine substantially in recent times, especially in relation to file-sharing cases. It is noteworthy that prior to the *Intellectual Property Rights Enforcement Directive*, European courts actually stressed the protection of fair uses. For example, the Amsterdam Court of Appeal absolved Kazaa of liability for copyright infringement since it was not used solely for the file-sharing of copyrighted music, but also served as a communication tool.<sup>138</sup> The European P2P community should not get its hopes up though. Not only does the Amsterdam decision appear to be the only favourable decision for them in the world,<sup>139</sup> but it will unlikely stand given the policy direction of the 2004 Directive and the entertainment industry's advancing front on file-sharers throughout Europe.<sup>140</sup>

### Elsewhere: An Emerging Pattern

Australia has also ratified the WIPO internet treaties via their *Copyright Amendment (Digital Agenda) Act 2000*.<sup>141</sup> Quite recently the Australian Federal Court found Kazaa liable, holding that the defendant had knowledge of and 'authorised' the infringing uses of its P2P software.<sup>142</sup> Like *Grokster*, the Australian Court found Kazaa had direct financial interest in the infringing activities and ordered damages of US\$1.15 million. Kazaa was also required to implement search filtering technology or else cease operation.<sup>143</sup> Similar stances towards file-sharing are found in Asia, with courts in Korea, Japan, and Taiwan holding local P2P service providers accountable for copyright infringement through civil and criminal liability.<sup>144</sup> Interestingly, under current Canadian law it is legal to download on P2P networks via the 'private copying' exception, but this may be lost after Canada implements its DMCA-style copyright reforms.<sup>145</sup> Perhaps the emerging pattern of countries hastily yielding to the United States' protectionist stance against P2P technology is unsurprising. Just as information travels quickly in a globalising world, the interdependence between nations in a highly networked society will inevitably see jurisdictions converge on commercial copyright issues.

137 Ibid 250.

138 *Noot bij Kazaa v Buma-Semra Hof* (Amsterdam, 28 March 2002, no. 1370/01). See Bates, above n 6, 251.

139 Chen, above n 2, 2.

140 Bates, above n 6, 248.

141 Finch, above n 7, 171.

142 *Universal Music Australia Pty Ltd v Sharman License Holdings Ltd* [2005] FCA 1242. See also *Universal Music Australia Pty Ltd v Cooper* [2005] FCA 972.

143 Chen, above n 2, 2.

144 See *ibid* generally.

145 See M Geist, 'Piecing the Peer-To-Peer Myths: An Examination of the Canadian Experience' (April 2005) 10 *First Monday* 4 <<http://www.michaelgeist.ca/content/view/780/139/>> at 28 January 2009.

*New Zealand: Jumping on the Bandwagon*

**Introduction: New Zealand Copyright in the Digital Age**

A salient feature of the copyright scene in New Zealand is the lack of litigation on ISP liability, most likely because the insignificance of our market does not make it worthwhile for the battle against piracy to extend to our shores.<sup>146</sup> In that sense, there was probably no pressing need for law reform.<sup>147</sup> On the other hand, New Zealand's key trading partners such as the United States and Australia have already ratified the internet treaties through changes to their copyright legislation<sup>148</sup> and, as a small country reliant on free trade, New Zealand probably felt compelled to update its legislation to bring it in line with global standards.<sup>149</sup> In any event, after several years of submissions and discussions since 2001, the *Copyright (New Technologies) Amendment Act 2008* was finally passed in April 2008. The public policy objective behind the new Amendment is to provide incentives for the creation and dissemination of, and investment in, creative works to meet society's needs and encourage further innovation.<sup>150</sup> The Amendment further aims to minimise costs to society by providing users with certain exceptions to the rights of copyright owners.

New Zealand's statutory copyright regime draws heavily from international conventions.<sup>151</sup> Under the *Copyright Act 1994*, individual file-sharers may be liable for primary infringements, which provides for strict liability when anyone other than the copyright owner does one of the 'restricted acts'.<sup>152</sup> Similarly to other copyright jurisdictions, there are several 'fair dealing' exceptions, such as for educational or critique purposes.<sup>153</sup> The Amendment provides an additional exception for 'format shifting' of sound recordings, although it is possible to contract out of this.<sup>154</sup> Oddly enough, other types of media such as videos are left out of this new exception, which is somewhat of an anomaly given the prevalence of portable media devices today that are armed with video playback capacity alongside countless other functions.<sup>155</sup>

**Secondary Liability: The Long Road to Uncertainty**

Prior to the 2008 Amendment, it was quite difficult to establish ISP liability under primary or secondary infringement.<sup>156</sup> Secondary liability for infringement before the 2008 copyright reforms could be imposed in several

146 J Nebel, 'MED's Position Paper on Digital Technology and the Copyright Act: Legislation Without a Solution?' (2005) 36 *Victoria University of Wellington Law Review* 59-60.

147 *Ibid* 57-9.

148 Finch, above n 7, 171.

149 Ministry of Economic Development, *Regulatory Impact Statement: Digital Copyright Review* (June 2003) 1.

150 *Ibid* 2.

151 Finch, above n 7, 167.

152 *Copyright Act 1994*, s 16.

153 *Ibid* ss 42-43, 176. See Frankel & McLay, above n 1, 272-6.

154 *Ibid* s 81A.

155 J Te & K Ngan, 'The Copyright (New Technologies) Amendment Act: Dragging Copyright Into The 21st Century' (May 2007) *Simpson Grierson FYI x-tech 2* <<http://www.simpsongrierson.com/assets/publications/xtech/newsletters/xtechMay07web.htm>> at 23 November 2008.

156 Nebel, above n 147, 50.

situations. Firstly, secondary liability may fall under joint tortfeasance, which depended on passing a towering ‘common design’ threshold.<sup>157</sup> This requires close proximity between the actors as well as the existence of a ‘common intention’;<sup>158</sup> mere assistance will not amount to liability as a joint tortfeasor.<sup>159</sup> Secondly, a defendant may also incur indirect liability through inducement to commit a tort. This arises where the defendant wilfully induced another to do the unlawful act, which, but for the defendant’s persuasion, would not have been committed by the primary infringer.<sup>160</sup> Comparatively, this appears to be even stricter than *Grokster’s* inducement doctrine, since in New Zealand it must be shown that the defendant actually procured a particular infringement before they can be a joint infringer.<sup>161</sup> The third way in which secondary liability may arise is through vicarious liability, which is much narrower than the United States version.<sup>162</sup> In New Zealand, vicarious liability mostly applies in principal-agent or employer-employee scenarios;<sup>163</sup> it is hard to foresee such relationships arising between an individual file-sharer and the service provider.

Another way by which an ISP may incur secondary liability under the Act before the Amendment, and one which deserves more in-depth discussion, is via ‘authorisation’ of copyright infringement. As already mentioned, under s 29 of the *Copyright Act 1994* it is an infringement for anyone other than the copyright owners or its licensee to perform any of the restricted acts, but s 16(1)(i) further states that to ‘authorise’ another person to do any of the restricted acts is itself a restricted act. This has been anything but straightforward, chiefly because the meaning of ‘authorise’ has been shrouded with uncertainty. Not only is the term undefined in the statute with little guidance from New Zealand Courts, but the contradictory approaches of the English and Australian courts have complicated the matter further.<sup>164</sup>

The purpose of introducing the concept of infringement through ‘authorisation’, which first appeared in the English *Copyright Act 1911*, was to provide an alternative to the very limited scope of vicarious liability. In the context of copyright law, plaintiffs were often frustrated by the requirement of an agency relationship.<sup>165</sup> The House of Lords thought a defendant who either expressly or impliedly granted, or purported to grant, a third party the right to do the act complained of amounted to ‘authorising’ the act.<sup>166</sup> In *Amstrad*, music producers tried to hold blank cassette tape manufacturers liable for authorising infringement through high-speed dubbing of

157 P Apathy ‘Napster and New Zealand: Authorisation Under the Copyright Act 1994’ (2002) 33 *Victoria University of Wellington Law Review* 290.

