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Limits to the Copying of Digital Content: Where We've Been and Where We're Going

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Before the ubiquity of the Internet, technology prognosticators spoke longingly of "digital convergence" – a future in which computers would be as likely to play music, record a television show or place a phone call as they were to balance a checkbook or print a letter. To a surprising extent, their predictions are coming true. But while technologists may have been well prepared, lawmakers seem to have been caught by surprise. Statutes and legal rulings simply did not anticipate the scope or speed of this sea change, leaving widespread uncertainty about how the law treats digital information.

Nowhere is this uncertainty more evident than in the entertainment industry. Widespread broadband Internet access, recordable CDs and DVDs, and increasingly powerful PCs have given the public the tools necessary to copy and distribute their music and movie libraries with pristine perfection. But confusion about the legality of doing so abounds, with industry executives taking every opportunity to denounce such activities as illegal.

> The entertainment industry is looking to both technology and the law to limit the bite that piracy takes out of its bottom line

Rules regarding the right to copy songs and movies may seem complex and inconsistent. But although the law in this area is still developing, there are some answers to be had. They usually derive from one of three sources: the "fair use" doctrine ensconced in the federal Copyright Act, the Digital Millennium Copyright Act of 1998 (DMCA) and the Audio Home Recording Act of 1992 (AHRA).

The source that provides the most direct guidance is also the narrowest in reach: the AHRA. It was enacted in 1992 in response to the development of the digital audio tape (DAT), a media that, for the first time, permitted consumers to make exact digital audio recordings. The Act was intended as a compromise between those who wanted to codify a consumer's right to home taping of music, and those who wanted to ensure that the advent of perfect digital copies did not bring about industry-crippling piracy. The Act offers consumers and digital audio equipment manufacturers immunity from suit for noncommercial copying of music, but requires that digital audio recording devices incorporate technical measures to permit only "first generation" copies of digital music files. In other words, the devices must not allow copies of copies to be made.

The AHRA, which preceded the commercialization of the Internet and the recordable CD, failed to provide a lasting solution to the digital recording quandary, however. Its limitations became evident in a 1999 case challenging the legality of the first portable MP3 player. Examining definitional language in the Act, the Ninth Circuit Court of Appeals in RIAA v. Diamond Multimedia Systems, Inc. concluded that the AHRA did not apply to music stored on computer hard drives because the "primary purpose" of computers was not to make digital audio recordings and the hard drives contained computer programs in addition to music files. As a result, the AHRA does not legally require computers to incorporate circuitry preventing them from making additional copies of music stored on their hard drives. By extension, individuals who use computers to duplicate digital music files presumably do not enjoy the AHRA's immunity from suit. Because virtually all copies of digital music today have been "ripped" or down-loaded onto computer hard drives, the AHRA has been left with little role to play in today's digital tumult.

While the AHRA has provided little return for the music industry, the movie industry has had more luck in its backing of the DMCA. Controversial since its inception, a key aspect of the DMCA restricts the use

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and distribution of devices designed to bypass encryption schemes or other "technological means" which limit access to copyrighted content.

Most commercial DVDs employ an encryption scheme known as CSS (for Content Scrambling System), which is intended to prevent the movies on the discs from being copied or played on unauthorized machines. The encryption scheme is weak, and was cracked by a Norwegian teenager in 1999. Movie studios argued that, although the teen's "DeCSS" decryption software made it technically possible to unscramble DVDs, using it (even to simply watch, and not copy, a DVD) was illegal under the DMCA. In 2000, a New York judge sitting in the case of Universal City Studios, Inc. v. Reimerdes bought the argument, and enjoined a web site from posting the decryption software and making it available to the public. Reimerdes and decisions following it have effectively kept the tools to decrypt DVDs out of the hands of all but the most technically savvy computer users.

