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Is the Internet a Safer Place for Content Owners?

How *Disney Enterprises v. Hotfile* May Apply To Secondary Infringement Claims

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Part One of a Two-Part Article

Many battles have been fought in courtrooms across the United States over the unauthorized Internet sharing of copyrighted books, music, movies and television shows. These include disputes over increasingly more sophisticated software products and websites that appear designed to respond to the latest court rulings over the scope of the Digital Millennium Copyright Act (DMCA; http://www.copyright.gov/legislation/dmca.pdf) "safe harbor" protections and the elements required to establish secondary copyright infringement liability. The names of many of the defendants are very familiar to copyright law warriors and include the litigations that have involved Napster, Grokster, LimeWire, YouTube and many others.

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Success for Content Owners

The recent lawsuit between the Motion Picture Association of America (MPAA) and the popular Internet file storage site Hotfile concluded in December 2013 with Hotfile reportedly agreeing to pay the MPAA $80 million and cease operating Hotfile's site. This resolution — entered into less than a week before the start of a damages trial — was reached just over three months after the U.S. District Court for the Southern District of Florida granted the MPAA's motion for summary judgment on its claim that Hotfile committed vicarious copyright infringement. *Disney Enterprises Inc. v. Hotfile Corp.*, 11-20427 (S.D.Fla. 2013).

While the full significance of the MPAA's victory in the *Hotfile* case, in defining how copyrighted works may be distributed over the Internet, remains to be seen, the court's decision suggests some winning — and losing — arguments for competing sides to mount in upcoming disputes. Further, in combination with such content owner victories in *Arista Records LLC v. Lime Group LLC*, 784 F.Supp. 2d 398 (S.D.N.Y. 2011), and *Columbia Pictures Industries Inc. v. Fung*, 710 F.3d 1020 (9th Cir. 2013), *cert. dismissed* by U.S Sup. Ct. 2013, it is clear that content owners are achieving success in fact patterns that are likely to recur in future litigations.

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These cases demonstrate that even when owners cannot prevail on one theory of secondary copyright infringement, they may still prevail on another. In *Hotfile* and *Lime Group*, content owners won summary judgment on a single secondary liability claim despite losing summary judgment on others. Beyond this, in *Hotfile* and *Columbia Pictures*, the courts denied DMCA "safe harbor" protection to the defendants. (In the wake of the *Columbia Pictures* ruling that the operator of the BitTorrent site "isohunt" had committed secondary copyright

infringement, the site was shuttered and the operator reportedly agreed to pay a $110 million settlement.)

But during the same period that owners prevailed in the *Hotfile*, *Lime Group* and *Columbia Pictures* cases, they also suffered well-publicized losses, such as those against the popular video-sharing YouTube and Veoh websites. In those cases, the courts dismissed copyright infringement lawsuits brought against YouTube and Veoh, and upheld their right to safe harbor protection under the DMCA, despite undisputed evidence of the defendants' general awareness of large scale direct copyright infringement committed by users of their sites. *See*, *Viacom Int'l Inc. v. YouTube Inc.*, 676 F.3d 19 (2d Cir. 2012); *UMG Recordings Inc. v. Shelter Capital Partners LLC*, 718 F.3d 1006 (9th Cir. 2013).

(In *Hotfile*, the district court also denied Warner Brothers' motion for the summary judgment dismissal of Hotfile's counterclaim challenging 890 takedown notices that Warner submitted to Hotfile. This is a cautionary tale to rights owners that the DMCA's notice and takedown process is not risk free. Under 17 U.S.C. §512(f), a person who makes a material misrepresentation in a takedown notice is liable for damage and attorney fees to the extent that the recipient of the notice relied on the misrepresentation. In its counterclaim, Hotfile asserted that the technology Warner used to identify files for which it sent takedown notices only detected whether Warner "owned" the works contained on the files and not whether the works were "infringed" or whether the fair use doctrine protected their use. Based on the record before it, the district court concluded that there was "sufficient evidence to suggest that Warner intentionally targeted files it knew it had no right to remove." *See also*, *Lenz v. Universal Music Corp.*, 572 F.Supp. 2d 1150 (N.D. Calif. 2008) (*appeal pending*) (denying motion to dismiss claims asserted under 17 U.S.C. §512(f) where defendant allegedly sent takedown notices without considering whether alleged infringement constituted "fair use" under Copyright Act).)

