

## The Future of Streaming Technology after *Grokster*

**GLOBAL SALES OF RECORDED MUSIC FELL** by 20 percent from 2001 to 2004,<sup>1</sup> and in the first half of 2005 sales fell by a further 1.9 percent, while the share of digital music sales tripled to 6 percent of total record industry sales.<sup>2</sup> Many in the recording industry attribute these massive losses to rampant Internet piracy. A recent U.S. Supreme Court decision, *Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd.*, may now help the industry begin to recover. (On November 7, 2005, the Associated Press reported that Grokster had “shut down operations” to settle the suit brought by the recording industry.)

Though music has been recorded in a digital format for many decades, until relatively recently the file sizes have been so large, and the transmission technology (modems) so slow, that online distribution was impractical, if not impossible. However, several technological changes have converged to cause a sea change in the way musical recordings can be delivered to consumers. First, the rapid growth of high-speed Internet access has created a new channel for consumers to access music. Coupled with that development are advances in compression technologies—primarily the popular mp3 format—which have made it possible for consumers to create and transmit perfect digital copies of entire songs in a matter of minutes, or even less. Although mp3 technology was available as early as 1995, it was not until 2004 that the first commercially successful, legitimate online distribution model arrived on the market in the form of Apple’s iTunes Music Store.

During the Internet boom of the late 1990s, a number of unauthorized online services arose to fill the rising demand for digital music downloads. Unlike traditional retail stores, these online services did not sell music to their consumers. Instead, they allowed users to share the music on each other’s computers through various means. Generally, consumers would “rip” (copy) music from a CD and save the songs onto their computer hard drive. These sharing services would then allow users to download music that other users had ripped and stored, typically in the mp3 format. These services are generally referred to as peer-to-peer networks, because they operate by allowing users to share files with one another, rather than the traditional retailer distributing to individual consumers.

Napster, the original peer-to-peer network, was created in 1999 by Shawn Fanning, a college dropout.<sup>3</sup> It was the first popular service that enabled easy searching and downloading of a vast library of music supplied by its users. Digital music files had been circulating on the Internet for a few years, but it was not until Napster came into being that a service existed by which consumers could log on and find nearly any song they wanted and download it onto their hard drives within minutes for free. Within its first year of operation, Napster had tens of millions of infringing individual users trading files on its service every single day.<sup>4</sup>

Just as Napster was a magnet for a growing wave of users looking for fast, free, and easy downloads, it was a lightning rod of the recording industry. As traditional CD sales plummeted, the record companies were unable to prevent file sharing, and piracy started to



become the accepted norm to a new generation of music fans. Not surprisingly, the recording industry saw little option but to take Napster and its successor peer-to-peer services to court to try to stem the ever-growing torrent of piracy at its source. After a five-year legal battle involving a number of lawsuits, the music industry finally received the relief it sought from the courts through the U.S. Supreme Court’s ruling in *Metro-Goldwyn-Mayer Studios Inc. v. Grokster, Ltd.*<sup>5</sup> To understand the significance of this decision, it is important to understand its historical context.

### Antecedents of *Grokster*

The legal principles governing online file sharing originated with a different technology: the videocassette recorder. In the early 1980s, Sony developed and began marketing the Betamax VCR to consumers as a means of “time shifting” television shows so that consumers could watch their favorite programs even if they were not home when they aired. The movie studios protested that the same technology could easily be used to illegally copy and distribute commercial videotapes. The studios ultimately sued Sony on this basis, claiming

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that it was vicariously and contributorily liable for copyright infringement because it knowingly distributed and profited from technology that was being used to engage in copyright infringement.

