GLOBAL FILE-SHARING PROBLEMS

Graeme W. Austin, *Importing Kazaa—Exporting Grokster*, 22 Santa Clara Computer & High Tech. L.J. 577 (2006)

Kazaa was based on a full record and the judgment was rendered after a complete bench trial. The Australian federal court began its analysis with the Australian copyright statute, which expressly provides that a copyright is infringed by someone who "does . . . or authorizes the doing . . . of any act comprised in the copyright." This is the parallel provision to 106 of the U.S. Copyright Act, which enumerates the acts that comprise rights of the copyright owner, and states that the copyright owner "has the right to do and to authorize" those acts. The approach of the Australian court contrasts markedly with that of the Grokster Court, which did not ground its liability theory in the right of the copyright owner in 106 "to authorize" others to do the exclusive acts that comprise the rights of the copyright owner. Indeed, in U.S. case law, there is very little judicial analysis of the meaning of "to authorize" in 106. United States courts, including the Supreme Court in Grokster have almost invariably substituted the "authorization" concept with common law theories of vicarious, contributory, and now, inducement liability.

Unlike the U.S. copyright statute, the Australian Copyright Act provides judges with further, and quite elaborate, guidance on the concept of "authorization." The Australian Copyright Act lists a number of non-exclusive factors that courts are required to take into account, including:

(a) the extent (if any) of the person's power to prevent the doing of the act concerned;

(b) the nature of any relationship existing between the person and the person who did the act concerned;

(c) whether the person took any other reasonable steps to prevent or avoid the doing of the act, including whether the person complied with any relevant industry codes of practice.

These factors build on judicial analyses in a long line of Australian and Commonwealth cases that have considered the scope of the concept of infringement by "authorization." However, the statutory factors are not exhaustive, and they can be supplemented as the particular facts of cases demand. Significantly, the factors appear to provide for a finding of authorization in situations in which the authorizing defendant cannot control the end user. This is implied by the use of the words "if any" in the first factor of the Australian Copyright Act.

In Anglo jurisprudence, the interpretation of "authorise" had become quite narrow. The House of Lords held in *C.B.S. Songs Ltd. v. Amstrad Consumer Electronics PLC*, a case involving a dual audio cassette player, that "to authorize" means "a grant, or purported grant, which may be express or implied, of the right to do the act complained of." This standard was meant to be narrower than an earlier test that focused on whether the defendant "sanctions, approves, or countenances" infringement by another. In Australia, however, the High Court maintained the broader test. It held in *University of New South Wales v. Moorhouse* that authorization does not require the granting of express or active permission to infringe copyright. Under *Moorhouse*, the defendant will be liable for infringement if: the defendant controls the means by which infringement takes place; makes that means available for the use of persons who might use it to infringe; and is indifferent as to whether or not they do in fact infringe.

In Kazaa, Justice Wilcox further developed the Moorhouse authorization principle and tailored it to the P2P context. He emphasized that the Kazaa defendants were not to be found liable merely because they provided facilities used to infringe the applicants' copyrights. "Something more" was required. With respect to the Sharman defendants, who were the principal operators of the Kazaa system, Justice Wilcox found that "something more" in Sharman's promotion of the P2P file-sharing facility, its exhortations to users to use the facility to share files, and its promotion of the "Join the Revolution" movement on its website, a movement that, in the court's words, "is based on file-sharing, especially of music, and which scorns the attitude of record and movie companies in relation to their copyright works."

Justice Wilcox observed that, "Especially to a young audience, the "Join the Revolution' website material would have conveyed the idea that it was "cool' to defy the record companies and their stuffy reliance on copyrights." Similar analyses grounded on the specific facts of the case support the conclusion that most of the other named defendants had also infringed the applicants' copyrights by "authorizing the doing of" the acts that comprise the copyright owners' exclusive rights.

The Australian court also paid close attention to the ability within the overall Kazaa system to monitor search requests by Kazaa users. The Kazaa search functionality was two-tiered, involving two types of "blue" and "gold" files. Sharman had been involved in a joint enterprise with another firm, Altnet, with the intention of developing a business to distribute copyright licensed content which eventually would turn a profit. From the user's perspective, this meant that both unlicensed and licensed copyright material, the latter accompanied by digital rights management information, was available on the Kazaa system. Altnet was able to disseminate licensed material to users of the Kazaa software in part by monitoring users' "blue" file searches. Search for the "gold" files was facilitated by a TopSearch index, which was regularly "pushed" to the computers acting as Kazaa supernodes. "Gold" files were distributed by Altnet with metadata, regularly updated according to patterns of users' searches, which facilitated the sales of "gold" files. If a Kazaa subscriber's "blue search" search terms matched the terms included in the "gold" file metadata, Kazaa users were offered "gold" files along with the results of the "blue" file search.

