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NEWS: ANALYSIS & COMMENTARY

Coming To Grips With *Grokster*

Now the only thing innovators are sure of is that they'll have to watch their step

With its landmark ruling in *Metro-Goldwyn-Mayer Studios Inc., et al. v. Grokster Ltd., et al.* on June 27, the U.S. Supreme Court handed the technology industry a bowl of mush. The decision forbids companies from encouraging customers to steal intellectual property -- or, as lawyers put it, from actively inducing copyright infringement.

Sounds clear enough, in theory. But in the wake of the decision, companies that are dedicated to making creative new gadgets, services, and software to distribute music, movies, video games, and books have been scrambling to figure out how *MGM v. Grokster* applies to their businesses. The ruling does not supply "a clear standard," says Mark F. Radcliffe, a partner at the East Palo Alto (Calif.) office of DLA Piper Rudnick Gray Cary, which works with VCs and technology companies. "This is a decision that causes a fair amount of heartache in the venture community."

While it will take courts years to define the precise boundaries of the ruling, many entrepreneurs don't have the luxury of waiting. The next generation of peer-to-peer services, such as BitTorrent, which allows the rapid transfer of large files, will have to be developed under the shadow of the court's new "active inducement" standard. So will innovations such as podcasting -- the creation of radio shows for downloading onto digital listening devices such as iPods.

"A BIG 'SUE ME' SIGN"

Podcasting is just one of many technologies that are shaping a new world where music, movies, and digital books will flow across fast broadband and wireless connections to digital devices that can easily store, search, and copy huge amounts of data. Almost all of these nascent technologies have two things in common. First, their widespread commercial implementation is still far in the future. Second, they can be used for both legal and illegal purposes. For companies involved in creating the products and software that will determine the emerging media and entertainment environment, the Grokster decision has created "a gray area in which lawyers will thrive," says Gary Little, a general partner at venture firm Morgenthaler Ventures in Menlo Park, Calif.

At this point the only thing that's clear is that entrepreneurs will have to watch their step more carefully in every phase of business development, from funding fresh ventures and designing products to communicating with customers. The item at the top of the list of concerns is marketing.

The Supreme Court based its ruling, in part, on the advertising efforts by Grokster to lure fans of the outlaw Napster service after the file-sharing pioneer shut down -- which were taken as evidence that Grokster's backers intended to encourage music piracy. Now some lawyers predict that ads such as Apple Computer Inc.'s (**AAPL**) "Rip. Mix. Burn" or Microsoft Corp.'s (**MSFT**) "Swap Pictures, Music, Video and More" pitch for its instant-messaging service won't be imitated. "It's like painting a big 'Sue Me' sign on the technology," says Radcliffe.

Customer communications will also go under the microscope. In the *Grokster* case, the high court criticized the company for giving customers instructions on how to download copyrighted music. Now businesses will need to be

vigilant about scrubbing online FAQs to ensure that they don't appear to encourage copyright infringement or even give vague examples of how the technology could be used to find popular shows or songs. Customer help line workers could also require special compliance training. And startups may have to invite lawyers in on product-development discussions from the beginning to help draw up plans and work with engineers on research and development. "Rather than pay people like me to argue about this in court, it's better to take care of [it] up-front," says Ian C. Ballon, a partner at Manatt, Phelps & Phillips LLP in Palo Alto, Calif.

VULNERABLE AREAS

Another tricky concern for innovators: how to respond once they become aware that their technology may be being used for rampant piracy. In the past, companies were safest when they didn't admit to knowing about the thievery. The ruling states that mere knowledge of copyright violations isn't illegal. But such awareness, when combined with other actions, such as ads or statements by employees or executives, could leave a company vulnerable to lawsuits if it doesn't take action after receiving a warning from a music label or studio that potentially illegal copying was occurring. "With all of these inducement elements floating around, you don't know what will end in liability," says Catherine S. Kirkman, a partner at Wilson Sonsini Goodrich & Rosati in Palo Alto.

Some startups, such as the social networking site MySpace.com, remove disputed copyrighted works as a matter of policy. We "have [a] strict policy [and] actively enforce that policy, because long-term these content guys are going to go after you if you don't," says Geoff Yang, a founding partner at VC firm Redpoint Ventures, an investor in MySpace.

The new uncertainties are prompting Silicon Valley types to make dire announcements. "It might take 10 years of litigation to get a clear sense of this," says Larry Lessig, an intellectual-property professor at Stanford Law School. "In Internet time, it's an eternity. That's 10 years of chilled innovation. That's really quite costly." He may be crying wolf -- but there's no doubt that, in the short-term, the court has made life more complicated for innovators.

By Heather Green in New York, with Lorraine Woellert in Washington