The case reached its way to the U.S. Supreme Court, which, in a landmark decision, held that Sony was not liable.<sup>6</sup> The Court concluded that the basic distribution and sale of Betamax VCRs was insufficient to support a claim for contributory copyright infringement because the VCR had significant noninfringing uses. It held that “the sale of copying equipment, like the sale of other articles of commerce, does not constitute contributory infringement if the product is...merely...capable of substantial noninfringing uses.” In other words, though consumers were using the VCR for infringing purposes, Sony was not responsible for their conduct. Because the VCR was “capable of commercially significant non-infringing uses,” the Supreme Court held that its manufacturer could not be held liable for possible infringing uses of which it had no knowledge.<sup>7</sup>

Sony thus became Napster’s obvious defense when the recording industry brought suit in *A&M Records Inc. v. Napster Inc.*<sup>8</sup> The recording industry invoked legal theories of secondary liability, since the defendant did not directly infringe on copyrightable material. In order to establish a theory of secondary liability, the record companies argued that Napster was a contributory and vicarious copyright infringer based on the direct infringement of its users. Although it was undeniable that its service was being used by consumers for the illegal swapping of copyrighted files, Napster claimed that it could not be liable because its service had a substantial noninfringing purpose in that it could be used to swap legal files, such as songs by independent artists.

The trial court agreed with the plaintiff, granting the industry’s request for a preliminary injunction, which Napster immediately appealed.

The Ninth Circuit upheld the trial court’s preliminary injunction. It distinguished *Napster* from the *Sony* case on the grounds that, unlike Sony and the VCR users, Napster had actual knowledge of its users’ infringing conduct. Napster utilized a centralized network for file indexing and user registration by which it could oversee its users’ illegal conduct. Each connection between file sharers was established through Napster’s servers. As such, the court could not ignore the fact that Napster knew of each and every specific act of infringement, yet failed to act. Additionally, the court found that the Recording Industry Association of America provided Napster with notice of the infringing

content being shared over its servers, but Napster took no steps to prevent it. Accordingly, the court held that *Sony* did not apply and Napster was both contributorily and vicariously liable.<sup>9</sup>

Shortly after the Ninth Circuit decided the *Napster* case, the Seventh Circuit addressed a similar case of peer-to-peer file sharing in *In re Aimster Copyright Litigation*.<sup>10</sup> Like Napster, Aimster allowed its users to search for specific music files and then link directly to one another to swap them. It made use of AOL’s instant messenger technology but also maintained centralized servers that stored user and file information. Though Aimster did have a legitimate purpose—the sharing of public domain or otherwise authorized files—there is no doubt that some of its members used the system to illegally swap copyrighted files. Like the Napster service, however, Aimster did not copy any music files itself.<sup>11</sup>

The recording industry filed suit against Aimster alleging contributory and vicarious liability for its users’ copyright infringement. Aimster, too, attempted to use the *Sony* doctrine to shield it from secondary liability, since its network could be used for legitimate purposes.<sup>12</sup> Just as in the Napster case, the trial court disagreed, granting the plaintiffs a preliminary injunction. Aimster appealed to the Seventh Circuit, which affirmed the trial court’s ruling.

Like the Ninth Circuit, the Seventh Circuit rejected Aimster’s argument that the *Sony* doctrine insulated it from liability. The Court held that the *Sony* shield is not automatically applicable simply because a product is capable of a noninfringing use. Rather, the court concluded that the burden was on Aimster to show the probability that its technology was actually used for substantial noninfringing purposes. Aimster not only failed to submit evidence of substantial noninfringing uses, the record suggested that it encouraged infringement. Aimster provided a tutorial for its users to show them how to share music, illustrating the tutorial solely with copyrighted works. The Court held that “[t]he tutorial is the invitation to infringement that the Supreme Court found was missing in *Sony*.”<sup>13</sup> As a result, the court of appeals reaffirmed the suitability of secondary liability for peer-to-peer networks by upholding the trial court’s preliminary injunction against Aimster.<sup>14</sup>

The most notable feature of both the *Napster* and *Aimster* cases is that both services exercised some degree of control over the infringement being committed through use of their software and respective networks. Though neither service was actually aware of infringement at the moment it happened, both stored information on their servers that

included lists of copyrighted songs and user information. They had means to attempt to block infringement by restricting files and users, but they made no effort to do so. Whereas Sony had no knowledge or control over consumers’ use of the VCR after it entered the market, Napster and Aimster did maintain some dominion over their technology. In the end, their control and ability to restrict consumers’ use of their software was their undoing. Because Napster and Aimster had the ability to control their systems, they also had the responsibility to do so. By choosing to turn a blind eye, they exposed themselves to secondary copyright liability.

