# INNOVATION FOR THE 21ST CENTURY

## HARNESSING THE POWER OF INTELLECTUAL PROPERTY AND ANTITRUST LAW

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# 7. DAMAGING COPYRIGHT DAMAGES

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Threats to innovation come not only from copyright's substantive law but also from its remedies for infringement. Of particular concern is the law of damages. Among other remedies, the copyright laws allow owners to recover *statutory damages* regardless of the amount of harm they suffer. These damages can reach $150,000 for infringement of each individual work.

Such relief does not appear in any other IP regime. Nor has its recent use promoted Congress's intent. As discussed in the last chapter, dual-use devices such as peer-to-peer (P2P) software, digital video recorders, and portable satellite radio receivers can be used not only for lawful purposes but also to commit copyright infringement. Subjecting the manufacturers of such devices to statutory damages does not advance the legislature's purposes of (1) awarding damages that cannot be proven and (2) offering modest, but not excessive, deterrence.

Instead, copyright owners have wielded the remedy as a sword of Damocles, decapitating dual-use technologies not because of the merits of their infringement cases but because of the sheer size of the potential award. The statutory damages regime allows copyright owners to seek $150,000 for each act of willful infringement. With widespread use and a loose definition of willfulness, such damages quickly reach into the *billions* of dollars. Just one recent example involves Viacom, which sued YouTube and Google for copyright infringement based on 160,000 unauthorized clips available on YouTube.[1] Multiplied by a potential $150,000 per clip, YouTube could be liable for *$24 billion*, nearly 15 times the $1.65 billion Google spent to buy the entire company.

This threat is exacerbated by two related issues. First, the size of the award often will prevent technology companies from posting the bond necessary for appellate review. As a result, the firms will not be able to appeal adverse rulings and may be forced into bankruptcy. Second, contrary to the general rule of

1. *Viacom Files Federal Copyright Infringement Complaint Against YouTube and Google*, Mar. 13, 2007, VIACOM, http://www.viacom.com/news/News_Docs/Viacom%20Press%20Release.pdf.

corporate law, courts in statutory damages cases have held investors personally liable for a company's debts, which has chilled the flow of venture capital.[2]

Despite these roadblocks to innovation, the momentum, believe it or not, is in favor of *increasing* damages. In May 2008, the U.S. House of Representatives passed the Prioritizing Resources and Organization for Intellectual Property (PRO IP) Act of 2008, which was designed to increase IP enforcement.[3] One provision in an earlier version of the legislation would have increased damages, allowing copyright owners to obtain "multiple awards of statutory damages" for the infringement of compilations.[4] In other words, owners could have sought statutory damages for each song on a CD or each article and photograph in a magazine. This provision was ultimately removed from the bill due to opposition and copyright owners' inability to offer any examples of inadequate compensation.[5] The incident nonetheless demonstrates the live and precarious nature of the issue.

This chapter begins by providing an overview of the law of statutory damages. Next, it examines Congress's intent, describing the purposes of assuring adequate compensation and deterring infringement. It then discusses two cases that demonstrate the perils posed by bond requirements and the application of statutory damages in the context of indirect infringement. The chapter concludes with a proposal to prohibit the application of statutory damages to secondary infringers, limiting the remedy to actual damages and profits. Such a recommendation promises to increase radical, disruptive innovation.

## STATUTORY DAMAGES: LAW

Copyright owners can select from a range of potential remedies for copyright infringement:

- Obtain an injunction preventing further infringement
- Impound infringing copies of the material
- Destroy infringing copies

2. *E.g.*, *UMG Recordings, Inc. v. Bertelsmann AG*, 222 F.R.D. 408 (N.D. Cal. 2004); *Capitol Records, Inc. v. Wings Digital Corp.*, 218 F. Supp. 2d 280, 285 (E.D.N.Y. 2002).

3. Final Vote Results for Roll Call 300, H.R. 4279, May 8, 2008, http://clerk.house.gov/evs/2008/roll300.xml.

4. Prioritizing Resources and Organization for Intellectual Property Act of 2007, H.R. 4279, 110th Cong., 1st Sess. §104 (2007).

5. *See* Richard Esguerra, *'PRO IP Act' Aims To Increase Infringement Penalties and Expand Government Enforcement*, Dec. 7, 2007, http://www.eff.org/deeplinks/2007/12/pro-ip-act-increase-infringement-penalties-and-drastically-expand-government-enfor; Sherwin Siy, *Roundtable on Copyright Damages: "What Are We Doing Here?,"* Jan. 28, 2008, http://www.publicknowledge.org/node/1369.