158 *The Koursk* [1924] P 140 (CA). See *ibid* 290.

159 *CBS Songs Ltd v Amstrad Consumer Electronics Plc* [1988] RPC 567.

160 *Allen v Flood* [1898] AC 1 (HL).

161 *CBS Songs Ltd v Amstrad Consumer Electronics Plc* [1988] RPC 567.

162 Apathy, above n 158, 290.

163 *Ibid* 292.

164 *Ibid*. See also Frankel & McLay, above n 1, 230.

165 For example, the result in *Russell v Briant* (1849) 137 ER 737 (QB). See also Banks LJ in *Falcon v Famous Players Film Co* [1926] 2 KB 474, 491 (CA) per Bankes LJ, and Apathy, above n 158, 295-6.

166 *Falcon v Famous Players Film Co* [1926] 2 KB 474 and *CBS Songs Ltd v Amstrad Consumer Electronics Plc* [1988] RPC 567.

copyrighted music.<sup>167</sup> However, the Law Lords did not think liability for authorisation was established by merely making the means for infringement available. In saying so, they cited the case of *CBS Inc v Ames Records & Tapes Ltd*,<sup>168</sup> where a library that lent records as well as offering discounted blank cassette tapes for sale was held not to have 'authorised' infringement. Hence the English position required that the defendant actually claims to have the authority for permitting the infringing act before liability for authorising infringement could be imposed.<sup>169</sup> The 'permitting' element is somewhat controversial, though; it is very broad and can potentially encompass both active and passive acts. Indeed, Lord Scrutton was wary of imposing liability on defendants who had little involvement with the infringement.<sup>170</sup>

Subsequent Australian decisions, however, began introducing a 'control' component into the authorisation test, which is actually a key element in agency cases.<sup>171</sup> In contrast to English decisions, the High Court of Australia in *Moorhouse v University of New South Wales*<sup>172</sup> used a much wider and more passive definition of 'authorisation'. The Court thought that defendants could be liable for authorising infringement if they controlled facilities whilst 'knowing' or 'having reason to suspect' that they will likely be used for infringing purposes.<sup>173</sup> The plaintiffs in that case successfully claimed against universities for infringements made by students using their photocopying machines, notwithstanding that the machines were also used for legitimate 'fair uses', such as private study, or lecture notes.<sup>174</sup> Essentially, the Australian Court equated the term 'authorisation' with 'facilitation', but only if the defendant controlled and possessed the means for infringement.<sup>175</sup> Thus, the elements of 'authorisation' in Australia are firstly, control over the equipment used to infringe copyright, and secondly, 'virtual certainty' that it was being used in such a manner.<sup>176</sup> A modern application of the test arose in *Universal Music Australia Pty Ltd v Cooper*,<sup>177</sup> where a defendant operated a website containing links to infringing material. The operator was found to have 'authorised' copyright infringement by the users who downloaded the files and also by the ISP who stored the files, even though the files were never actually uploaded to, or downloaded from, the defendant's website.<sup>178</sup> The Federal Court of Australia found the website operated in a manner that was 'clearly designed to', and 'does facilitate and enable' the infringing downloads.<sup>179</sup> Moreover, the Court thought the defendant had 'knowingly

167 Frankel & McLay, above n 1, 230.

168 [1982] Ch 91.

169 Ibid 231.

170 *Performing Right Society v Cyril Theatrical Syndicate* [1924] 1 KB 1 (CA). See Frankel & McLay, above n 1, 301-2.

171 Apathy, above n 158, 301-2. For example, *Performing Right Society v Mitchell and Booker* [1924] 1 KB 762 (KB).

172 [1976] RPC 151 (HCA).

173 Apathy, above n 158, 294-5.

174 Frankel & McLay, above n 1, 230.

175 Ibid.

176 Ibid 231.

177 [2005] FCA 972.

178 Finch, above n 7, 206.

179 *Universal Music Australia Pty Ltd v Cooper* [2005] FCA 972, [84].

permitted, and approved the use of his website in this manner and designed and organised it to achieve this result'.<sup>180</sup> Tamberlin J discussed the 'control' element of the authorisation test, noting that the defendant could have prevented the infringements by either removing the links or structuring it in a way that inhibited other website operators from publishing their links on the defendant's website automatically.<sup>181</sup> It is also worthwhile to note that the host ISP of the defendant's website provided the service for free in return for advertising placement. From this the Court inferred that the ISP was aware of potential copyright infringements via the defendant's website, and therefore held the ISP, as well as its directors and employees, liable for authorising infringement.<sup>182</sup>

Unfortunately, the discussion of authorisation by New Zealand courts is generally scarce and almost non-existent in the internet context.<sup>183</sup> In *Spantech Pty Ltd v BPM Contracts Ltd*<sup>184</sup> the High Court left open the question of whether *Amstrad* or *Moorhouse* should be followed in New Zealand; but cases concerning the commission of a work are not really on point for examining ISP liability.<sup>185</sup> Notably, the Supreme Court of Canada has explicitly rejected *Moorhouse* in dealing with a similar case concerning photocopiers, choosing a more restrictive *Amstrad*-like definition of 'authorise' to mean 'give approval to, sanction, permit, favour, encourage'.<sup>186</sup> A further obstacle to holding ISPs liable for authorising infringement in New Zealand is the territorial limits of the *Copyright Act 1994*. Under the English statute, the authorisation need not have occurred within the United Kingdom for a defendant to be liable. English Courts can therefore extend its jurisdiction to websites and services that are easily accessible within the United Kingdom, even if they are hosted overseas.<sup>187</sup> In New Zealand, however, infringement via authorisation is subject to the same jurisdictional limitations as the other forms of infringements under the 1994 Act.<sup>188</sup>

Finally, ISPs may be liable for secondary infringement under s 37(1) if they provide a means for making infringing copies. This provision was not present in the older *Copyright Act 1962*, so the addition may be an indication of Parliament's intention to specifically address the issue of secondary liability where a person provides the means to infringe rather than directly commit the infringement.<sup>189</sup> Since the section requires that the object be 'specifically designed' or adapted for making copies of work, it may arguably not apply in P2P file-sharing cases given the 'dual purpose' of such software.<sup>190</sup> On

180 Ibid

181 Finch, above n 7, 206.

182 Ibid 207.

183 Frankel & McLay, above n 1, 232.

184 16 August 2004, Associate Judge Gendall, HC Wellington CIV-2003-454-160.

185 Finch, above n 7, 205.

186 *CCH Canadian Ltd v Law Society of Canada* (2004) SCC 13. See M Rimmer, 'Canadian Rhapsody: Copyright Law and Research Libraries' (2004) 35 *Australian Academic & Research Libraries* 198-201.

187 Frankel & McLay, above n 1, 229.

188 Ibid 229-30.

189 Apathy, above n 158, 295.

190 Finch, above n 7, 216.

the other hand, if New Zealand is swept along by overseas trends then, with the advent of *Grokster* and *Cooper*, the reading of s 37(1) may be slackened to cover devices not specifically designed to make infringing copies. Some speculate that it might even apply to ISPs who merely encourage users to infringe;<sup>191</sup> however, this provision still awaits direct examination by New Zealand courts in the context of the file-sharing services.

