No. 04-480

In The
Supreme Court of the United States

METRO-GOLDWYN-MAYER STUDIOS INC., ET AL.,

Petitioners,

v.

GROKSTER, LTD., ET AL.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF *AMICI CURIAE* KENNETH J. ARROW, IAN AYRES, GARY BECKER, WILLIAM M. LANDES, STEVEN LEVITT, DOUGLAS LICHTMAN, KEVIN MURPHY, RANDAL PICKER, ANDREW ROSENFIELD, AND STEVEN SHAVELL IN SUPPORT OF PETITIONERS

DAVID A. STRAUSS*
DOUGLAS LICHTMAN
ANDREW ROSENFIELD
1111 East 60th Street
Chicago, IL 60637
(773) 702-9601
**Counsel of Record for Amici Curiae*

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INTEREST OF THE *AMICI CURIAE*[1]

Amici are professors and scholars who teach and write on economic issues and, in particular, on the economics of innovation, the economics of intellectual property, and the economics of both deterrence and enforcement. They are Kenneth J. Arrow, Ian Ayres, Gary Becker, William M. Landes, Steven Levitt, Douglas Lichtman, Kevin Murphy, Randal Picker, Andrew Rosenfield, and Steven Shavell. A summary of the qualifications and affiliations of the individual *amici* is provided at the end of this brief. *Amici* file solely as individuals and not on behalf of the institutions with which they are affiliated. *Amici* represent neither party in this action, and write solely to offer an economic perspective on the important social issues at stake in this dispute.

SUMMARY OF ARGUMENT

One of the central conclusions of economics is that competitive markets allocate goods efficiently. But markets cannot perform this important function in the absence of clearly defined property rights. This is why the law recognizes ownership interests in everything from automobiles and wristwatches to computers and telephones. Who would create and care for these resources in a world where title was precarious and theft rampant?

[1] The parties have consented to the submission of this brief, and their letters of consent have been filed with the Clerk of this Court. This brief was not written in whole or in part by counsel for a party. No person or entity other than *amici* made any monetary contribution to the preparation or submission of this brief. *Amici* and their counsel were not compensated in any way.

How could these products be bought and sold in markets without rules preventing unauthorized appropriation and defining the consequences of any such appropriations?

Federal copyright law embraces this basic economic insight. It recognizes that competitive markets are an effective means by which to encourage authors, artists, and publishers to produce and disseminate creative work. It therefore invests in authors certain exclusive rights to duplicate, distribute, and otherwise exploit that which they create, and it empowers courts to defend those rights by awarding damages and issuing injunctions against individuals and entities that violate them.[2]

In this dispute, the Court is being asked to clarify the conditions under which those conventional remedies should be supplemented by an additional cause of action: liability that would hold responsible a firm whose product or service facilitates copyright infringement. The argument in favor of this sort of "indirect" liability is that in certain circumstances it will be the only practical way to maintain the efficacy of copyright markets. That is, direct liability is so costly in certain situations that, without indirect liability, authors would in those settings no longer have a meaningful right to prevent unauthorized use of their work. The argument against indirect liability is that, because the products and services at issue here have both legal and illegal uses, any legal intervention must be

[2] This is not to imply that formal markets are the only means by which to accomplish this goal. The cultural arts obviously long have benefited from interactions unconnected to express markets, such as uncompensated philanthropic contributions and the unrewarded efforts of the starving artist.

cautious or else risk inadvertently interfering unreasonably with legitimate activity.

We offer analysis along two dimensions. First, we summarize the economics of indirect liability, emphasizing the conditions under which indirect liability is an efficient mechanism by which to enforce the law. The thrust of this discussion is to show that the courts below have ignored many of these considerations, allowing oft-repeated but imperfect legal formulations to drown out meaningful analysis of the issues. Second, we consider specifically the liability rule adopted by both courts below and argue that it is inefficient for two reasons, but most importantly because it fails to give manufacturers any incentive to deter infringement even in instances where deterrence could be accomplished at low cost and without any significant interference with non-infringing uses.

ARGUMENT

1. Indirect liability is routinely imposed in instances, like the one at issue here, where direct deterrence is unlikely to be effective because of the high costs associated with identifying and pursuing individual violators.

