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### Indirect Liability for Copyright Infringement: An Economic Perspective

William M. Landes  
William.Landes@chicagounbound.edu

Douglas Gary Lichtman  
DouglasGary.Lichtman@chicagounbound.edu

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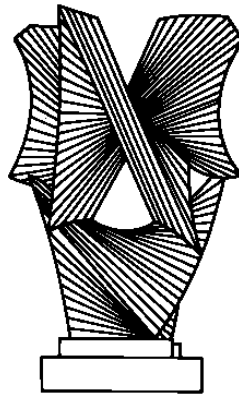
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## Indirect Liability for Copyright Infringement: An Economic Perspective

*William Landes and Douglas Lichtman*

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## Indirect Liability for Copyright Infringement: An Economic Perspective

William Landes and Douglas Lichtman\*

When individuals infringe copyright, they often use tools, services, and venues provided by other parties. An enduring legal question asks to what extent those other parties should be held liable for the resulting infringement. For example, should a firm that produces photocopiers be required to compensate authors for any unauthorized copies made on that firm's machines? What about firms that manufacture personal computers or offer Internet access; should they be liable, at least in part, for online music piracy? Modern copyright law addresses these issues through a variety of common law doctrines and statutory provisions. In this essay, we introduce those rules and evaluate them from an economic perspective. In the process, we emphasize that every mechanism for rewarding authors inevitably introduces some form of inefficiency, and thus the only way to determine the proper scope for indirect liability is to weigh its costs and benefits against those associated with other plausible mechanisms for rewarding authors.

When it comes to venues for copyright infringement, there was a time when nothing could compete with the flea market. Traditionally, flea markets are places to buy and sell secondhand goods and antiques. But in the 1970s and 1980s, flea markets became in addition places to buy and sell unauthorized recordings of copyrighted music. It was big business. Indeed, as late as 1991, police raided a California flea market and walked away with over 38,000 illegal tape recordings.<sup>1</sup>

The legal issues raised by flea market infringement were contentious in their day. The first step was easy: individual sellers of pirated music were obviously guilty of copyright infringement. But what about the firms and individuals that owned implicated markets? Were they also liable? On the one hand, surely not, as these owners had done

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\* William Landes is the Clifton R. Musser Professor of Law and Economics and Douglas Lichtman is Professor of Law, both at the University of Chicago Law School. An earlier version of this Essay appeared in the Spring 2003 issue of the *Journal of Economic Perspectives*. Our thanks to the *Journal* for authorizing this expanded treatment, and to David Friedman, Assaf Hamdani, Neil Netanel, John Pfaff, and Lior Strahilevitz for helpful comments. We also gratefully acknowledge the Olin and Bradley Foundations, Merck, Microsoft, and Pfizer for their generous financial support of the law and economics program at the Law School

nothing more than create a space where buyers and sellers could interact. From another perspective, however, these owners did benefit from infringement in that cheap music was part of what brought buyers and sellers to the market. Moreover, the owners likely could have done more to clamp down on unlawful behavior, such as screening vendors more aggressively or performing spot checks on transactions.

Today, the flea market is no longer a significant battleground for copyright law, but the same basic legal question continues to loom: how far should copyright liability extend beyond any direct lawbreakers? For example, consumers use videocassette recorders to make both legal recordings of television programs and illegal duplicates of rented feature films. The consumers are directly liable for any violations of copyright law; but should manufacturers of videocassette recorders also be held liable on grounds that they knowingly profit from the sale of a tool that can be used for infringement? If knowledge and profit are sufficient, what does that mean for firms that manufacture photocopiers or digital cameras? Similarly, what about firms that manufacture modems and personal computers; should they be held accountable for copyright infringement when strangers use these products to trade unauthorized music, software, and movies online?

In this essay, we inquire into the question of when indirect liability should be used to increase compliance with the law. The argument in favor of liability is that third parties are often in a good position to discourage copyright infringement either by monitoring direct infringers or redesigning their technologies to make infringement more difficult. The argument against is that legal liability almost inevitably interferes with the legitimate use of implicated tools, services, and venues.<sup>2</sup>

### **The Economics of Indirect Liability**

Unlike the Patent Act, the Copyright Act of 1976 does not explicitly recognize the possibility of indirect liability. Nevertheless, courts have held third parties liable for

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<sup>1</sup> *Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259, 260 (9th Cir. 1996).