The Australian court enjoined most of the Kazaa defendants from authorizing users to reproduce and publicly distribute copyright protected works, and from entering into a common design to "carry out, procure, or direct the said authorization." The technical information about the interrelationship between the Kazaa software and the Altnet search system that was secured through discovery also enabled the Australian court to craft a ruling that would have allowed the Kazaa system to operate, albeit, on a different commercial basis, while implementing protections for the applicants' copyrights. The court's formal orders are worth reproducing in full:

> Continuation of the Kazaa Internet file-sharing system (including the provision of software programs to new users) shall not be regarded as a contravention of order 4 if that system is first modified pursuant to a protocol, to be agreed between the infringing respondents and the applicants or to be approved by the Court, that ensures either of the following situations:
>
> > (i) that: (a) the software program received by all new users of the Kazaa file-sharing system contains non-optional key-word filter technology that excludes from the displayed blue file search results all works identified (by titles, composers' or performers' names or otherwise) in such lists of their copyright works as may be provided, and periodically updated, by any of the applicants; and (b) all future versions of the Kazaa file-sharing system contain the said non-optional key-word filter technology; and (c) maximum pressure is placed on existing users, by the use of dialogue boxes on the Kazaa website, to upgrade their existing Kazaa software program to a new version of the program containing the said non-optional key-word filter technology; or
> >
> > (ii) that the TopSearch component of the Kazaa system will provide, in answer to a request for a work identified in any such list, search results that are limited to licensed works and warnings against copyright infringement and that will exclude provision of a copy of any such identified work.

The Kazaa court did not fully delineate the territorial reach of its holdings or of the remedy it imposed. In its declaration of infringement, the court described the infringement as "authorizing the doing in Australia" of Kazaa users' of the infringing acts of reproducing sound recordings and communicating the recordings to the public. The Australian statute makes plain that the act constituting the primary infringement must occur in Australia; however, it does not specify where the authorization needs to occur. Consistent with this statutory scheme, Justice Wilcox's holdings on liability are indifferent to the location where the act constituting the authorization occurs. Other aspects of the holding and remedy are likewise only loosely tethered within territorial confines. For example, the "modifications" of the Kazaa system required by the Court are directed at the software "received by all new users of the Kazaa file-sharing system." Similarly, "all future versions" of the Kazaa system are to include filter technology, and maximum pressure is to be placed on "existing users," without limitation to those in Australia, to upgrade to a system that deploys these filters. There are no apparent restrictions on where those users are located or to where new versions of the Kazaa system software must be distributed. To be sure, Justice Wilcox's remedy was limited to placing "maximum pressure" on users to upgrade to a version of the Kazaa program that included filtering technology, which is perhaps a tacit recognition of some of its limitations. Also, the record disclosed that there was a significant volume of directly infringing activity occurring in Australia. Even so, there is no suggestion that the court was specifically concerned about the territorial limits of its holdings insofar as the acts of authorization (as compared with the direct acts that were authorized) are concerned.

We might wonder about the source of authority for the court's facially broad interventions-specifically, about how the holdings comply with the traditional principle that copyright law is inherently territorial. Implicitly, at least, the Australian court appears to be reaching out in an effort to require changes in software and users' behavior in foreign jurisdictions. The territorial restriction in the court's analysis concerns the direct infringement of reproduction and communication. This tracks the statutory definition of infringement, which imposes liability for copyright infringement on one who "does in Australia, or authorizes the doing in Australia of, any act comprised in the copyright." This approach is also consistent with the leading English authority on authorization, *Abkco Music & Records Inc. v. Music Collection International Ltd.*, where the English Court of Appeal held that a foreign firm that authorized infringement of copyright by primary acts within the United Kingdom was liable for authorizing infringement under the U.K. copyright statute.