We use the phrase "indirect liability" to refer to legal rules where the law holds one party liable because of a wrong directly committed by another.[3] A familiar setting is

[3] Our discussion of indirect liability follows the classic economic analysis articulated in, among many others, STEVEN SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW 170-75 (Harvard University Press 1987); Alan Sykes, *Vicarious Liability*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 673 (Peter Newman, ed.,

(Continued on following page)

the employment relationship, where an employer can be held liable for torts committed on the job by employees. But other examples abound. Bars sometimes are held liable when bartenders serve alcoholic beverages to patrons who later harm others while driving drunk. A motor vehicle owner can be held to account if a driver to whom he loans his car ends up causing an accident. Landlords are sometimes deemed responsible if they take inadequate precautions against criminal activity that in turn harms tenants. Even products liability law has this same structure: a buyer might use a dangerous product in a negligent manner and cause injury to a third party; if the victim can show that the accident would not have occurred had the manufacturer employed better product design, the victim might be able to recover from the manufacturer instead of (or in addition to) the buyer.

Conventional economic analysis suggests that an explicit rule imposing indirect liability is not necessary when the parties directly responsible for unlawful conduct can be themselves effectively deterred by legal sanctions. Thus, if the employees and drunk drivers from the examples above were easy to identify, inexpensive to sue, and they had assets sufficient to pay for whatever harm they might cause, there would be no need to introduce an additional layer of legal liability. Wrongful conduct would be adequately addressed by imposing criminal penalties or assessing monetary damages on the direct actors alone.

1998); Reinier Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J. L. Econ. & Org. 53 (1986). The actual text used here is modified, with permission, from Doug Lichtman & Eric Posner, *Holding Internet Service Providers Accountable*, in THE LAW AND ECONOMICS OF CYBERSECURITY (Mark Grady & Francesco Parisi, eds., Cambridge University Press, forthcoming 2005).

Similarly, in instances where the relevant direct actors are expensive to prosecute but penalties can be raised such that the low likelihood of prosecution can be offset by high penalties for the few cases actually brought, again direct deterrence will work and indirect liability is therefore unnecessary and likely unwise.[4]

In cases where direct enforcement cannot be effective, however, indirect liability may be efficient. There are two basic theories. One theory suggests liability in instances where there exists an indirectly involved party who is in a position to deter the bad acts in question at low cost. This is, for example, one of the main reasons why employers are responsible for torts committed by their employees. An employer can control employees. The employer can monitor their behavior, screen them before entrusting them with dangerous equipment, develop compensation schemes that encourage them to exercise due care, and otherwise beneficially influence their on-the-job decisions. The prospect of indirect liability gives employers an incentive to make use of those mechanisms and, in that way, to minimize the expected cost of accidents.

The second theory suggests liability in instances where there exists an indirectly involved party who encourages or facilitates the bad act in question without bearing direct responsibility for the consequences. For example, even when a retailer can do nothing more to

[4] This understanding of deterrence is just an application of the principle that, in instances where the likelihood of detection is low, deterrence can be achieved by increasing the penalty imposed. *See* Gary Becker, *Crime and Punishment: An Economic Approach*, 76 J. Pol. Econ. 169 (1968).

ensure that the drivers of its delivery vans take appropriate care, it is likely efficient to have the retailer pay at least some fraction of the costs of any delivery accidents. The reason is that the retailer is making other decisions that affect the likelihood of accidents – the retailer sets delivery prices, for example, and determines the delivery schedule – and thus liability is necessary as a way of ensuring that the retailer accounts for the possibility of accidents when making those decisions. If accidents are unavoidable, the delivery price will rise and the frequency of deliveries will fall, which is exactly what should happen given this unavoidable harm. Note that the purpose of liability here is not to encourage specific precautions such as more careful screening of delivery drivers, but instead to influence how often the harmful activity in question takes place.

These theories help to identify cases where indirect liability might be efficient. The actual question of whether and how liability should be imposed, however, typically turns on other, often setting-specific, considerations. Thus, while the telephone company surely has the ability to deter crank phone calls by more carefully monitoring calling patterns, it is unlikely that indirect liability would in this setting be attractive. Such monitoring would raise serious privacy concerns, and there would be too great a risk that, in its attempts to address the problem of crank calls, the telephone company would inadvertently interfere with substantial legitimate telephone activity. To reject indirect liability in this situation is to announce that the costs of crank telephone calls are not sufficiently high as compared to the costs of using indirect liability to prevent them. Similarly, the mere fact that an airport provides a venue from which airlines generate pollution and noise does not itself justify imposing liability for that harm. The reason is that private parties who own property near the airport themselves make decisions that increase and decrease the importance of these airport externalities; in a world where the airport absorbed the costs in full, neighbors might inefficiently decide to build homes with thin windows, or to use their properties to raise livestock or to care for the elderly, uses so sensitive to noise and pollution that they likely should be disfavored given the proximity of the airport.