<sup>2</sup> A large literature considers the economics of copyright law more generally, not focusing explicitly on indirect liability. For a good introduction, see William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325 (1989).

copyright infringement under two long-standing common law doctrines: contributory infringement and vicarious liability.<sup>3</sup>

### *Contributory Infringement*

Contributory infringement applies where one party knowingly induces, causes, or otherwise materially contributes to the infringing conduct of another. The adverb “knowingly” is perhaps misleading in that it takes on an unusual meaning in this setting. It does not simply mean “awareness of infringement” but instead implies some meaningful capacity to prevent or discourage infringement. Consider the following example. Suppose that *C* manufactures a decoder box that enables any purchaser *B* to unscramble premium and pay-per-view cable programs without paying for them. *A* is the injured copyright holder who owns those programs. Should the equipment maker *C* be held liable for purchaser *B*’s infringement of copyright?

Two considerations bear mention. First, there are likely to be substantial enforcement and administrative savings if injured copyright holders like *A* are allowed to sue *C* rather than pursuing each *B* individually. Even if each *B* has sufficient resources to pay for the harm he causes, the costs of tracking down the many *B*s, gathering evidence as to each *B*’s specific activities, and then litigating that many separate lawsuits would likely make it uneconomical for *A* to enforce its copyright.<sup>4</sup> Because each *B* knows this in advance, each has little incentive to comply with the law. If the law holds *C* liable for damages caused by *B*, by contrast, the savings in enforcement costs are likely to be sufficiently large for *A* to enforce its copyright. *A* might still face problems proving damages—that requires evidence about the separate actions of the many *B*s—but the prospect of liability will most likely put *C* out of business and, in this example, lead most *B*s to pay for cable rather than stealing it.

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<sup>3</sup> For a more formal introduction to these doctrines, see Robert A. Gorman & Jane C. Ginsburg, *Copyright: Cases and Materials* 560-573 (6th ed. 2001); Marshall Leaffer, *Understanding Copyright* 245-260 (3d ed. 2002). Renier Kraakman surveys the concept of indirect liability outside the copyright setting in Kraakman, *Third Party Liability*, *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW*, VOL. III (ed. Peter Newman 1998).

<sup>4</sup> If *C* is sued, *C* will often be allowed to sue the various *B*s for compensation. The same factors that made it uneconomical for the copyright holder to sue each *B*, however, may make these lawsuits uneconomical for *C* as well.

Second, if there are lawful uses of *C*'s product, this weakens the case for liability. The "lawful use" question does not arise in the decoder example because its only conceivable use involves violating the law. But consider a firm that produces photocopiers or personal computers. Such a firm does literally "know" that some of its customers will infringe copyright, but the firm does not have specific knowledge about any particular customer. Thus, even though substantial savings in enforcement costs might still arise in these cases were courts to impose liability, it is unlikely that any court would be willing to do so. The benefits in terms of increased copyright enforcement come at too high a cost in terms of possible interference with the sale of a legitimate product.<sup>5</sup>

In some cases it may be possible for the equipment maker *C* to redesign its product in a way that would eliminate or greatly reduce the level of infringement without significantly cutting down on the quantity and quality of lawful uses. In such cases, liability is again attractive. Often, however, these sorts of solutions are out of reach. For instance, it is hard to imagine a redesigned photocopier that would make infringement less attractive but not at the same time substantially interfere with lawful duplication. Given that, holding the equipment manufacturer liable would be equivalent to imposing a tax on the offending product. The "tax" would reduce overall purchases of photocopiers and it would redistribute income to copyright holders, but it would not alter the incentive of users to substitute noninfringing for infringing uses.