The *Hotfile* Case

Hotfile began operations in February 2009, offering a storage system on the Internet on which registered users could upload and store their files. Each uploaded file received a unique URL link containing the name of the file and an extension. Uploaded files could be downloaded an unlimited number of times by anyone who entered the URL link assigned to the file. While Hotfile itself did not publish an index of, or offer a search feature for, the files stored on its system, it encouraged its registered users to share URL links through its "affiliate" program. Under this program, Hotfile paid its users/"affiliates" for downloads made of files stored on Hotfile, with the payment increasing based on the size of the file and frequency of its download. Foreseeably, Hotfile affiliates created websites on which they catalogued and provided search tools for files stored on Hotfile and otherwise promoted the available files. Based on the affiliate program and affiliate activity, the district court viewed Hotfile as not just a "storage site," but also a "file distribution network." Although the amount paid per download was just a fraction of a penny, in the few years that it has been operating, the court noted that Hotfile has paid "millions of dollars" to affiliates.

Hotfile made its system available for free to the public, who could store files for a three-month period, and download files at the rate of one file every thirty minutes. Hotfile also offered a "premium" registration level for $9 per month. "Premium" registrants were entitled to store files for more than three months, download files at faster speeds than "free" users and download files without the 30-minute per file restriction. The registration fees that Hotfile received from its "premium" users were its only source of revenue.

U.S. Southern District of Florida Judge Kathleen M. Williams found it was "undisputed" that Hotfile's affiliate program resulted in users converting to premium (*i.e.*, fee paying) status and increasing their use of the Hotfile system. According to Hotfile, when the lawsuit was filed, which was two years after the site's February 2009 launch, 123 million files were stored on its system, they had been downloaded more than 2.9 billion times and Hotfile had 5.3 million registered users.

The first critical issue in litigation over the unlicensed availability of copyrighted content on the Internet is whether the defendant is eligible for protection under the DMCA safe harbors. The DMCA "safe harbors" only apply, of course, to "online service providers," which include Internet sites that store, transmit or route digital online content at the request of a user without modification of the content. *See*, 17 U.S.C. §512(k)(1)(A). Thus, safe harbor issues do not arise when the challenged conduct involves the distribution of a product that is not tethered to the defendant's operation of a website. *See*, *e.g.*, *Metro-Goldwyn-Mayer Studios Inc. v. Grokster Ltd.*, 545 U.S. 913 (2005) (distribution of peer-to-peer software product); *Arista Records LLC v. Lime Group LLC*, op. cit.

The issue of the availability of the DMCA safe harbor arose in *Hotfile* because the Hotfile system stored digital content at the request of its users. Additional requirements to qualify for safe harbor protection are set forth in 17 U.S.C. §512(c)(1), §512(c)(2) and §512(i)(1)(A). Under §512(c)(2), online service providers must designate an agent to receive "takedown notices" by providing the agent's name, address, phone number and e-mail address on both its website in a location accessible to the public and to the U.S. Copyright Office. Under 17 U.S.C. §512(i)(1)(A), a service provider must adopt, implement and inform its subscribers/account holders of its policy to terminate "in appropriate circumstances" the right of "repeat infring-

ers" to continue to subscribe/hold an account on the site.