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- Recover actual damages and profits
- Obtain statutory damages
- Recover costs and attorneys' fees[6]

Chapter 7 focuses on the remedy of statutory damages. At any time before the court enters a final judgment, a copyright owner, as long as its work is registered with the Copyright Office, can choose between receiving statutory damages, on the one hand, and actual damages and profits, on the other.[7] The current version of the statute provides that copyright owners can obtain

> an award of statutory damages for all infringements . . . with respect to any one work . . . in a sum of not less than $750 or more than $30,000.

The court may increase the award to $150,000 when a copyright owner demonstrates willful infringement. It can reduce the award to $200 when the infringer shows that it "was not aware and had no reason to believe" that its activity constituted infringement.[8]

## STATUTORY DAMAGES: LEGISLATIVE HISTORY

The first comprehensive scheme for statutory damages appeared in the 1909 Copyright Act.[9] The Act provided that "in lieu of actual damages and profits," the court could award "such damages as . . . appear to be just." Such statutory damages generally ranged between $250 and $5,000. But specific categories of works were subject to different ranges:

- $50 to $200 for newspaper reproductions of photographs
- $10 for each infringing copy of paintings, statues, and sculptures

6. 17 U.S.C. §§ 502, 503, 504, 505 (2004). *See generally* Julie E. Cohen et al., Copyright in a Global Information Economy 768–69 (2006). Destruction of infringing copies cannot occur until a court finds infringement, and the recovery of profits is limited to those not otherwise considered in the calculation of actual damages.

7. 17 U.S.C. § 412. A copyright owner can receive statutory damages only for (1) unpublished works it registers with the Copyright Office before infringement and (2) published works it registers within three months of publication.

8. 17 U.S.C. §§ 504(c)(1), (c)(2).

9. The first version of statutory damages appeared in the Copyright Act of 1790, which imposed damages of 50 cents for each infringing sheet of maps, charts, or books "found in [the infringer's] possession." Act of May 31, 1790, ch. 15, § 2, 1 Stat. 124 (1790). Subsequently, the Copyright Act of 1856 provided damages of at least $100 for any person giving an unauthorized performance of a dramatic work. William S. Strauss, *The Damages Provisions of the Copyright Law,* Copyright Revision Study No. 22, 86th Cong., 2d Sess. 3 (1960).



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- $1 for each infringing copy of books, periodicals, maps, drawings, photographs, and prints
- $50 for each infringing delivery of a lecture, sermon, or address
- $10 for each infringing performance of a musical composition[10]

In addition to its complexity, the 1909 Act did not specify the role for statutory damages when the copyright owner could prove actual damages or profits. As a result, courts split on the issue, with some not permitting statutory damages and others allowing it in their discretion.[11] This "confusion and uncertainty" encouraged Congress to provide courts with "specific unambiguous directions concerning monetary awards" in the 1976 Copyright Act.[12] Dissatisfaction with the 1909 Act also stemmed from plaintiffs' frequent inability—despite the "substantial expense and inconvenience" of case preparation and trial—to recover more than nominal damages.[13]

This scheme would be simplified in the 1976 Copyright Act, which allowed courts to set statutory damages of $250 to $10,000. Courts could adjust the award up to $50,000 for willful infringement and down to $100 for innocent infringement.[14] The Act clarified that copyright owners could obtain either "actual damages and any additional profits of the infringer" or statutory damages, but not both.[15] The legislative history of the Act stretches over two decades as the Copyright Office authorized a series of studies in preparation for a comprehensive revision of the law.[16]

The two central purposes of statutory damages were presented most succinctly in the 1961 Report of the Register of Copyrights:

(1) "Assur[ing] adequate compensation to the copyright owner for his injury"
(2) "Deter[ring] infringement"[17]

These rationales trace back at least to the early 20th century. In its consideration of the 1909 Copyright Act, Congress highlighted the primary purpose in

10. Act of Mar. 4, 1909, ch. 320, § 25, 35 Stat. 1081 (1909). The award was $100 for the first infringement of dramatic, choral, or orchestral compositions and $50 for each subsequent performance.

11. Strauss, at 7–8 (providing examples of courts on both sides of the issue).

12. S. Rep. No. 94-473, at 143 (1975).

13. Strauss, at 9.

14. Pub. L. No. 94-553, 90 Stat 2541, *codified at* 17 U.S.C. § 504(c)(1), (2) (1976).

15. 17 U.S.C. § 504(a) (1976).

16. Staff of House Comm. on the Judiciary, 87th Cong., 1st Sess., *Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law* iii (Comm. Print 1961), *reprinted in* 3 Omnibus Copyright Revision Legislative History (George S. Grossman ed., 1976) [hereinafter 1961 Report].

