

NO END OF TROUBLE?

INTERMEDIARY LIABILITY AFTER *PERFECT 10 V. VISA INTERNATIONAL*

Alekhya Prakash
P. Pallavi*

§ Introduction: An Intermediary Primer

An internet intermediary is the virtual equivalent of a middleman. Acting as a go-between for product/service providers and consumers, intermediaries are usually targeted towards overcoming information asymmetry, information impactedness, distrust and high transaction costs associated with information¹, thereby enhancing utility. Commonly, such intermediary services comprise internet service providers (ISPs), payment intermediaries (such as Visa and PayPal), and auction intermediaries (like eBay).

Internet intermediaries owe their existence to the fact that most internet entities are not sufficiently involved in internet transmissions to be directly connected with individual customers in all ways required to conclude a *virtual* transaction. More importantly, internet transactions inherently preclude direct cash transactions and hence, there is an imminent necessity for payment and auction intermediaries. Specifically, payment intermediaries, such as credit card providers, peer-to-peer systems and other entities that might aid or provide electronic payments², are enlisted to facilitate the transferring of funds from the buyer to the seller in a reliable manner.

§ Intermediary Liability: To Be or Not To Be?

The common sense understanding of liability is succinctly contained in tags put on wares in most curio shops: *you break it, you pay for it*. Intermediary liability is mostly an exception to this rule: the intermediary is made liable for a third-party action under certain circumstances³. This is because, such intermediaries with predetermined commercial roots are easier to trace than individual infringing transactions and domestic jurisdiction is easier to establish over such services. Further, given the identification requirements of such intermediary servers (such as sites that require registration using credit card numbers), internet transactions lose most of their anonymity and infringements become easier to locate by enlisting intermediary cooperation. Thus, intermediaries may be subjected to third-party liability based on a “gatekeeper strategy”⁴ simply because they are the “weakest link”⁵ in the virtual transaction chain.

On the flip side are considerations of cost-effectiveness given that such monitoring on the part of intermediaries would affect infringing and non-infringing activities equally: the smaller intermediaries would have to close offices and the bigger fishes would at the very

* Students, (B.A., LL.B. (Hons.), NALSAR University of Law, Hyderabad.

¹ Cotter, Thomas, “Some Observations on the Law and Economics of Intermediaries”, (2006) *Mich.ST.L. Rev.* 67, 69.

² Because of the fluidity of payment mechanisms on the internet, there are a wide variety of service providers of various kinds (companies like Checkfree, Cybernet, and Authorize.net, for example) that might or might not be regarded as intermediaries, depending on the circumstances.

³ Such as degree of control over the infringing action by the third-party, whether such infringement was materially contributed to or induced by the intermediary, etcetera. See *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004 (9th Cir. 2001).

⁴ Gatekeeper strategy implies that essentially the intermediary would monitor all activities and transactions online in order to ensure that the third parties act suitably. See “Regulating Internet Payment Intermediaries”, (2004) 82 *Tex. L. Rev.* 681, 708.

⁵ Kreimer, Seth, “Censorship By Proxy: The First Amendment, Internet Intermediaries and the Problem Of The Weakest Link”, (2006) 155 *U.Pa.L.Rev.* 11, 11.

least have to charge risk premiums from their customers. This in turn would automatically raise the bar for certain people to enter into internet transaction via such intermediaries. Additionally, there are juro-logic problems: how does the intermediary regulate infringement, based on what parameters, to what extent and under which safeguards against wrongful regulation of apprehended infringement⁶. It is these parameters that the judicial pronouncements on intermediary liability have attempted to negotiate in order to hold pragmatic persuasiveness.

§ The “ImPerfect” Matrix: Pre-Perfect 10 Discourse

Secondary liability for third-party infringement can be either contributory or vicarious. In the former, one who, with knowledge of the infringing activity, induces, causes or materially contributes to the infringing conduct of another, may be held liable as a contributory infringer.⁷ The logic is evidently similar to that for abetment in criminal law, however, the only problem is identifying where an activity crosses over into constituting *material* contribution, though mostly insistence is placed on relatively specific knowledge of the infringement and direct assistance⁸. Thus, in *Sony Corporation of America v. Universal City Studios, Inc.*⁹ (referred to as *Sony Corporation*), mere knowledge of potential infringing uses did not entail contributory liability if the technology/service in question had substantial non-infringing use, unless the defendant had specific knowledge of the identity of the infringer and the works being infringed¹⁰.