The examples of the decoder box and the photocopier mark two extremes and serve to delineate the key issues. All else equal, indirect liability is more attractive: (a) the greater the harm from direct copyright infringement; (b) the less the benefit from lawful use of the indirect infringer's product; (c) the lower the costs of modifying the product in ways that cut down infringing activities without substantially interfering with legal ones;

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<sup>5</sup> An interesting counterpoint is to consider whether the result should be different when the issue is not photocopying machines sold individually to consumers but instead photocopying services like those provided by Kinko's and various university copy centers. Perhaps in the latter case liability is more sensible, for example because copy center employees are in a good position to monitor for and discourage copyright violations. See *Princeton Univ. Press v. Michigan Document Services, Inc.*, 99 F.3d 1381 (6th Cir. 1996) (en banc) (photocopying service liable for direct infringement).

and (d) the greater the extent to which indirect liability reduces the costs of copyright enforcement as compared to a system that allows only direct liability.

### *Vicarious Liability*

Vicarious liability applies in situations where one party—often an employer—has control over another and also enjoys a direct financial benefit from that other’s infringing activities. A typical case arises where an employer hires an employee for a lawful purpose, but the employee’s actions on behalf of the employer lead to copyright infringement. One rationale for imposing liability in this instance is that the employer should be encouraged to exercise care in hiring, supervising, controlling and monitoring its employees so as to make copyright infringement less likely. A second rationale is that it is usually cheaper for copyright holders to sue one employer rather than suing multiple infringing employees. A final rationale is that liability helps to minimize the implications of bankrupt infringers. An employee cannot be held liable if he does not have adequate financial resources. Indirect liability solves this problem by putting the employer’s resources on the line, thereby increasing the odds that the harm from infringement will be internalized.<sup>6</sup>

The example of a dance hall operator illustrates these points. Dance hall operators hire bands and other performers who sometimes violate copyright law by performing copyrighted work without permission. Often these performers lack the resources needed to pay for the associated harm. In these circumstances, indirect liability has real policy allure. It is probably less expensive for a copyright holder to sue the dance hall operator than it is for him to sue each performer individually, both because there are many performers and because the dance hall operator is likely easier to identify and serve with legal process. Putting litigation costs to one side, it is also the case that dance hall operators are typically in a position to monitor the behavior of direct infringers at a relatively low cost. After all, the operator is probably already monitoring the dance hall

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<sup>6</sup> Of course, the employer might also lack sufficient funds. Note, too, that employers are only held responsible for infringements that occur within the scope of employment. Infringement committed by an employee on his own time and for personal reasons would not trigger vicarious liability. For a discussion of the economics, see Alan O. Sykes, *Vicarious Liability*, in *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW*, VOL. III (Peter Newman, ed. 1998).



quite carefully in order to ensure that patrons are being well treated, employees are not siphoning funds from the till, and so on. Finally, because performers are more likely than dance hall owners to lack the resources required to pay damages for copyright infringement, vicarious liability in this instance prevents the externalization of copyright harm.

It is worth pointing out that the threat of vicarious liability has encouraged dance halls, concert halls, stadiums, radio stations, television stations and other similar entities to look for an inexpensive way to acquire performance rights. For the most part, they do this by purchasing blanket licenses from performing rights societies, the two largest of which are Broadcast Music International (BMI) and the American Society of Composers, Authors, and Publishers (ASCAP). ASCAP and BMI hold non-exclusive performance rights to nearly all copyrighted music. The blanket licenses they sell give licensees the right to perform publicly all the songs in the performing rights society's repertoire for as many times as the licensee likes during the term of the license. The blanket license saves enormous transaction costs by eliminating the need for thousands of licenses with individual copyright holders and by eliminating the need for performers to notify copyright holders in advance with respect to music they intend to perform. In addition the blanket license solves the marginal use problem because each licensee will act as if the cost of an additional performance is zero—which is, in fact, the social cost for music already created.

### **Statutory and Common Law Evolution**

The doctrines of contributory infringement and vicarious liability have evolved over time, with adjustments coming from both the courts and Congress. Of these, probably the most significant was the 1984 Supreme Court decision in *Sony v. Universal Studios*.<sup>7</sup> The plaintiffs were firms that produced programs for television; the defendants manufactured an early version of the videocassette recorder (VCR). The plaintiffs' legal claim was that VCRs enable viewers to make unauthorized copies of copyrighted television programs. This was troubling to the copyright holders mainly because viewers watching taped

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<sup>7</sup> 464 U.S. 417 (1984).

shows can more easily skip commercials, and that obviously diminishes the value of the associated copyrighted programming. Suing viewers directly would have been both infeasible and unpopular, so the program suppliers sued the VCR manufacturers on theories of both contributory infringement and vicarious liability.