17. *Id.* at 103.



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recognizing the difficulty of proving actual damages and profits. Representatives declared that damages "not easily proven . . . should be recovered" and that the "object of th[e] clause" was "a specific remedy to reimburse [a copyright owner] where he is unable to prove the exact amount of injury."[18] Copyright owners also testified to the difficulties in calculating profits when an illustration was inserted in a magazine or a "pirated article" included in a newspaper.[19]

The 1961 Report reiterated that "actual damages are often conjectural, and may be impossible or prohibitively expensive to prove" because of the uncertain value of copyrights and losses caused by infringement. Relatedly, "[a]n award of the infringer's profits" would be inadequate in many cases because "there may have been little or no profit, or it may be impossible to compute the amount of profits attributable to infringement."[20]

Congress's second reason for implementing statutory damages was to deter potential infringers. The remedy played a role in the early and middle 20th century in reducing infringement in music performance rights, motion pictures, and sheet music. Exhibitors in the 1930s, for example, had displayed movies at unauthorized times and places. But after owners raised copyright awareness, "every exhibitor knew and understood that the copyright law provided minimum statutory damages of $250 per copyright infringed." As a result, the tens of thousands of unauthorized showings were "virtually . . . stamped out."[21]

A generation later, the Register of Copyrights explained that statutory damages were necessary "for the copyright law to operate as an effective deterrent against numerous small, erosive violations of a copyright owner's rights."[22] And the most recent congressional amendment in 1999 increased damages "to provide more stringent deterrents to copyright infringement."[23] Congress explained

18. 3 Legislative History of the 1909 Copyright Act 229, 236 (E. Fulton Brylawski & Abe Goldman eds., 1976).

19. *Id.* at 230, 235.

20. 1961 Report, at 102–03. *See also* George E. Frost, *Comments and Views Submitted to the Copyright Office on the Damage Provisions of the Copyright Law*, Copyright Revision Study No. 22, 86th Cong., 2d Sess. 38 (1960) (noting that actual damages and profits are often uncertain or "too small to be meaningful").

21. Ralph S. Brown, Jr., *The Operation of the Damage Provisions of the Copyright Law: An Exploratory Study*, Copyright Revision Study No. 23, 86th Cong., 2d Sess. 76 (1960); Harry G. Henn, *Comments and Views Submitted to the Copyright Office on the Operation of the Damage Provisions of the Copyright Law*, Copyright Revision Study No. 23, 86th Cong., 2d Sess. 101 (1960).

22. House Comm. on the Judiciary, 89th Cong., 1st Sess., *Copyright Law Revision, Part 6: Supplementary Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law: 1965 Revision Bill* 137 (Comm. Print 1965), *reprinted in* 4 Omnibus Copyright Revision Legislative History (George S. Grossman ed., 1976).

23. Congress increased the damages range to $750 to $30,000, with an adjustment up to $150,000 for willful infringement. In 1988, the legislature had increased the damages range to $500 to $20,000, with an adjustment up to $100,000 for willful infringement



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that statutory damage levels had not taken into account "inflation . . ., increased utilization of certain types of [IP], or current trends in global distribution and electronic commerce." In particular, the legislature lamented software piracy, which caused nearly $3 billion in theft that led to "lost U.S. jobs, lost wages, lower tax revenue, and higher prices for honest purchasers of copyrighted software."[24] And it targeted computer users who "believe[d] that they [would] not be caught or prosecuted for their conduct" and infringers that "continue infringing, even after a copyright owner puts them on notice."[25]

Despite the importance of deterrence, Congress has recognized the role of an upper limit on statutory damages. The legislative history of the 1909 Act includes discussion of keeping the damages "small enough to enable the jury to [award] a verdict" and less than the "hundreds of thousands of dollars" that a court would be "very doubtful" to enforce.[26] Courts and Congress have also acknowledged the importance of judicial discretion in limiting excessive awards. Courts have "exercise[d] their discretion in arriving at an equitable result" when application of the 1909 Act schedules would have led to "exorbitant statutory damages in comparison with actual damages."[27] And one of the legislature's primary goals in its revisions to the 1976 Act was to allow courts to "adjust recovery to the circumstances of the case, thus avoiding some of the artificial or overly technical awards resulting from the language of the existing statute."[28]

The drafters were aware of the draconian effects of statutory damages on innocent infringers. They thus included a provision that "protected against unwarranted liability in cases of occasional or isolated innocent infringement."[29] They also crafted an exception to damages awards for employees of nonprofit educational institutions, libraries, archives, and public broadcasting entities that reasonably believed their activity was protected by the "fair use" defense.[30]