The third source of guidance, that embodied in the doctrine of "fair use," is perhaps the least clear but most sweeping. It is this doctrine that says that some degree of unauthorized copying, in the appropriate circumstances, is permissible under federal copyright law. Fair use exists in both commercial and noncommercial contexts, although it is given much more latitude in the latter than the former. In the entertainment arena, fair use took a huge leap forward in 1984, when the Supreme Court reached its decision in Sony Corporation of America v. Universal City Studios, Inc. The Court in that case held that the public's use of VCRs to tape television broadcasts qualified as fair use, because it amounted to no more than "time shifting" the content to a period more convenient for the viewer. In Diamond Multimedia, the Ninth Circuit took that a step further, suggesting that the ripping of CDs and the transfer of the resulting music files to a portable MP3 player would qualify as fair use because it amounted to mere "space shifting."

Fair use has its limits, however, and Courts have been loathe to allow large-scale copying and sharing of copyrighted content on the Internet. In one early case, UMG Recordings, Inc. v. MP3.Com, Inc., a federal district court judge in New York rejected a "fair use" argument from a company that had purchased thousands of music CDs and copied them to its servers without permission. The idea was to "stream" the songs over the Internet to users who had previously "proved" they owned the music in question by registering their CDs with the defendant's system. The Court dismissed as irrelevant the argument that the copying was acceptable because the songs were heard only by individuals who had already purchased them.

Similarly, in two series of judicial opinions addressing the legality of online file sharing services the Napster decisions and the Grokster decisions – the Courts had little trouble concluding that the anonymous sharing of music between individuals using those systems constituted illegal infringement. Those cases instead turned on whether the defendant companies could be held responsible for their users' infringing behavior. In the A&M Records, Inc. v. Napster, Inc. line of decisions, the Court concluded that the company's involvement was sufficiently direct to make the company liable. While Napster did not actually store or copy the music files being illegally traded, the company's servers did maintain and manage the index of available songs and provided a central hub to which all users connected. This was an important factor in the Court's decision to essentially shut the business down. In contrast, the Court in MGM Studios, Inc. v. Grokster, Ltd. found that the defendants were more removed from the sharing and trading process. Consequently, the Court concluded that the defendants were not responsible for infringing activity that took place on their networks.

TLB Comment: *A picture is finally beginning to emerge, although it is not yet in focus. The entertainment industry is looking to both technology and the law to limit the bite that piracy takes out of its bottom line. For protected content (such as CSS-scrambled DVDs and copy-protected CDs), the DMCA provides a strong club for copyright owners to use to limit unauthorized copying – even in a noncommercial setting. The music industry is still struggling to find a copy-protection technique compatible with the millions of CD players already in the hands of consumers, however. That leaves music largely unprotected by the DMCA, and open to questions of fair use. While there may be support for the proposition that some private duplication of music will qualify as "fair use" (such as taping a CD to permit it to be played in a car's cassette player, or creating a "mix" of songs already owned by the consumer), it likely will be up to the Courts to define the limits of these activities.*

SHORT NOTES

New Massachusetts Business Corporation Law

Massachusetts has enacted a new business corporation law (Chapter 156D) which takes effect on July 1, 2004, replacing Chapter 156B. In general, Massachusetts-incorporated companies are not required to take specific action in order to be compliant with the new law, but may wish to do so in order to take advantage of new flexibility enabled by the change. That being said, the changes in the new law will be of limited usefulness to most of our clients. The changes in the law are mostly cosmetic: for example, although shareholder action by written consent will no longer be required to be unanimous, there will still be a built-in delay (at least 7 days) as contrasted to the immediate effect under Delaware corporate law. Similarly, appraisal rights will continue to be available for amendments to the Articles of Organization in certain situations – as contrasted to Delaware corporate law where appraisal rights are limited to mergers and other business combination transactions. Accordingly, we continue to recommend that clients with plans for venture capital financing, or who anticipate significant stock-based compensation for employees, look to Delaware corporations as the entity of choice. On the other side of the spectrum, individuals desiring to "incorporate" themselves for liability protection reasons but who anticipate only a single shareholder (for example, consultants or other service providers) should seriously consider the benefits of a single-member Massachusetts LLC.