### **ISP Liability Post-Reform: A Contentious Case**

In the lead-up to the 2008 copyright reforms, the general mind-set was that ISPs should not be liable for copyright infringement unless they had failed to mitigate the problem after receiving notice of infringing activity by their users.<sup>192</sup> It was argued that requiring ISPs to supervise large volumes of data would not be cost-effective or practical.<sup>193</sup> Moreover, there was apprehension that making ISPs liable for copyright infringement may cause ISPs to pass on the additional costs to users through a price-hike or shut down altogether, both of which are economically and socially undesirable consequences.<sup>194</sup> Imposing strict liability on ISPs was also considered 'unfair' because innocent ISPs may not be able to bear the litigation costs to defend actions, even if the claims may not eventually be upheld. Such attitudes towards the role of ISPs in curbing online piracy were clearly quite different from the Europeans although after the *WIPO Copyright Treaty* there was a broad agreement that ISPs should be held responsible if they deliberately turned a blind eye to infringing activities by its users.<sup>195</sup>

The Amendment provides a further source of secondary liability for copyright infringement under a new s 37(2) where a person communicates 'knowing or having reason to believe that infringing copies will be made by means of the reception of the communication'.<sup>196</sup> A definition of 'communicate' has also been inserted into s 2(1), which means 'to transmit or make available by means of communication technology, including by means of a telecommunications system or electronic retrieval system'.<sup>197</sup> The definition of 'internet service provider' under the amended 1994 Act is rather broad and includes a person who 'offers transmission, routing, or providing connections for digital online communications, between or among points specified by a user, containing material of the users choosing', or 'hosts material on websites or other electronic retrieval systems that can be accessed by a user'.<sup>198</sup> These definitions will likely cover most P2P file-sharing services and websites like TradeMe, YouTube and Facebook.

A more controversial area of the Amendment comes from the limited ISP liability provisions, which essentially requires ISPs to delete or prevent access to infringing material as soon as possible after it becomes aware of

191 Ibid 216-17.

192 Frankel & McLay, above n 1, 748.

193 Ibid.

194 Ibid.

195 Ibid.

196 *Copyright (New Technologies) Amendment Act 2008*, s 20.

197 Ibid s 4.

198 *Copyright Act 1994*, s 2.

such infringing material.<sup>199</sup> Under the proposed s 92A<sup>200</sup> an ISP must also adopt and reasonably implement a policy for terminating accounts of ‘repeat infringers’.<sup>201</sup> The insertion of these sections is a plain effort to mirror the DMCA ‘safe harbour’ provision, but already there are two pivotal concerns anticipated. The first concern relates to the knowledge requirement of these new sections. An ISP may ‘become aware’ either through receiving a valid ‘take-down notice’ from the copyright owner or independently.<sup>202</sup> An example of independently becoming aware may be via the ISP’s own internal monitoring or from notification by a third party. Where an ISP has received notice from a third party, however, it is unclear to what extent the ISP must investigate the validity of such claims before it removes the alleged infringing content.<sup>203</sup> Some have suggested that an ISP in such a scenario might be expected to invite the copyright owner to issue a valid take-down notice before commencing removal. In the United States, it has been held that copyright owners should consider whether such alleged infringement of copyright work falls within the ‘fair use’ exception.<sup>204</sup> This poses the question of whether s 92A requires ISPs to undergo the same analysis upon receipt of a take-down notice, or perhaps go even further. For example, it may be that ISPs are expected to mull over all the other legal uncertainties that may arise in determining copyright infringement, such as ascertaining what is ‘substantial’.<sup>205</sup>

The second concern arises because the Act provides little guidance as to what constitutes ‘repeat infringing’, nor is it clear who counts as a ‘repeat infringer’. It appears that the possible interpretations of such a term may prove to be a double-edged sword.<sup>206</sup> At one end of the spectrum, ‘repeat infringing’ may be where a court has found the person guilty of committing multiple infringements. This seems doubtful seeing that, as it is simply not financially worthwhile to litigate over, the majority of these cases are settled out of court.<sup>207</sup> Such a reading would therefore render the ISP obligation under s 92A ineffective. At the other end of the spectrum, whether someone is a ‘repeat infringer’ may merely be determined on the ISP’s own terms and conditions, or in the more extreme case, upon the receipt of multiple infringement notices in relation to the same user. However, this may tempt copyright owners to

199 See *Copyright Act 1994*, ss 92B-E and *Copyright (New Technologies) Amendment Act 2008*, s 53. See P Sumpter, ‘Copyright Law Tackles Digitisation and the Internet Revolution’ (2008) 2 *New Zealand Business Law Bulletin* 2.

200 Section 92A as proposed by s 53 of the *Copyright (New Technologies) Amendment Act 2008* does not come into force until 28 February 2009 so that ISPs have time to reach an agreement as to how it is implemented through regulations. See M Slade, ‘ISPs tread risky path with new rules on piracy’, *The New Zealand Herald* (Auckland), 9 January 2009 <[http://www.nzherald.co.nz/technology/news/article.cfm?c\\_id=5&objectid=10551079](http://www.nzherald.co.nz/technology/news/article.cfm?c_id=5&objectid=10551079)> at 28 January 2009.

201 *Copyright (New Technologies) Amendment Act 2008*, s 53.

202 *Copyright Act 1994*, s 92C. See R Watts, S Hill & E Shearing, ‘Are ISPs Getting A Rough Deal? The Uncertain Position of ISPs Under the Copyright (New Technologies) Amendment Act’ (November 2008) *Simpson Grierson FYI x-tech 2* <<http://www.simpsongrierson.com/assets/publications/xtech/newsletters/xtechNovember08web.htm>> at 23 November 2008.

203 Watts, Hills & Shearing, above n 203, 2.

204 *Ibid* 3.

205 *Ibid*.

206 Slade, above n 201.

207 Watts, Hills & Shearing, above n 203, 2.

'bombard' ISPs with multiple complaints.<sup>208</sup> There would also need to be a way to track all complaints towards a particular user, which may be problematic for users who have engaged the services of multiple ISPs.<sup>209</sup>

The prevailing view during the early stages of reform discussion was that ISP liability should be limited, but this was contested by some who regarded ISPs being in the best position to 'fight piracy'.<sup>210</sup> As it turns out, and this is perhaps revealing as to why the RIANZ strongly supports it under the guise of protecting artists' rights, the proposed limited liability provisions are actually quite onerous on ISPs.<sup>211</sup> Firstly, the ISP's obligation to block access or remove potentially infringing material may conflict with their contractual obligations to provide access. Secondly, since ISPs will risk spoiling their reputation if they carelessly block material or users, they will be forced to expend resources to consider the legal merits of each claim.<sup>212</sup> From a technical perspective, it is also unclear whether service providers actually have the capability to block access in de-centralised networks, especially in the age of 'third generation' P2P software that have anonymity features built into them.<sup>213</sup> All of this supports the view that the obligations on ISPs under the proposed s 92A may actually conflict with one of the stated reform goals: to provide for cost-effective access to the internet. The proposed section also has an indirect negative effect on the other policy objective of encouraging the dissemination of creative works and innovation. Already there is vocal opposition to the implementation of s 92A. Parties representing businesses and consumer rights would prefer to see a less burdensome version of the section, such as a 'notice and notice' approach whereby the ISP plays the role of messenger between its user and the copyright owner instead of policeman.<sup>214</sup> Some opposition groups go even further by contesting the provision on a more fundamental basis. They stress that s 92A is effectively a presumption of guilt upon accusation, without evidence or fair trial, while false allegations go unpunished.<sup>215</sup> Such trepidations certainly pose the question of how far society should curb civil rights in hunting down 'pirates'.