## The Second Generation P2P

The legal landscape created by the *Napster* and *Aimster* decisions led to the rise of an innovative new form of peer-to-peer network. The next generation networks became decentralized, permitting each user to share files with another user without ever transmitting information back to its software distributor. Unlike Napster and Aimster, new services, led by companies like Grokster and Kazaa, did not require centralized servers to store user or file data. Instead, more like the VCR, once the technology was distributed, the consumer alone governed its use. This new design shielded the distributors from actually knowing which files were being swapped and cut them out of the users’ file-sharing loop. As the recording industry began to stamp out the old centralized peer-to-peer network, the new decentralized networks quickly grew in prominence to take their place. In the face of continually plummeting sales, the industry once again turned to the courts.

This time the recording industry filed suit against two companies, Grokster and StreamCast, which created and freely distributed software that allowed users to swap files over a peer-to-peer network.<sup>15</sup> Each company created its own technology which functioned quite similarly. Unlike the original version of Napster, the defendants’ software utilized no centralized server, thus preventing them from knowing which files their users were actually infringing. And even though their networks could be used to share any type of digital file, the defendants’ software was mostly used to share copyrighted music and video files without permission. In fact, the industry plaintiffs commissioned a study that found that 90 percent of the files available on the peer-to-peer network offered by Grokster were unauthorized versions of the plaintiffs’ copyrighted works. Since the defendants’ software had been downloaded more than 100 million times, and billions of copyrighted files were being shared every month,<sup>16</sup> the recording industry plaintiffs were understandably anxious to get the same kind of

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judicial relief they had obtained in the *Napster* and *Aimster* cases.

As in the previous peer-to-peer cases, the recording industry asserted claims against the *Grokster* defendants for contributory and vicarious infringement. This time, however, the trial court sided with the defendants, granting summary judgment in their favor.<sup>17</sup>

The recording industry appealed the decision to the Ninth Circuit, which affirmed. The appellate court held that the defendants could not be secondarily liable for distributing their software because the *Sony* doctrine shielded them from liability.<sup>18</sup> By strictly applying the rules laid down in *Sony* and *Napster*, the Ninth Circuit analyzed whether the defendants were contributory infringers. First, the court considered whether *Grokster* had constructive knowledge of infringement by considering the substantial noninfringing uses of their software.<sup>19</sup> To this end, the court noted that while 90 percent of the files shared using defendants' software were infringing, the remaining 10 percent were sufficient to constitute substantial noninfringing uses. Therefore, the court held, the defendants did not have constructive knowledge, because the software had substantial noninfringing uses.

Without constructive knowledge, the Ninth Circuit would only extend contributory liability if the defendants had both 1) actual knowledge of their users' infringing acts and 2) materially contributed to that infringement.<sup>20</sup> The court determined that defendants lacked actual knowledge because they were neither technically able to supervise illegal file sharing at the exact time a file was copied nor capable of preventing illegal sharing by blocking access to specific unlawful users.<sup>21</sup> Instead, the court decided that the defendants lacked control over their networks, and were only notified of any act of infringement after it had already occurred. Without control, the defendants could not have materially contributed to any infringing acts. The Ninth Circuit therefore concluded that *Grokster* was not a contributory infringer, and was thus immune from secondary liability.

The recording industry appealed to the U.S. Supreme Court, which granted certiorari to resolve the groundbreaking issue of how the *Sony* doctrine is to be applied to emerging technologies.

### The Supreme Court Decision

The U.S. Supreme Court unanimously held in favor of the recording industry, concluding that the defendants were liable for their end users' direct infringement, because they created their software for unlawful purposes and encouraged users to infringe. It found that the lower courts erred by applying the *Sony*

doctrine too broadly, stating that, "nothing in *Sony* requires courts to ignore evidence of intent to promote infringement if such evidence exists....It was never meant to foreclose rules of fault-based liability derived from the common law."<sup>22</sup> Thus, the Supreme Court reaffirmed but narrowed the "safe harbor" rule set forth in *Sony*.