The approach of the English Court of Appeal in Abkco Music focused on a close reading of the U.K. statute, but was also grounded in the commitment by the English courts to the premise that "copyright is strictly territorial." Professor Paul Goldstein has suggested that copyright law is concerned principally with the relationship between authors and their public, a relationship that is usually manifest in the creation of markets for copyright protected works. The territoriality principle is consistent with this perspective, to the extent that it recognizes that each nation's copyright laws, taken together, create those markets. The commitment to the territoriality of copyright is also consistent with the view that the law governing that relationship should also govern the direct and indirect actions that threaten or interfere with it. This approach severs the authorization tort from the primary act of infringement and allows basic principles of a nation's copyright law, particularly those aspects that determine the basic rights of authors, to apply within the boundaries of the relevant nation state. Though the Kazaa court did not address this point directly, the absence of territorial limitations on the "authorization" aspect of the liability theory and the potentially broad reach of the court-imposed remedy indicate that the holding is consistent with these general ideas.

However, Australian law also offers a far more radically extraterritorial approach to enforcing the rights of copyright owners. As part of a package of reforms enacted in 2000, the Australian Parliament added a new right to copyright owners' bundle of rights: the right to "communicate" a work to the public. Communicating a work also includes the making available of copyright protected works including, for instance, the uploading of a work to a generally-accessible website. Among other things, the Copyright Amendment (Digital Agenda) Act (2000) enacted the legislation necessary for Australia to comply with the WIPO Copyright Treaty ("WCT") which also includes a right to communicate a work to the public. Article 8 of the WCT provides that "authors of literary and artistic works shall enjoy the exclusive right of authorizing any communication to the public of their works, by wire or wireless means, including the making available to the public of their works in such a way that members of the public may access these works from a place and at a time individually chosen by them." Article 8 applies to the full bundle of rights of the copyright owner, and was intended to pave over gaps in the rights to disseminate copyright protected works provided in the Berne Convention. The WCT is, however, silent on the extraterritorial reach of the communication right. As enacted into domestic Australian law, nonetheless, the communication right has an express extraterritorial reach. According to Australian law, "to the public means to the public within or outside Australia." The official commentary on the legislation made clear that the inclusion of this definition means that "Australian copyright owners could control the communication from Australia of their material directed to overseas audiences." The Australian law on the communication right goes further than is required by the WCT in this aspect, and thus has the potential to be "exported" to-and, in effect, "imported" into-every nation in the world to which copyright protected material might be communicated without a license. Moreover, the communication right does not appear to require proof that the communication to users in foreign territories is itself infringing in the countries where the communication is received.

There are some important limitations on the scope of the communication right as it is enacted in Australian copyright law. Consistent with the Agreed Statement in Article 8 of the WCT, which carves out a safe harbor for the "mere provision of physical facilities for enabling or making a communication," the Australian Copyright Act provides that a person, including an ISP, who provides facilities for making, or facilitating the making of, a communication is not taken to have authorized any infringement of copyright in a work "merely because another person uses the facilities so provided to do something the right to do which is included in the copyright." Additionally, the Australian Act appears to limit direct liability for unlicensed communication by defining the person making the communication as "the person responsible for determining the content of the communication." One cannot be held liable for communicating a work to the public merely by providing the facilities by which a communication is made; one must be responsible for determining the content of the communication. Because users generally determine the content of communications facilitated by P2P networks, there may be significant obstacles to imposing liability on those responsible for providing P2P products or services that directly communicate a work to the public. Here, the authorization concept once more becomes critical. As was noted above, the court identified factors that enabled it to hold that the Kazaa defendants did more than "merely" provide facilities because they did in fact authorize such communications.

If we layer the territorially-confined "authorization" tort onto the extraterritorial "communication" concept, we see that Australian law might offer copyright owners a powerful legal mechanism capable of reaching many unlicensed foreign communications of copyright protected works. Assume that the users of P2P services are considered responsible for the content of the communication, for instance, by making copyright protected works available for downloading by others (works they have at some stage selected themselves by downloading them from other users): They are then primarily liable for all communications, domestic and foreign. But if a party is liable for authorizing those unlicensed communications, the indirect liability theory also has the potential to reach both communications within Australia and communications made to P2P users in foreign territories. Moreover, because the Anglo-Australian approach to localizing the authorization does not appear to require the act of authorization itself to have occurred within Australia, a firm operating outside of Australia may, in some circumstances, be found to have authorized communications that begin from Australia, even if the communications themselves are directed or made available to users outside of Australia. Put another way, the Australian regime seems to suggest that so long as there is a "communicator" located in Australia, Australian law can reach the conduct of a U.K. firm whose conduct can be characterized as "authorizing" infringing communications to the U.K. and every other country to which the communication is transmitted.