The legislative history includes a recognition of the dangers of secondary liability, as the imposition of statutory damages against theaters and radio stations would result in "a staggering problem unrelated to the reality of the

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and down to $200 for innocent infringement. These changes roughly track inflation. Berne Convention Implementation Act of 1988, Pub. L. No. 100-568, § 10, 102 Stat. 2853; Digital Theft Deterrence and Copyright Damages Improvement Act of 1999, Pub. L. No. 106-160, § 2, 113 Stat. 1774; U.S. Dept. of Labor, Bureau of Labor Statistics, Consumer Price Index Inflation Calculator, http://data.bls.gov/cgi-bin/cpicalc.pl (last visited Apr. 23, 2008).

24. H.R. Rep. 106-216, at 2, 3, 6 (1999).

25. *Id.* at 3.

26. 3 Legislative History of the 1909 Copyright Act 235, 241.

27. Strauss, at 11.

28. S. Rep. No. 94-473, 94th Cong., 1st Sess. 143 (1975).

29. H.R. Rep. No. 94-1476, 94th Cong., 2d Sess. 163 (1976); S. Rep. No. 94-473, at 145.

30. 17 U.S.C. § 504(c)(2).



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damage sustained."[31] And the drafters recognized that "the line between innocent . . . and willful infringement" may have been clear in 1909—when "[a]ll the known methods of infringement involved using a published copy of the copyrighted work" and "the mere fact of infringement demonstrated automatically that it had been willful"—but that advances in technology muddied the issue.[32] In short, for both direct infringement and secondary liability, the drafters recognized the need for limits on statutory damages. The MP3.com and XM cases demonstrate the dangers that flow from the neglect of these limits.

## MP3.com

MP3.com created a service that enabled subscribers to build an online library permitting them to listen to their music at any location with access to the Internet. Before using the service, a subscriber needed to buy a CD of the desired recording or prove that she already owned it.[33]

The Recording Industry Association of America (RIAA), the trade group representing the U.S. recording industry, sued the company for copyright infringement, claiming the unauthorized copying and storage of music files. The district court rejected MP3.com's fair use defense, finding that the defendant had a commercial purpose, that the entirety of creative works was copied, and that the activity "usurp[ed]" a market. As a result, it granted the RIAA's partial motion for summary judgment, finding MP3.com liable for infringement.[34]

Four months later, the judge considered the remedy of statutory damages. He concluded that MP3.com "had actual knowledge that it was infringing plaintiffs' copyright" and thus was a willful infringer. Based in part on the plaintiffs' failure to demonstrate any actual damages, the judge decided not to grant the maximum award of $150,000 per infringed CD. Instead, he concluded that "the appropriate measure of damages [wa]s $25,000 per CD." Such an award would result in damages of either $118 million (according to the defendant's claims of 4,700 potentially infringed CDs) or $250 million (according to the plaintiffs' claims of 10,000 CDs).[35]

31. Henn, at 53.

32. Strauss, at 26.

33. *UMG Recordings, Inc. v. MP3.Com, Inc.*, 92 F. Supp. 2d 349, 350 (S.D.N.Y. 2000).

34. *Id.* at 350–53.

35. *UMG Recordings, Inc. v. MP3.Com, Inc.*, No.00 CIV.472 (JSR), 2000 WL 1262568, at *4, *6 (Sept. 6, 2000); Jim Hu & Evan Hansen, *Ruling Against MP3.com Could Cost $118 Million*, News.com, Sept. 6, 2000, http://www.news.com/Ruling-against-MP3.com-could-cost-118-million/2100-1023_3-245377.html.



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Rather than appealing, MP3.com paid more than $53 million to settle the case.[36] Why? As its founder, Michael Robertson, explained:

> We didn't want to settle. I wanted to take it the appellate court for examination of our issues. However, we weren't able to do this. This is because the media companies can elect statutory damages. So although they could not prove they were harmed even $1 (and we had ample evidence that they actually profited from our technology), they were able to elect statutory damages which meant potentially tens of billions of dollars in damages.
>
> The problem arises in that to appeal you have to first bond the judgment assuming you lose at any step. Well, there's no way a small company can bond even a hundred million dollar award much less a multi-billion one. This means that the media companies can find just one judge to rule in their favor, elect statutory [damages] and the legal battle is over.[37]

In other words, even if MP3.com had legitimate arguments that its activity constituted fair use (because users were required to purchase the CDs and the service could have increased demand), it never had the chance to present those arguments to an appellate court. The reason can be traced to the requirement of posting bond.