Peter Moldave

New FASB Treatment of Stock Options

The Financial Accounting Standards Board recently circulated an exposure draft of a proposed Statement of Financial Accounting Standards. If adopted, the new standards will dramatically alter the accounting treatment of compensatory stock options. At present, the grant of most stock options results in no accounting charge. Under the new accounting rules, public companies will have to value the options on the date of grant and expense that amount over the vesting period (the "fair value method"). Non-public companies will have a choice of using either the fair value method or the "intrinsic method," which effectively requires any increase in value of the underlying stock during the vesting period to be expensed each year. While these proposed rules are already reducing the popularity of stock options in some circles, the good news is that greater creativity in plan design will be possible as the prior accounting constraints will be removed. If adopted, the new rules will take effect for fiscal years beginning after December 15, 2004 for public and certain non-public companies and December 15, 2005 for all other companies. Most practitioners believe that adoption of these rules is virtually certain although there may be some limited changes made before adoption.

Ken Appleby

Massachusetts Court Exercises Personal Jurisdiction Based on E-Mails

While there are now many cases where the courts in one state have exercised jurisdiction over an out-of-state defendant based on the publication of an interactive Internet web site, cases involving the exercise of jurisdiction based on e-mail lists are rare. Recently, the Massachusetts federal district court decided that a Texas company that sent its mailings to 8,000 subscribers, including 60 Massachusetts residents, is subject to jurisdiction in a defamation action brought against it in Massachusetts by a Massachusetts company. To oversimplify slightly, in this case, First Act, Inc. v. Brook Mays Music Company, the court analogized an e-mail list to newspaper subscriptions: because Brook Mays (the Texas defendant) controlled its e-mail list, it must be held to the knowledge that it was sending its e-mail newsletter into Massachusetts, where First Act is based, and where the injury would be suffered. The lesson to be learned from this case is that the courts continue to be willing to extend jurisdiction arising from Internet-based contacts, and any company that uses the Internet to communicate out-of-state, no matter how minor the contacts, should conduct a risk assessment before assuming that it doesn't risk an out-of-state lawsuit.

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GU Events & Announcements

EVENTS

June 11, 2004 - *Tom Durkin* will co-chair the Massachusetts Continuing Legal Education (MCLE) 7th Annual Intellectual Property Law Conference 2004 held in Boston. *Lee Gesmer*, of the firm, will chair the morning plenary session on IP litigation. The Conference will explore what business lawyers and litigators need to know about intellectual property in the current economy. For information and registration go to www.gesmer.com/whatsnew/

July 20, 2004 - *Ken Appleby* will be a presenter at a seminar on Advanced Partnerships, LLCs and LLPs sponsored by Lorman Education Services held in Peabody, MA. Ken's presentation will focus on sophisticated tax planning for pass-through entities. More information can be obtained from www.gesmer.com/whatsnew/

August 17, 2004 - *Andrew Updegrove* will be a speaker in Ottawa, Ontario, at the Annual Meeting of the Standards Engineering Society. Andy's topic will be "Standards Trends of the Future."

ANNOUNCEMENTS

April 16, 2004 - *Gesmer Updegrove LLP* filed a "friend of the court" brief with the Federal Trade Commission, authored by Andrew Updegrove, on behalf of eleven major standard setting organizations (representing over 8,600 companies, universities and government agencies) seeking the reversal by the FTC of the decision of an Administrative Law Judge favoring Rambus, Inc. For more information, see www.gesmer.com/whatsnew/rambus.php

April 26, 2004 - *Andrew Updegrove* has been appointed by the American National Standards Institute (ANSI) to serve as a member of the National Standards Strategy Committee. Andy will be representing the interests and opinions of the consortium community on the committee.

April 28, 2004 - *Dongsup Samuel (Sam) Kim* received the Boston Bar Association Children and Youth Outreach Project Volunteer Leadership Award for his active involvement with the Mayor's Youth Council (MYC) and helping develop an effective program to help young people hone advocacy, leadership and teamwork skills.