Given these complexities, it is no wonder that the lower courts have struggled to articulate an efficient generic baseline rule, let alone deal with special cases and exceptions. The precise zone for the efficient use of indirect liability cannot be boiled down into any simple single-sentence formulation. Indeed, in our judgment, the main reason this case has reached the Court is because simple summaries of a complex process have been allowed to drown out meaningful analysis. Thus the complicated balances recognized in *Sony* have been allowed to devolve into the simplistic conclusion never to use indirect liability for products merely capable of substantial non-infringing use; and the very question of whether liability attaches in the first place has become a distracting debate over the distinction between vicarious and contributory liability rather than a careful consideration of whether direct liability might plausibly be effective, whether the party at issue could at low cost deter the relevant bad act, and whether asking the party at issue to account for some of the consequences of its decisions might help that party to make more efficient decisions in the first place.

We therefore ask the Court as an initial matter to do here for copyright law what it recently did for patent law in *Warner-Jenkinson*: direct attention away from the various imperfect verbal formulations that are today regularly echoed in the case law, and instead refocus both the parties and the lower courts on the fundamental principles at issue.[5] The lower courts might in response begin to focus on obviously relevant economic factors – such as whether the indirectly liable party at low cost could have discouraged the infringing uses, and whether the complaining copyright holder at low cost could have pursued the direct infringers rather than litigating on indirect liability theories – and not dismiss those factors because they were for one reason or another not salient in a previous case. Given time, complete and accurate legal formulations will surely develop. For now, however, the lower courts seem to be missing the forest for the trees, and doing so because they are under the mistaken impression that this Court's decisions require them to.

[5] In *Warner-Jenkinson*, this Court explicitly refused to endorse any of the competing, overly simplistic verbal formulations that at that time were urged as the proper articulation of patent law's doctrine of equivalents. *See Warner-Jenkinson Co., Inc. v. Hilton Davis Chemical Co.*, 520 U.S. 17, 40 (1997) ("In our view, the particular linguistic framework used is less important than whether the test is probative of the essential inquiry: Does the accused product or process contain elements identical or equivalent to each claimed element of the patented invention?"). *See also Graver Tank & Mfg. Co. v. Linde Air Products Co.*, 339 U.S. 605, 609 (1950) ("Equivalence, in the patent law, is not the prisoner of a formula and is not an absolute to be considered in a vacuum.").

2. Indirect liability should not be excused simply because a product is potentially capable of non-infringing use.

In this case, both the district court and the Ninth Circuit adopted a relatively narrow interpretation of this Court's decision in *Sony Corp. of America v. Universal City Studios, Ind.*, 464 U.S. 417 (1984). That narrow reading applies to technologies that facilitate both infringing and non-infringing activity. Put simply, it states that the manufacturer of this sort of technology is immune from liability as long as the product in question is capable of substantial non-infringing use. We do not believe that this is an economically sound rule, nor a logical reading of *Sony*. However, because this interpretation has been adopted twice below and has been praised by at least some copyright commentators, we thought it important to specifically comment on it from an economic perspective.

a. The rule adopted below gives manufacturers no incentive to deter infringement even when deterrence could be accomplished at low cost and without any significant interference with non-infringing uses.

If firms that produce peer-to-peer technology know that they are completely immune from liability as long as their technology makes possible some qualifying amount of non-infringing use, they will have no incentive to attempt to discourage infringing uses even if the costs of doing so are very low. This is the most significant defect in the rule adopted below. By offering blanket immunity the moment a firm can demonstrate sufficient legitimate use, the rule completely destroys any incentive for the firm to do better.

Other indirect liability rules designed to protect copyright on the Internet do not have this defect. One provision of the Digital Millennium Copyright Act, for example, encourages Internet service providers to block access to allegedly infringing content by immunizing service providers from liability for wrongful removals made in good faith.[6] But the provision restores the incentive to take due care by (among other things) requiring that service providers notify any party whose webpage is blocked[7] and reestablish access to the material in approximately ten business days if the implicated copyright holder has not in that time successfully petitioned a court for injunctive relief.[8] Another provision of the Digital Millennium Copyright Act similarly immunizes from liability Internet intermediaries like eBay,[9] but only on the condition that they act expeditiously to remove infringing content the moment they are made aware of its existence.[10]

As these examples suggest, immunity is routinely paired with obligation. The result is not an onerous burden, but a balanced rule that gives parties an incentive to respect the law. In this spirit, firms responsible for promulgating peer-to-peer technology might be expected to undertake good faith efforts toward identifying and implementing plausible low-cost mechanisms that might discourage infringement. Or these firms might in cases of innocent complicity be made subject only to injunctive relief rather than cash damages, again as a way of

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[6] 17 U.S.C. § 512(g)(1).

[7] *Id.* at § 512(g)(2)(A).

[8] *Id.* at § 512(g)(2)(C).