Hotfile's conduct provided a "how not to qualify" for safe harbor protection guide under §512(i)(1)(a) and §512(c)(2), which made the district court's refusal to apply the safe harbor straightforward. Hotfile failed to adopt *any policy* to deal with "repeat infringers" from its inception in 2009 until May 2010. Further, the policy that it adopted in May 2010 did not delineate the circumstances under which repeat infringers would be terminated and made no attempt to determine whether specific account holders were the target of multiple takedown notices. (Hotfile terminated only 43 subscribers under its May 2010 policy.) Not only did the court rule that Hotfile's May 2010 policy was deficient under the DMCA, but the evidence also revealed a shocking number of repeat offenders:

- When the MPPA filed suit in February 2011, 24,790 Hotfile users had received more than three takedown notices, of which nearly 12,000 received more than 10 notices and nearly 6,000 received 25 or more notices.
- These 24,790 users, who comprised only 1% of Hotfile's users, had collectively uploaded approximately 50 million files (*i.e.*, 44% of the total files uploaded to the site). Further, 15.6 million of the files uploaded by the 24,790 users were the subject of takedown notices.
- Within a few months of the filing of the Complaint and implementation of its "three strikes" repeat infringer policy, Hotfile terminated over 22,000 users. (Under Hotfile's "three strikes" policy, *i.e.*, if three takedown notices were filed against an account holder following implementation of the policy, the account holder's right to use the Hotfile system/network would be terminated. Because the MPAA did not assert claims based upon Hotfile's conduct after its adoption of the "three strike" policy, the district court did not rule whether it was sufficient under 17 U.S.C. §512(i); however, the court did comment that it was unaware of any situation in which a "three strikes" policy was deemed "ineffective.")

In addition to its failure to implement a satisfactory and timely "repeat infringer" termination policy, the district court ruled that Hotfile failed to comply with the requirement to designate a registered agent under 17 U.S.C. §512(c)(2) prior to May 2010. Hotfile's non-compliance with this requirement was egregious. Initially, it failed to provide the required agent information either to the Copyright Office or on its website. Thereafter, in December 2009, Hotfile provided the required information to the Copyright Office, but continued its failure to include the required information on its website until May 2010. Even then, Hotfile provided an incomplete address for its registered agent, providing only a PO address. While the court indicated that providing the PO address may have sufficed to bring Hotfile into "substantial compliance" with §512(c)(2) in May 2010, it ruled that prior to that date Hotfile did not qualify for safe harbor protection, not just because of its failure to maintain an adequate "repeat infringer" policy but also because its non-compliance with §512(c)(2).

The MPAA spent considerable effort arguing that Hotfile was also ineligible for protection because it had "actual" or "red flag" knowledge of infringing content. *See*, §512(c)(1)(A). "Actual knowledge" exists if the defendant subjectively knows facts of specific infringements; "red flag" knowledge exists if the defendant subjectively knows facts that would make the existence of specific infringements objectively obvious. *See*, *Columbia Pictures*, op.cit. The *Hotfile* court characterized the MPAA's proof as consisting of circumstantial evidence of infringement, including Hotfile's creation of its "affiliate" program and its payment to "affiliates" based on downloads, which the MPAA argued transformed Hotfile into the type of peer-to-peer sharing system that courts have repeatedly shut down as secondary infringers.

Because the DMCA imposes no obligation on a service provider to monitor activity or affirmatively seek facts indicating the presence of infringing activity, and "general awareness of rampant infringement" does not constitute "actual knowledge" of specific infringing activity, the district court ruled that a disputed issue of fact existed as to whether Hotfile "knew or blinded itself to actual infringement of particular works." So whether Hotfile failed to satisfy the requirements of §512(c)(1)(A) could not be determined at the summary judgment stage.

In contrast to *Hotfile* ruling with respect to the "actual" and "red flag" knowledge prongs of §512(c)(1)(A), in *Columbia Pictures*, the court ruled at the summary judgment stage that undisputed facts established that the defendant website operator did have "red flag" knowledge of actual infringements based upon its actively encouraging users to upload and download particular copyrighted works, providing assistance to those seeking to watch copyrighted films and helping users burn copyrighted material onto DVDs. That court reasoned that the material in question was "sufficiently current and well-known" so that it "would have been objectively obvious to a reasonable person that the [specific] material solicited and assisted" was copyrighted and not "licensed to random members of the public." The *Hotfile* court's contrary decision reflects that even when courts apply the same rules to similar fact patterns, there is no guarantee they will reach consistent results in determining whether a defendant is entitled to safe harbor protection.