## JUSTIFICATIONS: THE CASE FOR (AND AGAINST) STRENGTHENING COPYRIGHT

### *The Economics of Copyright Protection*

The above analysis attempts to state and clarify the legal position of copyright law concerning P2P file-sharing in various jurisdictions. Overall, there has been a global trend of strengthening protection for copyright owners

208 Ibid.

209 Ibid.

210 Nebel, above n 147, 50.

211 Te & Ngan, above n 155, 3.

212 Watts, Hills & Shearing, above n 208, 3.

213 T Chothia, *A Survey of Anonymous Peer-to-Peer Filesharing*, <<http://www.lix.polytechnique.fr/~tomc/P2P/index.html>> at 15 February 2009.

214 Consumer Institute NZ Inc, *Submission to the Commerce Committee on Copyright (New Technologies & Performers' Rights) Amendment Bill* (March 2007) 2. Note also the strong opposition in the United Kingdom to similar provisions, see Pilcher, above n 130.

215 See for example the Creative Freedom Foundation <<http://www.creativefreedom.org.nz>>.

in cyberspace. World bodies are increasingly recognising that intellectual property should be protected because of its high value.<sup>216</sup> Piracy has become a central focus of international relations and trade talks, resulting in robust enforcement efforts that were unheard of in the previous decades.<sup>217</sup> More subtly, however, those with much smaller voices than the entertainment industry highlight the hazards of such stoutly-pushed copyright protections. A holistic discussion of this topic therefore requires an examination of the justifications for copyright law in the realm of creative works. Such examination is fundamental to determine whether the current legal stance is socially and economically desirable, and if not, consider the alternative routes on which copyright law should take. After all, it should not be naively assumed that the interests of legislators are necessarily consistent with those of society when formulating copyright laws.<sup>218</sup> Even if a more benign view of politicians is taken, it is not given that they always have a full understanding of the issues at hand, nor do they necessarily have the best solutions.<sup>219</sup>

Before undergoing an economic analysis of the topic, it is useful to review some of the basic economics of copyright law. Copyright law protects the expression of ideas, which, being intangible and abstract, may be classed broadly as 'information'.<sup>220</sup> Economists often refer to the market for 'goods', and in dealing with information as a good, they recognise it as having unique characteristics that give it a 'public good' quality.<sup>221</sup> However, in economics this does not mean that such a good is publicly provided, but rather that it has 'non-excludable' and 'non-rivalrous' characteristics. Information is non-excludable because it is either impossible or extremely costly to exclude people from consuming it even if they have not paid for it.<sup>222</sup> A 'free rider' problem therefore arises in relation to non-excludable goods. Information is also non-rivalrous because an individual's use of information does not deprive it of availability to others.<sup>223</sup> Public goods pose a dilemma: the producer's inability to exclude people from using the good results in a lack of incentive to provide such a good in the first place as they are unable to recoup their investment, notwithstanding that the good may be beneficial to consume for society. It follows that a less-than-socially-optimal quantity of the good will be produced.<sup>224</sup> On the other hand, charging for the use of a non-rivalrous good might be seen as an unjustified limitation on the use of the socially-beneficial good. Individuals who are unwilling to pay as much as the set price are excluded from the good, even though they would have

216 M McAleer & L Oxley, 'Intellectual Property and Economic Incentives' (2006) 20 *Journal of Economic Surveys* 489.

217 *Ibid* 489-90.

218 T Bell, *Intellectual Privilege: Copyright, Common Law, and the Common Good* (forthcoming, 2008) 48 <<http://www.intellectualprivilege.com/book.html>> at 12 September 2008.

219 M Boldrin & D Levine, *Against Intellectual Monopoly* (2007) 6-7.

220 F Lévêque & Y Ménière, *The Economics of Patents and Copyright* (2004) 2, <<http://www.bepress.com/leveque/>> at 12 September 2008.

221 *Ibid* 64.

222 *Ibid* 4.

223 Thomas Jefferson quoted in Corbett, above n 28, 387 said '[h]e who receives an idea from me receives instruction himself without lessening mine'.

224 S Liebowitz & R Watt, 'How To Best Ensure Remuneration For Creators In The Market For Music? Copyright And Its Alternatives' (2006) 20 *Journal of Economic Surveys* 514-15.

benefitted from the information at no additional cost to anyone.<sup>225</sup> Such ‘market failures’ associated with public goods mean societal welfare is not ‘maximised’.

The rise of digital formats and P2P file-sharing technologies has intensified the public good problems. Information copied in analogue formats such as photocopying and cassette tape dubbing are limited by the marginal reduction in quality of each copy; the duplication of digital files on P2P networks, on the other hand, is potentially infinite.<sup>226</sup> In the latter case, the only cost to consumers of obtaining digital copies is the internet connection and time spent downloading. Like any other market failure society is faced with, the popular response is to introduce government intervention. For legislators, the perceived conundrum in the P2P debate is that on the one hand, ‘piracy’ reduces the incentive for creation and invention, but reinforcement of intellectual property may hamper the distribution of creative works and technological innovation.<sup>227</sup> Copyright laws claim to strike a balance between encouraging the production of expressive works and preventing unnecessary restriction of its consumption by giving authors certain exclusive rights over the work for a limited period. Although excludability is artificially created, it is only temporary and as the public will have access once the work enters into the public domain.<sup>228</sup> On this view, the emergence of P2P file-sharing tips this delicate balance because its facilitation of the diffusion of works is at the expense of the authors’ ability to profit from their creations.<sup>229</sup> Stronger copyright protection is said to restore this balance by raising the cost for copiers who now have to take into account the higher possibility of getting caught and suffering the penalty for infringing activities.<sup>230</sup>

One critique of this ‘balancing’ approach to copyright law, however, is that it is naturally imperfect for it only addresses the public good problem sequentially rather than simultaneously.<sup>231</sup> Moreover, the vocal complaints by the entertainment industry of how file-sharing impacts their profits often muffle the fact that copyright protection imposes costs on society as well. Firstly, there are the transaction costs involved in maintaining the copyright system, for example the negotiation and enforcement of contracts, and the significant expenses involved in infringement prosecutions.<sup>232</sup> Secondly, the lobbying undertaken by copyright owners for copyright protection is ‘rent-seeking’ behaviour. This is where different ‘bidders’ in the entertainment industry spend extensive resources in persuading political authorities to grant them a monopoly over expressive works.<sup>233</sup> Such spending is wasteful as a bidder is not guaranteed to win over other bidders and resources are

225 Bell, above n 219, 14.

226 Lévêque & Ménière, above n 221, 62-3.

227 Ibid 2-3.

228 Bell, above n 219, 9.

229 Lévêque & Ménière, above n 221, 76. See also A Zentner, ‘Measuring The Effect of File Sharing on Music Purchases’ (2006) 49 *Journal of Economic Surveys* 65.