The Supreme Court rejected both theories.<sup>8</sup> Vicarious liability was rejected because the Court did not believe that VCR manufacturers had meaningful control over their infringing customers. As the Court saw the issue, the only contact between VCR manufacturers and their customers occurred “at the moment of sale,” a time far too removed from any infringement for the manufacturers to be rightly compared to controlling employers.<sup>9</sup> Contributory infringement, by contrast, was rejected on grounds that the VCR is “capable of substantial non-infringing uses”—legitimate uses that in the Court’s view left manufacturers powerless to distinguish lawful from unlawful behavior.<sup>10</sup>

Whether one agrees or disagrees with these results, there is much to criticize in the Court’s analysis. On vicarious liability, the Court took a needlessly restrictive view of what it means for a manufacturer to “control” its purchasers. For example, the Court did not consider whether a relatively simple technology solution—say, making the fast forward button imprecise and thus diminishing the ease with which purchasers can skip commercials—might have gone a long way toward protecting copyright holders without interfering unduly with legitimate uses. On contributory infringement, meanwhile, while the Court was certainly right to focus on the fact that the VCR is capable of substantial non-infringing uses, the Court erred when it failed to put that fact into context. Full analysis requires that the benefits associated with legitimate use be weighed against the harms associated with illegitimate use. The Court failed to consider that balance. Instead, its ruling implies that VCR manufacturers can facilitate any copyright violation they wish so long as they can prove that VCRs also facilitate some non-trivial amount of legitimate behavior.

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<sup>8</sup> As a technical matter, it is ambiguous whether the Court’s analysis of vicarious liability is binding precedent or mere dicta. *See id.* at 435 n.17.

<sup>9</sup> *Id.* at 438.

Importantly, however, to just parse the legal analysis is to miss the heart of the *Sony* decision. The driving concern in *Sony* was a fear that indirect liability would have given copyright holders control over what was then a new and still-developing technology. This the Court was unwilling to do. Copyright law, the Court wrote, must “strike a balance between a copyright holder’s legitimate demand for effective . . . protection, and the rights of others to freely engage in substantially unrelated areas of commerce.”<sup>11</sup> The analogous modern situation would be a lawsuit attempting to hold Internet service providers liable for online copyright infringement. It is easy to see why courts would be reluctant to do that. Copyright law is important, but at some point copyright incentives must take a backseat to other societal interests, including an interest in promoting the development of new technologies and an interest in experimenting with new business opportunities and market structures.<sup>12</sup>

After *Sony*, the next significant refinement to the law of indirect copyright liability came from Congress in the form of the Audio Home Recording Act of 1992.<sup>13</sup> As a practical matter, this statute is unimportant; it carefully regulates a technology that turned out to be an embarrassing commercial flop. But in understanding indirect copyright liability, this statute marks an important step. It immunized from liability two groups: producers of digital audiotape equipment and manufacturers of blank digital audiotapes. Immunity was contingent, however, on digital audiotape equipment being redesigned to include a security feature that would diminish the risk of infringement by limiting the number of duplicate recordings that can be made from any single digital audiotape. In addition, the statute imposed a modest royalty on the sale of blank tapes and new digital audio equipment, the proceeds of which were to be shared among copyright holders as an offset against their anticipated piracy losses. By mandating a change in technology to reduce the risk of copyright violation and by setting up a compensation fund for injured

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<sup>10</sup> *Id.* at 442.

<sup>11</sup> *Id.* at 442.

<sup>12</sup> Several recent articles emphasize this relationship between either copyright law and market structure, or copyright law and political institutions. See, e.g., Randal C. Picker, *Copyright as Entry Policy: The Case of Digital Distribution*, THE ANTITRUST BULLETIN 423-63 (Summer/Fall 2002); Jessica Litman, *War Stories*, 20 CARDOZO ARTS & ENT. L.J. 337 (2002).