A party can stay (in other words, delay) a damages award while its appeal is pending by posting a *supersedeas bond*.[38] Such a bond is "required of one who petitions to set aside a judgment or execution" and allows "the other party [to] be made whole if the action is unsuccessful."[39] Its purpose is to maintain the status quo during the pendency of the appeal, thereby protecting the interest of the nonappealing party.[40] A company that is not able to post bond typically will not be able to stay the enforcement of the judgment.[41] When a district court awards astronomical statutory damages, the firm's inability to post bond effectively precludes appeal.

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36. *UMG Recordings, Inc. v. MP3.com, Inc.*, 2000 U.S. Dist. LEXIS 17907 (S.D.N.Y. Nov. 14, 2000).

37. Tim Lee, *Why the MP3.Com Decision Was Never Appealed*, Technology Liberation Front, http://www.techliberation.com/archives/038260.php (last visited Apr. 15, 2008).

38. Fed. R. Civ. P. 62(d).

39. Black's Law Dictionary 1438 (6th ed. 1990).

40. *E.g.*, *Wilmer v. Board of County Commissioners*, 844 F. Supp. 1414, 1417 (D. Kan. 1993); *Poplar Grove Planting & Refining Co. v. Bache Halsey Stuart, Inc.*, 600 F.2d 1189, 1190–91 (5th Cir. 1979).

41. In certain cases, the district court judge could exercise an "inherent, discretionary power" to reduce the amount of the bond below a full supersedeas bond. *Alexander v. Chesapeake, Potomac & Tidewater Books, Inc.*, 190 F.R.D. 190, 192 (E.D. Va. 1999). For present purposes, however, courts that award statutory damages to secondary infringers are likely to adopt the deterrence rationale and unlikely to reduce bond significantly.



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In the *MP3.com* case, the company settled but ultimately entered bankruptcy.[42] Even higher statutory damages were threatened in the case of XM radio.

## XM RADIO

XM radio offers another example of the statutory damages roadblocks on the path of innovation. Satellite radio offered "commercial-free digital audio transmissions broadcast from satellites."[43] XM broadcast music, sports, and entertainment on 170 channels.[44] It also created the Pioneer Inno, which allowed subscribers to record and store up to 50 hours of broadcasts and combined "[t]he first live portable satellite radio and MP3 player."[45] The Inno offered radio, storage, and recording functions.

On behalf of the major record labels, the RIAA sued XM. It recognized that XM was a subscription transmission, which was "limited to particular recipients and for which consideration [wa]s required to be paid . . . to receive the transmission."[46] As a result, XM had the right to publicly perform copyrighted works pursuant to a compulsory license.[47] But the RIAA claimed that XM had developed a subscription service that "transform[ed its] satellite transmission from a radio broadcast into a digital download delivery service" allowing the creation of sound recording libraries.[48] Even though XM had limited storage (1 gigabyte, or 50 hours of recording) and did not allow users to transfer recorded music to other listening devices, the RIAA's CEO, Mitch Bainwol, complained that XM offered listeners "a free version of iTunes without paying the music companies for the right to sell their songs."[49] The RIAA also lamented XM's

42. Vivendi Universal acquired MP3.com, but, because of difficulties in growing the service, eventually dismantled the original site. *MP3.com*, WIKIPEDIA, http://en.wikipedia.org/wiki/Mp3.com (last visited May 4, 2008).

43. Jason A. Auerbach, *Recording Satellite Radio: Adapting to Modern Technology or Infringing Copyright?*, 29 CARDOZO L. REV. 331, 348 (2007).

44. XM, http://www.xmradio.com/whatisxm/index.xmc (last visited May 1, 2008).

45. Pioneer Inno, http://www.xmradio.com/pioneerinno/index.xmc (last visited May 1, 2008).

46. 17 U.S.C. § 114(j)(14).

47. 17 U.S.C. § 114. Different rules apply to (1) nonsubscription broadcast transmissions (such as AM/FM radio broadcasts), which do not receive any copyright protection, and (2) interactive transmissions, which enable recipients to receive specially created programs or to select particular recordings. 17 U.S.C. §§ 114(d)(1)(a), (j)(7).

48. Complaint, *Atlantic Recording Corp. v. XM Satellite Radio, Inc.*, Civ. Action No. 06-CV-3733, ¶ 6 (S.D.N.Y. 2006), http://www.publicknowledge.org/pdf/plaintiff-complaint-20060516.pdf.