The test established in *Sony* was never intended to immunize a distributor from secondary liability simply because the product in question was capable of substantial noninfringing use.<sup>23</sup> Rather, the *Sony* rule simply precludes imputing culpable intent from the mere characteristics of a product.<sup>24</sup> In other words, *Sony* could not be held liable for consumers' infringing use of the VCR, because there was no evidence that *Sony* had intended it to be used for infringing purposes or was aware of any specific act of copyright infringement.

The Court held that the Ninth Circuit read the *Sony* doctrine too broadly in the *Grokster* case to mean that "whenever a product is capable of substantial lawful use, the producer can never be held contributorily liable." In doing so, the Ninth Circuit "converte[d] the case from one about liability resting on imputed intent to one about liability on any theory."<sup>25</sup> The *Sony* doctrine was meant only to limit the imputation of culpable intent and liability based thereon. "But nothing in *Sony* requires courts to ignore evidence of intent if there is such evidence, and the case was never meant to foreclose rules of fault-based liability derived from the common law." Thus, "where evidence goes beyond a product's characteristics or the knowledge that it may be put to infringing uses, and shows statements or actions directed to promoting infringement, *Sony's* staple-article rule will not preclude liability."<sup>26</sup>

Instead, in *Grokster*, the Supreme Court applied an inducement test, extending liability if there is evidence that the defendant took active steps to encourage direct infringement. The Court held:

One who distributes a device with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, going beyond mere distribution with knowledge of third-party action, is liable for the resulting acts of infringement by third parties using the device, regardless of the device's lawful uses.<sup>27</sup>

In creating this inducement test, the *Grokster* Court borrowed a fundamental concept from patent law, which holds that a component of a patented device can be lawfully distributed if it is appropriate for use in alternate ways.<sup>28</sup> Similarly, the Court held that the common law rule that a copyright or

patent defendant who "not only expected but invoked [infringing use] by advertisement" was liable for infringement remains in place.<sup>29</sup>

The Court clarified that when an article is "good for nothing else' but infringement," there follows a presumption of unlawful purpose.<sup>30</sup> Yet, if the article has substantial lawful uses in addition to illegal ones, then the court will not presume that the distributor had an unlawful purpose. Justice Souter emphasized, "ordinary acts incident to product distribution, such as offering customers technical support or product updates" would not support liability in themselves without a further showing of "purposeful, culpable expression and conduct."<sup>31</sup> In fact, in the absence of other evidence of intent, the mere failure to take steps to prevent infringement would not be enough to create liability if a product has a substantial noninfringing use.<sup>32</sup> The Court highlighted that only encouragement of infringement coupled with providing users a tool to infringe gives rise to a claim for infringement.

In *Grokster*, the record clearly illustrated that the actual purpose of the software was to promote and enable infringement. The defendants admitted that consumers primarily used their software to illegally download copyrighted material.<sup>33</sup> There was also evidence that the defendants took steps to encourage such infringement.

The defendants attempted to leverage *Napster's* old user base by offering them an alternative to the original *Napster*. First, *StreamCast* named its software *OpenNap*, a name that closely resembles *Napster's* name, to draw *Napster* users and give them an immediate understanding of the software's purpose. Second, *StreamCast's* internal documents and promotional materials demonstrate that its goal was to become the next *Napster* and its belief that it would be in a great position to capture *Napster's* users if the courts pulled the plug on their rival. Third, *StreamCast* attempted to obtain the e-mail addresses of *Napster* users to entice them into using their software instead of *Napster*. Fourth, *StreamCast* created a kit for potential advertisers. In it, they described themselves as a company "which is similar to what *Napster* was." Indeed, *OpenNap* was "engineered to leverage *Napster's* 50 million user base."<sup>34</sup>

Similarly, *Grokster's* desire to gain *Napster's* user base was clear. *Grokster's* software was called *Swaptor*, a name that also invokes *Napster*. *Grokster* inserted metatags into its Web site so that search engines would find *Grokster's* Web site when searching for "Napster." These two facts, in conjunction, showed *Grokster's* unlawful intent.