[9] *Id.* at §§ 512(c)(1), (d).

[10] *Id.* at §§ 512(c)(1)(A)(iii), (d)(1)(c) & (d)(3).

lessening the burden of liability while still leaving incentives intact. These and comparable approaches would create at least some incentive to respect existing copyright rights when doing so is economical. The goal would be to obligate firms that benefit from copyright infringement to themselves protect copyright in instances where reasonable modifications to the relevant technology could reduce the number of infringing acts without substantially interfering with non-infringing uses.[11]

b. The rule adopted below mistakenly considers non-infringing uses in isolation, rather than evaluating them in light of substitute mechanisms already available to accomplish the same ends.

The Ninth Circuit explicitly celebrated peer-to-peer technology as a mechanism by which new artists might willingly introduce their work to the public. To the panel, this was a substantial non-infringing use of the technology and thus a reason not to impose liability for the various infringing uses to which the technology is also put. The economic flaw in this argument is that it fails to consider substitute technologies that might allow the same beneficial use but not cause the associated copyright harm.

Consider the Bible. Peer-to-peer technology could in theory be used to disseminate copies of the Bible. That

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[11] We take no position with respect to the question of whether reasonable modifications are possible for the technology at issue here. Our concern is that the lower courts deemed this question irrelevant. Were the case remanded, the lower courts would have an opportunity to review evidence along these lines, for example to see whether good faith efforts were undertaken.

would be lawful, as there is no copyright in the Bible; however, because there are already so many legitimate ways to acquire a copy of the Bible – dozens of websites post free copies online, religious institutions in every community offer free copies in print, and so on – the marginal value of additionally making the Bible available via peer-to-peer transfer is quite low. To label this a "substantial" non-infringing use is to overweight its beneficial consequences; the right approach is to evaluate substantiality in light of the next-best legally permissible approach.

This argument calls into question many of the supposed "substantial non-infringing uses" that are typically identified by proponents of peer-to-peer technology. For example, peer-to-peer technology is hard to defend on the ground that it helps strangers recommend new music one to another, because the closest substitute – a system that allows strangers to make suggestions one to another but without actually offering each other copies of the music files – makes possible almost all of the benefit but with none of the harm. Similarly, the argument about new artists using peer-to-peer technology to introduce their work must be received skeptically, given that free centralized websites (like the original mp3.com) can easily be used as repositories for music that is willingly placed in the public domain.

These examples all make the same basic economic point: at a minimum, possible legitimate uses of a technology should be evaluated in light of plausible alternative means by which to accomplish the same ends. The rule adopted below neglects this comparative analysis, and it therefore significantly misestimates the substantiality of any non-infringing uses.

*   *   *

Economic analysis of this dispute reinforces what common sense also suggests: the case was resolved prematurely, before key questions were asked and key facts considered. Can copyright rights be sufficiently enforced through direct liability such that indirect liability is unnecessary online? Did the accused firms in good faith consider improving their technologies in ways that would reduce infringement but not significantly interfere with non-infringing use? Are there non-infringing uses of this technology that still appear substantial even when this technology is compared to currently available substitute mechanisms? These are central questions from an economic perspective. The courts below failed to ask any of them.

CONCLUSION

The judgment of the court of appeals should be vacated and the case remanded for further consideration.

Respectfully submitted,

DAVID A. STRAUSS*
DOUGLAS LICHTMAN
ANDREW ROSENFIELD
1111 East 60th Street
Chicago, IL 60637
(773) 702-9601

**Counsel of Record for Amici Curiae*

APPENDIX: AFFILIATIONS OF THE AMICI

Kenneth J. Arrow
Joan Kenney Professor of Economics, Emeritus
Stanford University
Nobel Memorial Prize in Economic Sciences, 1972

Ian Ayres
William K. Townsend Professor of Law
Yale Law School

Gary Becker
University Professor, Department of Economics
Professor, Graduate School of Business
The University of Chicago
Nobel Memorial Prize in Economic Sciences, 1992

William M. Landes
Clifton R. Musser Professor of Law and Economics
The University of Chicago

Steven Levitt
Alvin H. Baum Professor of Economics
The University of Chicago
2003 John Bates Clark Medal

Douglas Lichtman
Professor of Law, The University of Chicago
Editor, The Journal of Law & Economics

Kevin Murphy
George J. Stigler Professor of Economics
The University of Chicago
1999 John Bates Clark Medal

Randal Picker
Leffmann Professor of Commercial Law
The University of Chicago

Andrew Rosenfield
President & CEO, Leaf Group LLC
Senior Lecturer in Law, The University of Chicago

App. 2

Steven Shavell
Samuel R. Rosenthal Professor of Law and Economics
Harvard Law School

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