Outside of Australia there are still further extraterritorial possibilities. In some jurisdictions, courts are willing to ascertain and apply foreign copyright laws. Some U.S. courts have suggested that trial courts should determine and apply foreign intellectual property laws. The English Court of Appeal, at least within the ambit of the (then) Brussels Convention, and probably further, has indicated that foreign copyright laws are justiciable in domestic fora. Suppose such a court is seized of a dispute in which application of Australian copyright law is appropriate and the allegations include unlicensed reproductions and distributions in Australia in addition to unlicensed communications from Australia. A foreign court that is willing to apply Australian copyright law at all will need to consider whether it is appropriate to apply those aspects of Australian law that have extraterritorial reach, as determined by the Australian Parliament. This will involve the courts of one nation contending with the implications of another nation's express rebuttal of the premise that domestic legislation has no extraterritorial reach.

BMG Music v. Gonzalez, 430 F.3d 888 (7th Cir. 2005)

EASTERBROOK, Circuit Judge.

Last June the Supreme Court held in *MGM Studios, Inc. v. Grokster, Ltd.* that a distributed file-sharing system is engaged in contributory copyright infringement when its principal object is the dissemination of copyrighted material. The foundation of this holding is a belief that people who post or download music files are primary infringers. *In re Aimster Copyright Litigation,* which anticipated *Grokster,* made the same assumption. In this appeal Cecilia Gonzalez, who downloaded copyrighted music through the KaZaA file-sharing network, denies the premise of *Grokster* and *Aimster*. She contends that her activities were fair use rather than infringement. The district court disagreed and granted summary judgment for the copyright proprietors (to which we refer collectively as BMG Music). The court enjoined Gonzalez from further infringement and awarded $22,500 in damages under 17 U.S.C. § 504(c).

A "fair use" of copyrighted material is not infringement. Gonzalez insists that she was engaged in fair use under the terms of 17 U.S.C. § 107—or at least that a material dispute entitles her to a trial. It is undisputed, however, that she downloaded more than 1,370 copyrighted songs during a few weeks and kept them on her computer until she was caught. Her position is that she was just sampling music to determine what she liked enough to buy at retail. Because this suit was resolved on summary judgment, we must assume that Gonzalez is telling the truth when she says that she owned compact discs containing some of the songs before she downloaded them and that she purchased others later. She concedes, however, that she has never owned legitimate copies of 30 songs that she downloaded. (How many of the remainder she owned is disputed.)

Instead of erasing songs that she decided not to buy, she retained them. It is these 30 songs about which there is no dispute concerning ownership that formed the basis of the damages award. This is not a form of time-shifting, along the lines of *Sony Corp. of America v. Universal Studios, Inc.* A copy downloaded, played, and retained on one's hard drive for future use is a direct substitute for a purchased copy—and without the benefit of the license fee paid to the broadcaster. The premise of *Betamax* is that the broadcast was licensed for one transmission and thus one viewing. *Betamax* held that shifting the time of this single viewing is fair use. The files that Gonzalez obtained, by contrast, were posted in violation of copyright law; there was no license covering a single transmission or hearing—and, to repeat, Gonzalez kept the copies. Time-shifting by an authorized recipient this is not.

Section 107 provides that when considering a defense of fair use the court must take into account "(1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work." Gonzalez was not engaged in a nonprofit use; she downloaded (and kept) whole copyrighted songs (for which, as with poetry, copying of more than a couplet or two is deemed excessive); and she did this despite the fact that these works often are sold per song as well as per album. This leads her to concentrate on the fourth consideration: "the effect of the use upon the potential market for or value of the copyrighted work."

As she tells the tale, downloading on a try-before-you-buy basis is good advertising for copyright proprietors, expanding the value of their inventory. The Supreme Court thought otherwise in *Grokster,* with considerable empirical support. As file sharing has increased over the last four years, the sales of recorded music have dropped by approximately 30%. Perhaps other economic factors contributed, but the events likely are related. Music downloaded for free from the Internet is a close substitute for purchased music; many people are bound to keep the downloaded files without buying originals. That is exactly what Gonzalez did for at least 30 songs. It is no surprise, therefore, that the only appellate decision on point has held that downloading copyrighted songs cannot be defended as fair use, whether or not the recipient plans to buy songs she likes well enough to spring for.