<sup>13</sup> Pub. L. No. 102-563, 106 Stat. 4237 (1992) (codified at 17 U.S.C. §§ 1001-1010 (2003)).

copyright holders, this law stands in sharp contrast to the *Sony* decision where VCR technology was left unchanged and injured copyright holders were left uncompensated.

Congress became involved with indirect liability again in 1998 when it passed the Digital Millennium Copyright Act. One provision immunizes from indirect liability a broad class of Internet access providers, telecommunications companies, and internet search engines, so long as these entities satisfy certain specific requirements designed to safeguard copyright holders' interests.<sup>14</sup> Before this legislation came into effect, the liability associated with many of these entities was in doubt. Was an Internet service provider vulnerable to a claim of vicarious liability given that it charges its users for Internet access and has ultimate control over what is, and what is not, available online? Was an online auction site like e-Bay liable since the site profits every time a seller sells an infringing item? The Digital Millennium Copyright Act answered these questions by establishing a safe harbor: if these Internet entities follow the requirements laid out by the statute—requirements that typically require the entity to act when a specific instance of infringement is either readily apparent or called to the entity's attention by a copyright owner—they are immune from charges of vicarious liability and contributory infringement.

The Digital Millennium Copyright Act added another significant indirect liability provision as well. Under this provision, it is illegal for a firm to manufacture, import, or otherwise provide to consumers a device primarily designed “to descramble a scrambled work, to decrypt an encrypted work, or otherwise to avoid . . . a technological measure” used to protect copyrighted work.<sup>15</sup> This provision has proven controversial because it significantly expands the scope of vicarious and contributory liability. The traditional doctrines hold a party liable only for facilitating infringement; the new provision holds a party liable for undermining technological protections even if no resulting act of infringement occurs. A troubling case, then, is a case where the facilitated act turns out to be perfectly legal. That is, if I use a tool to decrypt an encrypted software file and I do so solely for the purpose of engaging in lawful reverse engineering, the firm that sold me the

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<sup>14</sup> 17 U.S.C. § 512.

<sup>15</sup> 17 U.S.C. § 1201 (2003).

tool has likely violated the law even though I did not commit copyright infringement. That said, the intuition here is that many copyright owners use technology to protect their work and the law should support their efforts on grounds that this sort of self-help is less costly and more effective than more traditional forms of copyright protection.

That takes us to what is probably the most talked about litigation on indirect copyright liability, the music industry's recent lawsuit against Internet startup Napster.<sup>16</sup> As readers likely know, Napster facilitated the online exchange of music files in two ways: it provided software that allowed a user to identify any song he was willing to share with others, and it provided a website where that information was made public so that an individual looking for a particular song would be able to find a willing donor. Several firms in the music industry sued Napster on grounds that these tools promoted the unauthorized distribution and duplication of copyrighted recordings.

Napster's primary defense was that its service, like a VCR, is capable of both legal and illegal use. For example, the Napster technology can be used to trade recordings that are no longer commercially available (this is presumably legal) and to trade recordings by artists who are willing participants in this new distribution channel. Nevertheless, the Ninth Circuit has thus far rejected this proposed analogy to *Sony*, indicating that—whenever the litigation finally concludes—Napster will likely be found liable for at least some of the infringement it made possible.

The reason, according to the court, is that Napster had the ability to limit copyright infringement in ways that VCR manufacturers do not. For example, in applying the doctrine of contributory infringement, the court determined that Napster likely had the requisite level of knowledge because, first, Napster had “actual knowledge that specific infringing material [was] available using its system,”<sup>17</sup> and, second, Napster could have used that knowledge to identify and block at least some of the infringing material.<sup>18</sup>

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<sup>16</sup> *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001). Obviously, there is a substantial literature on this case, in part because of the extraordinary public fascination with the Napster service. For one excellent discussion and pointers into the rest of the literature, see Stacey Dogan, *Is Napster a VCR? The Implications of Sony for Napster and Other Internet Technologies*, 52 HASTINGS L.J. 939 (2001).