49. Eric Bangeman, *Universal, XM Settle Suit Over Receiver's Ability To Record*, ARS TECHNICA, Dec. 17, 2007, http://arstechnica.com/news.ars/post/20071217-universal-xm-settle-suit-over-receivers-ability-to-record.html; Robert Strohmeyer, *Opinion: RIAA Sues XM, Deserves Squat*, WIRED.COM, May 22, 2006, http://blog.wired.com/gadgets/2006/05/opinion_riaa_su.html.



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10-minute buffer, which permitted users to record songs after they had started and "facilitat[ed] the storage and librarying of permanent unlawful copies."[50]

The RIAA alleged nine counts against XM. (In 2007 and 2008, XM settled with the four major record labels, with the undisclosed settlement terms likely granting the recording industry a more active role in managing XM's innovation.[51]) In its complaint, the RIAA claimed that XM directly infringed its exclusive distribution and reproduction rights and that it was liable for inducement, contributory copyright infringement, and vicarious liability. The latter three claims most vividly underscore the statutory damages threat. For each one, the RIAA sought, among other remedies, "the maximum statutory damages" of "$150,000 with respect to each infringing copy made by each subscriber."[52]

XM's buffering allegedly infringed "every song on every channel to which an Inno user is tuned." As a result, the $150,000 figure would be multiplied by roughly (and as detailed in the footnotes) 250,000 different songs each year.[53] The result: *$37.5 billion in statutory damages*. Such an award would be multiples of the gross revenues of the *entire recording industry*.[54] Nor would it be remotely needed to effectuate Congress's intent to "assure adequate compensation" or "deter infringement."

## PERSONAL INVESTOR LIABILITY

The threats revealed in the *MP3.com* and *Inno* cases are exacerbated by courts' willingness to impose personal liability on a firm's officers and shareholders. A fundamental principle of corporate law is that shareholders are not responsible for a company's liabilities. Their maximum loss is the amount they invest in

50. Complaint ¶ 35.

51. Tyler Savery, *XM, Sony Settle Portable Receiver Lawsuit*, SEEKING ALPHA, Feb. 4, 2008, http://seekingalpha.com/article/62918-xm-sony-settle-portable-receiver-lawsuit; Joseph Weisenthal, *XM Settles with Warner Music Group Over Pioneer Inno; Second Settlement This Week*, PAIDCONTENT.ORG, Dec. 21, 2007, http://www.paidcontent.org/entry/419-xm-settles-with-warner-music-group-over-pioneer-inno-second-settlement-/; *EMI, XM Settle in Pioneer Inno Lawsuit*, ELECTRONISTA, June 10, 2008, http://www.electronista.com/articles/08/06/10/emi.xm.settle.inno.suit/.

52. Complaint ¶¶ 85, 96, 107.

53. Fred von Lohmann at the Electronic Frontier Foundation arrives at this figure by calculating that (1) "XM broadcasts 160,000 different songs each month"; (2) "20% of the songs each month are different from the last"; and (3) "Inno users are tuned into at least half of those songs." Fred von Lohmann, *Record Labels Sue XM Radio*, ELECTRONIC FRONTIER FOUNDATION, May 17, 2006, http://www.eff.org/deeplinks/2006/05/record-labels-sue-xm-radio.

54. *Id.*



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the corporation. Nearly all states have enacted laws limiting shareholder liability on the grounds that such limits encourage beneficial, but risky, activity that shareholders would avoid if they bore personal responsibility.[55]

Limited liability encourages efficient investment levels in two ways. First, it reduces information costs, allowing individuals "with money but neither the skill nor information needed for business management" to invest in others' enterprises without losing their entire portfolio. The investor is spared the task of "acquir[ing] detailed information on corporate operations, potential corporate liability, and potential individual exposure," which might otherwise persuade them to forgo the investment. Second, limited liability corrects excessive risk aversion, which follows from an investor's unreasonable fear of "the risk of losing all her assets."[56] As a result of these benefits, limited liability allows more efficient diversification and optimal investment decisions.[57]

At times, however, courts have *pierced the corporate veil* to impose personal liability on shareholders. Such cases have involved close corporations (such as family-owned businesses), parent-subsidiary relations, and instances of fraud or misrepresentation.[58] Veil piercing has been common in copyright cases.

One court rejected a motion to dismiss against Hummer Winblad, a venture capital firm charged with vicarious and contributory copyright infringement for investing in and controlling the operations of Napster.[59] Another held a president and sole shareholder of a company replicating CDs liable for contributory infringement and vicarious liability.[60]

When the personal assets of a corporation's officers, directors, and shareholders are on the table, venture capitalists will think twice before becoming involved in technology firms. As a result, small firms with disruptive new ideas often will not be able to bring the ideas to the market. In fact, such a chilling effect at least partially explains why funding for these firms has fallen in recent years.[61]

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55. *E.g.*, Nina A. Mendelson, A *Control-Based Approach to Shareholder Liability for Corporate Torts*, 102 Colum. L. Rev. 1203, 1204, 1211 (2002).