Although BMG Music sought damages for only the 30 songs that Gonzalez concedes she has never purchased, all 1,000+ of her downloads violated the statute. All created copies of an entire work. All undermined the means by which authors seek to profit. Gonzalez proceeds as if the authors' only interest were in selling compact discs containing collections of works. Not so; there is also a market in ways to introduce potential consumers to music.

Think of radio. Authors and publishers collect royalties on the broadcast of recorded music, even though these broadcasts may boost sales. Downloads from peer-to-peer networks such as KaZaA compete with licensed broadcasts and hence undermine the income available to authors. This is true even if a particular person never buys recorded media. Many radio stations stream their content over the Internet, paying a fee for the right to do so. Gonzalez could have listened to this streaming music to sample songs for purchase; had she done so, the authors would have received royalties from the broadcasters (and reduced the risk that files saved to disk would diminish the urge to pay for the music in the end).

Licensed Internet sellers, such as the iTunes Music Store, offer samples—but again they pay authors a fee for the right to do so, and the teasers are just a portion of the original. Other intermediaries (not only Yahoo! Music Unlimited and Real Rhapsody but also the revived Napster, with a new business model) offer licensed access to large collections of music; customers may rent the whole library by the month or year, sample them all, and purchase any songs they want to keep. New technologies, such as SNOCAP, enable authorized trials over peer-to-peer systems.

Authorized previews share the feature of evanescence: if a listener decides not to buy (or stops paying the rental fee), no copy remains behind. With all of these means available to consumers who want to choose where to spend their money, downloading full copies of copyrighted material without compensation to authors cannot be deemed "fair use." Copyright law lets authors make their own decisions about how best to promote their works; copiers such as Gonzalez cannot ask courts (and juries) to second-guess the market and call wholesale copying "fair use" if they think that authors err in understanding their own economic interests or that Congress erred in granting authors the rights in the copyright statute. Nor can she defend by observing that other persons were greater offenders; Gonzalez's theme that she obtained "only 30" (or "only 1,300") copyrighted songs is no more relevant than a thief's contention that he shoplifted "only 30" compact discs, planning to listen to them at home and pay later for any he liked.

BMG Music elected to seek statutory damages under 17 U.S.C. § 504(c)(1) instead of proving actual injury. This section provides that the author's entitlement, per infringed work, is "a sum of not less than $750 or more than $30,000 as the court considers just." But if an "infringer sustains the burden of proving, and the court finds, that such infringer was not aware and had no reason to believe that his or her acts constituted an infringement of copyright, the court in its discretion may reduce the award of statutory damages to a sum of not less than $200." Gonzalez asked the district court to reduce the award under this proviso, but the judge concluded that § 402(d) bars any reduction in the minimum award. This subsection provides: "If a notice of copyright in the form and position specified by this section appears on the published phonorecord or phonorecords to which a defendant in a copyright infringement suit had access, then no weight shall be given to such a defendant's interposition of a defense based on innocent infringement in mitigation of actual or statutory damages". It is undisputed that BMG Music gave copyright notice as required—"on the surface of the phonorecord, or on the phonorecord label or container". It is likewise undisputed that Gonzalez had "access" to records and compact disks bearing the proper notice. She downloaded data rather than discs, and the data lacked copyright notices, but the statutory question is whether “access” to legitimate works was available rather than whether infringers earlier in the chain attached copyright notices to the pirated works. Gonzalez readily could have learned, had she inquired, that the music was under copyright.

If BMG Music had requested more than $750 per work, then Gonzalez would have been entitled to a trial. What number between $750 and $30,000 is “just” recompense is a question for the jury, unless both sides agree to decision by the court. But BMG Music was content with $750 per song, which the district judge awarded on summary judgment. Gonzalez contends that this was improper: *Feltner*, she contends, holds that a jury must decide whether even the statutory minimum award will be allowed.