230 Bell, above n 219, 5-6.

231 Lévêque & Ménière, above n 221, 6-7.

232 Liebowitz & Watt, above n 225, 517-18.

233 See Boldrin & Levine, above n 220, 21-3.

diverted from more productive economic activities.<sup>234</sup> This ‘deadweight loss’, or wasted potential benefits, is exacerbated by digital technology when copyright owners and hackers engage in an arms race, a vicious cycle in which the former has to continually spend resources on copy-protections whilst the latter are ever-persistent in cracking such protections.<sup>235</sup> Finally, such monopolies restrict access to socially valuable creations by preventing innovation through imitation.<sup>236</sup>

### *Effect of P2P File Sharing on the Recording Industry*

Copyright law has so far been used as a policy tool, but policies should be formulated to promote the welfare of society.<sup>237</sup> Merely stating anti-piracy as a justification overlooks and conflates many crucial considerations. An imperative question is whether the current levels of copying are actually eroding the incentive to create.<sup>238</sup> If the answer is no, then any perceived conflict between the two objectives of copyright law may actually be imaginary. After all, contrary to the assertion that copyright provides the incentive to create, intuition suggests that just like any other monopoly copyright holders may become too lazy to innovate in the absence of threats from competitors.<sup>239</sup>

An investigation into the validity of the recording industry’s claims of revenue losses and consequent threat to the market for creative works obviously requires an empirical examination of the actual effect of unauthorised file-sharing on the recording industry. This is not an easy task considering the lack of consensus amongst economists to date on the issue.<sup>240</sup> Early literature suggests CD copying has minimal impact on legitimate markets.<sup>241</sup> However, the results from more recent literature focussing on the impact of P2P file-sharing seem to be ambiguous and non-conclusive notwithstanding the RIAA and MPAA’s claim of the millions lost in revenue from the music and movie industry.<sup>242</sup> Most studies do show a negative correlation between album sales and P2P file-sharing.<sup>243</sup>

Causality of P2P file-sharing on revenue losses will depend on whether consumers are downloading albums they value highly and would otherwise have purchased or ‘low-valued’ albums that they would not have bought anyway.<sup>244</sup> In the former case the distributors would be deprived of revenue

234 Liebowitz & Watt, above n 225, 516.

235 Shih & Ku, above n 15, 319.

236 Ibid 318-19. See also Liebowitz & Watt, above n 225, 516 and Boldrin & Levine, above n 220, Ch 6 for discussion on the social value of imitation.

237 Bell, above n 219, 1.

238 Liebowitz & Watt, above n 225, 518-19.

239 Shih & Ku, above n 15, 320.

240 Liebowitz & Watt, above n 225, 519-20.

241 Ibid.

242 Ibid 521-2.

243 See H Hietanen, A Huttunen & H Kokkinen, ‘Criminal Friends of Entertainment: Analysing Results from Recent Peer-to-Peer Surveys’ (2008) 5 *Script-ed* 31 generally.

244 See Zentner, above n 230, generally for a summary of studies. See also F Oberholzer-Gee & K Strumpf, ‘The Effect of File Sharing on Record Sales: An Empirical Analysis’ (2007) 115 *Journal of Political Economy* 1, and S Liebowitz, ‘How Reliable is the Oberholzer-

from the forgone sale; the latter case would not result in any harm at all to distributors.<sup>245</sup> One survey indicates people actually value their downloaded music less than their purchased music;<sup>246</sup> because music is an 'experience good' a consumer's valuation of the expressive work before a purchase may change afterwards. Indeed, the study showed that consumers valued their downloaded music less before than after they downloaded it,<sup>247</sup> which suggests that, in general, consumers are unlikely to have bought the music they downloaded even if the illegitimate version was unavailable.<sup>248</sup> Moreover, 'socially beneficial transactions' never happen in the absence of file-sharing. Downloaded music is actually valued by the consumer, and most likely at above the marginal cost of producing an additional copy of the album, but just not at the asking price of a legitimate CD.<sup>249</sup> Arguably then, illegal file-sharing may actually alleviate this deadweight loss somewhat by allowing consumers to 'price discriminate' based on their willingness to invest time and money in file-sharing or, if they value the music high enough, to actually buy the album.<sup>250</sup> In theory, the more users engaging in online trading of low-value music, the less harm there is to distributors' revenue, and the more beneficial file-sharing activity is to society.<sup>251</sup>

Furthermore, survey results show that albums that are popular to purchase are also popular for downloading, and persons who like music may both download and purchase, which perhaps hints at a positive relationship between downloading and purchasing of albums.<sup>252</sup> This leaves open the possibility that other factors may be causing the declining sales, for example, demographic changes or state of the economy.<sup>253</sup> One popular alternative explanation for the drop in CD sales in the past few years is due to the fall in prices of substitutes such as DVDs and video games.<sup>254</sup> However, studies seem to show a positive correlation between purchasing music and other forms of entertainment, meaning album sales should increase together with these alternative entertainment products.<sup>255</sup> Another theory is that illegitimate music downloads can complement legitimate products: it allows consumers to sample the music before buying the whole album, similar to hearing tracks at a record store, thereby

Gee and Strumpf paper on File-Sharing?' (unpublished, August 2007) <<http://ssrn.com/abstract=1014399>> at 12 September 2008, for the ongoing debate between Liebowitz and Oberholzer-Gee & Strumpf regarding the impact of file-sharing on the music market.

245 R Rob & J Waldfogel, 'Piracy On The High C's: Music Downloading, Sales Displacement, and Social Welfare in a Sample of College Students' (2006) 49 *Journal of Law and Economics* 31, 37-8.

246 Ibid 30.

247 Ibid 39.

248 Ibid 54.

249 Ibid 30. See also Lévêque & Ménière, above n 221, 7-8.

250 Rob & Waldfogel, above n 247, 30-1.

251 Ibid 38.

252 Ibid 60-1.

253 Liebowitz & Watt, above n 225, 519-20.

254 Oberholzer-Gee & Strumpf (2005) cited in S Liebowitz, 'File Sharing: Creative Destruction Or Just Plain Destruction' (2006) 49 *Journal of Law and Economics* 22.

255 Zentner, above n 230, 85.

potentially inducing the purchase of music.<sup>256</sup> Many of these alternative explanations have yet to receive conclusive empirical proof or disproof, and so more work is needed in the field.<sup>257</sup>

*Is The Entertainment Industry Worthy of Protection?*

Even if we accept the entertainment industry's claim that file-sharing is the direct cause of their revenue losses, this still leaves the issue of whether their profits are actually worth protecting. Copyright law does not exist for the sake of protecting the financial interests of distributors.<sup>258</sup> Digital distribution on P2P networks is clearly a threat to copyright protections, but this is not the same as saying society's interests are also under siege. The entertainment industry has yet to show that without strict enforcement of its monopoly rights the public will suffer from a less than optimal supply of creative content.<sup>259</sup> Moreover, if there is in fact sufficient market demand from the public, then recording companies should still find it profitable to distribute in traditional formats, but such incentives should not be artificially created by copyright law.<sup>260</sup> Indeed, despite growth in P2P file-sharing and the reported drop in revenue, the recording industry continues to profit and the number of artistic works continues to grow.<sup>261</sup>

In the digital age, the assumption that there is market failure due to insufficient incentives for innovators may no longer hold true.<sup>262</sup> Much of the economic literature on copyright ignores the existence of non-monetary motivators for artists who are willing to 'subsidise' production of expressive works.<sup>263</sup> After all, most artists when deciding to write and record a song do not consciously think about projected royalty revenues as the recording company is primarily concerned with: they usually seek to express feelings or ideas. Self-expression may, as a benefit to the artist, offset some of the costs associated with producing an expressive work but that alone may not be enough. Thus, the copyright law is said to allow artists to recoup some of their sunken investments.<sup>264</sup> But reality paints a very different picture: artists usually receive very little, if any, income from album sales or royalties. Many are actually in debt to recording companies for the manufacturing, packaging, marketing, and distribution of their music.<sup>265</sup> Frequently, the issue of how much artists earn is overlooked because of the assumption that the interests of content distributors and artists are aligned.<sup>266</sup> However, whilst megastars may enjoy lucrative returns from royalties, in the majority of cases the revenues do not trickle down less-popular artists. Evidence shows that

256 Ibid 76.

257 Ibid 74.

258 Shih & Ku, above n 15, 299.

259 Ibid.

260 Ibid 322.

261 Ibid 298.

262 Bell, above n 219, 71. See also J Litman, 'Ethical Disobedience' (2004) 5 *Ethics and Information Technology* 222.

263 Ibid 69.

264 Ibid 19.

265 Shih & Ku, above n 15, 308.

266 Towse discussed in McAleer & Oxley, above n 216, 486. See also Shih & Ku, above n 15, 267.

the main benefactors of copyright are actually the 'humdrum' commercial side of the creative industries rather than the creators.<sup>267</sup> For example, one source reveals that for every \$1 of licensed download, the performer gets 8c while the composer only receives 4c.<sup>268</sup> Copyright law therefore plays a minimal role, if any, in compensating artists for their investment.