56. *Id.* at 1217–18.

57. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. Chi. L. Rev. 89, 96–97 (1985); Joshua M. Siegel, Comment, *Reconciling Shareholder Limited Liability with Vicarious Copyright Liability: Holding Parent Corporations Liable for the Copyright Infringement of Subsidiaries*, 41 U. Rich. L. Rev. 535, 538–40 (2007).

58. Easterbrook & Fischel, at 109–12.

59. *UMG Recordings, Inc. v. Bertelsmann AG*, 222 F.R.D. 408 (N.D. Cal. 2004). The court later dismissed the suit because of the running of the statute of limitations.

60. *Capitol Records, Inc. v. Wings Digital Corp.*, 218 F. Supp. 2d 280, 285 (E.D.N.Y. 2002).

61. Dawn Kawamoto, *Lawsuits Dampen VCs' File-sharing Enthusiasm*, CNET News, Sept. 4, 2000, http://www.news.com/2100-1023-245275.html.



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## STATUTORY DAMAGES/SECONDARY LIABILITY DISCONNECT

Congress never intended for the remedy of statutory damages to be a "corporate death penalty" plunging technology manufacturers into bankruptcy.[62] It primarily intended to provide relief when a copyright owner was not able to prove damages. It secondarily, and relatedly, sought to deter infringement. As I show below, neither of those two goals is needed for secondary infringers. Nor are statutory damages appropriate for secondary infringers because of the uncertainty of liability, as exacerbated by bond requirements and personal liability.

First, the purpose of providing adequate compensation is not needed since the amount of damages generally can be ascertained. The amount of damages for which technology manufacturers could be held responsible equals the market value of the infringed copyrighted works.[63] This can be calculated by multiplying (1) the revenues a plaintiff would have gained from each work absent infringement by (2) the number of infringed works.[64] This figure can be estimated, especially as compared to the situations that motivated the drafters (such as where a plaintiff's losses were uncertain, a defendant's profit could not be calculated, or a defendant gained little or no profit).

For the first factor, a plaintiff can introduce evidence of its anticipated revenues per work. Even if an exact number cannot be ascertained, a rough estimate (certainly within an order of magnitude) is possible. And for the second, the statutory damage determination provides no added benefit since it requires the *exact same* computation that actual damages calls for: the number of infringed works. In other words, if the number of infringing copies is unclear for actual-damage determinations, it is unclear for statutory damages.

Statutory damages thus would assist in providing adequate compensation only if a plaintiff's revenues were incalculable and the statutory damage award was in the ballpark of the injury suffered. Neither of these conditions, however, is likely to be true. In fact, the only guarantee of a statutory damages award of $750, $30,000, or $150,000 for each musical work against a secondary infringer is that it will bear no resemblance to actual compensation. A monkey throwing darts at a dartboard of potential lost value would be more likely to award adequate compensation than a jury granting statutory damages. Even more impressively (or disturbingly), the monkey would come orders of magnitude closer to the actual damages.

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62. Fred von Lohmann, *Remedying Grokster*, Electronic Frontier Foundation, July 25, 2005, http://www.eff.org/deeplinks/archives/003833.php.

63. 4 Melville B. Nimmer & David Nimmer, Nimmer on Copyright § 14.02, at 14–14 (2006).

64. The number of infringed works reflects the injury suffered given that the sales of the plaintiff and defendant likely would occur in the same market and that the plaintiff would be able to show that infringement caused its losses. *Id.*



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Further demonstrating that statutory damages are not needed for compensation purposes, plaintiffs in many cases will not suffer *any* damages or will even *benefit* from the manufacturer's activity. Most of the technologies offer new opportunities to experience the works—in different locations, at different times, and in different forms. In other words, they tend to increase the value of copyrighted works. This is especially true where, as in the *MP3.com* case, listeners were required to buy CDs before being able to listen to them.

It thus is not a surprise that in *MP3.com* the plaintiffs never sought to introduce evidence of their actual damages. This is consistent with other cases. In 2007, the RIAA recovered $222,000 in statutory damages from an individual who uploaded 24 copyrighted songs even though a Sony BMG official admitted that "We haven't stopped to calculate the amount of damages we've suffered due to downloading."[65] Of course, where copyright owners have suffered, at most, a trivial amount of damages, statutory damages are not needed for adequate compensation.