Feltner holds that a claim for statutory damages under § 504(c) is a suit at law to which the *seventh amendment* applies. This does not mean, however, that a jury must resolve every dispute. When there are no disputes of material fact, the court may enter summary judgment without transgressing the Constitution. While acknowledging this proposition, Gonzalez insists that copyright cases are different. She relies entirely on a single passage from *Feltner*: “The right to a jury trial includes the right to have a jury determine the *amount* of statutory damages, if any, awarded to the copyright owner.” Gonzalez maintains that by adding “if any” the Court allowed a jury to send an author home empty handed, even if the statute makes $750 the minimum. In other words, she contends that *Feltner* creates a system of jury nullification unique to copyright litigation.

The Justices did not purport to give defendants in copyright cases the right to ask jurors to return verdicts in the teeth of the law. The sentence we have quoted is a general description of the jury’s role, which the Court drew from seventeenth-century English jurisprudence. That’s hardly a plausible source for a rule unique to American copyright law. In *Feltner* neither side had sought summary judgment. We read *Feltner* as establishing no more (and no less) than that cases under § 504(c) are normal civil actions subject to the normal allocation of functions between judge and jury. When there is a material dispute of fact to be resolved or discretion to be exercised in selecting a financial award, then either side is entitled to a jury; if there is no material dispute and a rule of law eliminates discretion in selecting the remedy, then summary judgment is permissible.

Gonzalez says that the ninth circuit understood *Feltner* differently on remand, but that’s mistaken. A jury trial was held—for there were material factual disputes—and the jury returned a verdict of $31.68 million in statutory damages (or $72,000 per infringed work, an award made possible by the jury’s conclusion that infringement had been wilful). The defendant, ruing its Pyrrhic victory in the Supreme Court (the judge’s original award, which the Court vacated, had been $8.8 million), maintained that § 504(c) is unconstitutional, and that only actual damages may be awarded, because § 504(c) does not provide for a jury trial. The court of appeals rejected that contention, noting that after the Supreme Court’s decision a jury trial had been held. Whether a jury resolves the dispute because of statutory language or because of the *seventh amendment* is all the same to the litigants. It is not possible to find, in a decision affirming a jury’s verdict, a rule of law that a jury is required even when there are no factual disputes to resolve and no discretion to exercise.

As for the injunction: Gonzalez contends that this should be vacated because she has learned her lesson, has dropped her broadband access to the Internet, and is unlikely to download copyrighted material again. A private party’s discontinuation of unlawful conduct does not make the dispute moot, however. An injunction remains appropriate to ensure that the misconduct does not recur as soon as the case ends. The district court did not abuse its discretion in awarding prospective relief.

AFFIRMED

Richard Owens, *TRIPs and the Fairness in Music Arbitration: The Repercussions*, 25 EUR. INTELL. PROP. REV. 49 (2003)

On July 27, 2000, the World Trade Organization ("WTO") Dispute Settlement Body ("DSB") adopted a Panel Report containing the first ruling of a WTO panel on the scope of copyright protection under the TRIPs Agreement. Based on a complaint against the United States brought by the European Commission ("EC"), the Report concluded that § 110(5)(B) of the US Copyright Act, as amended by the Fairness in Music Licensing Act ("FMLA") of 1998, is incompatible with the rights of public performance and communication to the public under Arts 11bis(1)(iii) and 11(1)(ii) of the Berne Convention, and by virtue of incorporation of those rights in the TRIPs Agreement, with the "three-step test" in Art.13 of TRIPs. On the basis of the Panel Report, the DSB requested that the United States bring its legislation into line with TRIPs within "a reasonable period of time", which came to an end on December 31, 2001 without amendment of the Copyright Act.

On July 23, 2001, the EC and the United States asked an arbitration panel constituted under Art.25 of the WTO Dispute Settlement Understanding ("DSU") to determine "the level of nullification or impairment of benefits to the European Communities as a result of the operation of § 110(5)(b) of the US Copyright Act". On October 12, 2001 the arbitrators issued their award, which was notified to the DSB and the TRIPs Council on November 9, 2001. According to the award, the level of EC benefits that are being nullified or impaired as a result of the operation of Section 110(5)(B) is ##1,219,900 per year, or US$1.1 million.

Following on non-compliance by the United States with the Panel Report, the award of the arbitrators in the Fairness in Music case raises worrying concerns for the enforcement of intellectual property rights under TRIPs which could reverberate well beyond the sphere of copyright.

