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COMMENTARY: TECHNOLOGY

By Lorraine Woellert

Hobbling Grokster -- and Innovation, Too

Hollywood's case against the online file-sharing service gives the Supreme Court a chance to defend the future of new technologies

When Elliott D. Frutkin, chief executive of Time Trax Technologies, set out to raise \$3 million in venture capital to develop his company's fledgling audio-recording system, would-be investors typically had two reactions. "The first was 'Wow, this is really cool,'" Frutkin recalls. The second: "What about Grokster?"

Although the U.S. Supreme Court won't hear arguments in *MGM Studios (MGM) v. Grokster* until Mar. 29, the case is already having a chilling effect on technological innovation. Feeling the sting of the massive theft by users of peer-to-peer (P2P) software made by Grokster and other defendants, movie and music studios are asking the court to hold tech companies liable for copyright infringement if people use their products to steal films, songs, or other protected works.

BETAMAX PRECEDENT. The justices might just need their grandchildren to explain MP3s and downloads. But they should be on notice that if they side with Hollywood, they could put an entire up-and-coming generation of technological innovation at risk.

The nation's highest court has been down this road before. Twenty-one years ago, it ruled Sony ([SNE](#)) couldn't be held responsible if its customers used their Betamax VCRs to copy movies and TV programs illegally. The 5-to-4 opinion protected any technology from liability, as long as it is "merely capable" of "substantial, noninfringing use." That language created a legal safe harbor that fostered many of today's popular consumer gadgets, such as Apple's ([AAPL](#)) iPod and TiVo ([TIVO](#)).

But that safe harbor is under siege, thanks to the legal uncertainty surrounding the Grokster case. Some companies are so fearful of getting sued they are consulting copyright lawyers at every step of the design process. "Our engineers have become very conversant in these legal matters," says Michael Malcolm, chairman and CEO of Kaleidescape, a Mountain View (Calif.) outfit that makes home viewing systems for DVDs.

RELUCTANT INVESTORS. And venture capitalists are reluctant to place their bets on promising technologies that might be subject to lawsuits from movie and music companies. "It's difficult to invest when you don't have any certainty about the legal environment," says Hank Barry, a partner at Hummer Winblad Venture Partners, a leading VC outfit. "Betamax gave us a pretty good degree of certainty about where the line would be drawn." That reluctance has hit Time Trax hard. "We have been put on hold by quite a few people," says Frutkin, whose Gaithersburg (Md.) company makes gadgets that let audiophiles copy satellite-radio programming onto their personal computers and MP3 players. "If the Grokster case did not exist, our round of financing would be closed."

Studios have little sympathy. Online content theft has reached epidemic proportions, with users of P2P software stealing millions of songs and films every day. Music, movie, and software execs say rampant piracy is the lifeblood of companies such as Grokster. Studies show illegal file-swapping accounts for at least 90% of the activity on P2P sites.

LIABILITY MINEFIELD. Grokster profits in part by selling advertising displayed to those millions of users. "This is a business model based almost exclusively on getting people to take what they haven't paid for," says Dan Glickman, president and CEO of the Motion Picture Association of America.

Movie studios and record companies want the court to set a new standard. Hardware and software companies should be

liable for infringement if they know their technology is being misused, or if they could have designed it to reduce that risk. P2P sites, for example, could be shut down if they know their customers are stealing but don't stop it.

But that standard, if made law, would give the content industry free rein to second-guess the design decisions of tech companies and expose nascent innovations -- such as P2P -- to potentially ruinous litigation. And the existence of controls doesn't give content owners the right to force third parties to use them.

UNEXPECTED WINDFALLS. "Just because there could be filtering [on P2P systems] doesn't give the content industry the right to demand it," says Michael Weiss, CEO of Streamcast Networks, a defendant in the Grokster case. And even when companies do try to install content safeguards, third parties often come along and thwart those efforts.

No one can predict the effects of squelching a technology on the drawing board. Even inventors of new technologies often fail to anticipate all the potential uses or commercial value -- and the content providers often win big despite themselves.

When Hollywood fought Betamax, studios didn't anticipate that video rentals would become the movie industry's leading source of revenue. "Every company morphs, every technology ends up being used for purposes that no one thought of at the beginning," says Hummer Winblad's Barry.

BENEFITS ABOUND. P2P technology already is winning adherents within the very industries that oppose it. A small group of musicians, including Ann and Nancy Wilson of Heart, rapper Chuck D, and songwriter Janis Ian, has sided with Grokster at the Supreme Court. They say P2P has introduced new audiences to their music, brought them new fans, and helped them find collaborators.

P2P sites host plenty of other content, too. Programmers use it to swap code, and academics are sharing scholarly papers. During the 2004 political campaign season, such advocacy groups as MoveOn.org circulated political ads using P2P software.

Ever since the invention of the player piano, the reigning entertainment titans of the day have fought new technologies, most recently taking up arms against VCRs, CDs, and MP3 players. Each time, they eventually came to recognize the value of these innovations, for themselves and for their customers. P2P -- and whatever as-yet-unimagined technologies might follow -- will be no different. The Supreme Court needs to keep the way clear for innovation.

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