There is a good historical reason for artists being so poorly paid: largely because of the high capital investment required to 'launch' them.<sup>269</sup> Recent technological progress, however, has drastically decreased the cost for artists in both producing and distributing their expressive works. In the past, the creation and distribution of a new song required many tens of thousands of dollars of investment. Nowadays it is possible to do the same by setting up a computer, recording software and equipment, and an internet connection for just a few thousand dollars.<sup>270</sup> Another point is that creators of expressive works earn their income primarily from their fame and publicity, for example, giving live performances or endorsing products.<sup>271</sup> This is a result of widespread distribution of their music rather than the distribution itself.<sup>272</sup> Hence, cutting out the middle man altogether potentially creates a win-win situation where artists can earn a living from expressing themselves while consumers gain cheaper access to works.<sup>273</sup> One real-life illustration was when the Smashing Pumpkins sidestepped an official commercial release of their album 'Machina II' after their recording label refused to support it by posting it on the internet for free downloading.<sup>274</sup> The internet has also facilitated new sources of income for creators by connecting them directly with their audiences: for example, Stephen King's 'ransom model' of self-publishing for his novel 'The Plant', and through 'tipping'.<sup>275</sup> The entertainment industry may still try to overstate its role in meeting the high costs of marketing expressive works.<sup>276</sup> Again, the internet has provided new cheaper ways for artists to market their works:<sup>277</sup> many now take advantage of networking websites like MySpace and internet radio services such as Last.fm.

Population and economic growth, as well as the removal of trade barriers over time, has undoubtedly contributed to the enlargement of the creative works market and the opening of new sources of revenue for artists.<sup>278</sup> Noticeably, consumers are now able to choose between hundreds and

267 McAleer & Oxley, above n 216, 486.

268 Litman, above n 264, 222. See also D Byrne, 'David Byrne's Survival Strategies for Emerging Artists – and Megastars', *Wired*, 18 December 2007 <[http://www.wired.com/entertainment/music/magazine/1601/ff\\_byrne?currentPage=all](http://www.wired.com/entertainment/music/magazine/1601/ff_byrne?currentPage=all)> at 30 January 2009.

269 Litman, above n 264, 222.

270 Bell, above n 219, 70-1.

271 Shih & Ku, above n 15, 311.

272 Ibid 308.

273 Bell, above n 219, 71. See also Litman, above n 264, 121.

274 D Fricke, 'Smashing Pumpkins Look Back in Wonder', *Rolling Stone*, 22 December 2000 <[http://www.rollingstone.com/artists/smashingpumpkins/articles/story/5918770/smashing\\_pumpkins\\_look\\_back\\_in\\_wonder](http://www.rollingstone.com/artists/smashingpumpkins/articles/story/5918770/smashing_pumpkins_look_back_in_wonder)> at 23 January 2009.

275 Shih & Ku, above n 15, 310. See also H Varian, 'Internet Changes the Economics of Information Industries', *The New York Times* (New York), 27 July 2000 <<http://partners.nytimes.com/library/financial/columns/072700econ-scene.html>> at 31 January 2009.

276 Ibid 315-16.

277 Ibid 316.

278 Bell, above n 219, 79-80.

thousands of specialised and narrowed interests, revealing an increasingly 'fractured' market.<sup>279</sup> In such markets, the internet provides the further benefit of making access to such niche works easier and cheaper.<sup>280</sup> Copyright law, on the other hand, may have the negative effect of hindering competition from similar works in an environment.<sup>281</sup> Instead of relying on the vigorous assertion of their copyright, artists in niche markets are willing to tolerate low revenues per copy because they are able to recover their 'creative costs' by distributing very widely using the new cheaper methods.<sup>282</sup> This suggests that it might actually be profitable for artists to forego their monopoly power and concentrate on extensive, low-cost marketing of their works.<sup>283</sup> After all, modern economies have all benefitted from specialisation in their industries: viably, the same can apply to the expressive works market.<sup>284</sup>

It follows that the exclusive rights created by copyright cannot be justified as necessary or even the most efficient means of encouraging creation. Over time, copyright laws may be rendered a pointlessly restrictive and obsolete tool for stimulating authorship.<sup>285</sup> A somewhat extreme, but not entirely erroneous view, is that copyright serves no purpose other than to transfer wealth from the public and artists to distributors.<sup>286</sup> If legislators are seriously concerned with motivating creativity and improving public access to expressive works then, as markets grow and technology progresses, relaxing copyright protections in order to further both goals can solve the public good problems concertedly.<sup>287</sup> The prevalence of file-sharing technology may actually be consistent with copyright law's goal of 'promoting science and useful arts'.<sup>288</sup> Accordingly, there is potential for the expressive works market to be highly competitive and efficient in the digital age, where the only factor in pricing is the creative costs and without any barriers to entry except for talent.<sup>289</sup> Even in the less ambitious scenario, advances in internet technology should drive down the cost of content distribution below what the entertainment industry currently sets.<sup>290</sup>

### *Freeing the Guilty Conscience: The Case for Alternative Solutions*

So far it has been demonstrated that copyright law may be superfluous in light of internet-based distribution methods. The lion's share no longer has to be fed to publishers and distributors.<sup>291</sup> In an increasingly globalising world,

279 Ibid 87.

280 Ibid.

281 Ibid 89.

282 Ibid 87-8.

283 Ibid.

284 Adam Smith cited by Bell, above n 219, 89.

285 Bell, above n 219, 87-8.

286 Shih & Ku, above n 15, 305.

287 Bell, above n 219, 88. See also Shih & Ku, above n 15, 300.

288 The United States Constitution, article I, section 8 states Congress may use its powers '[t]o promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries'. See Shih & Ku, above n 15, 267, 286.