Background

The Fairness in Music case was initiated in late 1998 by the EC following complaints from the Irish copyright management organisation ("CMO") IMRO. As amended by the FMLA in 1998, § 110(5)(B) of the US Copyright Law exempts eating, drinking and retail establishments that do not exceed a certain size (2,000 or 3,750 square feet, depending on the type of establishment) or exceed specified audio or audiovisual equipment requirements, from liability for the public performance of music played from radio and television. Section 110(5)(B) is an expanded version of the so-called "homestyle" exemption to the right of public performance contained in the Copyright Act of 1976 and based on the 1975 Aiken decision of the US Supreme Court, which absolved small "mom-and-pop" establishments from copyright liability for playing radio music using amplification equipment that would normally be used in a home setting. Underlying the original "homestyle" exemption (and the later FMLA) was that such establishments were not widely licensed by the US CMOs, owing to high transaction, administration and enforcement costs in relation to the licensing revenue likely to be generated. Notwithstanding the pre-existence of the "homestyle" exemption and low levels of licensing by US CMOs, the arbitrators relied on figures estimating actual licensing of relevant establishments by US CMOs in the three years prior to entry into force of the FMLA in their methodology for determining the level of nullification and impairment of EC benefits as a result of § 110(5)(B). The impact of that methodology in the award will be addressed below.

The Panel Report

The Panel Report found that § 110(5)(B) is inconsistent with all three prongs of the "three-step" test in Art.13 of TRIPs. In doing so it established important principles for application of Art.13 in future cases, particularly in regard to the second and third prongs of the test. First, the Panel found that § 110(5)(B) is not limited to "certain special cases". In a 1999 study requested by ASCAP based on 1998 data and the criteria in the 1998 FMLA amendment, Dun & Bradstreet had estimated that 70 per cent of eating establishments, 73 per cent of drinking establishments, and 45 per cent of retail establishments fell under the FMLA size limitations and would qualify for the exemption. The Panel stated, "[w]e fail to see how a law that exempts a major part of the users that were specifically intended to be covered by . . . Article 11bis(1)(iii) [of the Berne Convention] . . . could be considered as a special case in the sense of the first condition of Article 13 of the TRIPs Agreement" (emphasis in original).

Applying the second prong of the test, the Panel found that § 110(5(B)) conflicts with a normal exploitation of the work, based on the principle that exempted uses may not compete with actual or potential sources of gain from economic exploitation of the right in question:

"We believe that an exception or limitation to an exclusive right in domestic legislation rises to the level of a conflict with a normal exploitation of the work (i.e., the copyright or rather the whole bundle of exclusive rights conferred by the ownership of the copyright), if uses, that in principle are covered by that right but exempted under the exception or limitation, enter into economic competition with the ways that right holders normally extract economic value from that right to the work (i.e., the copyright) and thereby deprive them of significant or tangible commercial gains" (emphasis added).

The Panel rejected the United States' "double payment" argument that § 110(5)(B) does not conflict with a normal exploitation of the work because rightholders already receive royalties from economically more significant uses involved in "primary" performance and broadcasting. In assessing this argument the Panel noted that the TRIPs Agreement confers a number of exclusive rights under copyright, and thus "whether a limitation or an exception conflicts with a normal exploitation of a work should be judged for each exclusive right individually". It also emphasised that the current licensing practices of CMOs are not necessarily indicative of the scope of normal extraction of economic value under the second prong of the three-step test. The Panel stated that such a proposition "would equate 'normal exploitation' with 'normal remuneration' practices existing at a certain point in time in a given market or jurisdiction".

Applying the third prong of the three-step test, the Panel found that § 110(5)(B) "unreasonably prejudice[s] the legitimate interests of the right holder", based on several principles. First, while a certain degree of "prejudice" to legitimate interests must always be presumed, the Panel stated that such prejudice becomes "unreasonable" when, as in the case of § 110(5)(B), an exception causes or has the potential to cause an unreasonable loss of income to the copyright holder. It also declared that both actual and potential prejudice to rightholders caused by the exemption in question must be taken into account. Finally, the Panel stated that analysis of unreasonable prejudice should not be applied only to the interests of rightholders of the WTO Member that initiated the complaint, but should take into account the legitimate interests of copyright holders at large. This principle is particularly significant in the light of the approach taken later by the arbitrators.