While contributory infringement is based on tort-law principles of enterprise liability and imputed intent, vicarious infringement’s roots lie in the agency principles of *respondeat superior*, wherein the defendant must have the right and ability to supervise the infringing conduct, and a direct financial interest in the infringing activity.¹¹ This was, however, vastly altered with the coming of *Fonovisa v. Cherry Auction*¹² (referred to as *Fonovisa*), where mere ability to terminate *vendorship* was held to be sufficient control¹³. Further, an indirect financial benefit was ample to uphold the vicarious liability charge in the teeth of the *direct interest* test in the *Shapiro, Bernstein & Co. v. H.L. Green Co.*,¹⁴ (referred to as *Shapiro*). Consequently, the *Fonovisa* case led to the adoption of an expansive definition of secondary liability and more specifically vicarious infringement. Thus, in *Perfect 10, Inc. v. Cybernet Ventures, Inc.*¹⁵, processing membership payments and password systems was held to directly contribute to infringement, even though no direct financial interest accrued to Cybernet by virtue of a share in the profits generated by the infringement.

Meanwhile, the *A&M Records, Inc. v. Napster, Inc.*,¹⁶ (referred to as *Napster*) Court while holding the server liable held that, in the absence of any specific information which

⁶ In fact, the situation for the intermediary would gain increasing resemblance to a choice between the devil and the deep blue sea.

⁷ *Gershwin Publishing Corp. v. Columbia Artists Management, Inc.*, 443 F.2d 1159, 1162 (2d Cir. 1971)-

⁸ Yen, Alfred, “Third-Party Copyright Liability After Grokster”, (2006) 91 *Minn. L. Rev.*184, 195.

⁹ 464 U.S. 417 (1984)

¹⁰ For instance, see *A&M Records, Inc. v. Abdallah*, 948 F. Supp. 1449, (C.D. Cal. 1996), where Abdallah sold time-loaded cassettes to specific individuals, knowing they used the tapes to produce counterfeit recordings of popular music and financed his customers after a police raid.

¹¹ *Shapiro, Bernstein & Co. v. H.L. Green Co.*, 316 F.2d 304 (2d Cir. 1963), para 7.

¹² 76 F.3d 259 (9th Cir. 1996).

¹³ Unlike in *Shapiro, Bernstein & Co. v. H.L. Green Co.*, 316 F.2d 304 (2d Cir. 1963), where control comprised ability to fire the employees of the infringer, right to collect his cash receipts, paying his taxes, and issuing paychecks on behalf of the infringer.

¹⁴ 316 F.2d 304 (2d Cir. 1963), para 7.

¹⁵ *Perfect 10, Inc. v. Cybernet Ventures, Inc.*, 213 F. Supp. 2d 1146, 1156-57 (C.D. Cal. 2002).

¹⁶ 239 F.3d 1004 (9th Cir. 2001).

identifies infringing activity, a computer system operator cannot be held liable for contributory infringement merely because the structure of the system allows for the exchange of copyrighted material¹⁷; a sort of restatement of the *substantial non-infringing use* test in the *Sony Corporation* case¹⁸. Napster was held to satisfy this since it provided *the site and facilities* for direct infringement.¹⁹ For vicarious infringement, reliance was placed on the *Fonovisa* case again and increase in user base coupled with Napster's ability to locate infringing material listed on its search indices and its right to refuse service and terminate accounts was held to comprise vicarious infringement.²⁰

In the *Harlan Ellison v. Stephen Robertson*²¹ (referred to as *Ellison*), AOL was held to have materially contributed to the copyright infringement by storing infringing copies of Ellison's works on its USENET groups and providing the groups' users with access to those copies. Further, the *direct financial benefit* test was held to be not cabin'd, cribb'd and confin'd by the substantiality of the benefit in proportion to the defendant's overall profits.²² This was ironic, since the Court's definition of such *direct* benefit was solely predicated on the user base enhancement suggested in the *Napster* case, though here such enhancement could not be proven and hence the claim for vicarious infringement failed.