Given the existence of evidence suggesting

that the defendants intended to foster infringement, the Court also looked at their efforts to prevent infringement. Again, there was evidence that both companies took active steps to encourage user infringement. StreamCast created a searching tool that allowed its users to specifically search for “Top 40” songs.<sup>35</sup> Obviously, StreamCast realized that Top 40 songs were copyrighted material and anyone who downloaded them would be liable for copyright infringement. This searching capability facilitated and encouraged user infringement. Grokster went so far as to create a promotional newsletter sent out to its users. In it, Grokster described the software’s ability to locate popular copyrighted works. The Court distinguished the advertising in *Sony*, in which the company encouraged customers to use the VCR to “record favorite shows” or “build a library” in its advertisements, by specifically pointing out that neither of these activities were infringing.<sup>36</sup>

Despite their knowledge of mass copyright infringement, neither defendant made any attempt to impede infringement or develop filtering tools that would prevent certain copyrighted content from being shared with their software. Rather than taking any real steps to filter or impede, StreamCast took steps to prevent third parties from monitoring infringement on StreamCast’s networks. In fact, if StreamCast believed that an individual user was monitoring other users, it would block that user’s computer from utilizing the software. Thus, StreamCast shielded its users’ identities from being revealed and assisted them in remaining anonymous, thereby facilitating their infringement. Even when a third-party company offered to help monitor its network, StreamCast refused to allow it to do so.

The defendants’ business models also gave them an incentive to foster infringement. Both companies distributed their software for free and made money through advertising sales. The ads would appear on a user’s screen while searching or downloading material. Thus, the greater the number of users, the more advertising revenue the defendants earned. The more piracy they facilitated, the greater the number of users.

Thus, the defendants’ conduct in the *Grokster* case was distinguished from the *Sony* case by the evidence of the defendants’ intent to encourage infringement. Unlike Napster, Grokster did not actually store any information on its own servers. Nevertheless, there was other evidence in the record to suggest that Grokster knowingly fostered and benefited from infringement. Whereas Sony merely had knowledge that the VCR could be used for infringing purposes, Grokster and StreamCast took affirmative

steps to enable infringement. In the words of the Court, the “evidence of the distributors’ words and deeds going beyond distribution as such shows a purpose to cause and profit from third-party acts of copyright infringement.”<sup>37</sup> Thus, secondary liability—derived from deep-rooted common law principles and not subsumed by the *Sony* doctrine—remains a viable claim for plaintiffs to pursue against distributors who knowingly provide users a tool to infringe and foster such infringement.

### The Impact of *Grokster*

The Supreme Court took a practical approach in solving the inequities that were created by Grokster and StreamCast. It was impossible for the plaintiffs to sue each and every direct copyright infringer. The Ninth Circuit’s blind application of the *Sony* doctrine failed to adhere to fundamental notions of secondary liability principles and likewise lacked common sense because it maintained that companies could facilitate piracy on a mass scale, since the companies had no actual knowledge at the time of the infringement. The Ninth Circuit interpretation supports the theory that as long as distributors turn a blind eye to infringement, secondary liability would never attach. If this were the law, technology innovators would get the wrong message and would be able to violate traditional concepts of copyright law with impunity.

Some leading commentators have expressed concern that the Supreme Court’s decision will chill technological innovation.<sup>38</sup> The concern is that any company that develops technology that *could* be used for an infringing purpose must be concerned about liability, even if that technology has a substantial legitimate purpose. For instance, there is now a greater risk that a company selling technology that allows television viewers to share recorded programs could be exposed to liability. In fact, any software that facilitates streaming content could potentially be at risk. Given the basis for the Supreme Court’s ruling, however, these fears appear to be overblown.

The Supreme Court has laid down a clear lesson to future technology innovators that a business should not be built by ignoring other’s intellectual property rights. The Court applied basic notions of common law and borrowed principles from patent law to explain the common sensibilities that must be considered when there is mass piracy. When a company knows that its technology is used primarily for infringing purposes and it takes steps to encourage that use, it will be exposed to liability. When a company develops a technology that has substantial noninfringing uses and takes steps to discourage illegal uses, it will have the benefit of the *Sony*

shield.