<sup>17</sup> *Id.* at 1022.

<sup>18</sup> *Id.*

Similarly, in analyzing the applicability of vicarious liability, the court emphasized Napster's on-going relationship with its customers. At any time, Napster could have refused service to users who were violating copyright law. VCR manufacturers, by contrast, have no such power; their relationship with any customer ends at the moment of sale.<sup>19</sup>

One can quibble with all of these arguments. For instance, this analysis seems to blur the line between the requirement under contributory infringement that a culpable party have *knowledge* of the direct infringement and the requirement under vicarious liability that a culpable party have *control* over the specific infringer. Still, the opinion seems to get the basic logic right. Napster is different from a VCR manufacturer because it has low-cost ways of discouraging piracy without impinging on legitimate use. As we discuss next, that is the core insight necessary for the design of an efficient indirect liability regime.

### **Rethinking the Indirect Liability Standard**

To evaluate all these mechanisms and principles, begin by considering an instance where it would be relatively easy to identify and thwart copyright wrongdoing—say, a flea market, where the proprietor could at low cost wander the market and spot vendors hawking illegal music at rock-bottom prices. The economic analysis in such a case is straightforward. Assuming that there is sufficient social benefit from copyright protection in terms of increased incentives for authors to create and disseminate their work, legal rules should pressure the flea market proprietor to do his part in enforcing the law. The social benefits of those increased incentives likely outweigh both the presumptively small private costs imposed on the market owner and any minor inconvenience these measures might impose on legitimate sellers.

Now consider the opposite case, namely an instance where it would be prohibitively expensive to distinguish legal from illegal copyright activity. Internet service providers are a good example in this category, in that an entity like America Online would have a

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<sup>19</sup> *Id.* at 1023-24.

hard time differentiating the unlawful transmission of Mariah Carey’s copyrighted music from the perfectly legitimate transmission of uncopyrighted classical music. Perhaps surprisingly, it might still be efficient to recognize liability in this instance. After all, instead of trying in vain to distinguish lawful from unlawful activity, a firm in this situation would simply increase its price and use that extra revenue to pay any ultimate damage claims. Legal liability, then, would function like a tax. In many instances such a tax would be welfare reducing in that higher prices discourage legal as well as illegal uses. But in some settings, discouraging both legal and illegal activity would yield a net welfare gain. This would be true where illegal behavior is sufficiently more harmful than legal behavior is beneficial; it would be true where the harms and benefits are comparable but illegal behavior is more sensitive to price; and it would be true where the benefits in terms of increased copyright incentives outweigh the harms associated with discouraging legitimate use.<sup>20</sup>

Pulling the lessons from both of the preceding examples together, then, an efficient approach to indirect liability might start by applying a negligence rule to any activity that can lead to copyright infringement. Negligence rules are common in tort law; they hold a party liable in cases where that party’s failure to take economically reasonable precautions results in a harm. As applied to *Sony*, a negligence rule might have asked whether VCR manufacturers adopted a reasonable design for their technology given its possible legitimate and illegitimate uses. As applied to flea markets, a negligence rule might ask whether a given owner monitors his market with sufficient care. This approach is not radically different from current law. The difference is that current law focuses on knowledge, control, the extent of any non-infringing uses, and other factors without being particularly clear as to why those issues are central. An explicit negligence rule would lay bare the underlying logic of the indirect liability inquiry.

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<sup>20</sup> The accounting here is tricky. The benefit associated with imposing indirect liability is not the number of illegal users that indirect liability thwarts. It is the number of users who switch from copying illegally to purchasing through legal channels. In fact, individuals who stop using the copyrighted work illegally and then do not purchase legally represent social loss, in that their utility is obviously diminished but there is no offsetting gain elsewhere in society. Things become even more complicated when one considers the possibility that illegal use can lead to legal use—for instance when illegal music trading online ironically turns out to help a new artist gain a following. For a discussion of other wrinkles, see