It was with the *MGM Studios, Inc. v. Grokster, Ltd.*²³ (referred to as *Grokster*) that the Court realized the vastly divergent stances it seemed to be taking and hence, reverted to the criterion of the product being capable of substantial non-infringing uses even if such product is mostly used for infringement. Importantly, emphasis was placed on not only the ability but also the right to control the infringement²⁴, which had been steadily losing judicial countenance since the *Fonovisa* case.

Thus, the *site and facility* test was approved if it was coupled with a failure to stop specific instances of infringement once knowledge of those infringements was acquired. However, in the *Grokster* case it was the users of the software who, by connecting to each other over the internet, created the network and provided the access.

Post-*Grokster* case, there are three causes of action for secondary liability: vicarious liability, contributory liability, and inducement (which resulted from the Court's attempt to reconcile the divergent views on contributory infringement).²⁵ This was studiously followed in the *Perfect 10, Inc. v. Amazon.com, Inc* (referred to as *Amazon* case)²⁶ where Google would have been held contributorily liable if it had knowledge that infringing Perfect 10 images were available using its search engine, could take simple measures to prevent further damage to Perfect 10's copyrighted works, and failed to take such steps.²⁷ However, since there was no evidence to show the right to control direct infringement by third parties, vicarious liability

¹⁷ 239 F.3d 1004 (9th Cir. 2001), para 56.

¹⁸ *Sony Corporation of America v. Universal City Studios, Inc.*, 464 U.S. 417 (1984) para 98, 99.

¹⁹ 239 F.3d 1004 (9th Cir. 2001), para 58.

²⁰ 239 F.3d 1004 (9th Cir. 2001), para 51, 52.

²¹ 357 F.3d 1072 (9th Cir. 2004), para 18.

²² 239 F. 3d. 1004. (9th Cir. 2001), para 60.

²³ 545 U.S. 913 (2005).

²⁴ Here, given the lack of a registration and log-in process, Grokster had no ability to actually terminate access to file sharing functions, absent a mandatory software upgrade to all users that the particular user refused, or IP address-blocking attempts.

²⁵ *Sony Corporation of America v. Universal City Studios, Inc.*, 464 U.S. 417 (1984), para 98, 99.

²⁶ *Perfect 10, Inc. v. Amazon.com, Inc.*, 487 F.3d. 701 , 2007 WL 1428632 (9th Cir. May 16, 2007).

²⁷ The case was remanded for determination on this limited ground.

could not be proved, especially since in the absence of image-recognition technology, Google lacked the practical ability to police the infringing activities of third-party websites.²⁸

Thus, before this case, the law was that contributory liability is entailed in case of knowledge of the direct infringement; it could be either materially contributing to such infringement or inducing it. Vicarious liability, on the other hand is occasioned if there is a real right and actual ability to control the infringement and a failure to do so involves direct financial benefit to the defendant. Such *direct* benefit is expansively constructed and is not necessarily limited to a share in the profits of the actual infringement. Theoretically, this implies that vicarious copyright liability is strict and exists as long as a defendant has the necessary relationship with an infringer. If vicarious copyright liability were based on fault, then defendants would be able to escape liability by taking reasonable precautions that excuse them from liability for any infringement that happens to occur. However, contributory liability is a form of fault-based liability because it depends on the defendant's knowledge of and material contribution to the infringement of another.

§ Perfect-ing Intermediary Liability: Placing Perfect 10

Perfect 10, Inc. sued Visa International Service Association *et al.*²⁹ on 28 January 2004 alleging secondary liability under federal copyright and trademark law since the defendants continued to process credit card payments to websites that infringed Perfect 10's intellectual property rights after being notified by Perfect 10 of infringement by such websites, as well as for violations of California laws proscribing unfair competition and false advertising, violation of the statutory and common law right of publicity, libel, and intentional interference with prospective economic advantage.³⁰

The majority rejected the claim of contributory infringement since infringement via reproduction, alteration, display and distribution of the protected photographs can occur without payment: Visa was a step away from Google, which itself assists in the distribution of infringing content to internet users. Thus, Visa did not provide the *site* of the infringement but merely the method of payment, and hence there was no material contribution. There was also no action for inducement since no affirmative steps were shown to have been taken by Visa to foster the infringement. Finally, since the defendants lacked the ability to directly control the infringing activity³¹, and the mere ability to withdraw a financial *carrot* does not create the

²⁸ *Perfect 10, Inc. v. Amazon.com, Inc.*, 487 F.3d 701, 2007 WL 1428632 (9th Cir. May 16, 2007), para 86.