289 Shih & Ku, above n 15, 267, 305.

290 Ibid 305-6.

291 Litman, above n 264, 223.

it is feasible that common law, technological evolution and generosity are enough to stimulate creativity and innovation.<sup>292</sup> As it might be anticipated, some will disapprove of a purely economic-efficiency analysis of the issues at hand, and fairly so: it is fundamental in civil society to fully consider the ethical and moral foundations that underpin our laws. Copyright protections strengthened in the past century because of lobbying by powerful copyright owners and, today, they continue to do so under the pretext of fighting a ‘war against piracy’. However, labelling P2P file-sharing as ‘piracy’ already taints file-sharing activities with a value-based judgment. As trifling as it may appear, finding the right name for any purported ‘rights’ is vital. This is because it subconsciously influences the public attitude towards it, and the Courts often try to reflect such attitudes.<sup>293</sup>

Most people may not feel they are doing anything ‘wrong’ when they copy a CD for a friend or download a song, even if they are quite aware that it might be illegal.<sup>294</sup> However, some copyright owners equate such activities to ‘theft’ or ‘stealing’, which sounds fairly repugnant from a moral perspective. To steal or thieve commonly means to deprive a rightful owner of his or her property, for example, car theft. It follows that the analogy between file-sharing and car stealing would make sense only if the rights enjoyed by copyright holders are a form of property: but there are several reasons why this might be inappropriate.<sup>295</sup> Firstly, unlike a stolen car, unauthorised copying does not actually deprive the author or anyone else from enjoying the work because the sort of goods copyright law is concerned with are non-rivalrous. Rather, the loss is from missing out on extracting monopoly revenues.<sup>296</sup> Secondly, most other property (especially tangible property) is perpetual and comes with broad alienation powers. Copyright owners have no power to exclude others from their ‘property’ absent legislative backing, and any exclusive rights they do enjoy are also limited in duration.<sup>297</sup> Moreover, copyright statutes only confer on copyright holders a limited form of control (that is subject to further exceptions) over certain unauthorised acts in relation to the author’s work: the public retains rights to the residual uses.<sup>298</sup> Hence, unauthorised file-sharing is more akin to an incursion into the copyright owner’s limited rights rather than a theft of his or her property.<sup>299</sup>

Public choice economists often speak of the ‘concentrated benefits’ and ‘dispersed costs’ predicament:<sup>300</sup> the entertainment industry is a prime example. The usual suspects who campaign for greater copyright protections do so belligerently because the bulk of monopoly profits are divided between a few big industry players. On the other hand, regardless of the merits there

292 Bell, above n 219, 89.

293 Ibid 41-2.

294 Ibid 31. See also Buckingham & Savare, above n 65, 18.

295 Bell, above n 219, 38-41.

296 Ibid 32.

297 Ibid 38-41.

298 Ibid.

299 Litman, above n 264, 219.

300 See M Olson, *The Logic Of Collective Action: Public Goods and the Theory of Groups* (1971).

are few who bother petitioning for less copyright protection, and for those that do, the message falls on deaf ears. This is because the large costs of copyright protection that are borne by the public become negligible when divided amongst everyone individually. Copyright owners endeavour to create new laws to suit their interests through aggressive lobbying, but that in itself is no different from other self-interested groups. What is disturbing, though, is when they propagate made-up rules.<sup>301</sup> Members of the public already have trouble identifying what legal uses copyright law permits<sup>302</sup> and with the ever-increase of industry regulations along with the speed at which information now travels, it is no surprise that some 'fictional' laws have managed to slither in.<sup>303</sup> For example, American record companies insist they own all the rights to recordings as 'works made for hire'. While copyright in works created by employees within their scope of employment automatically belongs to the employer, in the United States this only applies if the employer treated the creator as an employee for tax purposes, which is not always the case.<sup>304</sup> Other examples include the issue of whether an unauthorised 'copy' is made and 'distributed' to the public when a work is shared on a P2P network, and of course, the applicability of the fair use exception.<sup>305</sup> Clearly, there are many unresolved copyright law issues in the internet sphere. The arguments surrounding these issues are typically quite technical, requiring courts to carefully determine what the legislature meant when such laws were enacted. Yet many cases never even make it to court because the industry intimidates defendants into settling before the court has a chance to decide on the merits of the case:<sup>306</sup> individual P2P users who have been the target of the RIAA blitz in the last few years rationally chose to settle for a smaller sum rather than risk a much greater fine as well as foot a gigantic legal bill.<sup>307</sup>

The real ethical challenge actually falls on the entertainment industry's strategy of fervently asserting their invented laws every chance they get until they eventually become embedded into the public mind-set.<sup>308</sup> Since legislators often succumb to public opinion, these imaginary laws sooner or later become real laws. The following example illustrates this effect. While the term 'piracy' initially referred to people who made large scale counterfeit commercial copies for sale, it has since been stretched to cover home-downloaders. Today, the public, media, and even lawmakers have caught onto the habit of calling those who make non-commercial and sometimes legal copies 'pirates'.<sup>309</sup> Not only is the legal standing of such claims questionable, but it also diverts attention from the advantages of P2P file-sharing as a useful distribution tool.<sup>310</sup> The result is that, because the

301 Litman, above n 264, 221.

302 Hietanen, Huttunen & Kokkinen, above n 245, 42.

303 Litman, above n 264, 218.

304 Ibid 221.

305 Ibid 219.

306 Ibid 220.

307 M O'Rourke, 'I Fought the Law and the Law Won' (2007) 54 *Risk Management* 10.

308 Litman, above n 264, 221.

309 Ibid 220.

310 Ibid 222.

public is told so often that ‘piracy is wrong’, no one really stops to think about it anymore. In playing the public conscience to their advantage, the entertainment industry has pulled the wool over the public’s eyes as to the underlying issues of internet technology.

The only remaining moral justification for stronger copyright laws is that people might ‘feel bad’ about downloading songs for free.<sup>311</sup> Artists may not necessarily require financial motivation to create works, but people like to know they are supporting their favourite artists. However, as already discussed, copyright laws have proven inadequate in compensating the creators of expressive works, so really it does not address the public’s ethical uneasiness. One straightforward alternative solution would be to simply reimburse artists through legalised file-sharing: having users pay for P2P content under a blanket licence.<sup>312</sup> In this model, existing common law rules such as property, contract and tort law will suffice to protect authors.<sup>313</sup> There is encouraging evidence that consumers are willing to pay for ‘legal’ file sharing services in the form of a monthly subscription service that enables unlimited music and video downloads.<sup>314</sup> This is especially so since many music consumers prefer to obtain single songs rather than entire albums in the traditional CD format.<sup>315</sup> Indeed, practical business models of legal online file-sharing already exist: many legitimate services now offer unlimited streaming audio or ‘tethered downloads’ for a fixed monthly subscription or a permanent ‘burnable’ download for a fixed price per song.<sup>316</sup> Examples of such authentic companies include iTunes, Rhapsody, and the now resurrected Napster, all of which either own the copyrights to the files or have agreements with copyright owners to distribute online.<sup>317</sup>

Yet, legitimate download services remain eclipsed by illegitimate P2P networks.<sup>318</sup> Apart from the difficulty of competing with a free product, another significant advantage of illegitimate P2P services over their legitimate counterpart is that the files found on the underground networks are free of digital rights management (‘DRM’) restraints.<sup>319</sup> Currently in New Zealand, it costs an additional 60c to receive a DRM-free version of a song bought online and an additional \$1.20 for a DRM-free movie.<sup>320</sup> Apple’s recent announcement that it will drop DRMs from its iTunes downloads may set the precedent for other legal online distributors to do the same.<sup>321</sup> Another superior characteristic of unauthorised networks is their larger and more diverse catalogue of available media.<sup>322</sup> This is due to the difficulty in

311 Boldrin & Levine, above n 220, Ch 1.

312 Litman, above n 264, 222. See also Liebowitz & Watt, above n 225, 533-4.

313 Bell, above n 219, 21.

314 Hietanen, Huttunen & Kokkinen, above n 245, 46-7.

315 Ibid.

316 Zentner, above n 230, 70-1.

317 Ibid.

318 Ibid 71.

319 Hietanen, Huttunen & Kokkinen, above n 245, 45.

320 ‘Apple Drops DRM on iTunes’, *The Press* (Christchurch), 7 January 2009 <<http://www.stuff.co.nz/4811674a26870.html>> at 7 January 2009.