One drawback to the modern implicit negligence approach is that, as applied to new technologies, it can engender considerable uncertainty. A producer responsible for a new audio recording device, for example, might find it difficult to predict what courts will require in the new setting. In response, such a producer might choose to be excessively cautious. This explains the safe harbor provision that was introduced by the Digital Millennium Copyright Act. Thanks to that provision, Internet service providers and other firms associated with the Internet know that they are immune from indirect liability so long as they follow the guidelines explicitly set forth. That eliminates the risk created by an otherwise uncertain legal standard. Unfortunately, these firms are likely still too cautious; as Neal Katyal notes, “because an ISP derives little utility from providing access to a risky subscriber, a legal regime that places [any risk of] liability on an ISP for the acts of its subscribers will quickly lead the ISP to purge risky ones from its system.”<sup>21</sup> That said, competition in the market for Internet service provision should mitigate this problem.<sup>22</sup>

In addition to negligence liability and safe harbors, an efficient indirect liability regime might also include a tailored tax applicable to particular tools, services, or venues associated with copyright infringement. We say “might” because a tax proposal is likely to be more influenced by interest group politics than by efficiency considerations, and we worry about opening Pandora’s box. Putting interest group concerns to one side, however, a tax would be appropriate in instances where a price increase would reduce the harm caused by illegal behavior more than it would interfere with the social benefits that

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Yannis Bakos, Erik Brynjolfsson & Douglas Lichtman, Shared Information Goods, 42 J. Law & Econ. 117 (1999).

<sup>21</sup> Neil Kumar Katyal, *Criminal Law in Cyberspace*, 149 U. PA. L. REV. 1003, 1007 (2001).

<sup>22</sup> For a more skeptical view—albeit applied to a strict liability rule as opposed to a negligence standard—see Assaf Hamdani, *Who’s Liable for Cyberwrongs?*, 87 CORNELL L. REV. 901 (2002).

There are of course other concerns to keep in mind when considering the desirability of a negligence standard. For instance, negligence rules work well only to the extent that courts can accurately assess damages, because the fear of having to pay damages where adequate precautions are not taken is what inspires adequate precautions in the first place. Unfortunately, in copyright, estimating damages is notoriously difficult. Has online music trading really taken the steam out of music sales, or has online trading sparked renewed interest in popular music? And even if online trading did decrease music sales, how does one price the harm of a single traded song, given that music is typically sold in multiple-song packages and that many people trade music that they would not otherwise buy? The better these damage estimates, the more efficient the negligence rule. But that is true for any liability scheme, from the negligence rule discussed in the text to even a strict liability alternative.



derive from legal interactions. Thus, for example, it might be attractive to impose a small per-use tax on photocopying machines, at least if the resulting revenues would non-trivially increase the incentive to create and disseminate copyrighted work and the tax itself would not significantly discourage legitimate photocopier use. The closest the current system comes to establishing a tax of this sort is the royalty regime created by the Audio Home Recording Act. That approach is different, however, in that the royalty regime displaces negligence liability instead of supplementing it.<sup>23</sup>

### **Indirect Liability in Context**

When evaluating different indirect liability rules from a broad public policy perspective, it is important to remember that indirect liability is just one of several mechanisms by which society tailors the incentive to create and disseminate original work. Other mechanisms abound, including most obviously adjustments to the scope and duration of copyright protection, and, less obviously, such alternatives as the criminal penalties now applicable to certain types of infringement<sup>24</sup> and even the cash incentives put forward by the National Endowment for the Arts. This is an important point because indirect liability must be evaluated in light of these alternatives. In the end, whatever incentive authors need, society should deliver it using the combination of mechanisms that imposes the least social cost.

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<sup>23</sup> It is possible that, in certain instances, the approach taken by the Audio Home Recording Act is the efficient one. For instance, Neil Netanel argues in a current working paper that Congress should declare certain types of unlicensed online file swapping legal and then, in exchange, require firms that profit from that activity to build a modest copyright levy into the price of their various goods and services. Neil Weinstock Netanel, *Impose a Noncommercial Use Levy to Allow Free P2P File-Swapping and Remixing*, University of Texas School of Law Public Law and Legal Theory Research Paper No. 044 (November 2002). The downsides to this proposal are the familiar objections that higher prices will discourage some legitimate purchasers; that private parties can negotiate this sort of license on their own if it is efficient; and that interest group politics can too easily influence this sort of particularized legislation. The upsides, however, are: first, having paid the copyright tax, consumers would be free to upload and exchange music at the efficient marginal cost of zero; and, second, that this compulsory license approach might better balance copyright holders' legitimate interest in earning a reward with society's competing interest in seeing unfettered competition in the design of new technologies and new business models.