²⁹ 494 F.3d 788, 2007 WL 1892885 (9th Cir. July 3, 2007). Visa and MasterCard entities are associations of member banks that issue credit cards to consumers, automatically process payments to merchants authorized to accept their cards, and provide information to the interested parties necessary to settle the resulting debits and credits. Defendants collect fees for their services in these transactions. For more details on the role of Visa and MasterCard in commercial transactions, see *Paul Emery v. Visa International Service Association*, 95 Cal. App. 4th 952, Jan 08 2002.

³⁰ This paper will however, focus solely on the findings pertaining to contributory and vicarious copyright infringement.

³¹ Defendants could block access to their payment system, but not to the Internet, to any particular websites, or to search engines enabling the location of such websites. They were involved with the payment resulting from violations of the distribution right, but had no direct role in the actual reproduction, alteration, or distribution of the infringing images. Though they could refuse to process credit card payments for those images, but while this refusal would reduce the number of those sales, that reduction would be the result of indirect economic pressure rather than an affirmative exercise of contractual rights. See *Perfect 10, Inc. v. Visa International Association, Inc.*, 494 F.3d 788, 2007 WL 1892885 (9th Cir. July 3, 2007) (Milan D. Smith, Jr.), para. 13.

*stick of right and ability to control*³², hence there was no proof of vicarious infringement either.

Both the majority and minority opinions are in concert as far as the legal principles governing contributory and vicarious infringement are concerned. The considerable divergence stemmed, to put it rather facetiously, from a difference of opinion as regards the potency of money.

Kozinski, J. in his dissent held processing the payment for the infringing transaction to be an essential step in the infringement process and not merely an economic incentive for infringement. Therefore, he effectively equated location services (like Google) with payment services and held both equally central to infringement since both substantially assist the infringement. Further, the defendants were also liable for vicarious infringement since they profited from the infringing activity of the *Stolen Content Websites* by processing the transactions. Hence, they had the ability to control the infringing activity and were therefore vicariously liable.³³

It is evident that the minority was patently misguided as regards the finding on vicarious infringement since mere financial benefit does not solely constitute infringement. An agency needs to be established based on the right and ability to control infringement. Visa does not approve of merchants, endorse their activities, authorize any particular transactions, and has no say whatsoever in how the businesses operate. It merely makes available a payment system to member financial institutions, which merchants can use, and adjusts credit transactions among those members.³⁴ This is in fact no different from the absence of liability of an issuing bank to an undisclosed principal for a letter of credit³⁵ or of a telephone company over whose facilities a customer transmitted information to bookkeeping establishments³⁶. Similarly, Visa was merely the conduit³⁷ and therefore, did not possess the right to control the infringing activity.³⁸ Moreover, Visa's knowledge of identity of the infringers was not specific and its support was not directly related to infringement. Hence, there is no case for materially contributing to the infringement. Merely processing payments does not qualify as sufficient assistance or inducement to infringe in absence of any further link between Visa and the infringement.

³² *Perfect 10, Inc. v. Visa International Association, Inc.*, 494 F.3d 788, 2007 WL 1892885 (9th Cir. July 3, 2007) (Milan D. Smith, Jr.), para. 11.

³³ Leaning on the dissent, Perfect 10 has petitioned for rehearing and rehearing *en banc* and the petition is pending: the last judicial word is still awaited in *Perfect 10, Inc. v. Visa International Association, Inc.* 494 F.3d 788, 2007 WL 1892885 (9th Cir. July 3, 2007).

³⁴ *Paul Emery v. Visa International Service Association*, 95 Cal. App. 4th 952.