The Award of the Arbitrators

On the basis of its conclusions, the Panel Report recommended that the DSB request the United States to bring § 110(5)(B) into conformity with its obligations under Art.13 of TRIPs. When it became clear by mid-2001 that amendment of the law to comply with the Panel Report was unlikely to occur within the reasonable period of time agreed between the United States and the EC, the United States and the EC submitted the case to arbitration under Art.25 of the DSU.

Before the arbitrators, the EC and the United States advanced fundamentally different arguments on methodology for determining the benefits involved. Consistent with the Panel Report's broad interpretation and application of the three-step test under TRIPs Art.13, the EC claimed that the level of benefits EC rightholders could expect to receive should be the potential licensing income realisable from exercise of the public performance right—with no deduction for costs of administration and enforcement—if the US CMOs were to license all eating, drinking and retail establishments which play radio and television music. Put another way, the EC argued that the basis for calculating the level of nullification and impairment of EC benefits should be the potential value of the right of public performance itself. On the basis of what the Panel Report characterised as a "bottom up" approach, the EC claimed that the benefits denied to EC rightholders amounted to US$25.5 million per year.

By contrast the United States argued that the number of users that US CMOs seek to license is a function of the ratio between transaction, administration and enforcement costs, on the one hand, and expected revenue per licence on the other. Thus the United States argued that the level of EC benefits nullified and impaired should be based on a "top-down" approach focusing on the number of establishments that would normally be licensed but for the exemption in § 110(5)(B). Though complete and accurate information on licensing levels was not available, the United States put forward a calculation based on payments by the US CMOs ASCAP and BMI to European rightholders in the three years prior to entry into force of the FMLA (1996-98), arriving at an estimate of benefits to EC rightholders nullified and impaired as a result of § 110(5)(B) of between US$0.4 and 0.7 million per year.

The arbitrators accepted the US "top-down" approach, as it focused on "historical figures" rather than the value of the public performance right based, inter alia, on theoretical higher levels of licensing of retail establishments by US CMOs. The arbitrators stated that the US approach was also preferable because it limited the number of assumptions and inferences necessary, while the EC "bottom-up" approach might require basing the calculation on what some arbitrations have described as a "counterfactual", i.e. basing the calculation on an "as-if" situation at the end of the reasonable period of time predicated on full licensing by CMOs of all establishments covered by the exemption. A third reason for acceptance of the US "top-down" approach was that "the Arbitrators have encountered particular difficulties due to the lack of precise information available", which "played a major role in the choices made . . . with respect to the methodology and the calculations".

In accepting the "top-down" methodology and focusing only on historical licensing data from US CMOs, the arbitrators declined to apply the Panel Report's rulings on application of the second and third prongs of the three-step test in Art.13 of TRIPs, namely that both actual and potential sources of revenue are to be taken into account in determining whether an exception conflicts with a normal exploitation of the work in question, and that actual and potential economic losses are to be considered in determining whether an exemption causes unreasonable prejudice to the legitimate interests of rightholders. It is worth quoting in full from the Panel Report on application of the third prong of Art.13:

"As regards the third condition [of Art.13] in particular, we note that if only actual losses were taken into account, it might be possible to justify the introduction of a new exception to an exclusive right irrespective of its scope in situations where the right in question was newly introduced, right holders did not previously have effective or affordable means of enforcing that right, or that right was not exercised because the right holders had not yet built the necessary collective management structure required for such exercise. While under such circumstances the introduction of a new exception might not cause immediate additional loss of income to the right holder, he or she could never build up expectations to earn income from the exercise of the right in question. We believe that such an interpretation, if it became the norm, could undermine the scope and binding effect of the minimum standards of intellectual property rights protection embodied in the TRIPs Agreement" (emphasis added).

The arbitrators noted that the EC had not alleged violation of the enforcement provisions of TRIPs, implying that such a claim might have required them to consider potential prejudice to rightholders' legitimate interests in their choice of methodology. As it was, in a comment on the above passage from the Panel Report the arbitrators distinguished their task of determining the level of benefits denied to EC rightholders resulting from operation of § 110(5)(B), on the one hand, from the task of the Panel in determining whether the exemption was compatible with Art.13 of TRIPs on the other.

As indicated above, the arbitration ended with a determination that the level of nullification and impairment of EC benefits as a result of the operation of § 110(5)(B) was ##1,219,900 per year, or US$1.1 million.