The second rationale for statutory damages, deterring infringement, also is not needed. Part of this goal overlaps with the primary objective: if the copyright owner is not able to calculate damages, it may not be able to recover. As a result, the infringer would be unlikely to be deterred. This problem, again, is not present here. In addition, statutory damages are not needed for more general deterrence. Actual damages provide a powerful tool against technology manufacturers. Copyright owners are able to recover their lost damages as well as any additional profits the defendant gained. The owners have never shown, in the context of secondary liability, that actual damages are insufficient to provide deterrence.

In addition to not being needed for the two primary purposes, statutory damages threaten three unique, related difficulties as applied to technology manufacturers.

First, they are not appropriate given the uncertainty of the activity's validity. Liability is clear for pirates directly infringing copyrighted works. Technology manufacturers, in contrast, are far less likely to know if their activity is legal. As discussed in Chapter 6, secondary liability is one of the murkiest areas of copyright law. In the *Grokster* case, the Supreme Court could not decide how the *Sony* noninfringing use test applied to P2P software, mustering only dueling concurrences on the issue. Given the potpourri of tests—based on, among other issues, the defendant's intent, the technology's primary use, the presence of a substantial noninfringing use, and the use of filtering measures—manufacturers typically will not be able to forecast whether a court will find them secondarily liable.

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65. Eric Bangeman, *Judge Tells Record Labels to Cough up Download Expenses*, Ars Technica, Nov. 27, 2007, http://arstechnica.com/news.ars/post/20071127-judge-tells-record-labels-to-cough-up-download-expenses.html; Eric Bangeman, *RIAA Trial Verdict Is In: Jury Finds Thomas Liable for Infringement*, Ars Technica, Oct. 4, 2007, http://arstechnica.com/news.ars/post/20071004-verdict-is-in.html.



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The "line between innocent . . . and willful infringement" may have been clear in 1909, and may still be apparent to pirates directly infringing copyrighted works. But it is not clear to secondary infringers today. Advances in technology and the indirect nature of infringement make secondary infringers a poor target for statutory damages.

Second, the magnitude of statutory damages has prevented firms even from determining the murky secondary liability issues discussed above. Copyright owners seeking settlements have brandished statutory damages as a sword of Damocles. The remedy also has prevented manufacturers from appealing their cases. Damage awards are so high that secondary infringers ordered to pay such damages in district court often cannot post the required bond while the case is on appeal. As a result, as the *MP3.com* case revealed, they are not able to appeal.

Third, all of these land mines strike close to home through courts' willingness to pierce the corporate veil and impose sizeable personal costs on individuals. Given astronomical risks and unclear liability, few shareholders and officers will resist the temptation to settle. As Mark Lemley explained: "If an innovator is at risk of losing her whole company (and her house and her children's education), even a very small chance of liability will be enough to deter valuable innovation."[66]

In short, applying statutory damages to secondary infringers has startling, unjustifiable consequences, which are not needed to carry out Congress's purposes and which pose great peril for innovation.

## PROPOSAL

I propose amending the copyright laws to limit statutory damages to cases of direct infringement. Such an approach would strike a more reasonable balance between promoting the creation of new technologies capable of noninfringing uses and deterring willful direct infringers. It would not have adverse effects on Congress's goals of providing adequate compensation and offering deterrence. It would remove the sword of Damocles hanging over innovators and investors. And it would promote innovation.

Copyright owners could still seek to recover significant actual damages from or impose injunctive relief against secondary infringers. But the proposal would allow technology innovators to make reasonable business decisions based on manageable levels of legal risk. No longer would they face a corporate death penalty at the hands of unpredictable and unjustified legal standards and remedies.[67]

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66. Mark A. Lemley, *Should a Licensing Market Require Licensing?*, 70 Law & Contemp. Probs. 185, 199 n.81 (2007).

67. Fred von Lohmann, *Remedying Grokster*.



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As the threat of statutory damages for secondary copyright infringement recedes, innovation—disruptive innovation, in particular—would flourish. The next generation of DVR, portable radio receiver, and iPod would not be stifled in its infancy.

It is difficult to envision, of course, the hypothetical world of products we would have enjoyed if not for the existence of statutory damages. We cannot know how many inventors and investors have pulled their innovation punches because of the threat of statutory damages. But the *MP3.com* case offers a glimpse of the entrepreneur carcasses lying on the side of the innovation highway. And the *Inno* case hints at the perils of innovation managed by the copyright industry. An amendment to the Copyright Act that eliminates statutory damages in secondary liability cases would play a significant role in fostering innovation.



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