Copyright law encourages creativity in our society, and our common respect for it has and will continue to greatly benefit our world. Infringement not only injures individual artists, but the collective society as a whole, as fewer artists will be given opportunities to foster and flourish if their works are considered public domain. The Supreme Court’s decision in *Grokster* maintains the balance set by the *Sony* Court of protecting legitimate technological development that fosters the distribution of original works while simultaneously protecting artists and publishers from rampant piracy that undermines their creative value. ■

<sup>1</sup> See <http://www.ifpi.org/site-content/statistics/worldsales.html>.

<sup>2</sup> See <http://www.ifpi.org/site-content/press/20051003.html>.

<sup>3</sup> See <http://www.time.com/time/poy2000/pwm/fanning.html>.

<sup>4</sup> Tim Wu, *When Code Isn’t Law*, 89 VA. L. REV. 679, 734 (2003).

<sup>5</sup> *Metro-Goldwyn-Mayer Studios Inc. v. Grokster Ltd.*, 125 S. Ct. 2764 (2005), *vacating and remanding* 380 F. 3d 1158 (9th Cir. 2004) and 259 F. Supp. 2d 1029 (C.D. Cal. 2003).

<sup>6</sup> *Sony v. Universal Studios*, 464 U.S. 417 (1984).

<sup>7</sup> See *Grokster*, 125 S. Ct. at 2768.

<sup>8</sup> *A&M Records Inc. v. Napster Inc.*, 239 F. 3d 1004 (9th Cir. 2001).

<sup>9</sup> *Id.* at 1021-22. The court’s decision effectively shut Napster down as it declared bankruptcy soon after the case was decided. The company reopened and now operates as a legal online music distributor.

<sup>10</sup> *In re Aimster Copyright Litigation*, 334 F. 3d 643 (7th Cir. 2003).

<sup>11</sup> *Id.* at 646.

<sup>12</sup> *Sony v. Universal Studios*, 464 U.S. 417 (1984).

<sup>13</sup> *Aimster*, 334 F. 3d at 651.

<sup>14</sup> *Id.* at 655.

<sup>15</sup> *Metro-Goldwyn-Mayer Studios Inc. v. Grokster Ltd.*, 259 F. Supp. 2d 1029, 1031 (C.D. Cal. 2003).

<sup>16</sup> *Metro-Goldwyn-Mayer Studios Inc. v. Grokster Ltd.*, 125 S. Ct. 2764, 2772 (2005).

<sup>17</sup> *Grokster*, 259 F. Supp. 2d at 1031.

<sup>18</sup> *Sony v. Universal Studios*, 464 U.S. 417 (1984).

<sup>19</sup> *Metro-Goldwyn-Mayer Studios Inc. v. Grokster Ltd.*, 380 F. 3d at 1158, 1160 (9th Cir 2004).

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* at 1165.

<sup>22</sup> *Metro-Goldwyn-Mayer Studios Inc. v. Grokster Ltd.*, 125 S. Ct. 2764, 2768 (2005).

<sup>23</sup> *Id.* at 2778.

<sup>24</sup> *Id.* at 2768.

<sup>25</sup> *Id.* at 2778.

<sup>26</sup> *Id.* at 2768.

<sup>27</sup> *Id.* at 2777.

<sup>28</sup> 35 U.S.C. §271(c).

<sup>29</sup> *Grokster*, 125 S. Ct. at 2768.

<sup>30</sup> *Id.* at 2777.

<sup>31</sup> *Id.* at 2780.

<sup>32</sup> *Id.* at 2781 n.12.

<sup>33</sup> *Id.* at 2772.

<sup>34</sup> *Id.* at 2773.

<sup>35</sup> *Id.* at 2774.

<sup>36</sup> *Id.* at 2777.

<sup>37</sup> *Id.* at 2781-82.

<sup>38</sup> See [http://www.businessweek.com/technology/content/jun2005/tc20050629\\_2928\\_tc057.htm](http://www.businessweek.com/technology/content/jun2005/tc20050629_2928_tc057.htm) (visited Oct. 3, 2005).