321 Ibid.

322 Zentner, above n 230, 71.

obtaining licences for all music, not to mention movies, games, software and other types of media, in different countries with different licensing schemes.<sup>323</sup> Certainly, streamlining licensing systems will give genuine services a competitive edge against their illegal rivals.<sup>324</sup> The concern with introducing a compulsory licensing scheme for P2P services is that it might force some existing online web stores out of business. However, that alone should not be an impediment to legalising P2P technology if it is actually an efficient and superior way of doing business.<sup>325</sup> although the transitional period may be painful in the short-run, experience shows that weeding out inefficient businesses is necessary for economic growth in the long-run.<sup>326</sup>

Since most copying requires some sort of physical support, such as computer equipment, software, and an internet connection, another possible substitute for copyright law is to tax copying devices.<sup>327</sup> The public good 'externality' is thus passed on to the population of technology users rather than producers of creative works.<sup>328</sup> A practical example is the *Audio Home Recording Act's* statutory levy on blank CD sales. Indeed, there has already been talk of implementing a user-levy on internet connections for non-commercial file-sharing.<sup>329</sup> one study estimates that a 2% levy would yield the equivalent of projected revenues of the digital download market for the year of 2002.<sup>330</sup> The advantage of this model is that it will only require monitoring consumers' aggregate use, rather than individual use, thereby solving the privacy concerns associated with identifying individual downloaders.<sup>331</sup> Other suggested alternatives to copyright law include auctions, bidding, or voluntary payments, or reliance upon tipping as a source of revenue. Such methods have been used by the novelist Stephen King (as mentioned above), and more recently, by Radiohead in their online release the album 'In Rainbows' for which consumers decide how much they pay for the download.<sup>332</sup>

At the end of the day, a complete deregulation of P2P file-sharing may seem like a radical market solution. However, it tackles the issues at the roots rather than plastering over it with new laws and then leaving it up to costly litigation to deal with. P2P file-sharing has the benefit of increasing diversity in 'culture consumption' by allowing users to access works that they cannot obtain from current authorised distributors and increases publicity for the works of new artists.<sup>333</sup> More importantly, legalising P2P

323 Hietanen, Huttunen & Kokkinen, above n 245, 48.

324 Ibid 47-8.

325 Ibid 48.

326 For example, New Zealand's economic reforms of the 1970s. See Bell, above n 219, 89.

327 Varian cited in Liebowitz & Watt, above n 225, 532.

328 Liebowitz & Watt, above n 225, 533-4.

329 Ibid 534.

330 Shih & Ku, above n 15, 313.

331 Ibid 314.

332 Liebowitz & Watt, above n 225, 536. G Kot, 'Ailing music industry should seek business tips from Grammy performers Radiohead, Lil Wayne, Paul McCartney', *Chicago Tribune* (Chicago), 29 January 2009 <[http://leisureblogs.chicagotribune.com/turn\\_it\\_up/2009/01/music-industry-should-get-business-tips-from-grammy-performers-radiohead-lil-wayne-paul-mccartney.html](http://leisureblogs.chicagotribune.com/turn_it_up/2009/01/music-industry-should-get-business-tips-from-grammy-performers-radiohead-lil-wayne-paul-mccartney.html)> at 31 January 2009.

333 Hietanen, Huttunen & Kokkinen, above n 245, 43-4.

services appears to be the only effective way to compensating artists in today's generation.<sup>334</sup> Such a move will see P2P service providers profiting from the content distribution process via advertising revenue, but at the expense of the current big players of entertainment distribution industry through royalties.<sup>335</sup> Therefore, it will undoubtedly be met with strong resistance. The purpose of copyright law to promote society's production and consumption of expressive works must be vigilantly kept in sight. Copyright law was never meant to protect the entertainment industry's control over the market.<sup>336</sup> In the absence of economic and moral justifications, copyright laws should not hinder free competition amongst content distribution services. The drastic drop in computer equipment prices over the last few years should result in greater access to file-sharing services:<sup>337</sup> deregulation of file-sharing technology will inevitably force current monopolies to keep up or be left behind. It is ironic, but also telling that record companies have begun to exploit the very technology they despise, for example, using data from P2P networks to survey consumer demand for newly released songs.<sup>338</sup>

#### IV. CONCLUSION

Just as with any other government interventions, calls for the strengthening of copyright protections against digital technology should be carefully considered:<sup>339</sup> the critique presented above demonstrates that society and its creators of expressive works may be better off without it. At a deeper level, it might even be said that the current direction in which global internet copyright laws are heading violates the 'fundamental rights' we naturally enjoy, namely freedom of expression and the presumption of innocence.<sup>340</sup> Copyright is therefore not a 'natural right' as the entertainment industry tries to make it out to be.<sup>341</sup> Rather, it is a privilege,<sup>342</sup> and any expansion of privileges that conflict with natural rights should be viewed with scepticism.<sup>343</sup> There are less intrusive and more effective alternatives to meeting the goals that copyright law aspires to, but has arguably failed. Deregulation of the market for expressive works is probably the best choice. Unfortunately, as the law and government attitudes stand in most jurisdictions at present, it seems unlikely that the current copyright monopolies will budge: it is difficult to envisage a viable P2P business model distributing copyrighted files that can

334 Liebowitz & Watt, above n 225, 534.

335 Shih & Ku, above n 15, 302-4.

336 Hietanen, Huttunen & Kokkinen, above n 245, 48-9.

337 Shih & Ku, above n 15, 321-2.

338 Hietanen, Huttunen & Kokkinen, above n 245, 44. See also K Holton, 'Music industry urged to embrace the Internet', *Reuters* (London), 20 January 2009 <<http://www.reuters.com/article/technologyNews/idUSTRE50J03U20090120>> at 30 January 2009.

339 Bell, above n 219, 48.

340 *Ibid* 21, 28.

341 John Locke is often cited as authority for elevating copyright to a 'natural right', but it is doubtful whether he really held that view. See Frankel & McLay, above n 1, 160 for a discussion.

342 Bell, above n 219, 35-7.

343 *Ibid* 47-8.

escape the clasp of the *Grokster* ruling,<sup>344</sup> and under its new digital copyright reforms, any sensible ISP in New Zealand will shy away from aiding such file-sharing activities. Yet, despite the industry's so-called victories against P2P 'pirates' around the world, it has not actually subdued underground online file-sharing.<sup>345</sup> Thus, even from the standpoint of the entertainment industry's commercial interests, the wisdom of continuing this costly fight against market forces is dubious.<sup>346</sup> An ounce of pity can be felt for the entertainment industry though: having sunk considerable resources in trying to defend their empire they have found themselves entrapped by the very war they started. Ultimately, before the creative market can be liberated, policy makers must resist succumbing to the entertainment industry's mounting pressure and reign in their privileges. For now, this depends on whether the cyber-community can wrestle the legislature's attention from the goliath.

344 R Dannenberg, 'Copyright Protection for Digitally Delivered Music: A Global Affair' (2006) 18 *Intellectual Property & Technology Law Journal* 12.

345 See S Bhattacharjee, R Gopal, K Lertwacharia & J Marsden, 'Impact of Legal Threats on Online Music Sharing Activity: An Analysis of Music Industry Legal Actions' (2006) 49 *Journal of Economic Surveys* 91.

346 E Pfanner, 'Music world embracing unlimited downloads', *International Herald Tribune* (Paris), 18 January 2009 <<http://www.iht.com/articles/2009/01/18/technology/midem.4-410564.php>> at 30 January 2009.