³⁵ A letter of credit is a document issued mostly by a financial institution which usually provides an irrevocable payment undertaking (it can also be revocable, confirmed, unconfirmed, transferable or others but is most commonly irrevocable/confirmed) to a beneficiary against complying documents as stated in the letter of credit. Once the beneficiary or a presenting bank acting on its behalf, makes a presentation to the issuing bank or confirming bank, if any, within the expiry date of the letter of credit, comprising documents complying with the terms and conditions stated therein, the issuing bank or confirming bank, if any, is obliged to honour irrespective of any instructions from the applicant to the contrary. See *Kools v. Citibank, N.A.*, (S.D.N.Y.1995) 872 F.Supp. 67.

³⁶ *People v. Brophy*, (1942) 49 Cal.App.2d 15, 120 P.2d 946.

³⁷ Contrast this with *Schulz v. Neovi Data Corp.*, 60 Cal. Rptr. 3d 810 (Ct. App. June 15, 2007) where Ginix and Pay Systems were held liable not for failure to police but because they contracted directly with EZ and received payment based on their activity and hence, went far beyond mere processing.

³⁸ In fact, no actual ability accrues either. Credit card companies process 14 million transactions a day and evidently, such huge traffic would be very difficult to monitor in real time on a daily basis. See Sandburg, B., "Strange Bedfellows", *The Recorder*, 7 June 2004, www.law.com/jsp/article.jsp?id=1085626379923, (last visited on October 14, 2007).

In both instances thus, the *Perfect 10, Inc. v. Visa International Association, Inc.*,³⁹ (referred to as *Perfect 10*) is true to type in as much as it squarely follows the *Grokster* case and, *in absentia* a relationship with the infringer akin to agency and material contribution to the infringement, since the fault requirements entailed in secondary infringement were not satisfied, the claim for vicarious and contributory infringement failed.

§ Conclusion: Intermediary Liability Today

It is interesting to note that the *Perfect 10* case relies primarily on judicial precedents that tend to impart a more liberal scope to secondary infringement and then limits these decisions as per the *Grokster* case. In doing so, it renders the law relating to secondary liability of intermediaries more uniform than before by upholding the primary requirement of a certain degree of fault, instead of the previous move towards a strict liability regime, which imposed third-party liability even in case of remote business relationship with an infringer.

Another remarkable point is that despite the existence of quite a few federal Court decisions on credit-card server's liability, the *Perfect 10* Court chose to rely only on judgments pertaining to 'location services', that is, services that provide the *site* or *facility* of infringement and hence, the fact whether payment providers' liability is equivalent or not obviously becomes a problematic analogy. This could have been avoided by simply relying on previous financial service providers' liability litigation, though admittedly in that case, the law as regards secondary liability could not have been detailed and clarified in accordance with the *Grokster* case.

However, copyright holders have legitimate interests in preventing infringement and being compensated. On the other hand, third-party defendants understandably wonder why they should pay for another person's infringement, which may put them out of business and suppress non-infringing as well as infringing activities. If the Court were to simply impose liability in the context of *Fonovisa et al.* and make companies subject to contributory liability on the basis of strict liability principles, the repercussions would extend across commerce⁴⁰, and unlike the naïve belief expressed by the minority in the *Perfect 10* case, differentiating between direct and incidental infringement would not be very easy, especially given the lack of legislative or judicial guidance to determine the same.

The *Grokster* case sent a strong signal that the Supreme Court considers fault as the primary theory of third-party copyright liability. The *Perfect 10* case is the perfect follow-up that emphasizes the need to limit vicarious liability to a relatively narrow range of facts, to ensure that contributory liability does not turn into a form of strict liability, and to tailor the doctrine of inducement within the rationale of fault-based third-party copyright liability.

Therefore, Visa was rightly held not liable for not taking more aggressive corrective steps, which it had no right or obligation to take. An intermediary is not a global policeman, and hence the logic of the majority opinion is hardly troublesome, as the minority seems to worry. In fact, post-*Perfect 10* case the law as regards secondary infringement finally seems to be gaining some coherence.

³⁹ 494 F.3d 788, 2007 WL 1892885 (9th Cir. July 3, 2007)

⁴⁰ And to absurd extents. For instance, an electricity company would be liable for secondary infringement since it can control whether infringement occurs by turning off the power. Additionally, the electric company has at least an indirect interest in the underlying infringement because infringing behavior increases the demand for electricity. Moreover, infringers could never commit the infringement without electricity. Yen, *Supra* note 20, 184, 210.