<sup>24</sup> Under the No Electronic Theft Act, for example, "any person who infringes a copyright willfully . . . for purposes of . . . financial gain," and any person who infringes a copyright willfully where the retail value of the infringing copies exceeds \$1,000 during any 180-day period, risks up to ten years imprisonment. See Pub. L. No. 105-147, 111 Stat 2678, codified at 18 U.S.C. §§ 2319-20 and 17 U.S.C. § 506 (2003).

One implication here is that sometimes indirect liability should not be an option. The costs in terms of unavoidable interference with legitimate products might be too high, and society would therefore be better off forcing copyright holders to rely on other mechanisms. Conversely—and this is a point typically overlooked in the copyright literature—sometimes other mechanisms are too costly and indirect liability should therefore be the only option. For example, in the 1980s many firms sold software tools that helped computer users pirate copyrighted videogames. Copyright holders were able to sue the firms on indirect theories and the computer users on direct ones. But because detection and litigation were so expensive, direct liability in this instance led to almost random penalties; of the millions of equally culpable computer users, only a handful were dragged into court. To many, the injustice of a legal right enforced that randomly outweighed whatever benefit those lawsuits offered. It therefore might have been better policy to take away the option of direct liability and allow copyright holders to sue only the firms.

To take another example, it might be the case that copyright holders injured by online music swapping should not be given the choice of either suing the individuals who swap music or suing the services that facilitate the practice, but instead should be allowed only to sue the services. After all, a lawsuit brought by one copyright holder against a service like Napster generates positive externalities that benefit all copyright holders. A lawsuit against a particular Napster user, by contrast, is unlikely to have so broad a beneficial effect. If that is true, it might well improve efficiency to require that copyright holders go after services, not individuals, even if the opposite strategy would be in the private interest of a given copyright holder.

We have focused thus far on comparisons among various legal and governmental tools, but of course indirect liability (like copyright law more generally) should also be evaluated in light of the many technological remedies available to copyright holders. Online music piracy, for example, can be discouraged through the use of encrypted music files that are difficult to copy without permission. Encryption is imperfect, and it also has its costs; for instance, encrypted music cannot be easily accessed by someone interested in making a lawful parody. As before, the point is that these costs and benefits can only

be evaluated by comparing them to the costs and benefits associated with direct liability, indirect liability, and any other workable alternative.

Lastly, like any legal issue, these questions about the relative virtues of indirect liability have to be evaluated dynamically. When the Ninth Circuit indicated that Napster would be liable for its role in online music piracy, new services arose to take Napster's place. Some of those services attempted to avoid liability by basing their operations outside the United States. Others designed their technologies such that there was no clear central party to hold accountable in court.<sup>25</sup> These sorts of responses were both predictable and inevitable. They do not argue against indirect liability; but they cannot be ignored when deciding how much the copyright regime should rely on indirect liability as a substitute for other types of marginal incentives.

Readers with comments should address them to:

Douglas Lichtman  
University of Chicago Law School  
1111 East 60th Street  
Chicago, IL 60637  
dlichtma@midway.uchicago.edu

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<sup>25</sup> Although it is unclear how helpful that strategy will prove. *See, e.g.*, Douglas Lichtman & David Jacobson, *Anonymity a Double-Edged Sword for Pirates Online*, THE CHICAGO TRIBUNE (April 13, 2000) (suggesting that anonymous peer-to-peer file swapping can be defeated through the use of decoy files polluting the network); Lior J. Strahilevitz, *Charismatic Code, Social Norms, and the Emergence of Cooperation on the File-Swapping Networks*, 89 Va. L. Rev. (forthcoming 2003) (emphasizing the fragility of the incentive to upload, as opposed to download, copyrighted music).

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